

# Outside of Plan Awards in 2015

This report summarizes the findings of a joint study on “outside of plan” executive compensation awards conducted by the Ontario Teachers’ Pension Plan and the Canada Pension Plan Investment Board. “Outside of plan” compensation is not part of the company’s pre-established compensation scheme applicable during the normal course of employment. Examples of such awards include payments granted for the purposes of retention, severance, sign-on and the successful completion of a transaction. By their nature, outside of plan awards represent extra compensation paid to executives.

The study was undertaken because we noticed outside of plan awards occurring with greater frequency in 2015 and we believe such a compensation practice warrants greater monitoring and awareness. We needed to better understand the mechanics and rationale for these awards and their impact on the “pay for performance” assessment.

## Scope of the Study

We reviewed outside of plan awards made at Canadian and US companies holding shareholder meetings between January 1, 2015 and October 31, 2015. We noted that 98% of the dollar value and 97% of the number of awards occurred at US companies. Given the predominance of awards in the US market, the study focussed on payments made at US companies. However, any conclusions or next steps resulting from this research are applicable to Canadian companies.

# Key Findings

The key findings from our study of outside of plan awards are set out below.

## 1) The value of outside of plan awards is significant

Total outside of plan awards in 2015 amounted to \$4.1 billion which, when compared to the amount of total direct compensation paid to executives in 2015, had the effect of increasing compensation by 12.6%.

## 2) Outside of plan awards occurred with a high frequency

1,120 US boards granted outside of plan awards in 2015. Based on the 2,354 US companies in the study, outside of plan awards were granted at almost half (48%) of all companies surveyed.

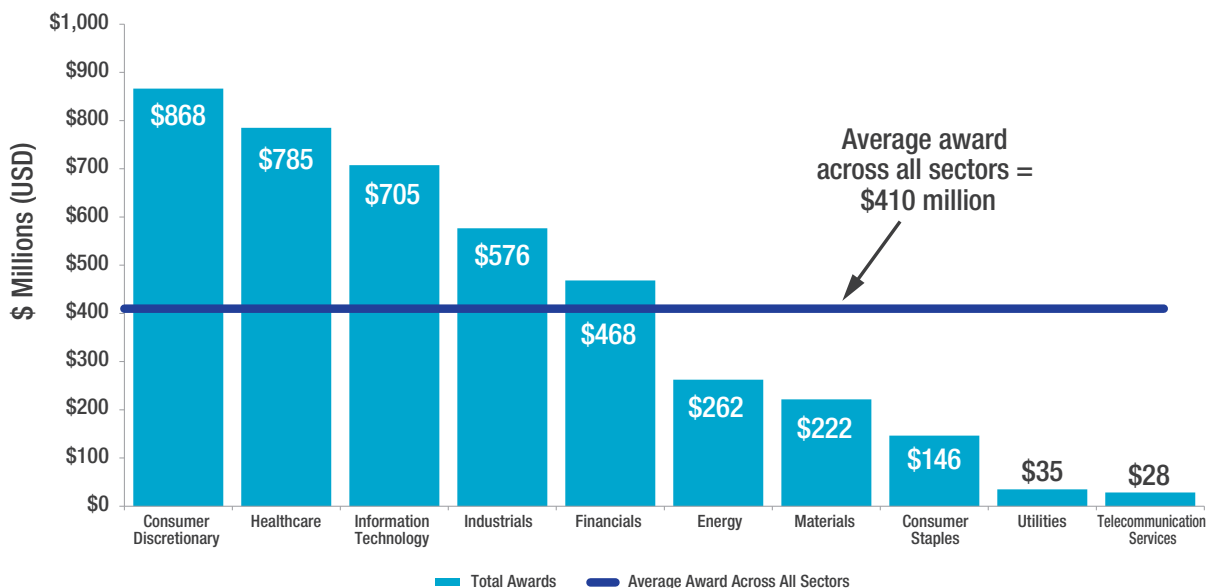
Boards awarding outside of plan payments would likely make multiple grants. 63% of the 1,120 boards making an outside of plan award did so to more than one executive in the company. Boards making more than one outside of plan award, on average, granted awards to 3.5 individuals at the company.

**Question:** Was 2015 an anomaly or are outside of plan awards a common method of compensation that will continue being used?

**Question:** Does the use of outside of plan awards point to issues with the design and structure of pay plans?

## 3) The frequency and size of outside of plan awards were concentrated to certain sectors

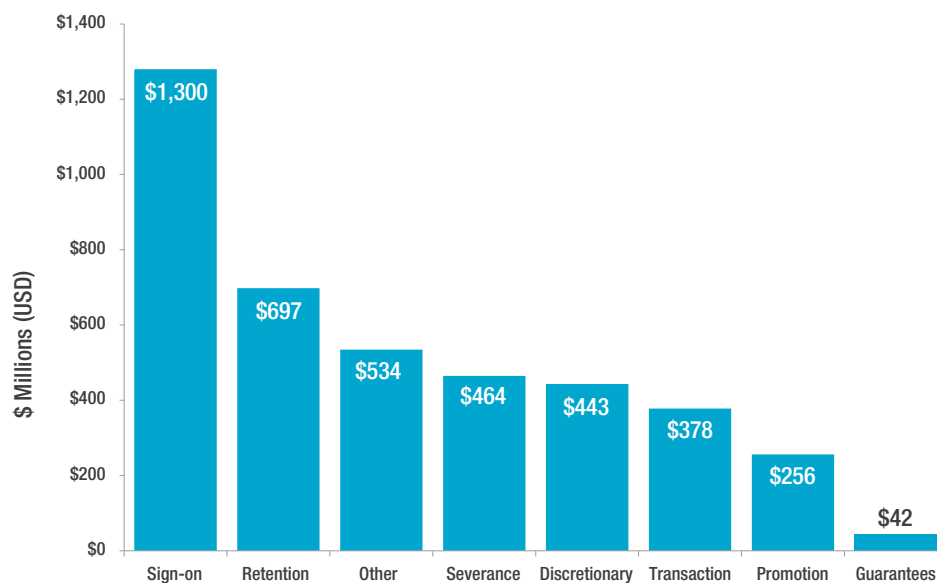
Above average awards were observed in the Consumer Discretionary, Healthcare, Information Technology, Industrials and Financials sectors.



**Question:** Is there a reason for the sector concentration of outside of plan awards?

## 4) The largest awards were related to executive succession

\$1.8 billion was awarded for activities related to executive succession (sign-on payments of \$1.3 billion plus severance payments of \$464 million). Awards were also granted for purposes of retention (\$697 million), successful completion of transactions (\$378 million) and in recognition of promotion (\$256 million). Almost \$450 million was categorized less precisely as board discretion (\$443 million).



Outside of plan awards classified as “Other” refer to awards that do not fit into the other categories used in this report and include awards for:

- Settlement of obligations related to previous pension arrangements,
- Company-wide non-perquisite incentives, such as 10 year service awards or patent awards, and
- Transitional arrangements, such as payments for added responsibilities/interim duties upon another NEO’s departure.

**Question:** The largest dollar value of outside of plan awards was related to executive succession. Should this raise concerns as to the effectiveness of boards’ management succession programs?

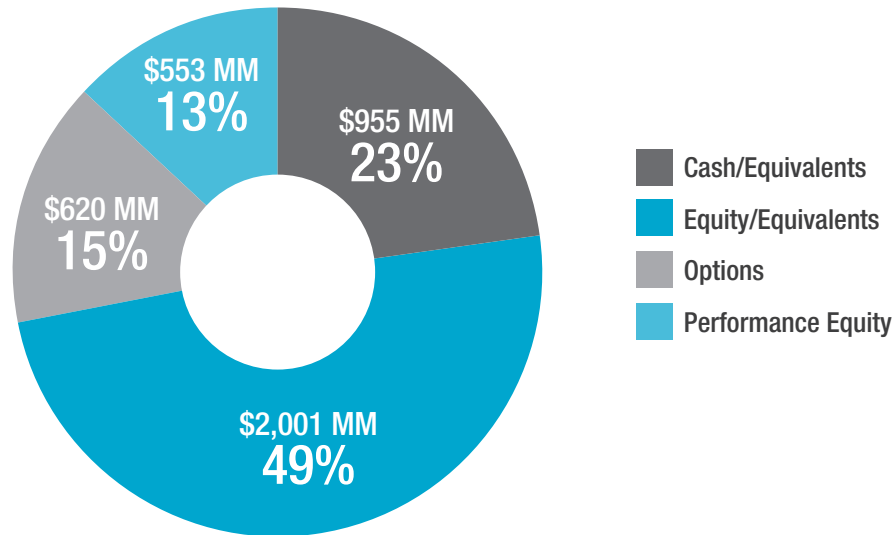
**Question:** Should shareholders be concerned that almost \$450 million was granted to executives for discretionary reasons?

**Question:** Is it appropriate to assume that executives are employed in part to complete transactions and, as a result, do outside of plan awards granted for the successful completion of a transaction represent “double-dipping”?

## 5) The vast majority of awards were not performance-based

Only 13% of awards were classified as performance-based. Awards are performance-based if the realization of the award is conditional on the executive achieving pre-established goals that are specific, objective and under the executive's control.

The following chart shows the breakdown of all awards based on four broad categories: Cash and Cash Equivalents, Equity and Equity Equivalents, Options and Performance Equity.



**Question:** Does the absence of performance metrics attached to outside of plan awards have negative consequences for pay and performance alignment?

## Next Steps

We will continue to track and study outside of plan awards going forward. The findings from 2015 suggest that this is a compensation practice worthy of monitoring. We are looking to better understand the answers to the questions raised by our findings set out in this report.

Many of these awards may be appropriate forms of compensation. However, we believe the onus is on boards to provide a clear rationale for granting outside of plan awards, as well as how the structure and quantum were determined, to give shareholders clarity on why any awards granted are acceptable.