CLIENT ALERT

Canadian Implications of U.S. Pay Versus Performance Disclosure

In the U.S., 2023 was the first year that public companies were required to comply with SEC rules concerning Pay Versus Performance (PVP) disclosure, which were implemented as part of the Dodd-Frank Act reforms. This Client Update considers Canadian implications of these requirements.

Background

U.S. companies were required to provide PVP disclosure for the first time in their 2023 proxy statements; the SEC also issued two sets of additional guidance in the second half of the year.

So far, impacted issuers appear to be treating these additional PVP disclosures primarily as a compliance item and not as an item likely to drive a change in underlying practices. The limitations of the PVP methodology prescribed by the regulators may mean it is unlikely that the PVP disclosures will be viewed as particularly helpful context by companies or shareholders. This, in turn, makes it less likely that Canadian companies will adopt the U.S. required form of PVP. However, we do expect the trend for Canadian companies to voluntarily provide realizable pay disclosure will continue to increase.

Under the new rules, companies are generally required to calculate Compensation Actually Paid (CAP) for the CEO as well as other Named Executive Officers. CAP must be disclosed annually for a specified lookback period, with financial metrics and total shareholder returns of the company and of an eligible peer group or market index, over that same period. The rules are in a phase-in period now, but eventually will require a full five years of data to be shown in the PVP table. *For more detail on this required disclosure, see Meridian's Client Alert here.*

Foreign Private Issuers (FPIs) are **not** required to provide the PVP disclosure, unless they also file a proxy statement (Form DEF-14A) with the SEC.

As a result, very few Canadian companies have been required to provide this disclosure to date.

Despite the name, CAP does not actually describe compensation realized by a public company executive. It might be best described as the periodic change in the value of compensation over time, based on changes in share price and updated performance expectations. For a company that sees a decline in share price between measurement dates, CAP can be a negative number(!). For this reason, among others, we do not think the PVP disclosure will have much of an impact on executive pay practices. However, it is shining a spotlight on disclosure in the proxy circular of each company's pay-for-performance alignment.

Why Should Canadian Companies Care?

- **Many American executive compensation regulations find their way into Canadian corporate governance norms over time.**
- Similar to other U.S. regulatory mandates (e.g., the CEO pay ratio, mandatory clawback policies, etc.), we expect that some Canadian companies – perhaps those that would like to be seen as market leaders in this space – may adopt a version of the PVP disclosures in Canada, potentially setting a new bar.

— For example, we note Scotiabank's approach with the CEO pay ratio disclosure required of U.S. companies, which is also treated essentially as a compliance item in the U.S.

- The introduction of these new requirements spotlights not just the question of **"Do we have pay-for-performance alignment?"** but also, **"Should we *disclose* why we have pay-for-performance alignment?"**
- We expect more companies to consider whether existing disclosures are adequate in light of this new baseline.

If your company is considering additional pay-for-performance disclosure…

- Keep in mind that a comprehensive disclosure requires either a mix of realized and realizable pay in the calculation, the use of assumptions, or both.
  - — In other words, you can either have an accurate and complicated analysis or an inaccurate and simple analysis, but you typically cannot have both.
- **Do** use metrics that speak to your company's pay-for-performance story in ways that tie to how management is compensated or to your company's value proposition.
- **Do not** calculate pay-for-performance the way U.S. companies are required to calculate CAP.

Other Implications/Considerations

All companies should periodically review their realized or realizable pay-for-performance alignment as part of good "checks and balances" in the compensation committee's approach to executive pay.

Whether companies should **disclose** this analysis can raise more complicated considerations:

- There is always a tension between measuring when pay was realized and measuring performance over the same timeframe.
  - — For example, Canadian companies (still) use more stock options than American companies, meaning pay may be realized at a point in time that is disconnected from the performance measurement period.
- In order to have any credibility with investors, once you establish and make this disclosure part of your proxy, companies should continue making it (when the story is good and when the story is not so good).
  - — Providing this disclosure on a selective basis is likely to cause a loss of credibility with investors.
  - — Given that many Canadian companies have commodity price exposure affecting their performance in ways that management teams cannot necessarily influence, this is not a trivial concern.
- Often pay-for-performance alignment is measured with reference to a peer set or industry.
  - — Setting aside whether it is a good idea to name competitors and their pay-for-performance alignment in a public filing, there can be a timing disconnect if peer data is included, as the available data for peers is likely to be at least a year out of date compared to the company's data.

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