

# CLIENT ALERT

## Navigating Compensation Governance

### Discretionary Clawback Policies

Looking into our crystal ball, if 2023 was the year of share ownership guideline policy review for Canadian companies, we think 2024 will be the year many companies revisit their discretionary clawback policies. The summer compensation committee meeting is typically less decision-oriented, with more opportunities to look at the pay program and governance policies more holistically.

After 2024 proxies are released, we think it is a good time for Canadian companies to evaluate how their discretionary clawback policies are designed and whether they align with best practice (specifically the triggering events and employee population covered by the policy).

We think this emphasis to review clawback policies will be driven by three key events:

1. Restatement-only clawback requirements came into effect in the fall of 2023 for U.S. companies and foreign private issuers (including many Canadian-listed companies).
2. Policy guidance from Glass Lewis for 2024 codifying its expectations for clawback policies (to be more expansive).
3. Recent case studies of reputational harm in the United States, linked to misconduct (e.g., McDonald's, Wells Fargo, Equifax).

#### U.S. Landscape

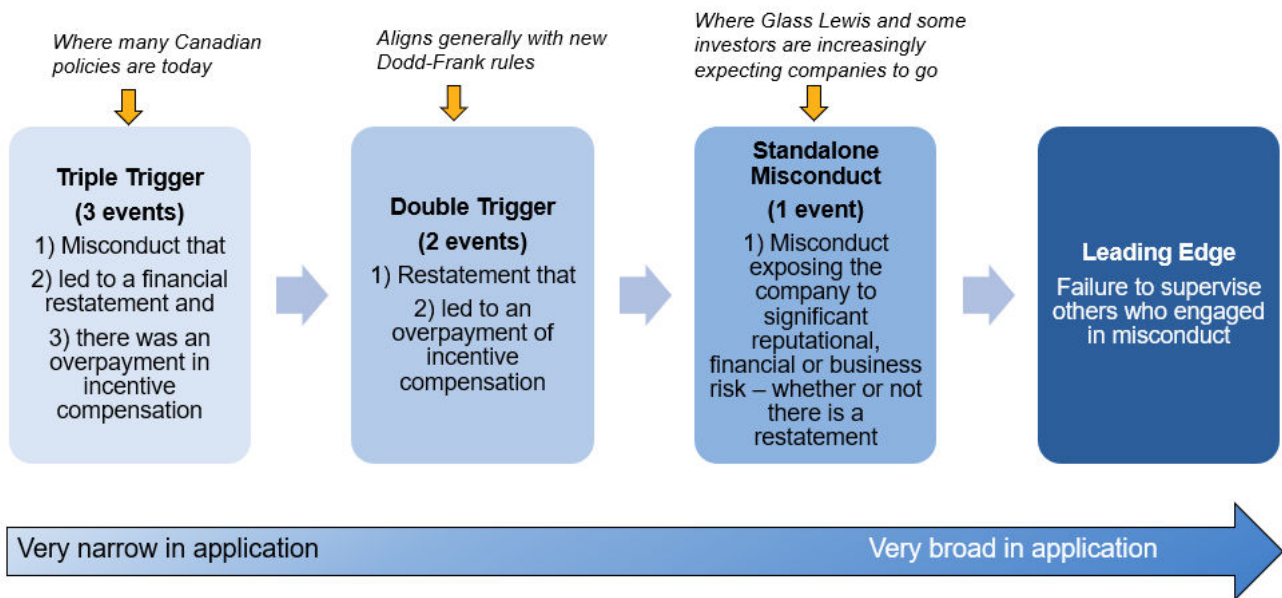
U.S. public companies (and Canadian foreign private issuers listed on a major U.S. exchange) became subject to mandatory clawback policies following the Dodd-Frank Act rules that were implemented in 2023. U.S. companies are now required to clawback incentive-based compensation if there is a financial restatement. To read a summary of the U.S. clawback requirements, click [here](#).

#### Canadian Landscape

Currently, many Canadian companies have "triple trigger" clawbacks with an increasing number having "double trigger" clawbacks and standalone misconduct clawbacks:

- **Triple Trigger:** Misconduct leading to a restatement and resulting in an overpayment of compensation
- **Double Trigger:** A restatement resulting in an overpayment of compensation, regardless of whether there was misconduct (generally aligned with the new U.S. clawback requirements)
- **Standalone Misconduct:** Misconduct exposing the company to significant reputational, financial, or business risk, whether or not there is a restatement

We think the combination of double trigger and standalone misconduct clawbacks is where the market is moving to and an area for further review.



## External Constituent Views

### Proxy Advisors

In its 2024 policy guidance, Glass Lewis codified its expectations for the use of clawbacks. Glass Lewis indicated that clawback provisions should include the ability to recoup incentive compensation where there is bad behaviour whether or not it results in a restatement of financial statements. Glass Lewis identifies bad behaviour as including: *material misconduct, material reputational failure, material risk management failure or material operational failure, which has not already been reflected in incentive payments*. The scope of a company's clawback provisions may be a qualitative factor in Glass Lewis' Say-on-Pay analysis.

The other large proxy advisor (ISS) does not specifically address clawback policy design in its proxy voting policies for TSX-listed companies.

### Canadian Coalition for Good Governance (CCGG)

CCGG believes that it may be appropriate for boards to require the return of compensation previously awarded to an executive if there is a material earnings restatement or other company-specific change that significantly reduces shareholder value. CCGG does not have a specific policy on standalone misconduct triggers, but we expect this will be an area of focus in future years.

### Largest Institutional Investors

Not all of Canada's largest institutional investors (defined here as RBC Global Asset Management, TD Asset Management, Mackenzie Investments and Fidelity Canada) have published policies on clawbacks. TD Asset Management is the only investor specifically addressing clawbacks in its policy language (with a preference for policies that trigger clawback on a financial restatement, misconduct, or other negligent behaviours that result in a negative impact to shareholder value).

### Company Considerations

When considering whether to amend an existing discretionary clawback policy, companies should consider:

- Whether they want the policy to be more easily used in the future, or whether usage should be rare. If the former, questions like enforceability become more important. If the latter, new policy language that sends signals might be sufficient.

- What types of events should trigger the policy?
  - Financial restatements
  - Misconduct leading to a financial restatement
  - Standalone misconduct
  - Reputational harm
  - Failure to supervise or oversee others who engaged in misconduct
- Who should be covered by a clawback policy?
  - All executives
  - All incentive compensation plan participants
  - Material risk takers

In determining which triggers to adopt, we find it's helpful to have an informed discussion at the Committee level grounded in:

- **Market Data:** What do peer companies include in their disclosed policies? Where is the broader market headed?
- **Philosophy:** The philosophy behind a move to a misconduct-only trigger is principles-based and risk-mitigation based. Companies that have recently faced executive and employee misconduct likely wanted specific tools to deal with recovery of incentive compensation and potentially severance in those situations. Do we want to be leading edge when it comes to compensation risk governance, or follow established market norms?

For Canadian foreign private issuers subject to the new Dodd-Frank clawback policy requirements, we continue to think best practice (and majority practice in the United States), is to retain a broader discretionary clawback policy alongside the mandatory Dodd-Frank policy that remains narrow in its application.

## Final Thoughts

We believe 2024 will be a year for many Canadian companies to consider adopting a discretionary clawback policy. Doing so entails some careful considerations to ensure that the policy will be effective, easily understood and administered.

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