



Executive Compensation Toolkit

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Southlea

October 2023



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The role of the Human Resources Committee (HRC) continues to evolve and become more complex. The decisions that are made are highly scrutinized and send important signals to stakeholders about the company’s strategy and priorities.

There are some unique aspects to the HRC, given the main areas of oversight do not have the same standardized rules and processes as those found in Committees such as Audit. In addition, HRCs are dealing with emotional and personal topics (compensation, talent) that can have a fundamental impact on the business and its performance.

Given these challenges, we leverage our 70+ years of combined consulting experience to provide a toolkit and reference guide to reinforce an effective HRC.

In this second toolkit, we focus on executive compensation from establishing the underlying compensation philosophy to pay levels and incentive design.

We provide an overview of the issues, various tools and templates to support the process, and **18 questions** that the HRC can consider to align their executive compensation programs in the best interests of the organization.

The toolkit works in sequential order:

Compensation philosophy

Compensation benchmarking

Incentive plan design

Pay for performance

Instructions

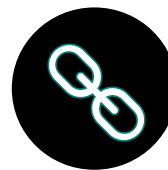
Click on each of the topics on the left to jump to that section of the toolkit.



Click on this icon (located on the top left of the page) to access a set of templates that you can complete for your organization.



Click on this icon to access an external resource that we think provides helpful context.



The toolkit works in sequential order:

Compensation philosophy

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Pay for performance

Executive Compensation Philosophy

In this section, we cover:

- Defining the Compensation Philosophy
- Elements of Total Rewards
- Aligning Compensation Levels with the Compensation Philosophy
- Developing Compensation Peer Groups

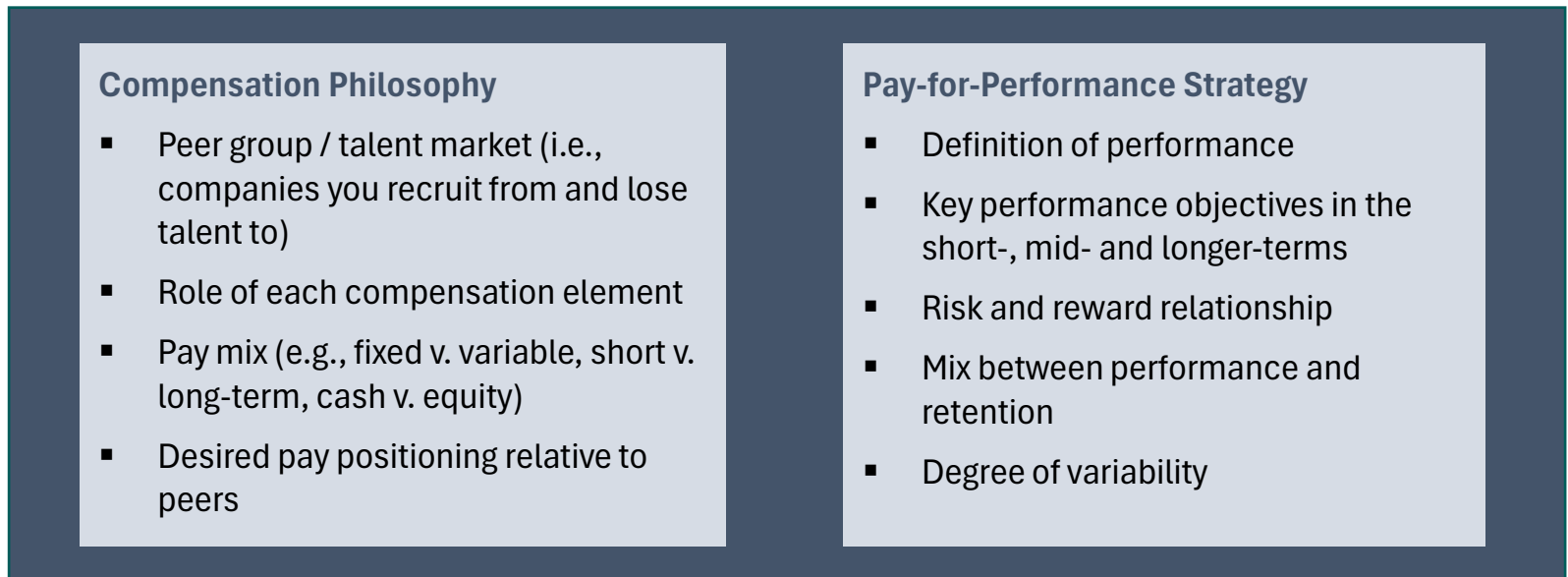
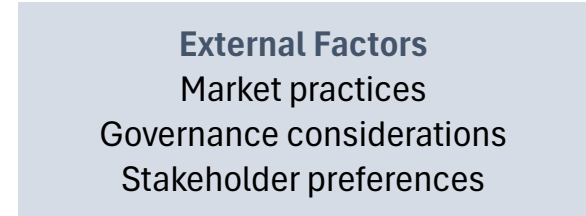
Key questions for the HRC

1. Does your compensation philosophy support the business and talent strategies?
2. Have you considered the role of each monetary total rewards element?
3. Have you defined a target market reference for each element of compensation?
4. Is your peer group grounded in well-defined selection criteria?



1. Does your compensation philosophy support the business and talent strategies?

The Employee Value Proposition (EVP) addresses, the “why” and “how” of employee experience as the foundation to the compensation philosophy. It may vary based on industry and/or business model.



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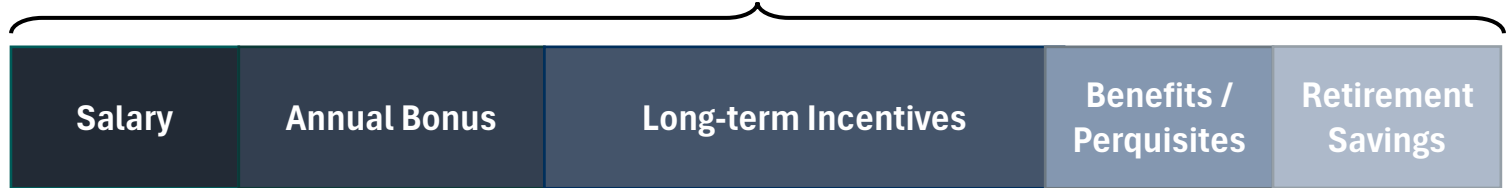
Pay for Performance

2. Have you considered the role of each monetary total rewards element?

Consider the role of each pay element to effectively communicate the value to employees and ensure alignment with the business strategy

Also consider non-monetary rewards such as training, development, paid time off, flexible work model, etc.

Monetary Total Rewards



To provide a base level of compensation reflective of the market rate for the role and the employee's relevant skills and experience

To motivate in-year performance and to focus employees on the areas that drive success at corporate, business / team and individual levels

To retain talent and to align employees with the longer-term success of the company

To provide support / benefits to employees in their work-lives and personal lives (e.g., health, dental, wellness, enabling remote work, forms of additional allowances / perquisites)

To support employees in planning for their financial future (very jurisdiction dependent)

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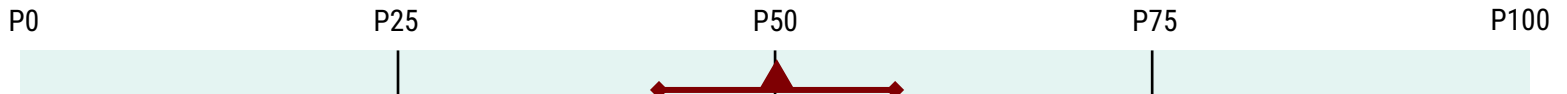
Pay for Performance

3. Have you defined a target market reference for each element of compensation?

Many organizations anchor their philosophy around “target” performance and consider the desired risk / reward relationship. The degree of alignment with market will vary based on business and talent strategies

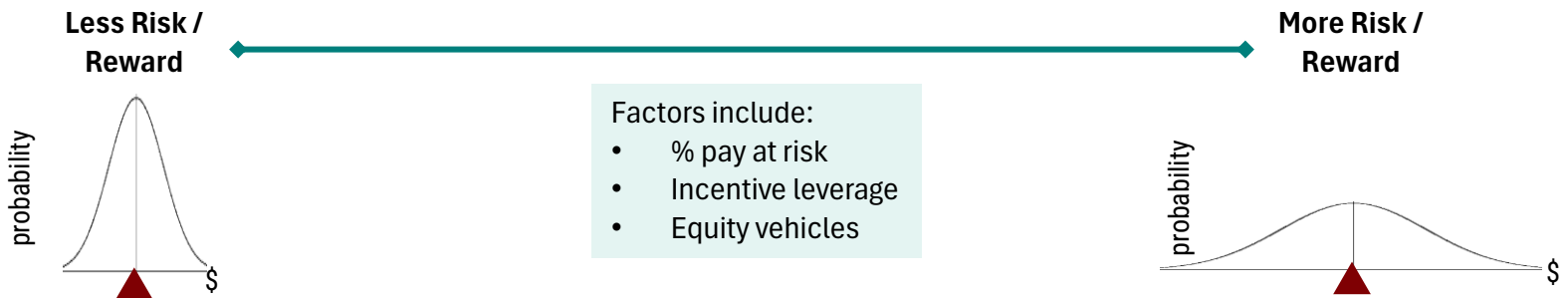
TARGET POSITIONING – PAY PHILOSOPHY

- Reflects the level of compensation typically delivered for meeting expectations
- Typically, organizations position their target pay structure at the 50th percentile of their reference market
- Can be positioned above / below the 50th percentile depending on various considerations, including relative size/scope, complexity and labour market dynamics. Individual executives can also have their pay positioned above / below depending on skills, experience and performance
- Difficult to defend positioning above 50th percentile, so adjustments to peer/ reference group is preferred lever
- Total compensation may be achieved through different positioning on each compensation element, depending on the compensation philosophy



ACTUAL PAY DISTRIBUTION – PAY OUTCOMES

- Reflect actual pay aligned with performance that can result in higher or lower pay than target
- The range of pay outcomes depends on risk / reward relationship which can vary by organization





4. Is your peer group grounded in well-defined selection criteria?

Considerations

Reflects a **sample of talent markets** – may be different from business competitors

Size and scope are good complexity considerations

Consists of **12-20 companies** (when using public disclosure)

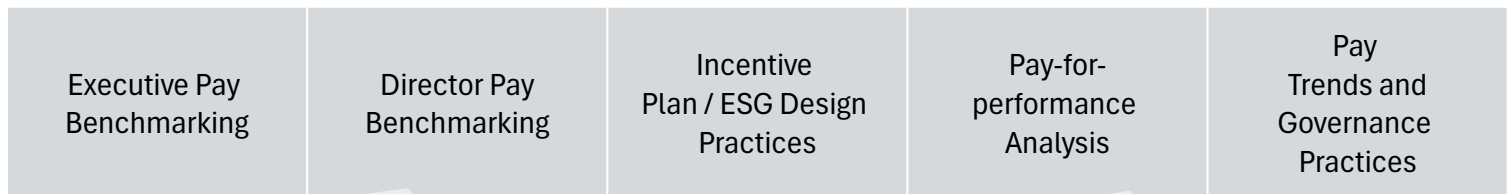
Uses **clearly defined selection criteria**, to avoid “cherry-picking” of select companies

Peer group for compensation benchmarking may differ from performance peer group

Typical Selection Criteria

Industry	Similar industries or industry fundamentals May need to expand to related industries
Geography	Market where executives are currently based and/or expected to be recruited from May consider shareholder perspectives (incl. proxy advisors)
Size	Organization size is typically correlated with pay levels for executives May vary by industry. Typically includes revenue, market capitalization, and / or assets
Business Specific Factors	Consider additional business specific factors that may be relevant (e.g., past performance, expected future transformation / growth, ownership structure) Number of regions / business units

Potential Uses



Director compensation peer group typically aligns with executive compensation peer group but can differ

Performance groups focus on business strategy, life-cycle, share price and performance dynamics

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In this section, we cover:

- Reviewing Executive Compensation Market Data
- Executive Compensation Review Methodology
- Interpreting Executive Compensation Market Data

Key questions for the HRC

5. Do you understand the elements of compensation being benchmarked?
6. Do you interpret market data within a competitive range vs. focusing on a single data point?
7. Do you consider your pay mix relative to market?
8. What factors do you consider beyond the market results when determining whether executive pay changes are appropriate?



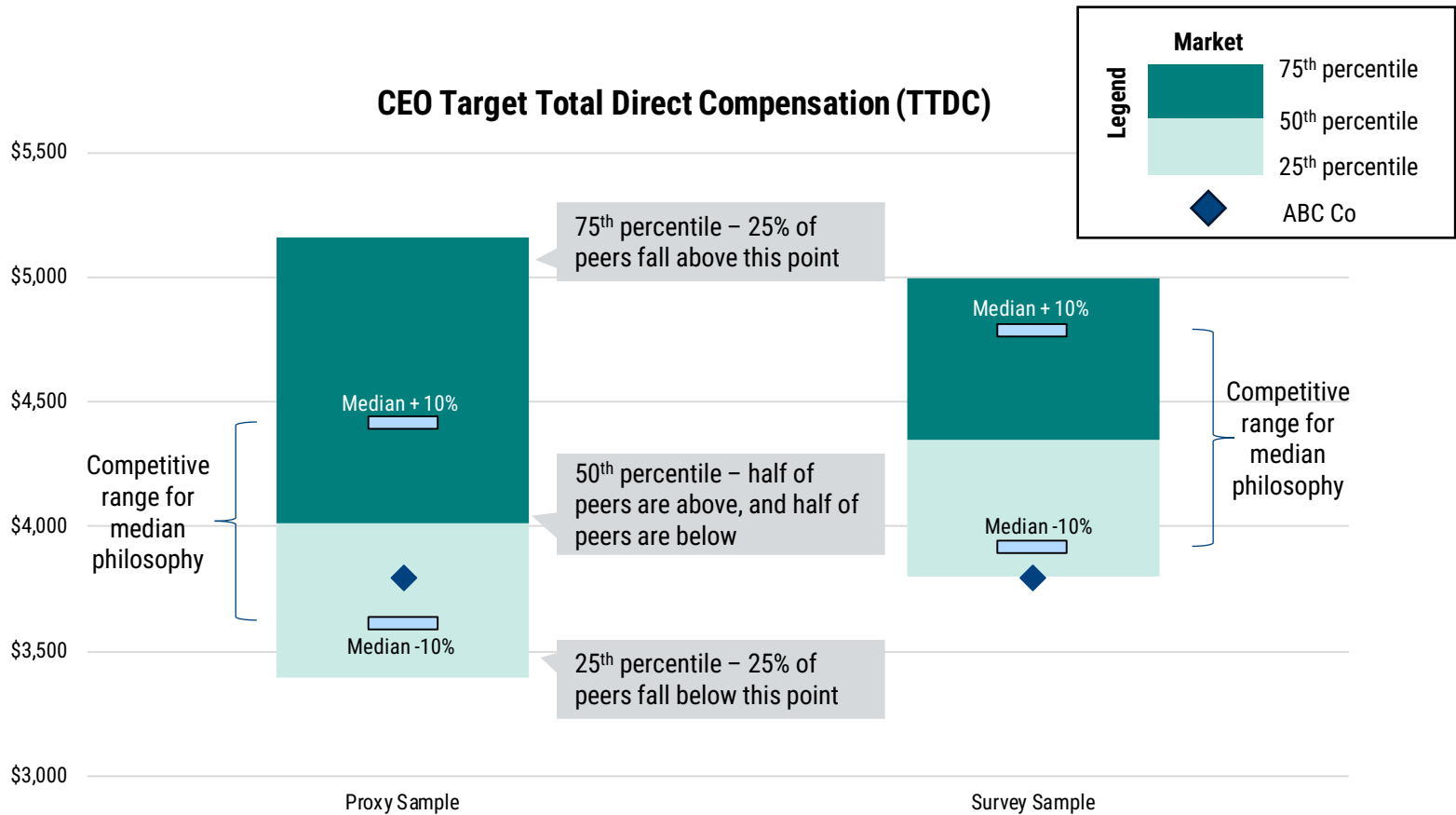
5. Do you understand the elements of compensation being benchmarked?

Incentive compensation (STI and LTI) may be defined as “target” or “actual”

- **Target** – Level of incentive compensation communicated in offer letter and typically delivered for meeting expectations
- **Actual** – STI actually paid based on performance during the year; grant date expected value of LTI

Salary	Target Total Cash (TTC)	Target Total Direct Compensation (TTDC)	Target Total Compensation (TTC)
Salary	Salary	Salary	Salary
	Target Short-term Incentive (STI)	Target Short-term Incentive (STI)	Target Short-term Incentive (STI)
		Target Long-term Incentive (LTI)	Target Long-term Incentive (LTI)
			Pension & Benefits

6. Do you interpret market data within a competitive range vs. focusing on a single data point?

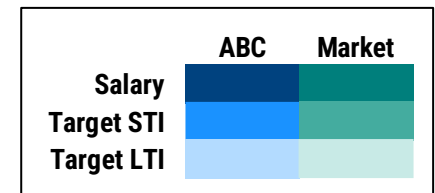
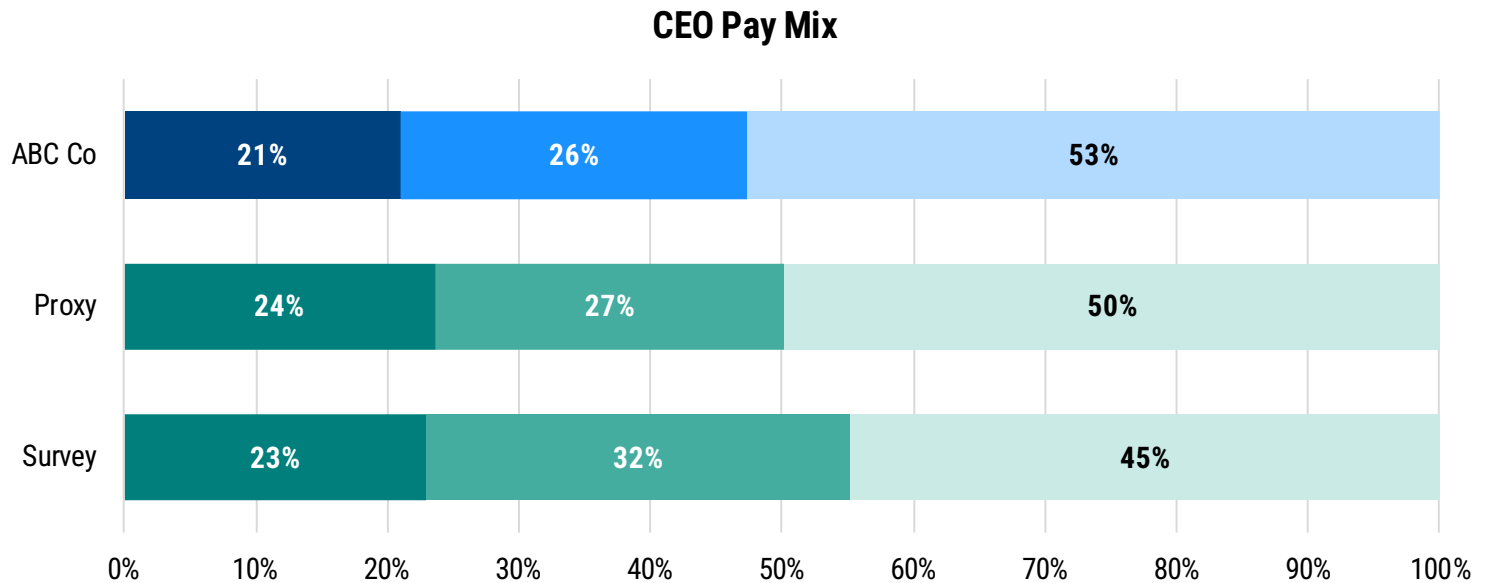


Given that market data approximates market rates of pay, Southlea generally considers compensation competitive within +/-10% of the desired reference point

7. Do you consider your pay mix relative to market?

Review pay mix relative to market samples

A differing pay mix relative to market may be appropriate depending on the organization's compensation philosophy (e.g., below shows ABC Co with more weight on LTI and less weight on salary)



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8. What factors do you consider beyond the market results when determining whether executive pay changes are appropriate?

There are role-specific and incumbent-specific considerations to determine “competitive” pay

Reasonable to position the incumbent...	
Below market if:	Above market if:
<ul style="list-style-type: none"> • Size of company is smaller than most peers • Lower scope of role, with fewer responsibilities vs. benchmark matches • Lower autonomy than is typical for the role in the competitive market • New in role and developing • Skills / experience can be replaced quickly (internally or externally) 	<ul style="list-style-type: none"> • Size of company is larger than most peers • Higher scope of role (e.g., 20% more than the typical benchmark match) • Higher autonomy vs. benchmark roles • Ability to work across area of expertise (breadth of skills and experience) • Significant experience and strong performance in the current role • Skills / experiences cannot be replaced, and are critical to the organization’s strategy and growth • Incumbent has other intangible and essential qualities and characteristics

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In this section, we cover:

- Incentive plan design principles
- Short-term incentive plan (STIP) design features
- Long-term incentive plan (LTIP) design
- Use of board discretion

Key questions for the HRC

9. What process do you follow when reviewing incentive plan designs?
10. Can you clearly articulate the principles supporting the design of the incentive plans?
11. Can the organization's long-term strategy be understood by looking at the incentive plan design?
12. Have you considered the LTI portfolio in the context of the organization strategy and broader total regards program?
13. Does the balance between performance and retention support the business and talent strategies?
14. Do you understand Canadian tax and accounting considerations related to various LTI vehicles / plan design features?
15. Have you considered multiple views of the quantum LTI being delivered?
16. Does the HRC have a process in place for evaluating the need to apply discretion?





9. What process do you follow when reviewing incentive plan designs?

Taking a structured approach to incentive plan designs ensures alignment with the overall business strategies while allowing for the right degree of customization

Incentive Design Step	Questions to ask
Define principles	<ul style="list-style-type: none"> <input type="checkbox"/> Do principles support the business and talent strategies? <input type="checkbox"/> Has the business stage been considered? <input type="checkbox"/> How do principles align with what is found among peers / within industry?
Select structure	<ul style="list-style-type: none"> <input type="checkbox"/> How should the short-term incentive plan be structured? <input type="checkbox"/> Does the approach to incorporating individual performance align with the design principles? <input type="checkbox"/> What long-term incentive vehicles should be used?
Select performance measures	<ul style="list-style-type: none"> <input type="checkbox"/> Do performance measures align with the long-term business strategy? <input type="checkbox"/> Are performance measures at the appropriate level (corporate, team, individual)? <input type="checkbox"/> Does the plan measure drivers of performance or performance outcomes?
Incorporate performance measures	<ul style="list-style-type: none"> <input type="checkbox"/> Is the approach to incorporating metrics appropriate (e.g., weighted, modifier, scorecard, etc.) <input type="checkbox"/> Do the relative weightings on performance measures align with the business strategy?
Determine time horizon	<ul style="list-style-type: none"> <input type="checkbox"/> Are performance measures being measured over an appropriate time horizon (short- vs. long-term)? <input type="checkbox"/> What time horizon is being captured in the LTIP? Is it truly long-term (i.e., > 3 years)
Define approach to incorporating informed judgement / discretion	<ul style="list-style-type: none"> <input type="checkbox"/> Have you considered ways to minimize the need for end of year discretion as part of the plan design? <input type="checkbox"/> Is there a process and/or structure for considering the use of discretion to adjust calculated incentive plan outcomes?
Determine and model performance and payout curves	<ul style="list-style-type: none"> <input type="checkbox"/> Do you review performance and payout curves annually to ensure continued appropriateness? <input type="checkbox"/> Have you reviewed potential payouts under various performance scenarios to ensure they are appropriate? <input type="checkbox"/> Do realized and realizable pay analyses show that the LTIP is achieving desired objectives?
Implement and communicate	<ul style="list-style-type: none"> <input type="checkbox"/> Have you developed a plan to communicate with plan participants and other stakeholders?

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10. Can you clearly articulate the principles supporting the design of the incentive plans?

It is important to understand the different incentive plan design decisions that can be made and how they align with the company's business and talent strategies



The “right” answer will depend on a variety of factors, including:

- Business strategy
- Talent strategy
- Sector / industry
- Peer practices
- Stage of lifecycle
- Ownership structure / investor perspectives
- Regulatory environment

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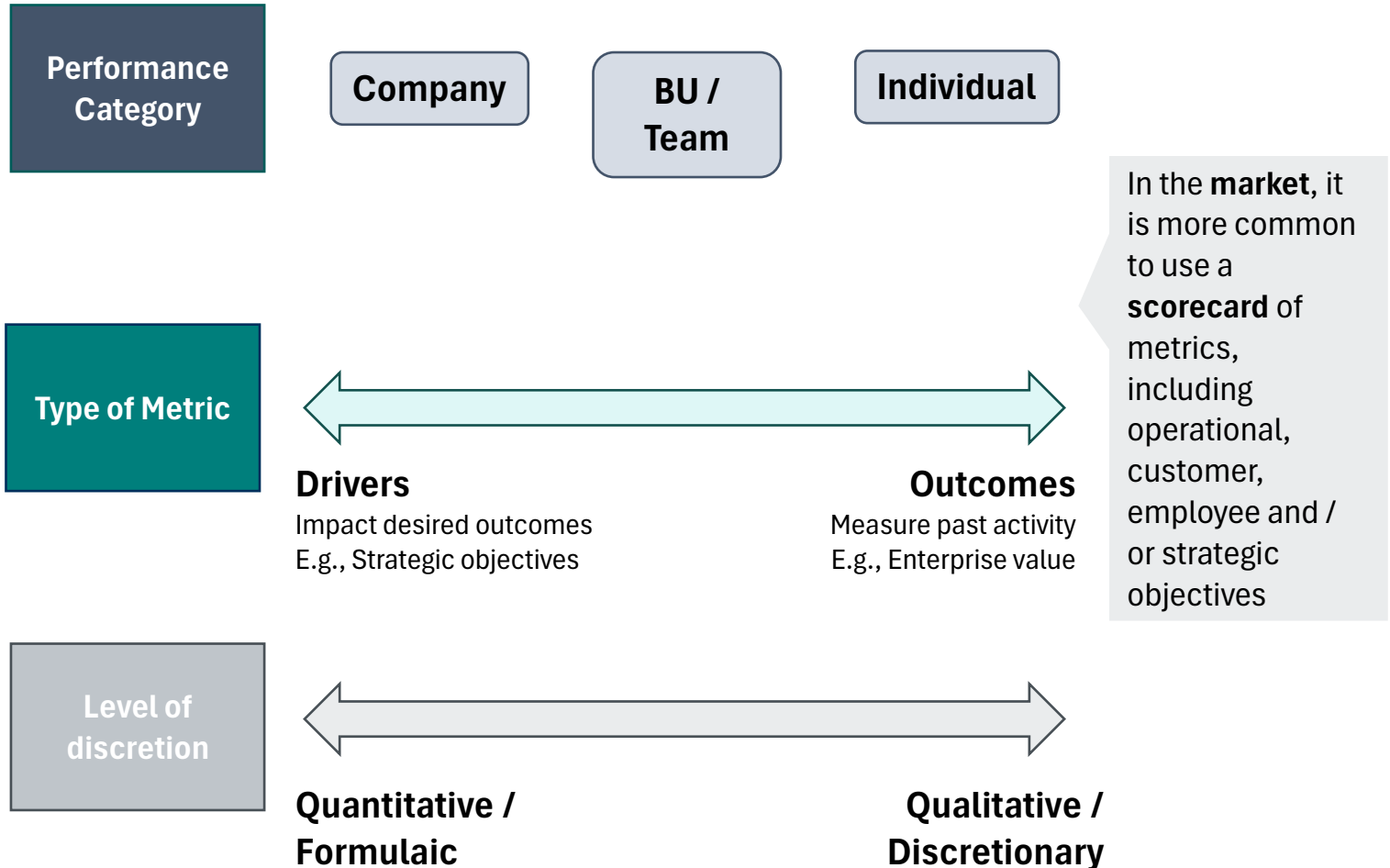
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11. Can the organization's long-term strategy be understood by looking at the incentive plan design?

Incentive plan performance metrics should support the organization in achieving its long-term business strategy



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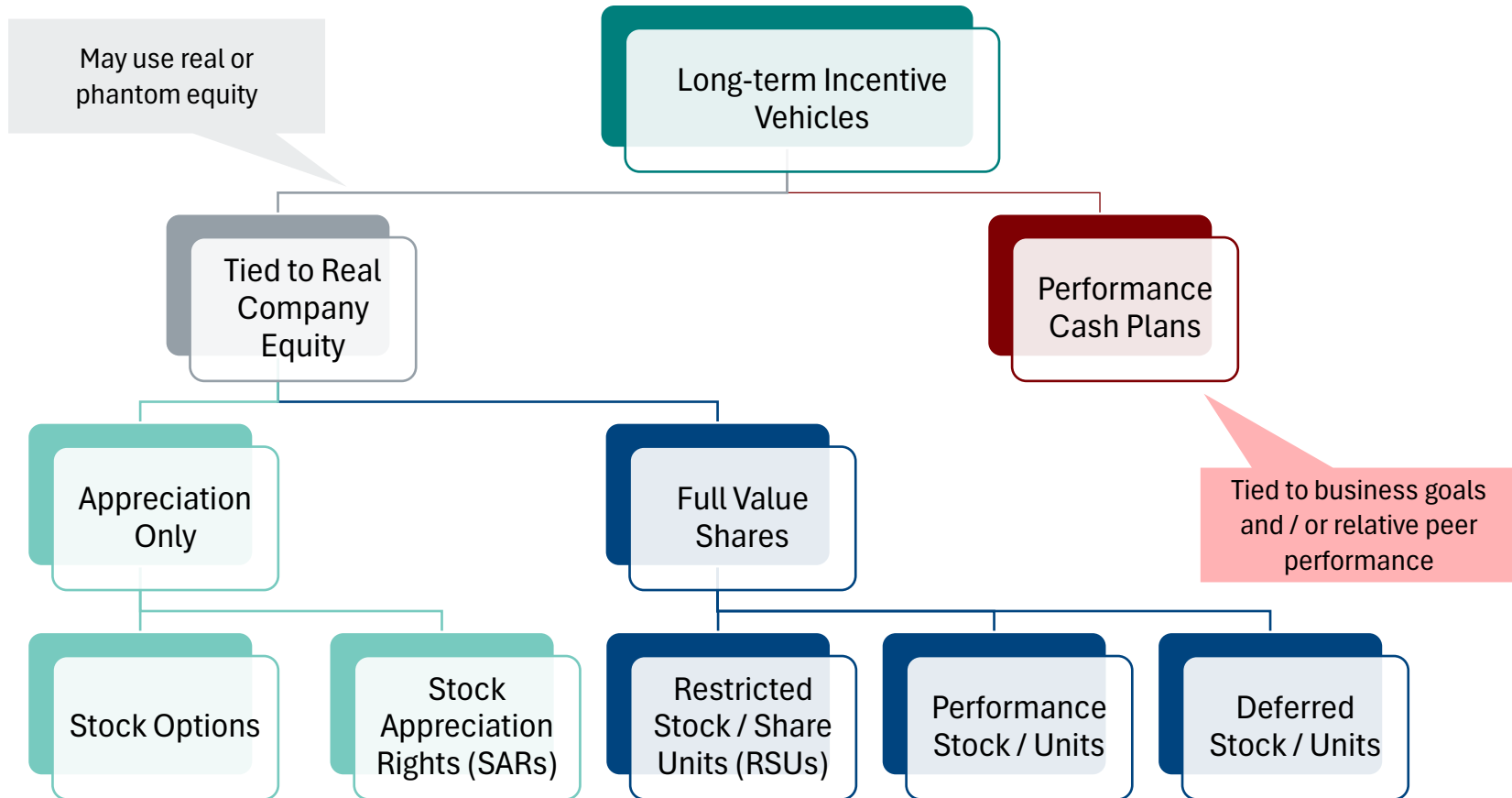
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12. Have you considered the LTI portfolio in the context of the organization strategy and broader total rewards program?

There are numerous LTI vehicles to consider depending on your business strategy and ownership structure. Each vehicle has its own risk / leverage profile



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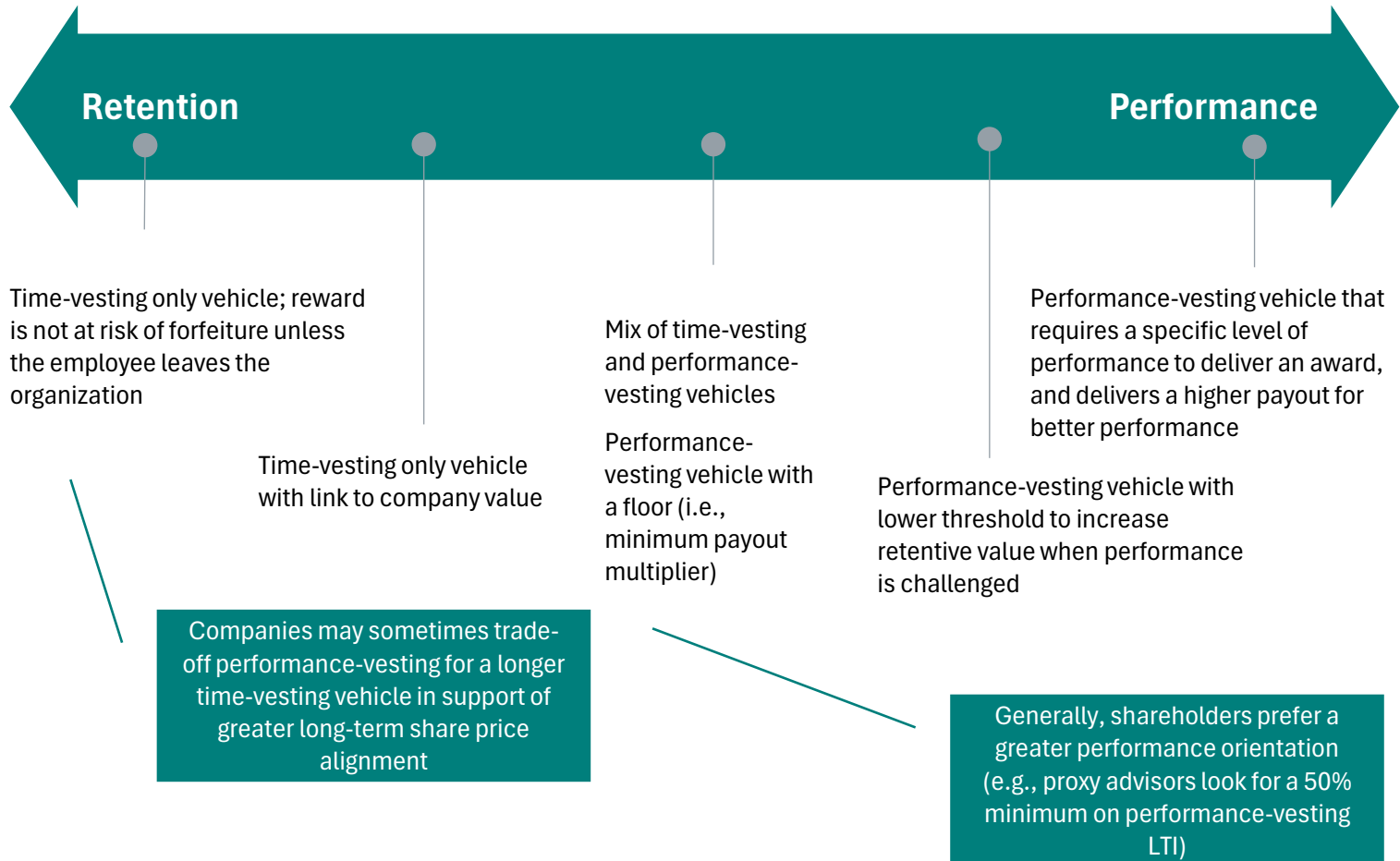
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13. Does the balance between performance and retention support the business and talent strategies?

LTIPs typically balance retaining executives and motivating performance that delivers on the organization's long-term strategy



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14. Do you understand Canadian tax and accounting considerations related to various LTI vehicles / plan design features?

Vehicle	Personal Tax	Corporate Tax	Accounting	Cash Flow / Dilution
Stock option	Preferential tax (up to specific limits)	Available where preferential tax not available to participants	Fixed accounting expense based on the grant date fair value of the award	Generally cash flow positive Dilutive
Stock appreciation rights	Taxed upon vest / exercise	Available based on payout value	Variable mark-to-market expense (using an option value model)	Cash flow negative Non-dilutive
Share units (cash settled or with shares purchased on market)	Taxed when paid	Available based on payout value	Variable mark-to-market expense (approach can vary based on measure – market v. nonmarket)	Cash flow negative Non-dilutive
Share units (shares issued from treasury)	Taxed when settled	Nondeductible	Fixed accounting expense based on the grant date fair value of the award	Cash flow neutral Dilutive

Southlea is not in a position to provide tax, accounting or legal advice. This is provided for guidance only.

15. Have you considered multiple views of the quantum of LTI being delivered?

When reviewing equity grants, the HR Committee should look beyond the expected value being delivered

$$\text{LTIP Expected Value} = \text{Share Price At Grant*} \times \text{Number of Shares Granted}$$

* For stock options, this is based on the Black-Scholes values at grant

Consider both the value and the number of shares / options being granted

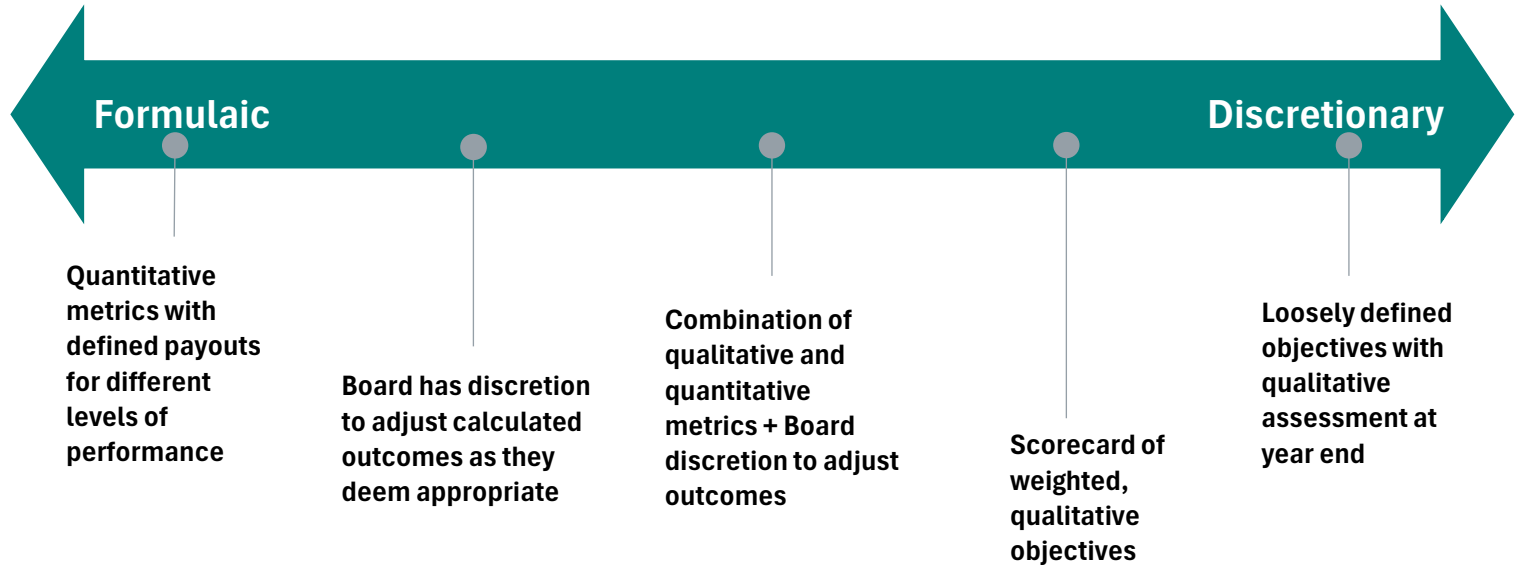
Variation in Value	Expected Value	Number of Shares / Options
Can adjust the value granted up/down to reflect company and/or individual performance/potential	Grant determined based on desired expected value to deliver under different scenarios	Grant determined based on a set number of shares / options or as a percentage of common shares outstanding

Consideration can also be given the dilution and run rate of the treasury reserve. While this applies only to share-settled plans, it can be helpful to understand the impact for all equity plans, including cash settled

Overhang # share units and options outstanding and available to grant divided by total number of shares	Measures how much the treasury reserve (if fully granted) would dilute ownership of current shareholders Commonly accepted limit in Canada is 10% (may be higher among technology companies and lower among larger companies)
Dilution # share units and options outstanding divided by total number of shares	Measures how much the treasury reserve currently dilutes ownership of current shareholders Provides guidance on how many more grants can be made based on the run rate relative to the overhang
Run Rate / Burn Rate # share units and options granted in year divided by total number of shares	Measures how quickly the company is using the available treasury reserve Among mature companies, maximum of 1-2% is commonly accepted depending on dilution

16. Does the HRC have a process in place for evaluating the need to apply discretion?

Incentive plan designs can vary from fully formulaic (calculated outcome) to fully discretionary



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In this section, we cover:

- Different views of compensation and performance
- Target and performance range setting
- Approaches to analyzing the pay for performance relationship

Key questions for the HRC

17. Does the HRC consider multiple views of pay and performance?
18. Do you review a realizable pay analysis annually to understand the link between pay and performance?





17. Does the HRC consider multiple views of pay and performance?

It is important to understand compensation from different angles, as each view provides different insights and together will tell the pay for performance “story”

Target Pay	Actual Pay			Maximum Pay
<ul style="list-style-type: none"> Reflects pay for meeting performance expectations Typically, a 1x on the articulated incentive opportunity Enables the evaluation of the structure of pay Does not account for the relative difficulty of the performance objectives 	<ul style="list-style-type: none"> Reflects pay outcomes for performance achieved in a given time period Helps companies understand and review the alignment of pay with performance Influenced by performance target setting Challenging to compare across industries with different market and economic conditions 			<ul style="list-style-type: none"> Reflects the theoretical maximum pay opportunity available in the program Supports an understanding of the risk / leverage philosophy in the program Does not take into account the probability of achievement
	<p>Grant value</p> <p>Salary + bonus paid + fair value of LTI at grant</p>	<p>Realized</p> <p>Salary + bonus paid + LTI paid</p>	<p>Realizable</p> <p>Realized + current fair value of LTI outstanding</p>	

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17. Does the HRC consider multiple views of pay and performance (continued)?

Just like “different views of pay,” there are different views of performance that should be considered in evaluating the relationship between pay and performance

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How is it measured?

Absolute

Evaluating the company's performance in isolation

Relative

Evaluating the company's performance compared to peer performance

What is measured?

Financial

Metrics in the financial statements (e.g., revenue, earnings, profit)

Market

Metrics related to the stock market (e.g., share price, yield, TSR, beta)

Over what period?

Annual

Multi-Year

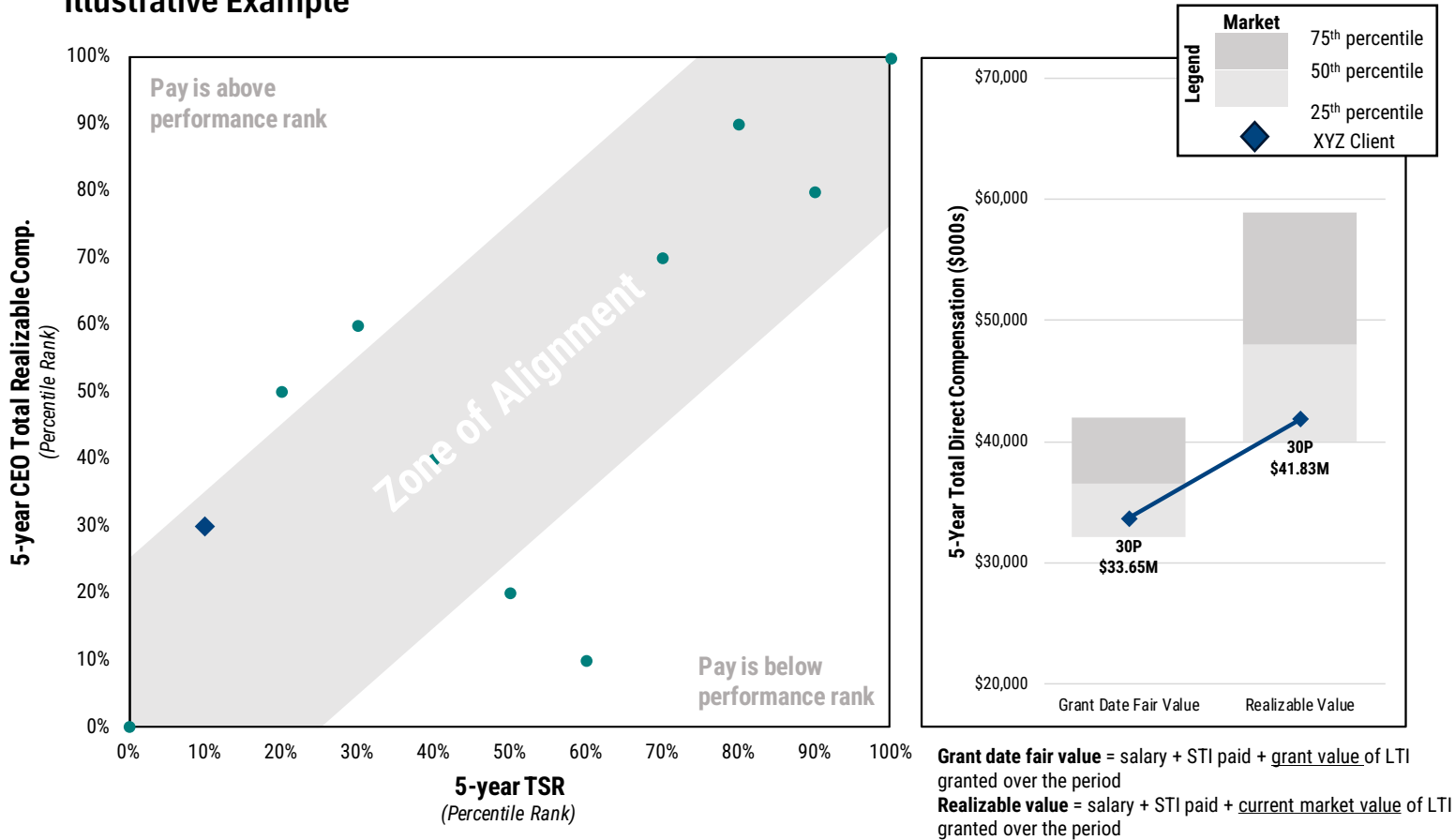
Looking Forward

Multi-Year

18. Do you review a realizable pay analysis annually to understand the link between pay and performance?

Analyses like those illustrated below can help with better understanding the pay for performance relationship

Illustrative Example



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18. Do you review a realizable pay analysis annually to understand the link between pay and performance (cont'd)?

Analyses like those illustrated below can help with better understanding the pay for performance relationship

Illustrative Example

Year	Compensation Awarded	Realized and Realizable Value as of Dec 31, 2022	Period	Value of \$100	
				CEO	Shareholder
2018	\$5,400	\$7,951	Jan 1, 2018 to Dec 31, 2022	\$147	\$168
2019	\$7,100	\$11,064	Jan 1, 2019 to Dec 31, 2022	\$156	\$169
2020	\$8,500	\$11,802	Jan 1, 2020 to Dec 31, 2022	\$139	\$143
2021	\$8,200	\$11,110	Jan 1, 2021 to Dec 31, 2022	\$135	\$127
2022	\$9,350	\$10,881	Jan 1, 2022 to Dec 31, 2022	\$116	\$124
Average				\$139	\$146

Compensation awarded aligns with what is disclosed in the Summary Compensation Table and typically referenced by third parties

Realized and realizable pay can vary overtime based on actual performance outcomes and what is earned by the executive

This can provide a useful comparison to gauge alignment of pay to shareholder experience

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Taking independent executive compensation and governance advisory to a **new level**

Southlea is an innovative and independent executive compensation and governance consulting firm.

We work with companies across Canada and internationally. As part of the Global Executive Compensation and Governance Group (GECN), we regularly partner with over 150 compensation professionals in 15 countries making us the only independent advisory firm in Canada with a global perspective.

As one of the largest compensation practices in Canada, our team offers a unique understanding of business and people strategies, specializing in the financial services, asset management, technology, and natural resources sectors.

We provide independent advice to the board while working collaboratively with management in the best interest of the organization.

Delivering fresh insights and perspectives based on the latest market trends and governance practices, we create compensation programs with impact.

Southlea is a certified Women's Business Enterprise and is Rainbow Registered as an LGBT+ friendly organization, and our diverse perspectives are embedded into everything we do.



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Executive compensation peer group selection criteria

Industry	
Geography	
Size	
Business Specific Factors	

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Incentive design steps

Incentive Design Step	Questions to ask
Define principles	<ul style="list-style-type: none"> <input type="checkbox"/> Do principles support the business and talent strategies? <input type="checkbox"/> Has the business stage been considered? <input type="checkbox"/> How do principles align with what is found among peers / within industry?
Select structure	<ul style="list-style-type: none"> <input type="checkbox"/> How should the short-term incentive plan be structured? <input type="checkbox"/> Does the approach to incorporating individual performance align with the design principles? <input type="checkbox"/> What long-term incentive vehicles should be used?
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Implement and communicate	<ul style="list-style-type: none"> <input type="checkbox"/> Have you developed a plan to communicate with plan participants and other stakeholders?

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Incentive design spectrum

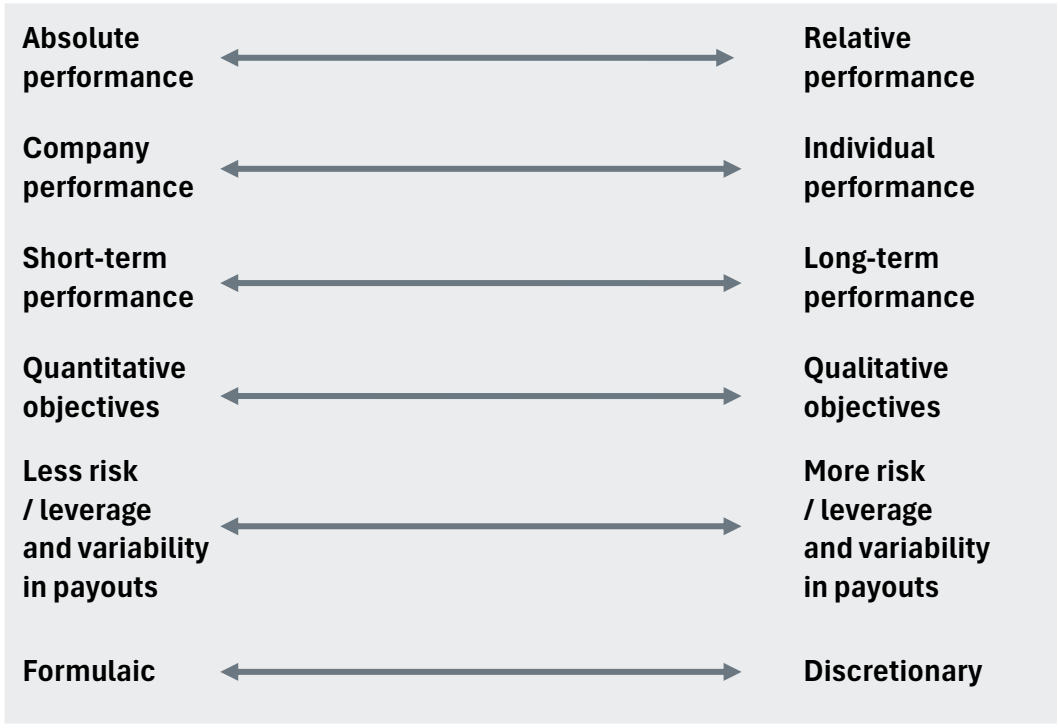
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◆ Use the diamonds provided and place them along the spectrum for current and desired states





CEO pay summary

May want to add a comparison to performance on an absolute or relative basis

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	Year 1	Year 2	Year 3	Year 4	Year 5
Target Pay					
Salary					
Short-term Incentive (STI)					
Long-term Incentive (LTI)					
Target Total Direct Compensation					
Actual Pay Awarded					
Salary					
STI					
LTI Granted (expected value)					
Actual Total Direct Compensation					
Realized and Realizable Pay					
Salary					
STI					
Value of LTI realized during year					
Value of unvested LTI at end of year ("realizable pay")					
Total Realized and Realizable Pay					