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EXECUTIVE COMPENSATION: DEVELOPMENTS FROM CANADA'S TOP COMPANIES

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OUR IN-DEPTH ANALYSIS OF HOW THE TSX60 REWARD THEIR TOP EXECUTIVES REVEALS THE PROGRESS AND EVOLUTION OF EXECUTIVE COMPENSATION STRATEGIES.

For your organization to succeed, you need to get executive compensation right. This helps make sure that the person in the driver's seat is performing at their best. The top 60 companies on the TSX – the TSX60 - understand this. That's why they are becoming more thoughtful about how they track, and reward, executive performance.

By revisiting their incentive plans and using both financial and non-financial performance metrics – including, increasingly, Environmental, Social and Governance (ESG) metrics – these top companies are responding to the demands of their extended stakeholder community: shareholders, proxy advisors, governments and the media.

Our in-depth analysis of how the TSX60 reward their top executives reveals the progress and evolution of executive compensation strategies. Taking these into account may help ensure that your top executives are incentivized to perform well and help your organization achieve its strategic objectives.

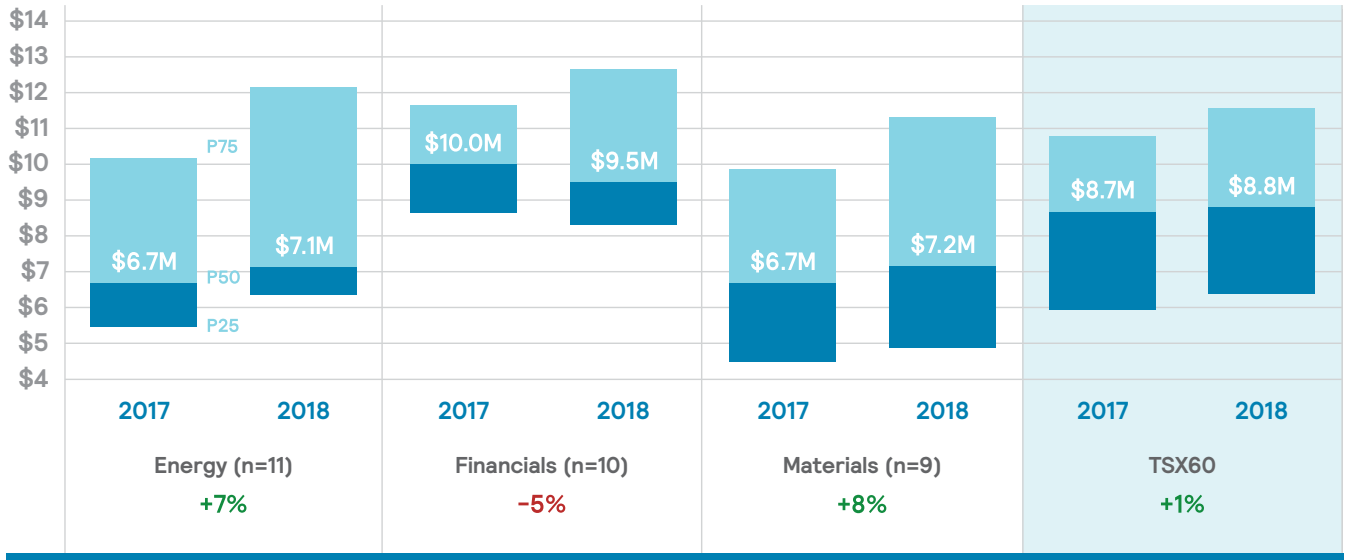
TOTAL DIRECT COMPENSATION UP FOR SAME INCUMBENT CEOS

Overall, reported CEO pay for all TSX60 companies remained flat between 2017 and 2018, but there were considerable variations between sectors. Median CEO Total Direct Compensation (TDC) pay rose 7% in the Energy sector and 8% in Materials, for example, but declined 5% in Financials. Across the entire sample, same incumbent CEOs saw their TDC rise by an average of 6%, through a base salary increase of 2% and a 5% increase in Long-Term Incentives (note – Short-Term Incentives remained flat year-over-year).

Figures for the three-year period (2016-2018) showed higher annual growth in same incumbent CEO median TDC. Across the entire sample, the overall annual increase was 7%. Financial sector CEOs saw an increase in median pay of 5%, those in the Energy sector saw an increase of 10% and Materials CEOs at 13%. For the majority of companies, their relative rankings (e.g. in percentile) in change in reported three year TDC generally aligns with their Total Shareholder Returns (TSR) ranking against their industry peers.

TOTAL DIRECT COMPENSATION ($M)

Total Sample – Actual Pay



Same Incumbent CEO YOY – Median Increase in Actual Pay (n=44)

Base Salary	+2%
Short-Term Incentives	0%
Long-Term Incentives	+5%
Total Cash Compensation	+3%
Total Direct Compensation	+6%

NEW METRICS FOR DETERMINING PERFORMANCE

Our analysis found that, in determining their executive incentive plans, organizations are taking a much needed broader view of performance, rather than focusing on a single measure such as Total Shareholder Return (TSR).

We believe that this is the right move, as investors, proxy advisory firms, governments and the public demand more from companies.

Each individual organization has its own stakeholder environment and circumstances. A broader view of performance ensures you can tailor your executives' incentive plan to your organization's specific circumstances and strategic goals.

Half the TSX60 companies use three or more corporate metrics when determining bonus payouts under their Short-Term Incentive Plan (STIP). One-third of the TSX60 made recent changes to their STIP to better measure performance as the business context continues to evolve and, in some cases, following engagement with shareholders. Profitability or earnings and operational metrics continue to be the most prevalent metrics, with earnings metrics having a weighting of just over 50% of the total bonus.

We continue to see a growing pressure through shareholder proposals and direct engagement to include Environmental, Social and Governance (ESG) metrics. These metrics measure a company's performance against criteria used by both socially conscious investors and the wider public, such as reduction in carbon emissions targets.

In our recent report, Investing in a Time of Climate Change – The Sequel, we found that socially responsible investors have a role to play in supporting an economic transition to a lower-carbon economy. Investors – both retail and institutional – have begun to understand the risk climate change poses, and they have begun to incorporate climate targets into their understanding of corporate performance, and thus into internal controls, procurement policies – and, of course, executive pay.

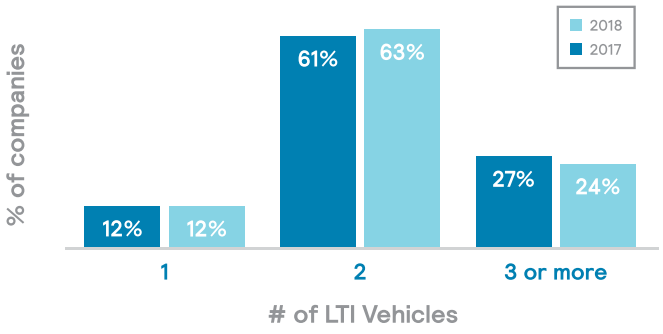
ESG metrics as a measure of performance are being adopted across the broader economy, not just among the TSX60. To gauge the extent of their use, Mercer conducted an ESG incentive plan metrics spot survey in May 2019 and found that almost one-third of the 135 Canadian and U.S. organizations that took part use ESG metrics, with a further 21% considering them. Our survey also found that Canadian participants are almost twice as likely to use them than their U.S. counterparts.

For their Long-Term Incentive Plan (LTIP), we found that most TSX60 companies still use a combination of two vehicles, typically Stock Options and Performance Share Units (PSUs), but with an increase in the weighting of PSUs. TSR is still the most dominant performance metric – whether it's relative to peers, absolute, or used as a modifier – but a growing number of companies are starting to combine TSR with an internal metric, such as returns or earnings metrics.

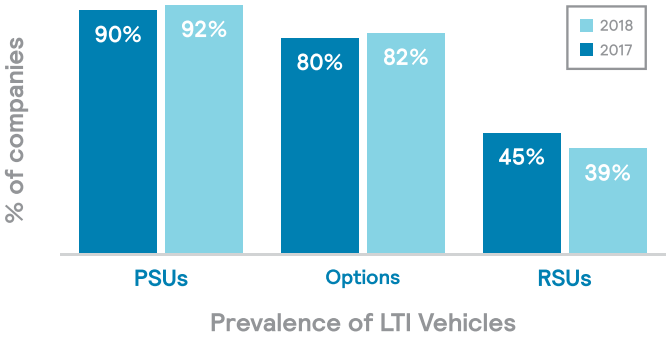
Over the past two years, more than two-thirds of PSUs have vested at or above target, with some companies de-risking their PSUs by providing a floor, or minimum vesting.

- Use of **2 LTI vehicles** predominantly
- Amongst such companies:
  - **PSUs & Stock Options** are most common
  - **PSUs** represent **at least 50%** of the mix
  - Most prevalent weighting is **50%/50%** in **PSUs/Options**

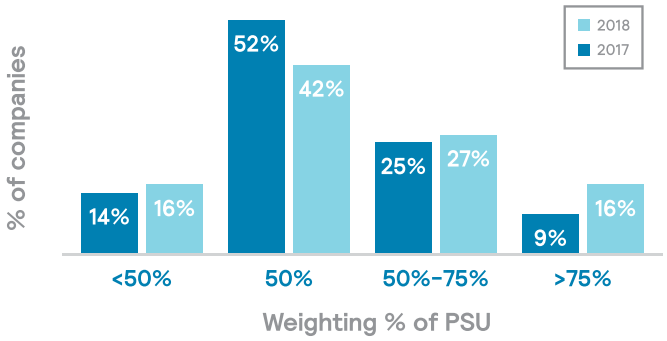
OF LTI VEHICLES USED IN TSX60



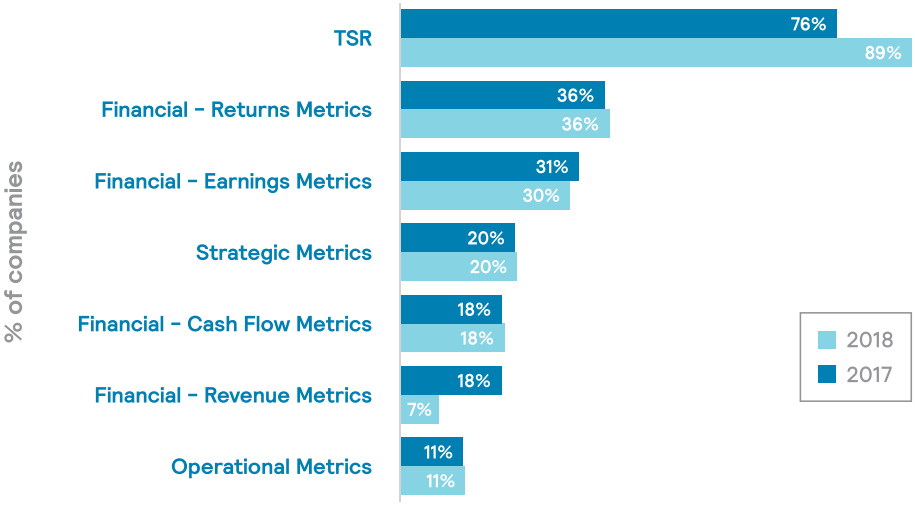
LTI VEHICLE PREVALENCE IN TSX60



PSU WEIGHTING PREVALENCE IN TSX60



MOST PREVALENT PSU PERFORMANCE IN TSX60



FIND THE RIGHT PEER GROUP

Any executive compensation program should be benchmarked against a credible peer group – but due to the composition of the Canadian market, Canadian peers can be difficult to find for some of the TSX60. As such, these companies tend to look to the US market for potential peers. In fact, more than half of the TSX60 include some US companies in their benchmarking peer group.

While this may be necessary for some of the TSX60, it is not for the vast majority of Canadian firms – and we strongly recommend that each company evaluate their situation on a case-by-case basis. As an aside, comparing against Canadian peers only is the approach taken by Institutional Shareholder Services (ISS), which also runs its CEO pay-for-performance analysis using only selected Canadian peers. But if there is little or no overlap in peer companies between ISS and your organization, our experience suggests that ISS may factor into their assessment your pay and performance alignment against your self-selected peer group.

BE PREPARED FOR ENHANCED SCRUTINY

Executive rewards and governance are coming under increased scrutiny by shareholders, proxy advisory firms, governments, the media and the general public. In Canada, most companies conduct themselves in a matter that would stand up to scrutiny, and do not engage in problematic practices such as single trigger change of control provisions and excessive perquisites. As most of these practices have now largely been eliminated, there is increased emphasis on addressing other issues, including incentive design and performance metrics and pay-for-performance linkages.

Members of the TSX60 are taking these steps due to pressure from their external stakeholder environment, but there are common-sense steps your organization can take whether or not you are subject to pressure from shareholders or proxy advisory firms.

Diversity on boards and in senior management positions, for example, has been a focus for boards and institutions for several years, and shareholders are joining the push, as they increasingly bring forward proposals to do more.

For example, the shareholders of Waste Connections Inc. (TSE:WCN) recently voted 64.49% in favour of a proposal requesting that the company develop plans to increase the representation of women on every level, from the Board to the C-Suite to the rank and file. This proposal is markedly more ambitious than other proposals, as it goes beyond mere compliance concerns to set diversity targets for the whole company.

The number of TSX60 companies with board diversity targets increased to over half over the past year. The main focus continues to be on gender diversity, with the typical target for female board representation being 30% to 33%. However, female executive targets are less common.

If your organization is looking to invest in diversity initiatives, our When Women Thrive research shows that executive buy-in matters, to ensure appropriate measurement and follow-through on diversity and inclusion. Having a strategy that addresses diversity and pay equity not only helps in meeting increased shareholder, government and public calls for greater diversity in organizations, it also drives business outcomes, whatever the size of your organization.

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LET'S TALK

For more information about *Executive Compensation: Developments from Canada's Top Companies* or to find out how Mercer's executive compensation and rewards advisory services can help your organization, contact your Mercer consultant.

ABOUT MERCER

At Mercer, we make a difference in the lives of more than 110 million people every day by advancing their health, wealth and careers. We're in the business of creating more secure and rewarding futures for our clients and their employees — whether we're designing affordable health plans, assuring income for retirement or aligning workers with workforce needs. Using analysis and insights as catalysts for change, we anticipate and understand the individual impact of business decisions, now and in the future. We see people's current and future needs through a lens of innovation, and our holistic view, specialized expertise, and deep analytical rigour underpin each and every idea and solution we offer. For more than 70 years, we've turned our insights into actions, enabling people around the globe to live, work and retire well. At Mercer, we say *Make Tomorrow, Today.*

HOW MERCER CAN HELP

Elevate your workforce with improved management, compensation, and communication strategies. Draw from rigorous analytics and data-driven insights to increase the efficacy of your workforce systems. Mercer can help you to design value propositions that appropriately recognize your talent and inspire engagement.

For further information, please visit www.mercer.ca

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