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EXECUTIVE COMPENSATION

# Executive compensation: On the cusp of change

The past twelve months saw several developments that will have a significant impact on compensation practices in 2020. These include proposed changes to taxation of stock options, the enactment of the federal *Pay Equity Act*, amendments to the *Canada Business Corporations Act* (CBCA), new U.S. hedging disclosure rules and a review of automatic securities disposition plans.

## Proposed changes to taxation of stock options granted on or after January 1, 2020

On June 17, 2019, proposed amendments to the *Income Tax Act* (Canada) were introduced which would apply to employee stock options granted by corporations and mutual fund trusts on or after January 1, 2020. See our Osler Update entitled "Canadian government introduces tax legislation applying to employee stock options granted on or after January 1, 2020" on osler.com. The tax treatment of options granted before 2020 is unaffected.

Generally,

- for options granted by employers that are Canadian-controlled private corporations (CCPCs) or other non-CCPC corporations that are "start-ups,

emerging or scale-up companies," employees will continue to be entitled to a 50% tax deduction in respect of the option benefits (i.e., only one-half of the tax benefits realized on the exercise of the stock options is included in income)

- for options granted by other corporations and mutual fund trusts
  - the ability of the employee to take the 50% tax deduction will be subject to a $200,000 annual vesting cap and is not available if, at the time the options are granted, the employer designates the options as not being qualified for such 50% tax deduction
  - an employer deduction may be available for the option benefits realized by employees, but only in respect of options which do not qualify for the employee 50% tax deduction benefit, subject to certain conditions being met

Final amendments, including guidance for determining whether a non-CCPC is a start-up, emerging or scale-up company, are expected in 2020.

While the use of stock options by publicly traded companies has declined over time, there has been a reluctance to eliminate stock options entirely, due to the financial benefit to employees of the favourable tax rate. However, a change in the tax rate may further increase the use of performance-based full value awards.

The federal *Pay Equity Act* now puts the onus on employers subject to the Act to identify and remedy pay gaps.

## Federal pay equity

The federal *Pay Equity Act* (the Act) received royal assent on December 13, 2018. A federal pay equity commissioner was appointed to lead the administration and enforcement of the Act in September 2019. We therefore expect that the Act will come into force in 2020. By contrast, implementation of Ontario legislation to provide for pay equity and transparency which was introduced by the former Liberal government and received royal assent in 2018 has been indefinitely delayed.

The *Pay Equity Act* applies to federally regulated workplaces, including the federal public and private sectors, parliamentary workplaces and the Prime Minister's and Ministers' offices. It is designed to proactively reduce the gender wage gap attributable to the undervaluation of traditionally female positions. While the right to equal pay for equal work has been in the *Canadian Human Rights Act* since 1977, the burden is on the employee to file a complaint with the Canadian Human Rights Commission. The Act, by contrast, will place the onus on covered employers to identify and remedy pay gaps.

Covered employers with 10 or more employees will be required to establish a pay equity plan within three years from the date the Act comes into force, and to review and update progress against the plan every five years thereafter. The pay equity plan must

- indicate the number of employees of the employer
- identify job classes within their workplace
- indicate whether each job class is female- or male-predominant or gender neutral, based on the historical and stereotypical profile of employees who hold the role
- evaluate the value of work performed by each job class

- identify the compensation associated with each job class (compensation includes salary, commissions, vacation pay, bonuses and employer contributions to employee benefit plans)
- compare the compensation associated with female-predominant and male-predominant job classes of similar value
- set out the results of the comparison and identify which female-predominant job classes require an increase in compensation
- identify when the increases in compensation are due
- provide information on the dispute resolution procedures available to employees

## Amendments to CBCA

As noted in Corporate governance: Evolution of existing trends in 2019, certain proposed amendments to the CBCA impose compensation-related disclosure requirements for prescribed corporations. Prescribed corporations would be required to provide annual disclosure with respect to compensation clawback arrangements applicable to directors and senior management. The proposed amendments also include an annual say-on-pay vote on the approach to director and senior management remuneration.

## New U.S. hedging disclosure rules

New U.S. hedging disclosure rules became effective for fiscal years beginning July 1, 2019. Previously, U.S. executive compensation disclosure rules required disclosure in the compensation discussion and analysis of material compensation policies. Policies respecting hedging of risks relating to the ownership of securities received as compensation are cited as an example of a potentially material compensation policy. In the upcoming year, companies subject to U.S. proxy circular disclosure rules also will be required to provide a fair and accurate summary of their practices or policies regarding hedging transactions relating to securities of the company, its parent and any subsidiary of the company or its parent, including the persons covered and the types of hedging transactions which are restricted or permitted. The SEC chose not to define the meaning of "hedge," preferring to leave it to companies to provide disclosure with respect to any arrangement which may limit or offset a decline in the value of securities.

Under Canadian executive compensation disclosure rules, companies are required to disclose whether or not named executive officers (generally, the CEO, CFO and next three highest paid executive officers) or directors are permitted to purchase financial instruments for purposes of hedging risks associated with ownership of equity securities held, whether or not granted as compensation. In making their recommendations on a say-on-pay vote, ISS and Glass Lewis consider the adequacy of the company's disclosure regarding its compensation risk management practices, including anti-hedging policies. Although Canadian companies which are foreign private issuers under U.S. securities laws are not subject to the new U.S. disclosure requirement, they may wish to consider whether to modify their approach to hedging in light of the increased disclosure now being provided by companies subject to U.S. proxy circular disclosure rules.

## Automatic securities disposition plans under review in Canada

In October, the Canadian Securities Administrators announced that automatic securities disposition plans (ASDPs) are under review. ASDPs allow insiders to sell securities of an issuer through an arm's length administrator pursuant to predetermined instructions. While provincial and territorial securities laws provide an insider trading defence for trades made under ASDPs, there is currently no national framework governing ASDPs.

Companies will need to be ready to respond as the legislative and regulatory changes initiated in 2019 start to come into effect.

### AUTHORS

**Lynne Lacoursière**
Partner, Corporate

**llacoursiere@osler.com**
416.862.4719

**Andrew MacDougall**
Partner, Corporate

**amacdougall@osler.com**
416.862.4732

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