

Staying Power

CEO Pay in Canada

Hugh Mackenzie





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ABOUT THE AUTHORS

Economist *Hugh Mackenzie* is a CCPA research associate based in Toronto.

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Staying Power

CEO Pay in Canada

Introduction

This report looks at the average, median, and total compensation of Canada's 100 highest-paid CEOs since 2008. As in previous years, it is based on an analysis of the earnings of CEOs of the Canadian corporations in the TSX Index, as reported in proxy circulars issued in 2015. The findings show the average pay of Canada's top 100 CEOs is extraordinarily resilient, in good times and in bad.

Total compensation of the 100 highest-paid corporate executives in Canada in 2014 amounted to \$896 million. That is down marginally from 2013, but it still exceeds the reported budgetary deficits for 2014–15 of every province in Canada with the exception of Ontario, Quebec, and Newfoundland and Labrador. Who are these guys?

Well, first of all, they are *guys*. To borrow a device from a recent article in *Corporate Knights* magazine, our list of 100 highest-paid CEOs includes five people named Steve, five named Paul, five named Peter or Pierre, four named John, four named Marc or Mark, and four named Michael or Michel. And two women, Linda and Dawn.¹

Average earnings across the Canadian population for someone working full time, year-round were \$48,636 in 2014, while the average minimum wage produced income of \$22,010. To put the discrepancy into perspective,

FIGURE 1 Canada's Top Paid CEOs and the Rest of Us

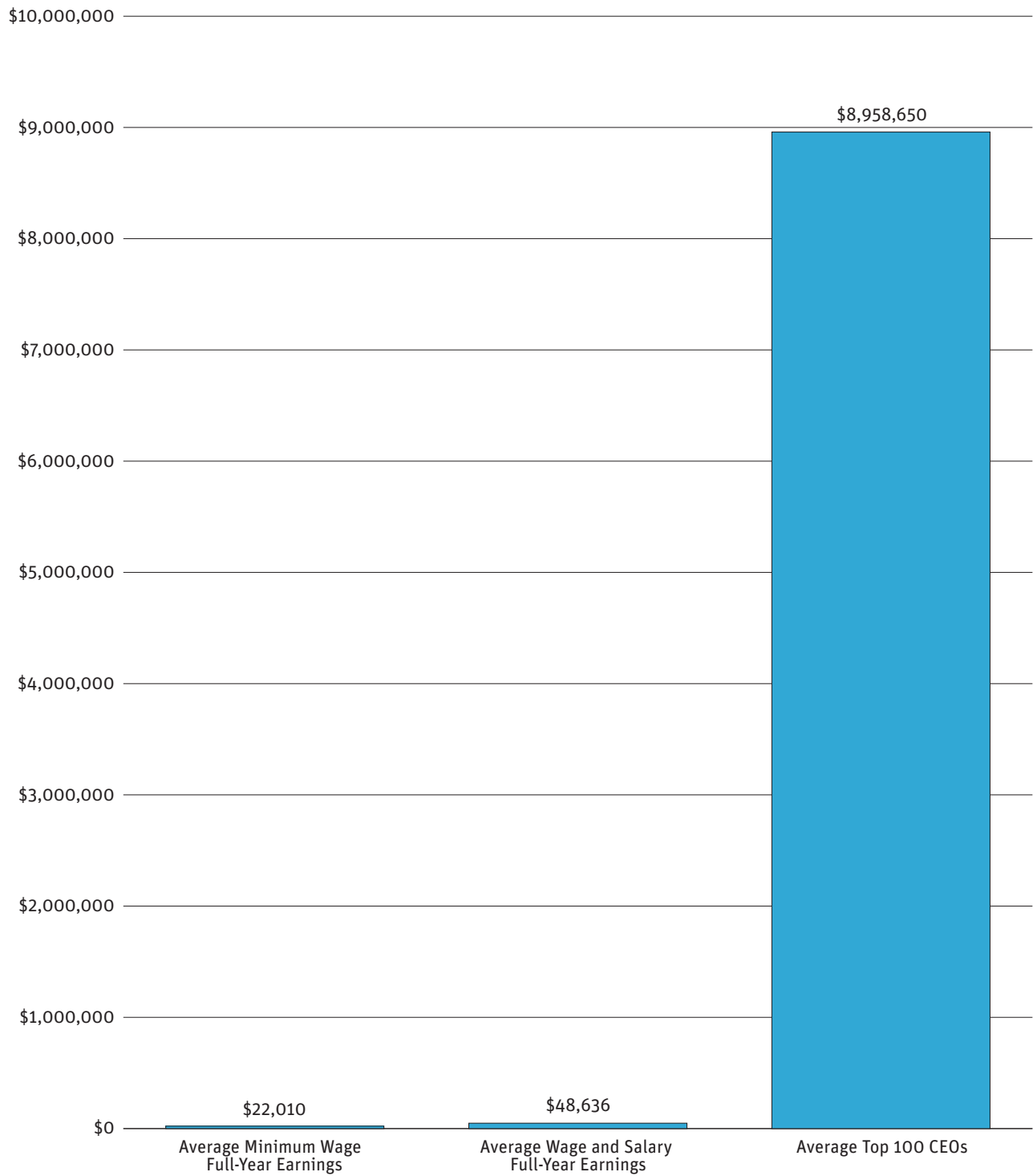
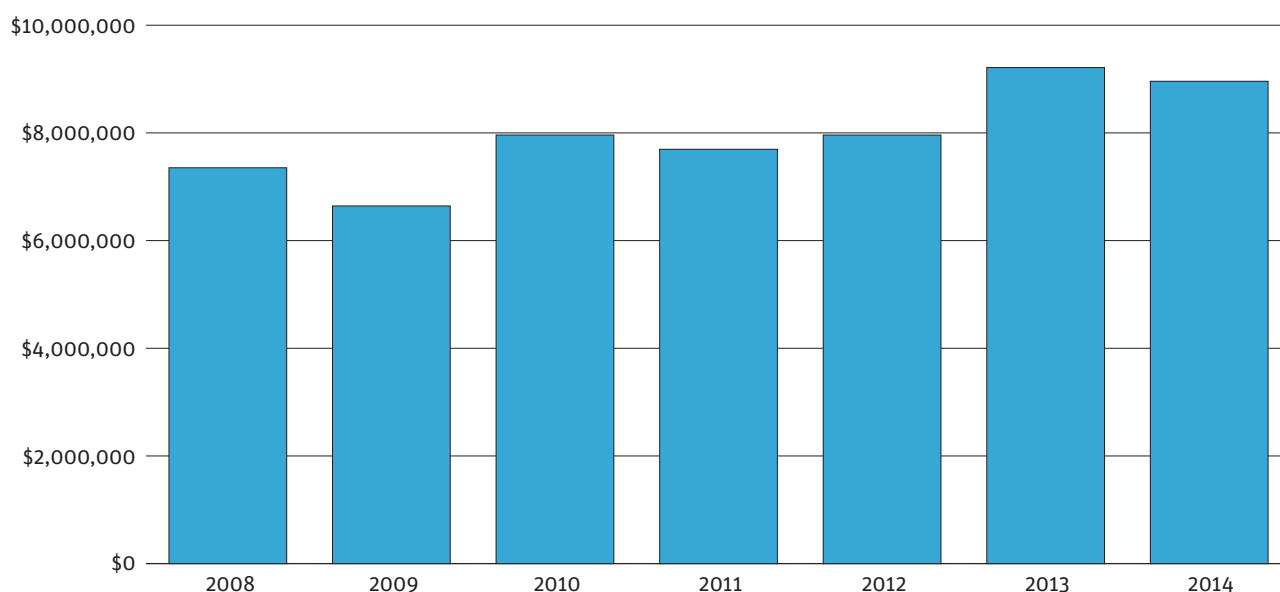


FIGURE 2 Average Pay of Top 100 CEOs, 2008–14



the average top-100 CEO will have earned the average worker's pay by 12:18 p.m. on January 4, 2016 — the second paid day of the year — and the average minimum-wage worker's pay by 2:07 p.m. — on New Year's Day.

Changes in Average CEO Pay, 2008–14

In 2008, the starting year for this series on corporate compensation (and first year such data was available using the current reporting system), the top 100 CEOs in Canada made, on average, \$7.3 million — 174 times more than someone working full time, all year, earning the average wage in Canada. In last year's report, based on the circulars for 2013, average CEO earnings at the top had risen to \$9.2 million.

The latest available data shows that in 2014, when the Canadian economy began to shake under the weight of a global commodity decline and government austerity budgets, Canada's top 100 CEOs made, on average, \$8.96 million. The remarkable staying power of CEO pay despite a global economic meltdown, slow growth reality, and rocky commodity market can be seen in *Table 1*.

The average pay of the 100 best-paid CEOs in Canada barely budged between 2013 and 2014, dropping from \$9.2 million to \$8.96 million, or by 2%.

That slight decline masks the consolidation of CEO pay gains since the Great Recession of 2008, which is clear in *Table 1*.²

CEO pay in 2014 was 22% higher than in 2008. The median pay of a top-100 CEO in 2014 was 32% higher, at \$7,759,000, than it was in 2008. And the pay of the lowest paid of the top 100 in 2014 was \$4.28 million — an increase of 33% from the lowest paid in 2008, at \$3.2 million. This shows pay is becoming more equitable in Canada, though only for the richest CEOs.

The composition of executive earnings also changed over this period. Bonus payments increased from 22% of pay in 2008 to 27% in 2014. Share grants increased from 26% to 39%. Stock options granted to CEOs dropped from 21% of CEO pay in 2008 to just 13% in 2014. All of that decline took place between 2013 and 2014.

One year doesn't make a trend, and 2014 may be an anomaly driven by valuation methods, since the number of CEOs in the top 100 who are paid in part through stock options has remained about the same. But it may also signal a response to criticisms of stock options as a form of executive compensation.

CEO Pay Comparisons

While changes in reporting requirements make it difficult to compare 2014 CEO compensation with pre-2008 levels, trends for both CEOs and average workers since 2008 — Canada's first recessionary year in the global economic meltdown — are still revealing.

In 2008, average reported compensation for the 100 top CEOs was \$7.35 million. In 2014, as noted, it was \$8.96 million, an increase of 22%. Over the same time period, the industrial composite average weekly wage in Canada reported by Statistics Canada increased by 11%, producing average earnings of \$48,636 for someone working full time, all year. The weighted average minimum wage in Canada increased by 17% between 2008 and 2014, from \$9.02 to \$10.58 per hour, roughly reflecting the average wage increase overall.

Based on these data trends, the average top-100 CEO will have earned the annual wage of the average Canadian worker by 12:18 p.m. on January 4, 2016 — the second paid day of the year — and the same as the average minimum wage worker by 2:07 p.m. — on January 1. This is an improvement, in the second instance, of 14 minutes from the perspective of the CEO, who earned the average Canadian minimum wage by 2:21 p.m. in 2008.

TABLE 1 Top Paid CEO Listing

Rank	Name	Company	Base Salary	Bonus	Shares	Options	Pension	Other	Total
1	John Chen	BLACKBERRY LTD	341,452	684,054	88,689,513	-	-	-	89,715,019
2	Donald Walker	MAGNA INTERNATIONAL INC	358,924	11,634,643	7,757,165	3,473,275	-	193,267	23,417,274
3	Gerald Schwartz	ONEX CORPORATION	1,435,694	19,700,252	-	-	-	-	21,135,946
4	Hunter Harrison	CANADIAN PACIFIC RAILWAY LTD	2,421,592	7,289,700	3,662,444	3,661,937	14,152	582,344	17,632,169
5	Mark Thierer	CATAMARAN CORP	1,325,256	2,125,932	10,943,301	1,894,012	-	41,966	16,330,467
6	Donald Guloien	MANULIFE FINANCIAL CORP	1,438,720	3,329,088	5,274,666	3,516,444	823,400	101,890	14,484,208
7	John Thornton	BARRICK GOLD CORP	2,760,950	10,491,610	-	-	828,285	180,618	14,261,463
8	Paul Wright	ELDORADO GOLD CORP	1,514,000	3,974,250	2,744,125	2,744,125	2,812,202	-	13,788,702
9	Bradley Shaw	SHAW COMMUNICATIONS INC-B	2,500,000	6,957,500	-	-	3,450,930	435,675	13,344,105
10	Steven Williams	SUNCOR ENERGY INC	1,361,731	2,055,000	4,955,500	3,894,000	-	155,945	12,422,176
11	Daniel Daviau (CEO North American Capital Markets)	CANACCORD GENUITY GROUP INC	494,325	8,643,243	2,605,323	-	-	-	11,742,891
12	Stanley Marshall	FORTIS INC	1,200,000	2,040,000	2,400,000	551,386	635,610	4,729,693	11,556,689
13	George Cope	BCE INC	1,400,000	3,433,500	4,406,250	1,468,750	605,130	166,620	11,480,250
14	Edmund Clark	TORONTO-DOMINION BANK	1,500,000	1,897,500	5,285,000	2,642,519	-	111,556	11,436,575
15	Michael Pearson	VALEANT PHARMACEUTICALS INTE	2,106,818	8,835,040	-	-	-	406,671	11,348,529
16	James Smith	THOMSON REUTERS CORP	1,711,789	3,144,556	2,995,669	2,995,679	-	35,182	10,882,875
17	Pierre Dion	QUEBECOR INC -CL B	1,056,667	1,523,971	-	8,117,100	143,500	-	10,841,238
18	Jeffrey Orr	POWER FINANCIAL CORP	4,237,000	-	2,272,160	1,821,329	1,801,506	487,250	10,619,245
19	Gerald McCaughey	CAN IMPERIAL BK OF COMMERCE	1,500,000	7,293,700	-	-	757,000	1,002,208	10,552,908
20	Brian Porter	BANK OF NOVA SCOTIA	1,000,000	2,370,000	3,850,000	1,650,000	1,385,000	1,242	10,256,242
21	Gordon Nixon	ROYAL BANK OF CANADA	1,126,027	2,111,000	5,925,000	-	1,034,000	36,247	10,232,274
22	Louis Vachon	NATIONAL BANK OF CANADA	1,050,354	2,126,250	3,375,000	1,687,536	1,517,000	391,488	10,147,628
23	Linda Hasenfratz	LINAMAR CORP	593,960	6,670,986	2,249,656	-	3,500	559,626	10,077,728
24	Donald Lindsay	TECK RESOURCES LTD-CLS B	1,493,500	1,932,200	2,861,250	2,861,100	475,000	353,807	9,976,857
25	William Downe	BANK OF MONTREAL	1,594,979	1,750,000	5,800,000	800,000	-	14,218	9,959,197
26	Doug Suttles	ENCANA CORP	1,042,191	2,353,866	4,497,624	1,499,197	110,162	325,560	9,828,600
27	Steve Laut	CANADIAN NATURAL RESOURCES	678,462	5,728,590	-	3,000,000	-	96,450	9,503,502
28	Joe Natale	TELUS CORP	1,041,260	450,000	6,450,000	-	1,433,000	53,299	9,427,559
29	Charles Jeannes	GOLDCORP INC	1,499,858	1,316,760	3,956,162	2,000,547	526,765	113,516	9,413,608
30	Claude Mongeau	CANADIAN NATL RAILWAY CO	1,187,338	2,544,099	3,373,982	2,113,200	40,000	82,988	9,341,607
31	Miguel de la Campa (Executive Co-Chairman and Director)	PACIFIC RUBIALES ENERGY CORP	1,388,257	2,088,180	5,530,223	-	-	284,199	9,290,859
32	Ronald Pantin (CEO & Director)	PACIFIC RUBIALES ENERGY CORP	1,388,257	2,088,180	5,530,223	-	-	247,326	9,253,986
33	Serafino Iacono (Executive Co-Chairman and Director)	PACIFIC RUBIALES ENERGY CORP	1,388,257	2,088,180	5,530,223	-	-	190,437	9,197,097
34	Jose Fancisco Arata (President and Director)	PACIFIC RUBIALES ENERGY CORP	1,388,257	2,088,180	5,530,223	-	-	172,034	9,178,694
35	Guy Laurence	ROGERS COMMUNICATIONS INC-B	1,200,000	1,286,250	2,820,116	2,820,030	600,605	262,147	8,989,148
36	Scott Saxberg	CRESCENT POINT ENERGY CORP	1,081,885	969,000	6,919,468	-	-	8,676	8,979,029
37	Stephen Wetmore	CANADIAN TIRE CORP-CLASS A	1,250,000	2,271,634	4,999,910	-	-	361,387	8,882,931
38	William Doyle	POTASH CORP OF SASKATCHEWAN	1,387,764	1,236,906	-	4,050,156	1,836,515	181,606	8,692,947
39	Michael Roach	CGI GROUP INC - CLASS A	1,300,000	-	7,170,443	-	-	174,859	8,645,302
40	Marc Poulin	EMPIRE CO LTD 'A'	1,000,000	2,993,816	3,500,000	1,000,000	79,000	3,139	8,575,955
41	Brian Ferguson	CENOVUS ENERGY INC	1,350,000	1,012,500	2,799,977	2,800,021	341,006	133,131	8,436,635
42	Paviter S. Binning (Pres.)	WESTON (GEORGE) LTD	1,075,500	1,666,841	3,300,066	1,650,000	38,000	648,378	8,378,285
43	Paul Rollinson	KINROSS GOLD CORP	1,237,568	1,577,899	3,807,902	951,976	464,088	264,865	8,304,298
44	Paul Mahon	GREAT-WEST LIFECO INC	964,231	1,627,140	499,992	1,051,060	3,834,551	236,002	8,212,976
45	Asim Ghosh	HUSKY ENERGY INC	1,704,500	2,058,000	3,364,209	788,130	153,405	124,521	8,192,765
46	Russell Girling	TRANSCANADA CORP	1,300,008	1,690,000	2,437,500	2,437,500	224,000	13,000	8,102,008
47	Craig H. Muhlhauser	CELESTICA INC	1,000,000	1,237,500	5,500,000	-	186,850	96,477	8,020,827
48	Calin Rovinescu	AIR CANADA	1,400,000	2,850,125	1,787,520	534,306	1,428,000	-	7,999,951
49	Pierre J. Blouin	MANITOBA TELECOM SVCS INC	850,000	521,790	2,881,261	-	-	3,529,190	7,782,241
50	Dean Connor	SUN LIFE FINANCIAL INC	1,000,000	1,455,000	3,750,002	1,250,003	272,310	8,623	7,735,938
51	Sean Boyd	AGNICO EAGLE MINES LTD	1,500,000	3,000,000	2,963,000	-	8,230	19,200	7,490,430
52	Rich Kruger	IMPERIAL OIL LTD	881,391	1,187,779	4,837,802	-	-	579,018	7,485,990

TABLE 1 Top Paid CEO Listing (Continued)

Rank	Name	Company	Base Salary	Bonus	Shares	Options	Pension	Other	Total
53	Bruce Flatt	BROOKFIELD ASSET MANAGE-CL A	662,628	-	6,659,411	-	-	24,275	7,346,314
54	Ravi K. Saligram (CEO)	RITCHIE BROS AUCTIONEERS	537,801	551,958	3,679,533	2,435,058	-	44,524	7,248,873
55	Alain Bedard (President/CEO/acting CFO)	TRANSFORCE INC	1,050,000	2,089,500	824,240	824,250	306,000	1,673,869	6,767,859
56	André Desmarais	POWER CORP OF CANADA	1,125,000	1,750,000	187,500	2,953,304	-	741,086	6,756,890
57	Steven K. Hudson (CEO)	ELEMENT FINANCIAL CORP	1,025,000	3,120,000	2,079,993	-	-	502,500	6,727,493
58	Charles Magro	AGRIUM INC	1,151,524	1,640,921	1,707,550	1,701,139	434,517	33,998	6,669,649
59	Mark Davis	CHEMTRADE LOGISTICS INCOM FD	729,167	4,296,640	1,250,000	-	350,000	26,930	6,652,737
60	Daniel Schwartz	RESTAURANT BRANDS INTERN	773,066	1,932,665	-	3,922,041	-	12,378	6,640,150
61	Paul Desmarais, Jr.	POWER CORP OF CANADA	1,125,000	1,750,000	187,500	2,953,304	-	522,012	6,537,816
62	Peter Marrone	YAMANA GOLD INC	1,432,701	1,700,745	2,397,861	-	671,189	167,981	6,370,477
63	John Floren	METHANEX CORP	844,750	1,470,000	1,844,370	1,819,575	185,845	196,379	6,360,919
64	Gregory Lang	NOVAGOLD RESOURCES INC	765,596	790,474	2,456,975	2,255,668	-	73,446	6,342,160
65	Clifford T. Davis	NEVSUN RESOURCES LTD	675,000	1,476,787	-	425,017	-	3,710,000	6,286,804
66	Geoffrey Martin	CCL INDUSTRIES INC - CL B	975,642	4,122,463	-	910,000	244,007	-	6,252,112
67	Michael H. McCain (President & CEO)	MAPLE LEAF FOODS INC	1,030,125	-	2,448,156	2,447,676	107,466	-	6,033,423
68	Al Monaco	ENBRIDGE INC	1,118,000	1,228,660	1,249,260	1,199,970	1,028,000	104,242	5,928,132
69	Francois Olivier	TRANSCONTINENTAL INC-CL A	950,480	2,723,520	1,985,632	-	187,423	79,125	5,926,180
70	Dori Segal	FIRST CAPITAL REALTY INC	720,000	-	443,750	72,000	-	4,687,800	5,923,550
71	Pierre Beaudoin	BOMBARDIER INC-B	1,400,906	652,357	2,370,883	1,185,441	-77,527	163,890	5,695,950
72	Rupert Duchesne (CEO)	AIMIA INC	872,692	872,692	1,800,008	1,801,816	130,696	174,832	5,652,736
73	Jose Boisjoli	BRP INC/CA- SUB VOTING	957,375	1,085,424	-	3,198,064	340,000	-	5,580,863
74	Jay S. Hennick (CEO)	FIRSTSERVICE CORP	1,748,514	3,802,908	-	-	-	-	5,551,422
75	Thomas Harrington (CEO - DS Services of America)	COTT CORPORATION	31,842	-	5,519,300	-	-	-	5,551,142
76	Robert A. Gannicott	DOMINION DIAMOND CORP	1,020,208	1,089,090	1,341,690	1,705,590	-	336,979	5,493,557
77	Ellis Jacob	CINEPLEX INC	1,000,000	846,503	2,500,000	856,000	-	148,977	5,351,480
78	Nick Orlando (Former President & CEO)	MARTINREA INTERNATIONAL INC	687,500	1,443,023	-	-	-	3,086,386	5,216,909
79	Bradley Nullmeyer (President)	ELEMENT FINANCIAL CORP	845,625	2,600,000	1,740,005	-	-	-	5,185,630
80	Edward Sonshine	RIOCAN REAL ESTATE INVST TR	1,200,000	2,400,000	-	1,511,004	-	-	5,111,004
81	Tim Gitzel	CAMECO CORP	936,400	1,060,000	1,686,349	1,123,648	292,700	-	5,099,097
82	Charles Brindamour	INTACT FINANCIAL CORP	869,846	1,402,875	2,610,000	-	179,466	-	5,062,187
83	Randy Smallwood	SILVER WHEATON CORP	899,617	737,781	1,820,054	1,604,230	-	-	5,061,682
84	Richard D. McBee	MITEL NETWORKS CORP	768,457	1,670,149	1,287,867	1,294,276	-	19,869	5,040,618
85	Galen G. Weston	LOBLAW COMPANIES LTD	1,000,000	1,342,099	1,666,650	833,333	-	181,673	5,023,755
86	Robert Card	SNC-LAVALIN GROUP INC	975,775	-	3,791,432	-	-	195,155	4,962,362
87	Scott Thomson	FINNING INTERNATIONAL INC	926,273	913,929	1,399,550	1,399,550	146,455	53,942	4,839,699
88	Stephen MacPhail	CI FINANCIAL CORP	750,000	3,630,000	-	450,000	-	-	4,830,000
89	Kevin A. Neveu	PRECISION DRILLING CORP	711,851	1,095,539	1,778,432	1,038,702	12,465	123,651	4,760,640
90	Christopher Huskilton	EMERA INC	875,000	1,237,399	962,380	962,608	550,000	31,817	4,619,204
91	Alain Bouchard	ALIMENTATION COUCHE-TARD -B	1,351,875	1,666,186	1,216,682	-	362,985	-	4,597,728
92	Dawn L. Farrell (President and CEO)	TRANSALTA CORP	950,000	1,105,088	2,090,000	-	304,400	70,000	4,519,488
93	John M. Cassaday (President and CEO)	CORUS ENTERTAINMENT INC-B SH	1,000,000	712,960	1,687,500	562,500	365,000	185,182	4,513,142
94	Marc Parent	CAE INC	854,167	823,450	1,319,879	830,496	528,000	134,827	4,490,819
95	Jason D. Waugh (VP)	CANADIAN ENERGY SERVICES & T	290,000	1,428,300	2,725,094	-	-	2,836	4,446,230
96	James Riddell (President)	PARAMOUNT RESOURCES LTD -A	446,250	-	1,864,135	2,086,000	-	12,135	4,408,520
97	Paul Conibear	LUNDIN MINING CORP	787,592	1,049,522	1,706,257	-	-	857,305	4,400,677
98	Rejean Robitaille	LAURENTIAN BANK OF CANADA	598,361	678,228	1,823,469	-	1,243,000	48,014	4,391,072
99	Glenn Chamandy	GILDAN ACTIVEWEAR INC	1,019,231	214,039	1,499,974	1,500,212	51,923	84,028	4,369,407
100	Peter J. Blake (Former CEO)	RITCHIE BROS AUCTIONEERS	387,455	-	-	187,264	-	3,705,867	4,280,586

Note Ranks # 11, 16, 52, 56, 61 and 77 – negative entries for pension disregarded; arise from difference between actual and projected salary, and do not represent an in-year reduction in pension entitlement. Where compensation is stated in US dollars, converted to Canadian dollars using the average exchange rate for 2014.

The most common way of looking at this massive income gap over the long term is through the evolution of the ratio of CEO pay to the pay of the average Canadian. Compensation data for the top 100 CEOs lets us go back to 1998, when the average executive pay was 105 times that of the average Canadian income. In 2014, the top 100 CEOs in Canada took home 184 times the average Canadian income.

When you adjust 1998 income for inflation, an even more dramatic picture emerges of how wide the gap between the top 100 CEOs in Canada and the rest of us has become. Adjusted for inflation, the average income of the top 100 CEOs has increased by 89% since 1998, while the average Canadian income grew by 8%. We should keep in mind that this income boom continued through a deep recession from which Canada has yet to fully emerge.

For a slightly deeper perspective, we can look at comprehensive data going back to 1995 on the compensation of Canada's richest 50 CEOs. That was the first year this data became available after regulatory changes to disclosure rules implemented in 1993.

In 1995, the 50 highest-paid CEOs in Canada earned 85 times what the average Canadian worker made. In 2014, this ratio had tripled: CEOs were making 253 times the earnings of the average Canadian worker.

While hard data of this kind are not available in Canada prior to 1993, it is generally accepted that in the United States the ratio of CEO pay to average pay in the late 1980s was approximately 40:1 and that Canada's ratio would have been somewhat lower.

Stock Options

As noted above, 2014 represented a sharp break from prior years in the extent to which corporations relied on stock options for the compensation of their chief executive officers. The estimated value of stock options granted to CEOs reached 27% of total pay in 2013 — the highest percentage in the period since 2008, when the basis for reporting options was standardized. This value declined to 13% in the 2014 list. At the same time, reliance on grants of shares increased to a peak of 39% of pay in 2014.

It is too early to tell if this represents a trend. But it may be a response by corporate boards to criticism in business media and journals of the use of stock options in the compensation of CEOs of large corporations, and in broader public policy circles of the implicit tax subsidy inherent in the way stock options are taxed.

For example, the Liberals promised during the election campaign to end the favourable tax treatment of stock options in the Income Tax Act. In government, the new Liberal finance minister has indicated the change may apply only to future stock option grants, giving corporations and their well-compensated executives ample time to come up with new ways to push up compensation and avoid tax.³

How Options Are Valued

A stock option is not actual cash when it is granted. When a corporation grants stock options to an executive, it gives the executive the right to buy a given number of company shares at a pre-determined price, known as the strike price. The strike price is normally the market price of the stock on the day the option is granted. When the price of the stock goes above the strike price, the difference represents the value of the option, since the executive could exercise his or her option at the strike price and sell at the higher price.

The values for stock option grants reported in proxy circulars since 2008 are determined using a statistical methodology known as the Black-Scholes method, named after its creators. The method develops an estimated value for an option based on statistical descriptions of the stock's price history. That valuation methodology has tended to produce conservative estimates of the value of the stock options granted to corporate executives.

To illustrate, consider the options granted to the CEOs of Canada's largest chartered banks in 2010 and 2011 that had not been exercised as of the banks' 2014 fiscal year reporting dates. The value reported in 2010 and 2011 for those options came to a total of \$15.7 million. The reported values were calculated using standard statistical methodologies and are based on the number of options granted, the strike price (normally the price of the shares on the date of grant), the vesting date (the earliest date the option can be exercised) and the expiration date (the latest date the option can be exercised). If we look at share prices as of November 6, 2015, those options were actually worth \$30.4 million — nearly double the amount reported.

How Options Are Taxed in Canada

A second reason we have to look more carefully at stock options as a component of executive pay is because of the way they are taxed.

When a CEO actually exercises previously granted stock options (i.e., exercises his or her right to buy the stock at the pre-determined price) the

income crystallized in the transaction is taxed at half the normal rate, as if it were a capital gain rather than ordinary income. So from an after-tax perspective, a dollar received from the exercise of a stock option is worth two dollars of salary income.

The difference in tax paid — half the top marginal rate of taxation, or 26% on average across Canada — amounts to a public subsidy paid to these already highly compensated executives. This is all the more significant because of how common stock options are as a form of executive pay.

Among the highest-paid 100 CEOs in Canada in 2014, 63 received stock options as part of their pay package; a further 17 had previously granted but unexercised “in the money” options. The average estimated option value for those granted options in 2014 was \$1.9 million. The total value of the unexercised “in the money” options was \$2.05 billion, an average of \$28.9 million for each CEO with unexercised options.

Applying the average tax rate of 26% on capital gains, we estimate the tax subsidy for the \$120 million in options granted to top 100 CEOs in 2014 to be \$31 million, and the anticipated tax subsidy related to their stockpile of unexercised “in the money” options to be \$505 million, for a total of more than half a billion dollars.

Stock Grants

The other major form of compensation linked to stocks is the granting of shares in the companies led by CEOs. Typically, these grants are subject to restrictions that impose a delay before the shares can be sold.

On the surface, share grants would appear to be a reasonable way to reward longer term performance not linked to short-term fluctuations in stock prices. In practice, however, CEOs whose earnings come in part through share grants benefit from stock price volatility just like holders of stock options, in part because share grant programs generally give CEOs stock of a pre-determined value rather than a fixed number of shares. This means that when share prices move downwards, the number of shares granted will tend to go up, increasing the CEO’s gains from stock price volatility.

In 2014, the 100 top CEOs in Canada were granted a total of \$349 million in shares of the companies they led — an overall average of \$3.5 million each, and \$4.2 million for the 83 CEOs who received share grants. Top 100 CEOs had a total of \$778 million in unvested share awards in 2014, for an

overall average of \$7.8 million each, and \$10.4 million for the 75 CEOs who had unvested share awards outstanding.

Pensions: Cash for Life; No Lottery Ticket Required

In the current debate over the expansion of the Canada Pension Plan, business leaders have been the most prominent opponents. They have argued that Canada's retirees already do well under the current set-up, making CPP expansion unnecessary, or that the required contributions (e.g., 1.9% of pay up to \$90,000 in the Ontario Retirement Pension Plan) are excessive and unaffordable.

Canadian business is also voting with its feet on the question of providing employees with a secure retirement income. Only about 11% of employees in the private sector in Canada belong to a defined benefit pension plan, either sponsored by their employer or provided through their employer's participation in a multi-employer pension plan.

It would appear, however, that the distaste senior business leaders have for defined benefit pension plans — either private sector corporate plans or the CPP — stops at the C-Suite door. Among our list of 100 highest paid CEOs, 46 have one themselves.

According to their employers' proxy circular disclosures, these CEO pensions will provide, on average, annual income of \$962,000 starting at age 65 — the equivalent of more than 85% of their current base salaries. The total accrued value of their pensions comes to more than \$567 million.

Shares: The Pride (and Benefits) of Ownership

Between the shares accumulated through grants of stock in annual compensation, and the equity ownership of founders and/or controlling shareholders who also serve as CEOs, Canada's 100 highest paid CEOs have accumulated substantial wealth in the form of shares in the companies they manage.

As a group, these CEOs report ownership of shares in their companies alone amounting to \$9.5 billion, or an average of \$95 million each. As share owners, the same 100 CEOs would have received dividends in 2014 amounting to an estimated \$118 million (\$1.18 million each).

Extraordinary Executive Pay: Does It Make Sense?

Governments and citizens around the world continue to focus attention on the astronomical salaries pocketed by CEOs. Especially in the U.S., there has been particularly strong public and political outrage at the payment of enormous bonuses to the executives who have overseen the wiping out of billions of dollars in shareholder value since the crash of 2007–08.

For years, the line has been that high CEO pay is a reward for good performance. Indeed, a virtual industry of compensation and communication consultants has emerged to rationalize executive compensation and justify its exorbitant levels to shareholders and the public. The notion that modern executive compensation systems are tied to corporate performance is as resilient in the face of evidence to the contrary as the compensation itself is to everything from economic recession to political pressure to shareholder activism.

A 2014 study by academics from Cambridge University, Purdue University and the University of Utah, published by the Social Science Research Network⁴ and reported by *Forbes* in 2014, analyzed 20 years of data on executive compensation and corporate performance, reaching the conclusion that “the more CEOs got paid, the worse their companies did.”⁵

A provocative analytical tool created by the *Globe and Mail* in 2012 plotted and compared five different categories of pay with seven different measures of corporate performance. The results, which were presented in scattergrams, are sobering. Rather than show any coherent relationship linking compensation to performance, the scatter plots looked more like fly-paper specks.⁶

One of the problems at the root of soaring and uncontrolled CEO pay packages is the role played by stock market-based forms of compensation in the form of stock options and grants of shares. Some claim that linking CEO pay to share performance is simple and straightforward, and a way to align executive interests to the long-term interests of shareholders.

A growing number of influential, independent experts begs to differ. Two leading Canadian business thinkers, Roger Martin and Henry Mintzberg, have been weighing in heavily on the issue for years.

An analysis by Martin, former dean of the University of Toronto’s Rotman School of Management, proposes that compensating CEOs based on stock prices (e.g., through share grants or stock options) rewards them for something they cannot influence or control.⁷ This is all the more strange, he reasons, because stock markets are “expectations markets,” in that the price of a company’s shares is based not on the performance of the com-

pany in the past, but on what investors expect the performance of the company to be in the future.

Using a football analogy, Martin likens paying a CEO based on share prices to paying a football quarterback based on whether or not his team beats the betting points spread. Not only does the points spread (the expectations market) have nothing to do with the quarterback's performance on the field, in football it is illegal for a quarterback to participate in that market. Using the same logic, Martin argues that CEOs should receive bonuses based on how their companies perform, the business plans they set, and profits they generate rather than on how the bets placed by investors influence the value of their shares.

Martin concludes:

If we are to emerge from this mess, executives must switch their focus entirely to the real market and completely ignore the expectations market. This entails building skills and experience in building real products, developing real consumers and earning real profits.... While these proposals might seem draconian, they are absolutely necessary to save corporations from themselves. Customers and employees will only accept the legitimacy of a business if its executives put customers and employees ahead of shareholders who buy shares from existing shareholders; companies will only become skilled at creating real value if they don't spend their time on the expectations market; and the negative impact of hedge funds will only diminish if executives stop spending their time jerking-around expectations.

Mintzberg, a renowned Canadian business thinker, starts from the same premise as Martin – that compensation should match performance – but goes much further in a November 2009 *Wall Street Journal* article arguing that corporate leaders should not be paid bonuses at all.⁸ He explains:

This may sound extreme. But when you look at the way the compensation game is played – and the assumptions that are made by those who want to reform it – you can come to no other conclusion. The system simply can't be fixed. Executive bonuses – especially in the form of stock and option grants – represent the most prominent form of legal corruption that has been undermining our large corporations and bringing down the global economy. Get rid of them and we will all be better off for it.

Despite the recession, the public outrage, the criticism of political leaders, and the devastating analyses of key business thinkers, the practice of

compensating Canadian CEOs has not changed perceptibly since the global economic meltdown.

The standard response to concerns about excessive executive compensation is that it is a discussion best left to corporate boards whose directors should see the benefit of reigning in salaries. But the evidence to 2014 suggests this approach is not working. Even the advent of advisory votes (“say on pay”) by shareholders has had little if any noticeable impact on compensation decisions by corporate boards, leaving us to conclude the will for reform simply isn’t there, despite the public utterances of several high-profile investors.

Warren Buffett is one of the wealthiest men in the world and renowned as one of the most successful investors in history. Viewed as the modern-day guru of value investing, his opinions and actions are enormously influential. So when Buffett spoke out publicly against the compensation of senior executives at Coca-Cola, where he is a major shareholder, people paid attention.

But when Buffett later revealed that despite his public comments he had voted in favour of an extravagant pay rise for Coke CEOs — he said he didn’t want to disrupt the collegial atmosphere on the board — he did more than frustrate shareholders; he took the wind out of the sails of those who claim that boards of directors can be relied upon to bring executive compensation under control.

That negative view of the potential for board-driven reform of the system is echoed in the 2015 edition of the *Globe and Mail’s* annual review of Canadian corporate boards, *Board Games*.⁹ Citing the issues for corporate performance noted above, and based on the views of a wide range of experts on corporate performance and governance, the report points to a similarly pessimistic conclusion about internal reform.

This leaves those who believe the corporate sector can manage its own compensation with two options. The first is voluntary restraint on the part of North American CEOs. The second would be regulatory changes to corporate governance that would have the effect of taking executive compensation decisions away from corporate boards and their self-reinforcing advisors. Failure to act in one of these directions could spark a hard political response, according to Martin:

The trend [towards higher compensation] cannot proceed unabated in the United States without provoking a political reaction. Top executives, private equity managers, and pension funds can avoid such a reaction by showing

the leadership of which they are fully capable and modifying their behavior to create a better mix of rewards for capital, labour, and talent.¹⁰

While he is correct to point to the significance of the growing gap between CEO and average compensation there is very little evidence of the leadership, restraint, or self-discipline he says are necessary to avoid political intervention. The public reaction to soaring executive bonuses in the lead-up to the financial crisis, coupled with the emergence of executive greed as a common theme in popular culture, has had no identifiable impact on compensation trends.

While there has been the odd example of self-restraint (e.g., Canadian bank CEOs who voluntarily gave up stock options or other bonus payments in 2008), they have been the exception rather than the rule. In a telling comment to the *Globe and Mail*, Martin admits he has all but given up on corporate boards as vehicles for change. “I’m never going on another board as long as I live,” he told the reporter. “I hate it. I hate it with a burning passion. I hated pretty much every minute.”¹¹

A Way Forward for Canada

It is increasingly clear that shareholders, working through their corporate boards of directors, are having a limited impact on decisions related to corporate compensation. There are good reasons why this type of voluntary restraint cannot adequately address the problem of runaway CEO pay.

In the first place, nearly everyone involved in determining compensation is “in the club,” or in the same community of interest. It includes independent consultants who can only advise on what CEOs *are* paid, not what they *should be* paid. Compensation decisions for CEOs, and for that matter other high flyers in the corporate world, are, in other words, based on a circular logic. As the Buffett story tells us, the club also includes fearful corporate boards. But those who do want to act face even further constraints.

To begin with, boards of directors are totally dependent on the CEO they hire — probably the most important decision the board gets to make — and there is a lot of pressure to get the right person. In the process, corporate boards find themselves in what game theorists call a prisoner’s dilemma, which goes something like this.

Every corporation would be better off if they all paid their CEOs less. But if one, and only one, takes that plunge, the corporation becomes a less attractive place to work than all other corporations. And because everyone

is prepared to assume that executives are motivated only by money, that corporation's choice of CEOs will be much more limited. To put it simply, boards fear that by stepping outside the norm (of excessive compensation) they undermine their ability to hire the best people.

In theory, company shareholders, through "say on pay" provisions in corporate charters, are supposed to be able to send messages up the chain of command about executive compensation. Directors are supposed to ignore these messages at their peril. The fundamental problem is that "say on pay" votes happen remotely, once a year, whereas boards of directors meet in person many times during the year. The limited intervention means shareholders can *say* they are unhappy with executive compensation; it does not mean they can actually do anything about it.

Improving on this system by making shareholder votes on compensation binding would require changes to Canada's corporate governance system with its reliance on the expertise and time commitment of corporate boards. It is a very unlikely prospect. That leaves government as the only actor left to inject reason into an irrational compensation system. Government can do this through one of two approaches: regulation or the tax system.

There are two major problems with a regulatory approach. First, it would be next to impossible to separate legitimate, carefully thought-out (e.g., performance-based) rewards to CEOs from other payments. This heavy-handed approach would also inevitably generate a storm of outrage from the business sector, ultimately threatening the acting government's political viability. Finally, any regulatory regime would simply kick off an elaborate game of evasion and entrapment between the regulated and the regulators.

The tax approach makes a lot more sense. If we, as a society, have concluded that excessive pay is unacceptable, we should be able to claw back a greater portion of it from the recipients, and structure the tax system to discourage corporations from paying those excessive amounts. In particular, if we have concluded that equity-based compensation is not in the public interest or the long-term interests of Canadian corporations, the tax system can be restructured to expressly discourage it.

Even without taking the provocative (and no doubt popular) step of raising taxes for well-compensated CEOs, the new Liberal government would benefit by following through on its election promise to end the public subsidy inherent in the tax loophole that allows executives to pay half the income tax rate on cashed-in stock options by claiming that revenue as capital gains. As calculated above, had the top 100 CEOs cashed in their options in 2014, Canada would have "lost" more than half a billion dollars in fore-

gone taxes — money that would go a long way toward addressing Canada's 1989 commitment to end child poverty, for example.

Economists will dispute the value of corporate taxes and higher taxes on CEO compensation to government revenues. But the equalizing effect of these taxes, the need to close the growing income gap between Canada's top earners and the rest of us, is valuable in its own right.

Notes

- 1** Mark Brownlie, “It’s hard to climb the ladder in high heels”, *Corporate Knights*, November 6 2015.
- 2** Source: CCPA annual top-100 CEO pay reports, 2009 to 2015.
- 3** “Tax Changes Won’t Apply to Existing Stock Options, Morneau Says”, *Globe and Mail*, 20 November 2015.
- 4** Michael J. Cooper, Huseyin Gulen and P. Raghavendra Rau, “Performance for Pay? The Relation Between CEO Incentive Compensation and Future Stock Price Performance”, *Social Science Research Network*, 1 October 2014; http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1572085.
- 5** Susan Adams “The Highest-Paid CEOs Are The Worst Performers, New Study Says”, *Forbes*, 16 June 2014; <http://www.forbes.com/sites/susanadams/2014/06/16/the-highest-paid-ceos-are-the-worst-performers-new-study-says/>.
- 6** The analytical tool based on 2010 and 2011 corporate data is still accessible through the *Globe and Mail*’s website at <http://www.theglobeandmail.com/report-on-business/careers/management/executive-compensation/bang-for-their-buck-compare-executive-pay-days-with-company-performance/article4232218/>.
- 7** Roger Martin, “Undermining Staying Power: The Role of Unhelpful Management Theories”, *Rotman Magazine*, Spring 2009.
- 8** Henry Mintzberg, “No More Executive Bonuses!”, *Wall Street Journal*, November 30, 2009.
- 9** Tim Kiladze and Janet McFarland, “The trouble with equity-based pay and the elusive quest for a remedy”, *Globe and Mail Report on Business*, December 5, 2015 pp.8–9.
- 10** Roger L. Martin, “The Rise (and Likely Fall) of the Talent Economy”, *Harvard Business Review*, October 2014, quotation at page 9 of the article in reprint.
- 11** Kiladze and McFarland, *op cit* p.9.



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