

At a Glance

In response to the severe economic downturn, over 70 per cent of respondents have made adjustments to their executive pay programs in FY 2009.

Many expect to make less extensive changes next year in anticipation of an eventual economic recovery.

The majority of respondents do not believe their compensation programs promote risky behavior.

Executive Pay in the New Economy

About the Survey

In mid-August, Watson Wyatt surveyed a cross-section of 53 Canadian-based organizations to understand what adjustments they have made to their executive compensation programs in light of the economic crisis (e.g., base salary/merit increases, annual incentives, long-term incentives) — and whether and when they will reverse any cuts/changes as the economy improves.

Executive Summary

Many Canadian organizations, particularly those strongly affected by the recent economic turmoil, have frozen or reduced their executive base salaries and bonuses in 2009. Less extensive adjustments are expected next year in anticipation of an eventual economic recovery. For those changing the pay mix between base salaries and short- and long-term incentives, the primary reason is to strengthen the link between executive pay and company performance. Risk reduction is not a determining factor when considering pay mix changes as few respondents believe their current executive compensation programs motivate excessive risk taking.



Key Findings

- All 53 companies indicated they have been adversely affected by the severe economic downturn.
- More than 70 per cent of respondents have taken some actions, regarding either base salaries, annual bonuses or long-term incentive (LTI) vehicles, to keep their executive pay in line with the challenging business environment.
- Many expect to make less extensive changes to their executive pay programs next year in anticipation of an eventual economic recovery.
- The vast majority of companies do not feel their executive compensation programs reward executives for risky behavior that could potentially lead to excessive risk taking.
- Close to 30 per cent of companies with LTIs reported they have recently changed or are considering changing the pay mix of their executive compensation.
- The most common reason cited for pay-mix changes is to strengthen the link between executive pay and company performance.

How Organizations Are Responding to the Economic Downturn and Their Plans for 2010

Considering the severity of the recent recession in Canada as well as in other major economies, it is not surprising that all companies in the survey indicated they have been adversely affected. Around half of respondents reported that the severe downturn has had strong impact on their organizations (see **Figure 1**).

Figure 1: Adverse effect on the company of recent events in the economy and financial markets

Not at all		Somewhat		Significantly
1	2	3	4	5
0%	17%	34%	36%	13%

In response to the economic turmoil, many Canadian organizations have made adjustments to their executive pay programs in fiscal year (FY) 2009. The most common actions taken were base salary freeze or reduction (40 per cent) and planned merit increases delay or reduction (26 per cent). Furthermore, executives in companies that have been strongly affected by the recent recession are more likely to see adjustments in their base salaries, annual bonuses and LTI grant dollar values (see **Figure 2**).

Figure 2: Actions taken in FY 2009 in light of the economic downturn

	FY09		
	All	Strongly affected by recession	Somewhat affected by recession
Base salaries freeze/reduction	40%	50%	30%
Planned merit increases delay/reduction	26%	23%	30%
Bonus funding reduction/elimination	19%	35%	4%
Target bonus opportunities reduction/elimination	6%	8%	4%
LTI grant dollar values reduction/elimination	9%	15%	4%

Overall, more than 70 per cent of respondents have taken some actions, in the form of either base salaries, annual bonuses or LTI vehicles, to keep their executive pay in line with the challenging business environment (see **Figure 3**). However, many expect to make less extensive changes next year in anticipation of an eventual economic recovery. For FY 2010, only 22 percent expect continued adjustments to the economic downturn. Very few respondents (13 percent) are planning to freeze or reduce their executive base salaries (see **Figure 4**).

Figure 3: Companies that have made or plan to make adjustments to their executive pay programs in FY 2009 and FY 2010

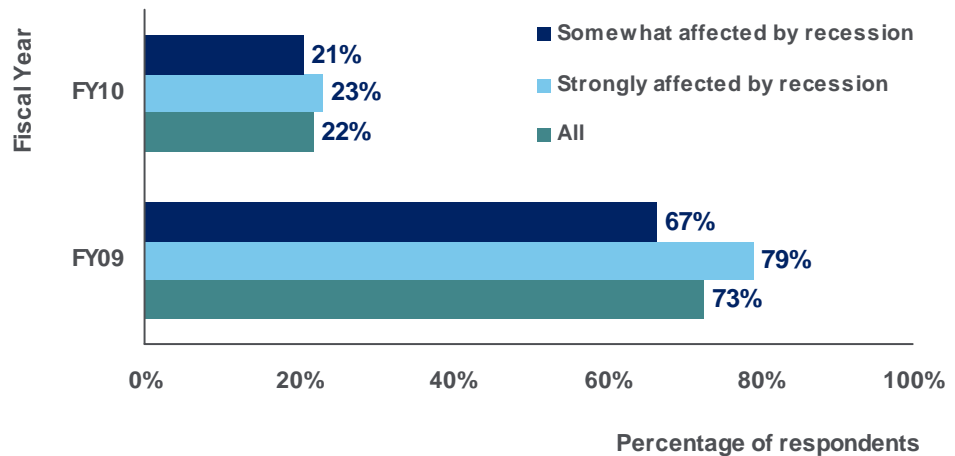


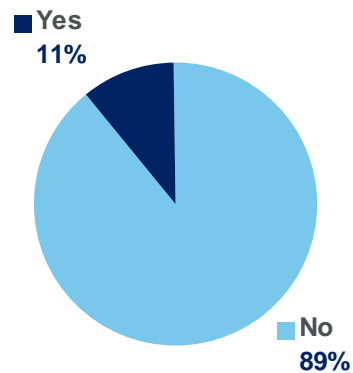
Figure 4: Actions planned for FY 2010

	FY10		
	All	Strongly affected by recession	Somewhat affected by recession
Base salaries freeze/reduction	13%	12%	15%
Planned merit increases delay/reduction	13%	12%	15%
Bonus funding reduction/elimination	11%	19%	4%
Target bonus opportunities reduction/elimination	2%	4%	0%
LTI grant dollar values reduction/elimination	4%	8%	0%

Impact of Executive Pay Programs on Corporate Risk Taking

The vast majority (89 percent) of respondents do not feel their executive compensation programs reward executives for risky behavior that could potentially lead to excessive risk taking, while only 11 percent believe they do (see **Figure 5**). Although critics of executive compensation hold that current practices are motivating risky behavior, it is not clear which components are contributing to this alleged behavior. Watson Wyatt is currently conducting research in an effort to identify the elements of executive compensation that aggravate or mitigate risk.

Figure 5: Correlation of the company's executive compensation program with excessive risk taking



Pay Mix Changes to Strengthen the Link Between Pay and Performance

Seventy-five percent of the companies in the survey offer long-term incentive programs to their executives. For those with LTIs, the most common vehicles are stock options/stock appreciation rights (SARs) and restricted share units (RSUs), particularly among publicly traded companies (see **Figure 6**).

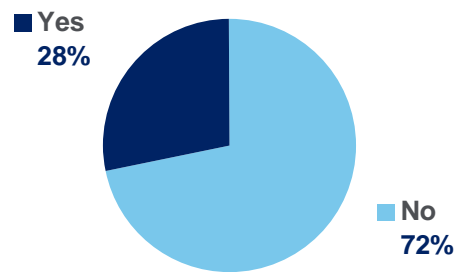
Figure 6: Prevalence of LTI vehicles

	All	Publicly traded
Stock options/SARs	58%	81%
RSUs	45%	63%
Deferred share units	18%	26%
Performance cash plan	18%	4%
Performance shares	15%	22%
Phantom stock	10%	0%
Other	13%	11%

Close to 30 per cent of companies with LTIs reported they have recently changed or are considering changing the pay mix of their executive compensation programs (see **Figure 7**). Companies appear to be putting more emphasis on annual bonuses and performance shares, while focusing less on stock options. The most common reason cited by respondents for a pay-mix change is to strengthen the link between executive pay and company performance.

Stock options are certainly under pressure during a recession where many organizations have seen their share price plunge by as much as 40 percent. Many executives have been left with worthless underwater options, and current valuations call for very high option grants that would be highly dilutive to un-accepting shareholders. The employee stock option plan is unlikely to fade away in Canada due to the simple fact it is the only long-term incentive vehicle that offers a tax advantage to plan participants. But as organizations regroup, it is not surprising to see a shift toward annual cash base incentives.

Figure 7: Companies with LTIs that recently changed or are considering changing the pay mix for executives



Demographics

Of the 53 organizations that completed the survey:

- Fifty-one per cent are for-profit, publicly traded companies; 21 per cent are for-profit, private companies; 11 per cent are not-for-profit organizations; and 17 per cent are government organizations.
- Participants are spread among industries. The industry with the most participants is financial services.

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For more information on executive compensation, call Watson Wyatt at 866.206.5723 or visit watsonwyatt.com.