

CCGG's updated Executive and Director Compensation Guidebook: highlights for board and compensation committee members

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The Canadian Coalition for Good Governance (CCGG) has released its updated Executive and Director Compensation Guidebook (the Guidebook)¹, marking the first revision since it was last updated in 2013. Originally published in 2009, the Guidebook has long served as a cornerstone for best practices in executive and director compensation among Canadian public companies.

What you need to know

- This latest edition reflects CCGG's continuing shift from high-level, principles-based guidance to more detailed commentary on best practices and areas of concern.
- While continuing to recognize that boards and compensation committees are best suited to make compensation decisions, the Guidebook provides helpful insights into how institutional investors may view an issuer's compensation policies and practices.
- The Guidebook compiles many of CCGG's previously published guidance while also providing new and more prescriptive guidance on long-term incentive plan (LTIP) structures, performance metrics, special awards, disclosure, risk mitigation strategies and director compensation.
- Boards and compensation committees may wish to review their compensation policies and practices against this updated guidebook in advance of annual proxy season to avoid any surprises on their say-on-pay and director election votes.

Key takeaways

The following are the key themes and certain notable areas of commentary from the publication.

Long-term performance awards are preferred

- Ensure a meaningful portion of executive compensation is at-risk and tied to clear, challenging performance goals focused on long-term value creation.

- RSUs and other awards that vest based on time alone are not considered at-risk, performance-based compensation.
- Focus on performance metrics over which management can have an impact and avoid too many metrics.
- Avoid guaranteed bonuses and guaranteed minimum vesting for performance share units (PSUs).
- CCGG prefers three-year cliff vesting as opposed to rateable vesting over three years as a way to focus on long-term value creation. This recommendation may be particularly challenging for issuers that have a long history of annual incentive vesting: any changes may require a transition period to smooth out payments for participants.

Limit the use of stock options and special awards

- Limit the use of stock options in favour of performance-linked, full-value awards for executives (and avoid stock options for non-executive directors). While we have seen the use of stock options decline in recent years, many issuers continue to view stock options as a tax-effective way to provide truly at-risk compensation.
- Where stock options are used, consider incorporating features like performance vesting, exercise prices set higher than current fair market value, or caps on the portion of long-term incentives received in the form of stock options.
- Limit the use of special awards. When these awards are provided, include clear disclosure of the rationale and terms of these awards and use deferred share units (DSUs) or share-settled awards, if possible. Awards to replace compensation forfeited at a previous employer will be viewed more favourably than special awards designed to replace incentives that fail to vest due to corporate underperformance.
- Review perks, pensions and severance packages to ensure they align with market norms and shareholder expectations.

Use appropriate benchmarking

- Select peer companies that reflect your business's strategic context and competitive landscape. Thoughtful peer group selection is essential for credible benchmarking and defensible compensation decisions.
- Focus on skill and performance in setting target compensation rather than over-rely on industry median pay levels.

Elevate disclosure practices

- Use plain language and reader-friendly analysis to explain performance metrics, targets, rationale and outcomes.
- When performance metrics or compensation decisions are tied to non-GAAP (Generally Accepted Accounting Principles) financial metrics, include a clear explanation of the adjustments from the applicable GAAP financial measure and why such adjustments are warranted.
- If the board uses its discretion to alter incentive payouts, such discretion should be disclosed in the company's proxy circular, along with reasons why it was appropriate in the circumstances. Such discretion should be applied sparingly and equally (i.e., it should be used to increase or decrease incentive payouts).

Structure director compensation appropriately

- At minimum, 50% of non-executive director total compensation should be in the form of common shares or other full-value share-based awards, such as DSUs.
- Directors performing similar roles should receive the same compensation regardless of their country of residence. We expect this recommendation to be a topic of board discussion as the market for director talent has increasingly accepted differences in compensation based on geography.
- Directors should not receive performance-vesting awards or pensions, benefits or perks.

CCGG's updated guidebook provides helpful guidance on institutional investor views and expectations on executive and director compensation practices. Issuers will be familiar with many of the themes and topics covered. However, boards and compensation committees may wish to review, in particular, the updated guidance on stock options, special awards, performance metrics and cross-border director compensation to assess whether any changes in approach may be warranted.

FOOTNOTES

To discuss these issues, please contact the author(s).

This publication is a general discussion of certain legal and related developments and should not be relied upon as legal advice. If you require legal advice, we would be pleased to discuss the issues in this publication with you, in the context of your particular circumstances.

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