

## FTR Now

# Executive Compensation for Ontario BPS Organizations – A Summary of Recent Changes

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On June 8 and 9, 2017, the Ontario government made a series of significant changes to the BPSECA Executive Compensation Framework. The changes include amendments to the content required of compensation programs, the timing of the development of those programs, and the process organizations must follow to implement their compensation programs. In this *FTR Now*, we will review the changes and how they affect your organization.

## Overview of the Changes

In understanding the changes made by the Ontario government, it is important to remember that Executive Compensation Frameworks and the processes required for their development and approval are governed by a number of different sources. The general parameters of executive compensation regulation are found in the text of the *Broader Public Sector Executive Compensation Act, 2014* (BPSECA). The terms of the Framework are set out in Ontario Regulation 304/16, which is titled “Executive Compensation Framework”. As part of its changes, the government [amended this Regulation](#) on June 8, 2017 to give effect to substantive changes to the terms of the Framework and to create new rules regarding government review of compensation programs and approval of certain elements of a program.

In addition, on June 9, 2017, the government published a Directive, the “[Broader Public Sector Executive Compensation Program Directive](#)” (Program Directive), which establishes the process that BPS organizations must follow to develop their compensation programs, seek the necessary government review and approvals, and undertake public consultations.

Also on June 9<sup>th</sup>, the government amended its existing “[Broader Public Sector Executive Compensation Guide](#)” (Guide) to reflect the changes to the Regulation and the new Program Directive. The Guide provides further information on the government’s expectations for the development of compensation programs.

## Timing

As part of the changes to the Framework, the government has eliminated the existing requirement that compensation programs be in effect by September 5, 2017. With the new review and approval process established by the Program Directive, the existing September 5<sup>th</sup> deadline was no longer viable. Rather, the government will now be requiring BPS organizations to submit draft compensation programs for review by **September 29, 2017**. This requirement is set out in Section 3.0 of the Program Directive. Those organizations wanting to include private sector and/or international comparators must receive pre-approval from Treasury Board prior to the September 29, 2017, deadline date.

Draft compensation programs are to be submitted to the organization’s “overseeing Minister”, which is the Minister in charge of the ministry which funds, oversees or otherwise usually deals with the organization. The Program Directive also provides that this new timing requirement may be extended in “exceptional circumstances”. Some examples of exceptional circumstances include where a new designated employer is created, where an organization is undergoing a mandate review or where there is an intended merger with another organization.

## Changes to the Framework

The substantive amendments to the Framework focus on salary and performance-related pay. In respect of salary and performance-related pay, the changes focus on two elements: (1) the calculation of the salary and performance-related pay caps that apply to designated executive positions or classes of positions; and (2) a new salary and performance-related pay envelope, which will be the primary mechanism through which annual increases to salary and performance-related pay will be enabled.

Rules relating to other elements of a designated executive's compensation remain unchanged. Those rules were reviewed in our September 7, 2016 *FTR Now*, "[Ontario Moves Forward with BPS Executive Compensation Restraint](#)".

## Salary and Performance-Related Pay Caps

As is currently the case, BPS organizations must continue to develop the salary and performance-related pay caps that apply to a designated executive position or class of positions by reference to comparator organizations. Moreover, the general comparator process continues to apply, with some important exceptions.

First, the Framework has been amended to require government approval of the comparator organizations chosen by a BPS organization. The Program Directive provides that the draft compensation program must list the comparator organizations and executive positions that were used in the benchmarking process, and must contain an explanation as to why they are comparable with reference to at least 3 of the 5 factors listed in section 3(2) of the Regulation.

Second, the government has implemented a new process by which the salary and performance-related pay caps can be increased on an annual basis without the need for a formal recalculation process. Under this new provision in the Regulation (section 3.1), the salary and performance-related pay caps may be adjusted once per "pay year" (defined as the 1-year period in respect of which organizations determine salary and performance-related pay for their designated executives) by the lesser of:

- the average rate of increase in salary and performance-related pay provided to non-executive managers in their most recent pay year; and
- the public sector wage settlement trend as set out in a number of specified public sources.

Increases to the salary and performance-related pay caps cannot be made until a year after the caps were initially established, and can then be increased annually after that time under this provision.

A few further points should be emphasized. One, the Framework continues to incorporate rules by which an organization would undergo a formal recalculation of its salary and performance-related caps – mandatory if the organization undergoes a significant organizational restructuring and optional where warranted in the circumstances. Two, this new process only applies to the salary and performance-related pay caps. Adjustments to actual salary and performance-related pay will be effected through the new envelope, discussed in the following section.

## Salary and Performance-Related Pay Envelope

The second major substantive change to the Framework is the creation of a new "salary and performance-related pay envelope" out of which all salary and performance-related pay paid to all designated executives must be paid. In effect, this is a new mechanism by which actual amounts paid to designated executives may be increased on a year-to-year basis. The mechanism works basically as follows.

BPS organizations calculate their "salary and performance-related pay envelope" according to the following formula:

$$P + (P \times R)$$

In this formula, P = the actual amount of salary and performance-related pay that was paid to the entire group of designated

executives at the organization in the previous pay year, while R = the rate of increase that may be applied to the envelope once per year, and which cannot be higher than the approved maximum rate of increase in the envelope (discussed below).

The Regulation establishes detailed rules for the calculation of the value of “P”, which we will not review here, but will need to be factored in by organizations. However, it is notable that, by basing the calculation on the previous pay year, the mechanism takes as its starting point the total salary and performance-related pay currently being paid to designated executives under the existing salary freeze.

The “R” factor is a new concept in the Framework. The value of R will drive how much new salary and performance-related pay can be paid to designated executives each pay year, including the first pay year after a compensation program comes into effect. There is no formula for calculating the value of R, but it cannot exceed the approved maximum rate of increase to the envelope. To determine this maximum rate, the organization must propose a value in its draft compensation program, and the proposed maximum rate is subject to the approval of the overseeing Minister.

In determining the value of the maximum rate of increase in the envelope, organizations must consider only the following factors

- the financial and compensation priorities of the government of Ontario as set out in a number of specified public sources;
- recent executive compensation trends in the Ontario BPS and Canadian public sector in the same industry in which the organization competes for executives;
- a comparison between the percentages of operating budgets used for executive compensation as between the organization and its comparator organizations;
- the effect on attracting and retaining talent to the organization’s executive positions and salary/performance pay compression as between executives and those who report to them; and
- any significant expansion in operations (but not if it is the result of a significant organizational restructuring).

(Based on government discussions with representatives of the key BPS stakeholder organizations, it appears unlikely that the government will approve a maximum rate in excess of 5%, absent exceptional circumstances.)

The revised Framework also sets out a range of circumstances when the maximum rate must be calculated – (1) when the salary and performance-related pay caps are first calculated, (2) when they are recalculated via the formal recalculation process, and (3) whenever an organization provides a designated executive with an additional element of compensation. It is prohibited to calculate or recalculate the maximum rate of increase in any other circumstance.

Once the formula is applied, it will yield a dollar amount that will be available to fund all salary and performance-related pay increases to the organization’s designated executives. How that dollar amount is to be applied to the executives will be at the discretion of the organization. Thus, some executives could receive a larger share of the available amount and receive a larger increase personally, while others could a smaller increase. However, it is important to emphasize that the salary and performance-related pay of each executive (or class of executives) remains subject to the applicable cap. The new envelope process does not permit exceeding the caps.

We also note that in addition to approval of the ministry, the Framework continues to require the approval of the board of governors of the organization. The Framework has been amended to also require board approval if the organization intends to provide salary and performance-related pay to a new designated executive that is greater than what was provided to the previous holder of that position.

## **Process**

The new process for developing and implementing compensation programs is detailed in the Program Directive and the Guide. Each organization must develop a draft compensation program in accordance with the revised Framework by

September 29, 2017. If an organization wishes to include comparator organizations that are from the private sector or from a jurisdiction outside Canada, they must obtain the approval of the President of Treasury Board during this initial development period (i.e. before September 29, 2017). Once the draft program is developed, the following 5 steps must be undertaken.

1. The draft compensation program must be submitted to the organization's overseeing ministry for review. The government has prepared a new Form – Broader Public Sector Executive Compensation Program Form – to serve as a template for executive compensation programs. This Form is not mandatory, but if a program is submitted in an alternate format, it must still include all of the information specified in the Regulation and the Program Directive.
2. The organization must review and address any government feedback that is provided as a result of the first step. This feedback could require changes to the draft program and resubmission to the government for further review. The organization must confirm that it has the approval of the government before it posts its draft program for public comment.
3. Conduct public consultations by posting the draft program for at least 30 days on the organization's public-facing website. The organization must give its overseeing ministry at least 2 days' notice prior to posting, and must address relevant public feedback.
4. The compensation program must be resubmitted to the organization's overseeing ministry, and the organization must summarize the public feedback that was received along with any changes that have been made to the program. At this step, the organization must confirm that the government has approved its comparator organizations, as well as the maximum rate of increase to be applied to the salary and performance-related pay envelope.
5. The board of directors of the organization must now determine whether to adopt the compensation program, and once this is done, the program may be posted on the organization's website, and will then take effect.

## Next Steps

Many BPS organizations have undertaken a significant amount of work to develop draft compensation programs under the prior Framework rules that were in effect until last week. For those organizations who have not already completed the process and posted a final compensation program (which is likely a significant majority of all BPS organizations), you will need to review your draft plan to determine what changes must be made to comply with the new rules. It is likely that significant portions of existing plans will continue to be relevant, but you will need to address the new elements and to consider the more detailed information requirements from the Program Directive.

For those organizations who already had posted a final compensation program before June 8 (the date the new Regulation came into effect), there are transition provisions that will apply. Those transition provisions set out a general rule that the compensation program that was already in effect will remain in effect, and that the old version of the Regulation continues to apply until the organization posts a new compensation program under the new Regulation. However, if these organizations want to update their existing plans, it appears they will be required to follow the new rules when doing so.

Finally, we remind those organizations who are also subject to Part II.1 of the *Broader Public Sector Accountability Act, 2010* (BPSAA) that the existing BPSAA wage freeze will remain in effect until all of the steps required to implement a BPSECA-compliant compensation program have been undertaken. How long the current freeze remains will be dependent on the time it takes to complete the approval process following the September 29, 2017 submission deadline to government.

Should you have any questions or require further information, please contact [your regular Hicks Morley lawyer](#).

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