ATTACHMENT 1 – GUIDING PRINCIPLES IN THE DEVELOPMENT OF SENIOR EXECUTIVE COMPENSATION POLICIES

Summary

1. Develop a detailed job description for each senior executive position.

2. Adopt a Total Rewards Approach in developing a senior executive compensation policy. The review must be comprehensive and consider all aspects of compensation including base salary, variable/incentive pay, merit pay, and benefits including pension benefits.

3. Complete a comparator analysis for each senior executive position to establish the median (midpoint) base salary using industry comparators in the public sector (excluding private sector comparators). The comparators must be "like" public sector agencies and corporations of similar size, organizational structure, business risk, and management complexity.

4. Establish a base salary range for each senior executive position. The midpoint of the base salary range should be the median (50th percentile) for the industry comparators, which include public sector comparators only. The minimum base salary should be no less than 15% less than the median (50th percentile) and with the maximum base salary no more than 15% of the median (50th percentile).

5. Document a clear and detailed rationale for the use of each comparator as part of the comparator analysis for each senior executive position to indicate why the use of the comparator is appropriate.

6. Consider the feasibility of a merit pay system based on meeting individual and/or organizational unit goals which are measureable to enable senior executives to progress through the base salary range as an incentive to achieve exceptional individual performance. Merit pay must not exceed 5% of the annual base salary.

7. Investigate the feasibility of utilizing variable/incentive pay as a means for motivating superior performance. Variable/incentive pay shall not exceed 25 percent of base salary, inclusive of merit pay.

8. If a variable/incentive pay program is implemented, payments to senior executives must only occur where they demonstrate superior performance exceeding expected performance as indicated by transparent, quantifiable performance measures. The stated performance measures, among other things, should relate to:

   (i) Strategic objectives articulated in the organization's Strategic Plan;

   (ii) The demonstrated growth in public value of the organization;

(iii) The creation of a positive, dynamic, professional, ethical, service oriented workplace culture that attracts, motivates and retains employees; and

(iv) Timely and thorough implementation of applicable City Council directives including Shareholder Directions, Relationship Frameworks, applicable City of Toronto corporate policy, and recommendations of City accountability Officers and internal ethics executives.

9. A review must be conducted of employee benefits to create an employee benefits package that helps attract and retain senior executives while ensuring that the benefit package is competitive, appropriate for the demographics of the senior executive talent pool, and provides the public value for money.

10. The employer pension benefit contribution (registered plan or supplemental private agreement) for senior executives should be reviewed. The ratio of the employer contribution must not exceed 1.0 times the employee's contribution based on their base salary, except as allowed under pension plan policy or applicable law.

11. Senior executive compensation policies must contain a policy on executive termination payments including development of a standard process for the determination of the amount of the payout.

12. Develop and implement a program for annual performance assessment of senior executives.

Guiding Principles - Background

Create Detailed Job Descriptions

This report recommends that detailed job descriptions be developed for each senior executive position. A detailed job description can clearly lay out the functions, accountabilities and the responsibilities of the executive position. The job description can help inform the performance appraisal process and help set clear expectations and goals respecting job performance

Undertake a Comparator Analysis

A key element in setting senior executive compensation policy is the use of comparator analysis. This process involves comparing senior executive compensation for "like" positions in "like" organizations. In a comparator analysis, relevant public sector organizations are surveyed in respect to the compensation, and its sub-components, paid to their senior executives. From the data a median value for the base salary and total cash compensation can be derived. This type of analysis can help a set a "job rate" defined as the midpoint of the base salary band. The range of public sector perks and benefits can be analyzed through comparator analysis although the cash value of the benefits may be hard to determine. Comparator analysis yields a general picture of the compensation levels within a sector. Overall, a comparator analysis gives insight into what range of compensation is required to attract, motivate and retain talented executives.

An important principle in conducting a comparator analysis is the need for a rationale for selecting the individual comparators which are used to set the compensation levels. A challenge with comparator analysis is that data can be difficult to collect because it is often confidential, internally sensitive, and can provide competitors data regarding what organizations pay their executives. Potential comparator organizations sometimes see limited or no benefit in providing comparator data and are reluctant to participate in the comparator study. Second, public sector corporations that may seem similar on the surface to profit, not-for-profit and regulated corporations, can in fact be quite different in respect to size, organizational structure, complexity, and business risk profiles. Therefore time and care has to be taken in selecting comparators and undertaking the analysis. Generally, comparator analysis does not provide a predictor of what the exact compensation should be but gives a good overview of the range of compensation, and the variance between organizations.

In some cases to attract talent to the public sector it may be necessary to consider private sector compensation to attract private sector executives. In such cases it is advisable to ensure that private sector compensation is used only as a guide, rather than as a key comparator.

This report recommends that as part of setting senior executive compensation policy that a detailed public sector comparator analysis along with a rationale for the use of comparators be developed.

Implement Base Salary Wage Grades

Using the comparator analysis described above as a guide, the City agency or corporation can set a base salary band for its executives. This report recommends that the base salary be set at the median, or job rate, of the appropriate and justifiable comparators with the minimum and maximum base salary set at 15% above below and above the median (job rate). Setting the initial base salary would be a function of senior executive's competency and experience. Progression through the base salary wage band would be a function of performance and growth in experience and individual competency.

Table 1 below summarizes how the salary band could be structured conceptually to reward individual experience and performance.

Table 1: The Base Salary Band Concept

Minimum	Median (Midpoint)		Maximum
15% below Median	7.5% below Median	7. 5 % above Median	15% above the median
• New Hire. Little experience at senior executive level. Significant Learning Curve	• Some experience at senior executive level. • Most skills already acquired. • Movement to midpoint occurs when all skills/tasks performed well.	• High skill and experience • Meets/exceeds performance expectations • Long term senior executive with good performance	• Only Exceptional Performers • Regularly uses High Skills/knowledge

New executives with minimal experience and a significant learning curve should be placed in the first band 15% below the median salary. More experienced executives with good, consistent performance can be placed in the band which is less 7.5% less than median, the job rate, if they still lack some skills. The executive can move past the median (job rate) if they demonstrate competency in all the skills required for the job and if they are a long term employee with consistently good performance. The maximum base salary is only reached by "star" performers that demonstrate consistent, exceptional performance.

In this compensation policy framework it is not automatic that an executive will exceed the median compensation level. In order to exceed the median, the job rate, they have to meet targets for their personal and skills development as an executive and show superior performance. A long term executive with consistent good performance could move above the job rate within the upper tier of base salary compensation. Only senior executives with exceptional long term performance and significant competencies regularly using highly evolved knowledge and skills would reach the maximum base salary.

Investigate Merit Pay

In 2013, City Council re-established merit pay for City non-union employees. http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2013.EX35.19.   Merit pay is designed to accomplish two objectives. The first objective is to permit step increases through the salary range for good performance of employees, with additional compensation for a small percentage of employees who are exceptional performers. The second objective is to reward long term employees at the top of their wage grade who demonstrate good performance. The effect of merit pay is to encourage the ongoing development of skills and competency at the job performed. Merit pay is generally a small percentage of base salary, not exceeding 5 - 7%. City current non-union employee merit pay range does not exceed 4.5%. Merit pay is focused on the achievement of individual and business unit goals. This report recommends that the concept of merit pay be investigated as part of the senior executive compensation review at City corporations and agencies.

Review Variable/ Incentive Pay

Variable/incentive pay, more commonly known as bonus pay, is typically used as a performance incentive at City corporations, and is not used by City service agencies. Variable /incentive pay is designed to "stretch" and motivate superior performance from senior executives towards exceeding strategic organizational goals that are quantifiable and clearly measurable. Variable/incentive pay is designed to ensure that the organization thrives as senior executives, as leaders, push the organization to exceed its stated strategic goals and strategic performance objectives related to the City Strategic Plan. Variable/Incentive pay should not be granted simply because a senior executive meets objectives, and does their work at a competent level. Rather, variable/incentive pay should only be paid the strategic goals of the organization are exceeded based on measurable performance measures. The payment of variable/incentive pay should reflect the senior executive's effectiveness not their effort alone. To facilitate development of "stretch" targets for variable/incentive pay, the organization's strategic plan needs to set annual, quantifiable goals for the organization. The performance measures for variable/incentive pay need to align with the goals of the strategic plan. This report recommends that in review of variable/incentive pay performance measures, the strategic plan and specific strategic metrics/objectives of the organization be examined to ensure it shapes the performance measures.

This report recommends that variable/incentive pay not exceed 20 percent of the base salary. This is consistent with past City Council directives regarding variable/incentive pay. Where senior executives are eligible for both variable/incentive and merit pay, the combination should not exceed more than 25 percent of base compensation.

Benefits

Benefits and pensions differ from organization to organization. Typically, benefits can include some or all of: holidays, sick time, dental, drug, and medical coverage, life insurance, and both short and long term disability. The benefits package, including pension benefits, offered to senior executives varies greatly between organizations. Sometimes there is limited discretion to customize benefits packages for individuals because the employer maintains a number of group policies. However, a trend in offering of employee benefits is to customize a menu of possible benefit coverage through a checklist approach with capped maximum expenditures on individual benefits. This approach caps employer benefit costs while providing the employee more flexibility in deciding what benefits they actually want and will use depending on their personal life situation. The disadvantage of the benefit menu approach is that employees will tend to fully utilize the customized benefit package so that the likelihood that the maximum benefit expenditure is reached is significant. However, for some organizations offering a flexible benefit package may help attract talent, provided factors such as base compensation, are comparable to competitors.

The consultant has recommended that, inclusive of mandatory benefits deducted as payroll deductions such as Unemployment Insurance and the Canada Pension Plan, that benefit costs to the employer should not exceed 20 percent of base compensation. This report recommends that City agencies and corporations review their benefit plans so they are effective in attracting and retaining senior executives, but are cost effective and provide value to the organization.

Pensions

Some, but not all, City agencies and corporations provide pension benefits. Pensions can take three forms defined benefit, defined contribution plans or Group RRSPs managed by the employer. In the a defined benefit plan such as the Ontario Municipal Employees Retirement system (OMERS) , an amount of money is deducted from the employee's pay and placed in a pension fund managed by a third party investment corporation thereby generating income for retirement. Depending on the employee's compensation and their length of service, upon retirement they receive a fixed amount of retirement income monthly. In contrast, with a defined contribution plan an employee is given an amount of money which can be invested by management but no specific benefit amount is guaranteed upon retirement. With defined contribution plans the amount of income received upon retirement is uncertain and depends on the performance of the investments. Essentially, the employee absorbs the investment risks. With

Group RRSP Plans the employer provides an RRSP contribution to employees which is invested jointly and managed either by management or a third party on behalf of management.

With Defined Benefit Plans there is a contribution ratio between the employee's and the employer's participation. For example, with the Ontario Municipal Employees Retirement Plan (OMERS) the contribution ratio for City of Toronto employees is 1:1. Each pay period a certain amount is deducted from the employee's pay and the City contributes an equal amount. At times the amount of the contribution level is raised or lowered or suspended depending on whether the pension fund is in surplus or deficit but the contribution ratio between the employer and employee generally remains unchanged. The employer pension contribution ratio can vary between employers and industries. This report recommends that the appropriate employee/employer pension contribution level for senior executives at City agencies and corporations be 1:1 exclusive of variable, incentive, and merit pay. Currently, the employer pension contribution ratio at City corporations is generally 1:1. In conducting a review of the senior executive compensation City agencies and corporation should assess whether a pension is an appropriate benefit, and if there is no pension benefit, whether the existing pension is the appropriate pension type on a go forward basis, and the appropriate employer contribution level.

Some pension plans place limits on the employee's contributory earnings which therefore caps their pension amount on retirement. For example, OMERS caps a member's annual contributory earnings to seven times their Canada Pension Plan earnings. For highly paid senior executives this means that not all of their salary can be used to calculate their pension retirement income and it is effectively capped. Some senior executives offset the pension contribution cap by entering into a private agreement with their employer for supplemental pension benefits. While the employer has a right to entertain such arrangements, their efficacy and appropriateness should be reviewed as part of the senior executive compensation policy developed.

Other Entitlements

There is no standard approach to the provision of other entitlements, i.e. perks. They can include car allowances/leases, paid or reserved parking, meal allowance, clothing allowance or attendance at conferences. The key principle is that the provision of other entitlements must be provided for in an accountable, transparent fashion and for matters related to performance of the duties of the position or physical or mental well being of the employee such as a fitness club membership or personal counselling services. Other entitlements and expenses should be posted on the City agency or corporation website.

Termination Payments

While circumstance for termination payouts is different depending on the nature of the employment contract and the circumstances around the termination it is important for City agencies and corporations to have a rigorous, standard process for determining the nature and amount of such payouts, including when payouts are predetermined in employment contracts. Several common and employment law considerations must be examined in developing a policy framework around termination payments. This report recommends that City agencies and corporations create a process and policy for determination of termination payouts as part of their senior executive compensation review.

Fiduciary Duty

City agency and corporation boards have a fiduciary duty as the employer to set executive compensation in a manner that promotes excellence. This means the compensation policy has to be fair and competitive so that it attracts, motivates and helps retain senior executives with the appropriate skills and experience. However, as public organizations the board also is accountable to City Council and the general public. Therefore, the compensation policy must also balance accountable and efficient use of financial resources, and must also provide the right incentives to encourage excellent executive performance. This report recommends that City agency and corporation Boards engage expertise to train them on their fiduciary duty in setting executive compensation.