

Review of City of Toronto Guiding Principles for Executive Compensation Policies at City Agencies and Corporations

Date: June 26, 2023

To: Executive Committee

From: City Manager

Wards: All Wards

SUMMARY

This report responds to City Council's 2021 direction to the City Manager to complete an independent external review of executive compensation policies and practices at City agencies and corporations and review and update the City's *Guiding Principles for the Development of Senior Executive Compensation Policies* (the "Guiding Principles"). This report provides the findings of the review and seeks Council's approval of updated Guiding Principles.

While the City is not the employer of agency and corporation executives, it supports agencies and corporations to set executive compensation in a transparent, rational, accountable and fair manner, taking into account the responsible use of taxpayer and ratepayer funds. Strategic compensation ensures senior executives are attracted and retained in the increasingly competitive labour market.

An independent external review of executive compensation at City agencies and corporations found that their policies were developed using some or all the components of the City's framework, and that most organizations' current policies and practices are consistent with those utilized in the public, broader public, and not-for-profit sectors, and in some cases, the private sector. The review also found key elements of the 2014 Guiding Principles to be sound, prudent, and reasonable but suggested changes in specific areas to better reflect current leading market practice and labour market conditions.

The Guiding Principles have been updated to provide flexibility for agencies and corporations while ensuring alignment to market indicators. The amendments include limited use of private sector comparators and incentive pay in accordance with predetermined criteria and within market norms. Utilizing the methodologies outlined in the updated Guiding Principles will result in caps to City agency and corporation executive compensation commensurate with their benchmarks.

RECOMMENDATIONS

The City Manager recommends that:

1. City Council approve the updated Guiding Principles for the Development of Senior Executive Compensation Policies at City Agencies and Corporations in Attachment 1.
2. City Council request the Boards of Directors of City agencies and corporations listed in Schedule B of Attachment 1 to this report to adopt or amend as appropriate their organization's executive compensation policy to align with the Guiding Principles for the Development of Senior Executive Compensation Policies at City Agencies and Corporations in Attachment 1, and to apply it to new executives hired and newly created executive positions.
3. City Council direct the Boards of Directors of City agencies and corporations listed in Schedule B of Attachment 1 of this report to provide their organizations' Board-approved adopted or amended executive compensation policy to the City Manager by Q1 2024.
4. City Council provide this report to the Boards of Directors of those City agencies and corporations that were not in scope for this review, except for the Seniors Housing Corporation to which the Guiding Principles apply, for their review, reference and use as those Boards deem appropriate.
5. City Council consider the condition set by City Council in Item 2021 EX34.31 (July 19, 2022) as satisfied and permit Toronto Hydro on a go forward basis to amend its current compensation policies, or amend the base or incentive compensation provisions of its existing employment contracts with Toronto Hydro senior executives or to hire any new permanent senior executives.

FINANCIAL IMPACT

Accurately predicting the impact on the City budget is challenging, as compensation decisions are made by third party employers (i.e., Boards) and complex market and internal variables. In addition, many agencies and corporations independently raise revenue to fund or offset expenditures.

Modelling suggests a potential financial impact on the City primarily due to City agencies being included in the City's budget, some of which receive subsidies from the City. Therefore, any compensation pressures will need to be managed and addressed by City agency Boards of Directors as part of the City's annual budget process.

Further, modelling also assumes that any executive compensation increases at City corporations would not require additional City subsidies or negatively impact corporation dividends to the City. Corporations are expected to address any compensation-related pressures within their 2023 and future year budgets, by applying strategies such as

phasing in potential changes as may be required. Any financial implications are expected to be addressed and managed by City corporations and not become a future City pressure.

The Chief Financial Officer and Treasurer has reviewed this report which may have future financial implications and agrees with the information as presented in this Financial Impact Section.

DECISION HISTORY

On July 19, 2022, City Council directed Toronto Hydro to refrain from amending its current compensation policies or amending the base or incentive compensation provisions of its existing employment contracts with Toronto Hydro senior executives or from hiring any new permanent senior executives until such time as City Council has considered the issue of executive compensation for all its agencies and corporations. <http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2022.EX34.31>

On July 14, 2021, City Council directed the City Manager to complete an independent external review of executive compensation policies and practices at the City of Toronto's agencies and corporations, including Toronto Hydro Corporation, and to report back to Council. In addition, City Council requested the City Manager to include in the 2021 review of executive compensation at City's agencies and corporations appropriate updates to the City's Guiding Principles adopted by City Council in 2014, in accordance with current leading industry practice. <http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2021.EX25.13>

On July 23, 2018, City Council directed the Board of the Toronto Hydro Corporation to review their executive compensation and compare with similar municipally owned electric utility companies, including Ottawa Hydro, Alberta Hydro, British Columbia Hydro, New Brunswick Power, Hydro Quebec, Manitoba Hydro and Saskatchewan Power. <http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2018.EX35.14>

On January 24, 2018, Executive Committee directed the City Manager to review executive compensation at all agencies and corporations and provide recommendations on an appropriate salary and compensation cap, which will limit compensation, for all new executives hired. <http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2018.EX30.35>

Also on January 24, 2018, Executive Committee considered EX30.10 and referred the item back to the City Manager with a request to review the executive compensation policy at Toronto Hydro and report back with recommendations on an appropriate salary and compensation cap for all new executives hired by the Corporation, and to request the Toronto Hydro Board of Directors to review current executive compensation packages and bonus policies at Toronto Hydro to assess opportunities respecting the provisions of currently existing contracts, to bring compensation in line with other City policies. <http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2018.EX30.10>

On July 12, 2016, City Council directed the Toronto Hydro Corporation to review its executive compensation policy and forward it to the City Manager for inclusion in a report through Executive Committee in 2017, and that the policy incorporate the Guiding Principles adopted by City Council, including public sector comparators, a limit on variable/incentive or merit pay at 25% of base salary, to be applied to new employment contracts or existing contracts that permit compensation adjustments.

<http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2016.EX16.10>

On August 25, 2014, City Council adopted EX44.8, Executive Compensation Policy at City Agencies and Corporations, that requested City agencies and corporations develop a comprehensive executive compensation policy independent of management, applying the Guiding Principles and practices set out in the report and that the Board approved policy be applied to new employment contracts, and to existing contracts, if any, that permit compensation adjustments, either during an existing term or under renewal.

<http://app.toronto.ca/tmmis/viewAgendaItemHistory.do?item=2014.EX44.8>

COMMENTS

This report specifically responds to City Council's 2021 directions to the City Manager to:

- Part A: complete an independent external review of executive compensation policies and practices at City agencies and corporations, and
- Part B: review and update the City's *Guiding Principles for the Development of Senior Executive Compensation Policies* (the "Guiding Principles").

Context

1) Employer Responsibilities of City Agency and Corporation Boards

City of Toronto's agencies and corporations are managed by their Board of Directors who are separate employers responsible for adopting compensation policies and for setting compensation for their employees. Boards of Directors of City agencies and corporations are responsible for the oversight and management of their respective organizations, and administrative heads (the most senior executive in the organization) report directly to their respective Boards.

While the City is not the employer of agency and corporation executives, it supports agencies and corporations to set executive compensation in a transparent, rational, accountable and fair manner, taking into account the responsible use of taxpayer and ratepayer funds. City supports include issuing Guiding Principles for the Boards of City agencies and corporations to provide guidelines for developing and adopting their organization's respective executive compensation policies. Strategic compensation ensures senior executives are attracted and retained in the increasingly competitive labour market.

The corresponding report from the City Solicitor, being considered at the same Executive Committee meeting as this report, provides the City Solicitor's confidential

advice regarding implementing these City Council directions, and provides additional context for this report.

2) City of Toronto 2014 Guiding Principles on Executive Compensation at Agencies and Corporations

In August 2014, City Council adopted a set of [Guiding Principles](#) for senior executive compensation at City agencies and corporations (Item EX44.8). The purpose of the Guiding Principles is to support compensation being set in a transparent, accountable and consistent fashion, that protects the public interest while being fair to executives. The Guiding Principles are a framework to set a base salary range using a relative comparator analysis. They also set limits on variable/incentive pay, merit pay, and employer pension contributions and require a review of executive benefits.

City Council requested that Boards of City agencies and corporations, independent of management, develop and adopt their own comprehensive executive compensation policies applying the Guiding Principles, and that the Board-approved policies be applied to new employment contracts and to existing contracts that permitted compensation adjustments. The City Manager communicated Council's Guiding Principles and directions to agencies and corporations.

Part A: Review of Executive Compensation Policies and Practices at City Agencies and Corporations

The objective of the review was to assess whether City agency and corporation executive compensation policies and practices are aligned with executive compensation practices in the public and broader public sectors, as well as with the City's Guiding Principles.

1) Review Methodology

Scope

Twenty (20) City agencies and corporations with direct accountabilities to the City were identified as in-scope for this review based on their governance structures. These entities include three wholly owned City corporations, nine City service agencies, and eight arena boards listed in Attachment 1, Schedule B.

A few City agencies and corporations were not within the scope of the study:

- Agencies governed by specific provincial legislation (i.e., Toronto Police Services and Toronto Public Library);
- Partnered corporations where the City is not the sole shareholder (i.e., Toronto Pan Am Sports Centre);
- Partnered agencies where the governance is shared with other municipalities (i.e., Toronto and Region Conservation Authority);
- Agencies with City employees (Toronto Public Health and the Association of Community Centres); and
- Organizations still developing their executive staffing model (i.e., Toronto Seniors Housing Corporation).

Engagement with Agencies and Corporations

To support the work on executive compensation at City agencies and corporations, the City engaged an independent third-party (i.e., Korn Ferry (CA) LT).

Engagement with in-scope City agencies and corporations was a key component of the review of their executive compensation policies and to inform the update to the City's Guiding Principles. Information from each agency and corporation was collected on their executive compensation policies and practices, data on 2021 job descriptions, incumbent compensation, benefits, and the existing comparator group used to determine executive compensation levels. Members of the executive teams were interviewed to understand their roles, mandates and business environments.

Using the information collected, the external consultant conducted reviews of the executive compensation policies and practices at each agency and corporation. As part of the process, agency and corporation Board Chairs were provided with the opportunity to be briefed on preliminary review findings, and Board members and executives were consulted on workforce pressures, the City's Guiding Principles, and their priorities and approaches to executive recruitment and retention. Key themes from these consultations are contained in the consultant's report forming Attachment 2 of this report.

The executive compensation policies and practices of the agencies and corporations were compared with executive compensation practices in the public and broader public sectors, as well as with the City's Guiding Principles (focussed on the common elements of both the 2014 Guiding Principles and the updated Guiding Principles recommended in this report in Attachment 1).

2) Findings from the Executive Compensation Review

The results of the review suggest that City agencies and corporations have structured their executive compensation policies using some or all the components in the 2014 framework, customised to their organizational structure, mandates, operating environment, and complexity. Compensation components are used in a manner largely consistent with market practices in the public and broader public sector, have been developed using a Total Rewards Approach as requested by City Council, and are generally aligned with key elements of the City's Guiding Principles. Details on the review findings are found in the external consultant's Executive Compensation Review Report forming Attachment 2 to this report.

Part B: Review and Update of the City's Guiding Principles

1) Review Methodology

The City's 2014 Guiding Principles were reviewed to ensure that they reflect current leading market practice in the public, broader public, not-for-profit and private sectors.

The independent external review was informed by their research and expertise in market practices, a review of frameworks in other Canadian jurisdictions, and consultation and information from in-scope City agencies and corporations.

2) Key Updates to the Guiding Principles

Findings from the review suggest that changes should be made to the City's Guiding Principles. While key elements of the 2014 Guiding Principles were found to be sound, prudent, and reasonable, changes were suggested to specific components to better reflect current market practice. The external consultant's report forms Attachment 2 to this report.

Based on the external consultant's findings and recommendations, City staff updated the Guiding Principles. These updates provide for increased flexibility in setting executive compensation for agencies and corporations of different sizes and complexity, operating in diverse industries, but with limits in place tied to market indicators and specific criteria. Key changes to the Guiding Principles are outlined in the Table below.

Table 1: Key Changes to Guiding Principles for Development of Executive Compensation

Comparator Selection and Analysis	Salary Bands	Merit and Incentive Pay Programs and Total Compensation Caps
<ul style="list-style-type: none"> • Set a minimum number of eight employer comparators to compare executive compensation. • Use exclusively public sector, broader public sector or not-for-profit organizations to set compensation by default. • When an agency or corporation meets specific criteria, private sector comparators may comprise up to one-third of the comparator group 	<ul style="list-style-type: none"> • Base salary bands should be established using the median base salary of the comparator group as the midpoint, and up to +/- 20% of the midpoint representing the maximum and minimum of the salary band. 	<ul style="list-style-type: none"> • Merit pay should be contingent on performance and align with market trends. • Incentive pay may be considered if specific criteria are met. • Merit pay and incentive pay amount should be based on individual and corporate performance measured by transparent and quantifiable indicators. • Specific ratios and limits on merit and incentive pay be replaced by limits on total compensation. Going forward, executive total cash compensation targets (i.e. base salaries plus merit and/or incentive pay) should be limited to the median of the comparator group total cash compensation target.

Taken together, these amendments update the Guiding Principles to better reflect compensation practice in the market and will position agencies and corporations to attract and retain skilled executives while balancing executive compensation costs of City-owned entities. Utilizing the methodologies and considerations outlined in the

updated Guiding Principles will result in caps to City agency and corporation executive compensation based on median compensation levels among comparable executive positions and parameters of their compensation structures.

This report recommends that Council approve the updated Guiding Principles in Attachment 2 to this report. To realize the benefits of the updated Guiding Principles, this report requests in-scope City agencies and corporations align their organization's executive compensation policy with the updated Guiding Principles, and to apply it to new executives hired or newly created executive positions.

This report recommends that City Council provide this report and related Council decisions to those not-in-scope boards for their review and reference as appropriate, except for Toronto Seniors Housing Corporation which is included in the recommendation in this report that Council request they align their executive compensation policy with the City's Guiding Principles.

Next Steps

1) Transparency, Accountability and Reporting Requirements

In order to track alignment with the updated Guiding Principles, this report recommends that in-scope City agencies and corporations provide their organizations' adopted or amended Board-approved executive compensation policy to the City Manager by Q1 2024.

Disclosure requirements for individual executive compensation at City agencies and corporations are already in place. Shareholder Directions to City corporations require executive compensation information to be disclosed on an annual basis and are typically reported through Annual General Meetings of the Shareholder (which take place during a portion of City Council meetings). Similarly, Relationship Frameworks with City agencies and City by-laws have similar provisions. The updated Guiding Principles also outline practices to disclose executive compensation information. The City Manager will continue to monitor executive compensation levels through these mechanisms.

2) Exploring Ongoing Supports for Executive Compensation Development

Alignment with the City's Guiding Principles can be a challenge for some City agencies and corporations. Boards and senior management of some organizations may lack the in-house capacity to develop compensation structures and levels, may not have the resources to engage independent consultants to assist them, and/or may not prioritize regular updates of their executive compensation policy. Further, the independent development of executive compensation policies at City agencies and corporations may result in the investment of considerable resources to retain consultants, inconsistent policies across City agencies and corporations, and/or different interpretations of the City's Guiding Principles.

The City will continue its advisory role for agencies and corporations in executive compensation and facilitate closer alignment with the City's updated Guiding Principles.

3) Toronto Hydro Executive Compensation Amendments and Hires

On July 14, 2021, City Council, as Shareholder, directed Toronto Hydro at its Annual General Meeting to refrain from amending its current compensation policies or amending the base or incentive compensation provisions of its existing employment contracts with its senior executives, or from hiring any new permanent senior executives until such time as City Council has considered the issue of executive compensation for all its agencies and corporations (Item EX34.31).

This report reviews executive compensation policies at City agencies and corporations, including Toronto Hydro Corporation. As such, this report recommends that City Council permit Toronto Hydro on a go forward basis to amend its current compensation policies or amend the base or incentive compensation provisions of its existing employment contracts with its senior executives or hire any new permanent senior executives.

Conclusion

The review of executive compensation policies at City agencies and corporations has demonstrated that most utilize policies and practices common in the public, broader public and not-for-profit sectors, and in some cases the private sector. To better align executive compensation with the market and the environment within which boards operate, this report recommends Council adopt the updated Guiding Principles presented in this report, request City agencies and corporations to align their current executive compensation policies with the updated Guiding Principles, and request City staff to consult with City agencies and corporations on opportunities to support the cost-effective, consistent and transparent development of executive compensation policies across agencies and corporations.

Updates to the Guiding Principles will provide for increased flexibility for agencies and corporations of different size and complexity operating in diverse industries in setting executive compensation, but with limits in place tied to appropriate market indicators. Along with the recommendations in this report, agencies and corporations will be supported to set executive compensation in a manner that is transparent, rational, and accountable while being fair to senior executives, so that talented management are attracted, retained and encouraged to perform, all in the context of a competitive labour market.

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SIGNATURE

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ATTACHMENTS

Attachment 1 - Guiding Principles for the Development of Senior Executive Compensation Policies at City Agencies and Corporations (Updated).

Attachment 2 - Korn Ferry Executive Compensation Review Report