Sun Life Financial

Jeffrey T. Kozan
SVP, Total Rewards

Sun Life Financial Inc.
150 King Street West
Toronto, Ontario
M5H 1J9
Tel: 416 979-6353
jeff.kozan@sunlife.com

Memo

Date: October 31, 2012

To: Institutional Shareholder Services (ISS)
(delivered via email to policy@issgovernance.com)

Re: Comments on Proposed Pay for Performance (Canada) Methodology

We appreciate the opportunity to comment on the new proposed methodology for Institutional Shareholder Services (ISS) to measure pay for performance for CEOs of Canadian companies starting in 2013. Our understanding is that the methodology is substantially similar to that adopted by ISS for US companies in 2012. The overview of the new methodology indicates it will apply in 2013, but it was not clear if it would apply to all Information Circulars released in 2013, or only for companies with fiscal year-ends on or after December 31, 2012.

Summary of Concerns with the Proposed Methodology

In reviewing the proposed methodology, we have some concerns that we would like to share so they can be considered in determining the final approach:

1. The peer selection process is too mechanical for the Canadian environment.

A fundamental component of the quantitative analysis in the proposed methodology is the selection of peer companies. The Canadian market is smaller than the US market and this often impacts how Canadian companies select peers for the purposes of benchmarking both compensation and performance.

- For most large Canadian companies there are a limited number of similar companies to select as peers if narrow size and industry criteria are applied. For this reason, Canadian companies often use one of two techniques to address the limited number of comparable peers:
  - Use a wider range of peers that are much smaller and/or larger and use size adjusting techniques (such as regression analysis) or judgment to develop peer compensation data that is appropriate for their size of company.
  - Use numerous samples of peer compensation data that may involve larger/smaller companies and companies from broader general industry samples as a reference. The compensation committee would then use judgment-based decision making to consider how to use the results from various samples to make compensation decisions.

- On a philosophical basis, some Canadian companies focus solely on Canadian companies for benchmarking pay levels for senior executives, whereas other companies will include companies from across different geographies. The decision to use companies outside of Canada introduces the potentially significant impact of exchange rates and foreign (typically US) pay levels and practices. The implication of this is that some companies feel it is more appropriate to use a Canadian peer group for compensation benchmarking and a broader international peer group for benchmarking performance.

The proposed ISS methodology of selecting peers does not consider the limited number of comparably-sized peers in the same industry within Canada, nor does it recognize that peer groups for pay and performance benchmarking are often different. The focus of any quantitative analysis should consider the need for different peer groups, or rely on the peers selected by each company in order to appropriately test their pay for performance alignment.

2. **The proposed quantitative analysis continues to use Total Shareholder Return (TSR) as the sole measure of performance.**

We feel using TSR as the sole measure of performance in the quantitative analysis will inherently impair pay for performance testing as many organizations:

- Use other measures of performance in annual and long-term incentive designs. TSR is just one measure of performance that is volatile and is sensitive to short-term investor expectations of performance. Other measures of performance (e.g., financial, operational, customer and strategic) are drivers of long-term value creation depending on the nature of the business, but may not fully align with TSR results over different time horizons depending on the perspective of the investor (short or long-term horizon) and other external market factors that drive stock market performance.

- Have pay components not explicitly aligned to performance. For example, the role of base salary in a total compensation package is to provide fixed compensation based on similar roles in peer companies and also to consider each individual's experience and expertise. Also, the role of pension and benefits in a total compensation package are to provide protection and income replacement in retirement rather than align to performance.

We believe using a quantitative pay for performance analysis focused solely on TSR does not reflect that some elements of pay are not designed to be performance sensitive, and that organizations have other measures of performance aligned to strategic objectives that may not always correlate to TSR performance. We also recommend that any quantitative analysis conducted on pay for performance should be focused on incentive compensation elements.

3. Grant date value of long-term incentive awards is not correlated to performance.

The design of most long-term incentive plans is to provide annual stock-based compensation awards based on delivering a grant date value that is competitive with awards provided by peers. The ultimate payout of these awards is subject to future performance through changes in share price and the impact of other performance measures.

We believe that realizable value (the change in the value of newly granted, outstanding and paid incentives over a performance period) is a much better basis on which to assess the alignment of pay for performance. Grant date value reflects the competitive amount that was delivered, but realizable value reflects the ongoing value of the award considering the impact of performance.

Conclusion

We appreciate that it is difficult to develop a quantitative measurement system that can contemplate and provide a basis of fair measurement of pay for performance that is appropriate across a range of companies in different geographies and markets. For this reason, we feel qualitative assessment is more important than quantitative analysis. In fact, many shareholder groups are calling for Directors to use more judgment (including disclosing why and how the judgment was applied) in making compensation decisions. We feel the shift to make your assessments based more on standardized quantitative analysis will not necessarily help shareholders to make effective judgments about the effectiveness of the compensation programs and outcomes.

Ultimately, Directors are accountable to shareholders for approving pay programs, monitoring the relationship between pay and performance and disclosing information about the decisions they have made. Directors attempt to make the best decisions for shareholders based on a deep understanding of the business, the Canadian competitive environment and the goals, plan designs and outcomes of the pay programs. For this reason, we stress the importance of direct dialogue with an organization before a final judgment is made on the appropriateness of the pay for performance relationship based on a quantitative analysis.

We would be pleased to have further discussion on any of the points raised.