March 4, 2022

Ms. Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street NE
Washington, DC 20549

Re: Reopening of Comment Period for Pay Versus Performance (Release No. 34-94074; File No. S7-07-15)

Dear Ms. Countryman:

The Center On Executive Compensation ("Center") is pleased to provide comments to the Securities and Exchange Commission ("Commission") in response to the reopening of the comment period ("Release") for the 2015 proposal regarding pay versus performance disclosures mandated by Section 953(a) of the Dodd-Frank Act ("2015 Proposal"). The Center remains concerned about several aspects of the 2015 Proposal, along with potential additional requirements discussed as part of the Release. The Center is providing these comments to reiterate and expound upon our views on the 2015 Proposal and to provide the perspective of our membership on the topics and questions raised in the Release.

The Center maintains the views and recommendations outlined in our July 2015 comment letter, which are still relevant as the Commission considers finalizing rules to implement Section 953(a). Those comments are included as appendix two to this letter.

The Center is a research and advocacy organization that seeks to provide a principles-based approach to executive compensation policy from the perspective of Chief Human Resource Officers at over 150 large companies, representing a broad cross-section of industries. These comments reflect the input of the top human resources and executive compensation professionals at our member companies, who have extensive experience in crafting compensation disclosures and in engaging with institutional investors on executive compensation matters.

Background

The Center appreciates the inherent challenge facing the Commission in implementing what is now a nearly twelve-year old statutory mandate. Compensation disclosure by registrants, communication between shareholders and investors regarding executive compensation and other matters, and the analytical tools available to institutional investors have all developed significantly since the Dodd-Frank Act was signed into law.[1] Underlying assumptions or

[1] Nasdaq / U.S. Chamber of Commerce 2020 Proxy Season Survey (73% of public companies have a regular year-round communication program with institutional investors); Morrow Sodali 2019 Institutional Investor Survey (87% of respondents indicate "proactive and regular engagement with the board of directors" assists in their evaluation of a company's culture, purpose, and reputational risk.)

arguments made in support of Section 953(a) and proposed new disclosure mandates are not as relevant today as they were twelve years ago. As discussed in further detail throughout this letter, we urge the Commission to consider market-driven developments that have occurred since 2015 and to carefully consider the potential costs and unintended consequences that would result from a "one-size-fits-all" prescriptive approach to disclosing the pay for performance relationship.

The Center strongly supports effective disclosure that enables investors to determine the relationship between executive pay and the financial performance of a company. Ensuring that executive compensation is aligned with performance has been established as a key focus of compensation committees and a top priority for institutional investors which are likely to closely examine executive compensation and other proxy disclosures provided by registrants. Companies have in turn continued to adapt disclosures to meet the demands of their shareholders. There is little debate about the importance and relevance of executive compensation issues – including pay for performance – to investors.

However, the Commission's proposed approach to implementation of Section 953(a) embraces inflexible, prescriptive disclosures that may not be appropriate for every company and would undermine the effectiveness of existing disclosures that registrants already provide describing the relationship between pay and performance on tailored metrics that support the company performance and strategy. This is at odds with both the statutory language of Section 953(a) as well as the Commission's longstanding approach to Compensation Discussion & Analysis (CD&A) disclosure.

Additionally, given the prevalence of pay for performance disclosure and the extensive resources available to investors to determine performance, it is not at all clear whether investors need or want the standardized, tabular disclosure contained in the 2015 Proposal, or how such information would enhance investors' understanding about the link between corporate pay and performance. The fact that an investor may disagree with a registrant's approach to pay for performance does not necessarily mean the investor is unable to *understand* how a registrant seeks to align pay with performance. The Center remains concerned that if a rule similar to the 2015 Proposal is finalized, it would create more confusion than clarity.

Indeed, BlackRock – the world's largest asset manager - expressed very similar concerns over the 2015 Proposal, stating:

> A prescriptive reporting requirement…could result in disclosures that are not relevant to particular issuers. This could result in issuers expending additional resources to explain the information, and investors also expending additional resources to understand the disclosures.[2]

BlackRock further explained its view that:

> We believe issuers' disclosures on executive compensation have generally improved over the past decade, and investors typically have the information and tools necessary to make an informed decision on pay versus performance.

---

[2] See July 2, 2015 letter from Zach Oleksiuk, Director, Head of Corporate Governance and Responsible Investment, Americas, BlackRock.

While institutional investors may have the resources and tools available to make informed decisions regarding pay for performance, retail investors typically do not. It is notable that the Release and 2015 Proposal make little mention of individual shareholders and how they would rely upon disclosures prescribed by the 2015 Proposal. Retail investors relying on the proposed table that includes potentially misleading or incomplete data – while institutional investors rely on their own (and likely more accurate) proprietary analysis based upon CD&A and other disclosures – would be a fundamentally unfair outcome and contrary to the SEC's responsibilities regarding corporate disclosure.

The Center reiterates our call for the Commission to adopt a more principles-based rulemaking that considers existing disclosure requirements and practices, and which allows registrants to tailor disclosure in a way that provides the most accurate and understandable description of pay for performance.

The Center continues to believe the statutory language of Section 953(a) permits the SEC significant flexibility in the rulemaking process, and that the Commission should take account of current disclosure and the potential for "one size fits all" mandates to cause investors to receive unnecessarily complex or misleading information. In our previous comment letter, the Center expressed our concerns that the 2015 Proposal would:

- Adopt a "one-size-fits-all" regime by forcing issuers to adhere to a standardized table despite the fact that such a table may not be the most effective mode of pay for performance disclosures for many companies;

- Fail to provide investors with a clear understanding of the connection between pay and performance, particularly with the manner in which compensation "actually paid" is compared to total shareholder return (TSR);

- Contribute to the phenomenon of "short-termism" in the capital markets by elevating the importance of short-term TSR over other metrics that may be a better measure of long-term, sustainable performance;

- Lead to confusion and unnecessary complexity by encouraging issuers to provide remedial disclosures that are intended to explain any misleading information that may be provided by the required new table;

- Create a rule that is contrary to the text of Section 953(a) and the latest market and research-based developments that seek to link pay to financial performance measures which are correlated with long-term shareholder value; and

- Generate significant costs for issuers – particularly smaller issuers – and their shareholders that will vastly outweigh any benefits of standardized and prescriptive disclosures.

Unfortunately, the Release does not address many of the fundamental concerns that the Center and several other commenters raised in response to the 2015 Proposal.[3] In fact, the release contemplates even *more* prescriptive disclosures in addition to what would have been mandated by the 2015 Proposal. We appreciate the SEC's position that these requirements are intended to provide "additional clarity" to investors regarding pay for performance. However, the Center respectfully submits our view that the requirements would in fact sow greater confusion for investors and would necessitate additional disclosure to mitigate the potential confusion and explain the differences between the required disclosure and existing pay for performance disclosure. Such an outcome would not be conducive to enhancing investor decision-making regarding pay for performance.

The Center is also concerned that the Release does not adequately address the flaws contained in the 2015 Proposal's calculation of "compensation actually paid." As noted in our previous comments, the 2015 Proposal's definition of "compensation actually paid" is based upon accounting definitions of pay and would not provide investors with the full scope of information they need to make investment or voting decisions.

The Center appreciates that the Commission is mandated by law to implement Section 953(a) and that, if left fully to its own discretion, the Commission might seek a different approach regarding pay for performance. Nevertheless, we reiterate our view that the statutory language of Section 953(a) does not restrict the Commission from adopting a principles-based rule that would mitigate unnecessary costs for registrants and prevent damage to investors' understanding of pay for performance.

The Center urges the Commission to consider the recommendations we outlined in our July 2015 letter. In response to the Release, we wish to emphasize the following points regarding the proposal:

---

[3] See e.g. July 7, 2015 letter from Society for Corporate Governance ("We do not believe the Proposed Rule…with its prescriptive tabular disclosure and narrow measures of compensation and performance, achieves section 953(a)'s purpose…"); July 10, 2015 letter from National Association of Corporate Directors ("A one-size-fits-all approach to the issue of pay versus performance – though simple and attractive to regulators, politicians, and some commentators – is a truly bad idea."); June 30, 2015 letter from U.S. Chamber of Commerce Center for Capital Markets Competitiveness ("…the CCMC believes that the Pay Versus Performance disclosure should follow a principles-based format allowing companies to describe the performance metrics they use and to explain their processes for establishing compensation guidelines in a way that expresses how pay and performance are aligned for their individual circumstances."); July 10, 2015 letter from National Investor Relations Institute ("The draft rule's mandate that companies prepare a new table with an annual TSR comparison will result in disclosures that may confuse many investors, especially retail shareholders who don't have sophisticated research tools at their disposal nor the time to fully explore the nuances of corporate compensation practices."); July 6, 2015 letter from Business Roundtable ("…the Commission is choosing to go beyond the Dodd-Frank Act's requirements and proposing lengthy, one-size-fits-all disclosure – without considering whether that disclosure is appropriate for a company's executive compensation program or informative to its investors."); July 6, 2015 letter from WorldatWork ("…the Proposal, as written…may even provide misleading information to investors and shareholders and is overly burdensome for companies."); July 6, 2015 letter from Financial Services Roundtable ("FSR generally is concerned that the Commission has proposed an overly-prescriptive, "one-size-fits-all" disclosure regime to implement Section 953(a), which would obscure important differentiations that the company believes are present in the total compensation program for its principal executive officer.")

I. **The Commission should remove the requirement for the performance table prescribed by the 2015 Proposal and instead adopt a principles-based rule that allows registrants to effectively explain the relationship between pay and performance.**

II. **Requiring the disclosure of prescriptive financial performance metrics (i.e., pre-tax net income and net income) is ineffective because there is no single metric or group of metrics that accurately reflects value creation for all companies.**

III. **The 2015 Proposal's definition of "compensation actually paid" does not accurately reflect that term. The Center believes the Commission should fundamentally rethink that definition, particularly as it relates to stock options and pension values.**

Each of these are discussed in greater detail below.

I. The Commission should remove the requirement for the performance table prescribed by the 2015 Proposal and instead adopt a principles-based rule that allows registrants to effectively explain the relationship between pay and performance.

The text of Section 953(a) reads:

> The Commission shall, by rule, require each issuer to disclose in any proxy or consent solicitation material for an annual meeting of the shareholders of the issuer a clear description of any compensation required to be disclosed by the issuer under section 229.402 of title 17, Code of Federal Regulations (or any successor thereto), including information that shows the relationship between executive compensation actually paid and the financial performance of the issuer, taking into account any change in the value of the shares of stock and dividends of the issuer and any distributions. The disclosure under this subsection may include a graphic representation of the information required to be disclosed.

The Commission acknowledged in the 2015 Proposal that Congress did not intend for the pay for performance rules to be "overly-prescriptive and…Congress recognized that there could be many ways to disclose the relationship between executive compensation and financial performance of the registrant."[4]

However, the Commission's approach to implementing Section 953(a) has largely relied on a prescriptive table that would compare a total pay number for one year to standardized performance measures. As the Center pointed out previously, this one-year total pay number would be comprised of different awards that are intended to reward various performance objectives over multiple time periods. Most companies also use multiple performance measures to craft their pay plans as opposed to the single measure (i.e., TSR) that was included as part of the 2015 Proposal.

[4] 80 Fed. Reg. at 26,330

The disclosure resulting from the proposed table would not properly communicate specific decisions made by the compensation committee of a registrant about performance criteria, performance time frames, and vesting schedules which form the basis of a registrant's connection between pay and performance. These decisions can involve:

- forms of pay, ranging from short-term cash (in the form of salary and incentives) to long-term performance shares, stock options, and restricted stock;

- performance measures that drive annual and long-term incentives and range from financial measures such as revenue, profit, and return to nonfinancial strategic measures;

- performance targets, which vary considerably among companies and industries based on business strategy, and;

- vesting schedules for long-term incentives, with performance shares typically vesting all at once after three or more years, restricted stock often vesting after several years to encourage retention and stock options vesting in equal amounts each year after three or four years.

To the extent any investor relies on the standardized table, it would likely be misleading or incomplete. This problem would be exacerbated if information in the table were compared to other performance disclosures included in a registrant's proxy statement. The Commission seems to have understood in the 2015 Proposal the potential for prescriptive rules to create misleading information and investor confusion. The economic analysis in the 2015 Proposal notes:

> The Proposed amendments may confuse shareholders about the optimality of pay practices if it brings attention to a particular relationship that may not be meaningful in the context of a given registrant.[5]

Unfortunately, the only solution available for registrants to address this problem would be to provide corrective disclosure intended to clarify any misleading or incomplete information included in the table. This would only add to the already growing volume of executive compensation disclosures provided by registrants, increasing the risk of "information overload" for investors and undermining the recent disclosure reform initiatives undertaken by Congress and the Commission.

By contrast, a principles-based rule:

- Would provide company-specific information that could be structured to compare consistent time periods for pay and performance;

- Would not be misleading and thus would minimize the confusion that is likely to lead to substantial duplication of disclosure already provided in the CD&A if the proposal is not adopted;

---

[5] 80 Fed. Reg. at 26,353

- Would not place the Commission's imprimatur on specific performance metrics or pay arrangements, since it would be up to each company to disclose the performance metrics used and the performance that resulted;

- Could be structured so that the time period for pay would match the time period for performance; and

- Is consistent with the language of Section 953(a).

The Commission has historically utilized a principles-based approach to executive compensation, most notably with the CD&A. The Commission could take this approach to pay for by performance while still carrying out the intent and requirements of Section 953(a). For example, a principles-based rule could still include a requirement that registrants include a discussion of stock price performance while leaving it to a registrant's discretion for how best to communicate their disclosure.

II. Requiring the disclosure of prescriptive financial performance metrics (i.e. pre-tax net income and net income) is ineffective because there is no single metric or group of metrics that accurately reflects value creation for all companies.

The Release suggests the Commission is considering additional performance metrics on top of those in the existing proposal. The intent of these metrics – including pre-tax net income, net income, and a single Company-Selected Measure – is supposedly to provide "additional clarity" to investors about pay for performance. However, in the Center's view, these new mandates would only further confuse investors and would not align with other disclosures provided by registrants.

No single performance metric is appropriate for every company across every industry. Superior value creation is the result of sustained outperformance on *industry-specific* financial and non-financial drivers over time. Because businesses and industries have dramatically different customers, markets, suppliers, talent, company culture and numerous other factors, no single measure or a set of measures will be correlated to shareholder value for every company, in every industry, for all time.

To illustrate this, the Center conducted an analysis of performance metrics across six compensation peer groups representing a variety of industries, with the goal of determining what financial performance metrics were most closely correlated with changes in Total Shareholder Return (TSR) over time[6]. Using multivariate statistical analysis, the analysis evaluated which pairs of financial metrics were most highly correlated to changes in TSR over five years, the period contemplated by the proposed performance table. Our analysis showed that no single

[6] See appendix 1 Center On Executive Compensation Metric Correlation Analysis, using the Incentive Plan Analytics Calculator (IPAC), a product of Equilar, Inc. using data as of February 28, 2022.

metric appeared in the top five of the most highly correlated metric pairs across all six peer groups; in fact, sixteen different financial metrics were represented in the thirty metric pairs.

Peer Groups	**Top Correlated Metric Pair**
Food producers	R&D, Gross Profit Margin (r^2 = .42)
Pharmaceuticals	SG&A Margin, Return on Assets (r^2 = .47)
Technology	EBITDA, Leveraged Cash Flow (r^2 = .60)
Technology and Related Services	EBITDA, Inventory Turns (r^2 = .65)
Air Transportation	SG&A, Return on Capital (r^2 = .56)
Banks and Financial Services	EBIT, Current Ratio (r^2 = .84)

Significantly, Net Income appeared only three times and in only two of the peer groups. Based on this analysis, we believe that requiring companies to show pay relative to Net Income and Pre-Tax Income will likely produce misleading results, as those metrics are not positively correlated to creating shareholder value over time; as such, there is no reason to believe that any pay for performance relationship should exist.

We have shown above that net income and pre-tax net income are not reliable indicators of long-term shareholder value for all companies. When it comes to incentive design, a review of prevalence shows that the same is true - not all companies base their incentive pay upon pre-tax net income or net income. For example, the Center estimates that only about 17% of companies in the S&P 500 use net income as a performance metric for incentive compensation plans, and virtually *no* companies use pre-tax net income. Implying that all companies do or should use this metric by requiring its inclusion in a table would be misleading and conflict with existing pay for performance disclosures in CD&A.

To the extent that companies do use net income as a performance metric, it is almost always in the annual plan.[7] However, the majority of compensation as reflected in the table will be long-term pay, so the comparison to net income and pre-tax net income is even less logical.

Further, the requirement to select and disclose a single "Company-Selected Measure" puts registrants in the difficult position of having to choose one performance metric above all others as the most "important" metric the registrant uses in designing incentive compensation plans. The Company-Selected Measure would be disclosed in the new table alongside other performance metrics including TSR, pre-tax net income, and net income.

As noted in our previous comments, most registrants use a combination of several performance metrics that are designed to drive both long-term and short-term business strategy.[8] These metrics and the combinations used by registrants can evolve over time and businesses can adapt their incentive plans based upon their own unique profile.

---

[7] Meridian Compensation Partners LLC "Compensation Trends and Developments Survey Results April 2021" Available at https://www.meridiancp.com/wp-content/uploads/2021/04/Meridian-2021-Trends-and-Developments-Survey-1.pdf

[8] *Id.*

A mandate for registrants to select one metric above all others and communicate that metric to investors as the most "important" will not provide investors with a comprehensive view of how an incentive plan was designed and will confuse the relationship between pay and the performance upon which it was based. Again, registrants would have to provide additional disclosure to add context and mitigate confusion.

The Release appears to acknowledge the confusion that the Company-Selected Measure mandate could create, stating in a footnote:

> If the registrant's most important performance measure were already included in the table, the registrant would disclose its next-most important measure as its Company-Selected Measure. For example, if the registrant's most important measure were TSR, its second most important measure were pre-tax net income, and its third most important measure were EBITDA, the registrant would include EBITDA as its Company-Selected Measure. If a registrant did not use any measures other than those already included in the table, it would indicate that fact in its disclosure.[9]

However, if a non-sophisticated investor were relying upon the table to assess pay for performance, it would be reasonable for them to assume that whatever metric is included in the Company-Selected Measure column is most important to the registrant when determining pay. Registrants would have to explain in writing that, in fact, the short-term and long-term plans include multiple metrics that cannot be considered in isolation, but that clarification would likely be buried underneath a host of other explanatory comments.

Further, the contemplated requirement that registrants assign rankings in yet *another* table to determine their five most important metrics would be duplicative of disclosure that already exists in the CD&A, would add further complexity and represents a departure from current practice. For most companies, this will consist of the five metrics to which the largest proportion of pay is tied in the short- and long-term plans – nothing more. This information is already included in the CD&A, so it is difficult to understand how repeating that information would help. If, in fact, the Commission has other expectations for this table, they should be clearly communicated, but as stated, there is no purpose to the table. Consistent with our previous recommendation, we believe the Commissions should remove any type of standardized tabular requirements in favor of a principles-based rule.

III. The 2015 Proposal's definition of "compensation actually paid" does not accurately reflect that term. The Center believes the Commission should fundamentally rethink that definition, particularly as it relates to stock options and pension values.

The statutory language of Section 953(a) necessitates an interpretation of the term "compensation actually paid." The Center appreciates the Release's acknowledgement of concerns the Center raised in response to the 2015 Proposal that the proposed definition could lead to misleading information for investors. Regardless of whether the Commission ultimately adopts the prescriptive approach of the 2015 Proposal or a more principles-based rulemaking, the Center suggests a number of changes to how "compensation actually paid" is defined.

---

[9] 87 Fed. Reg. at 5,753

The 2015 Proposal's definition is premised upon accounting definitions of pay and, similar to the summary compensation table in CD&A, combines pay received, accounting estimates of pay, and potential pay that may never be actually received. Any requirement or expectation that registrants label a mix of actual, potential, and estimated pay as "actually paid" would mislead investors in the context of pay for performance.

This is particularly relevant with regard to stock options and pension values. The Center believes that any disclosure or discussion regarding stock options by registrants should be based upon the intrinsic value (i.e., the spread between the exercise price and market price), while pension benefits that are not correlated with performance objectives and are outside the control of the compensation committee should not be included in any final requirement.

Regarding stock options, the Center offered the following perspectives in our 2015 comments:

> **Compensation Realized From Option Exercises Provides Clearest Picture of Pay for Performance**
>
> Under a principles-based approach, stock options should be valued using the amount realized to the executive when the options are exercised (i.e., the difference between the market price and the exercise price). This approach represents the compensation value to the executive and can be compared to total shareholder return over the period the options were outstanding. It is also consistent with the "Option Exercises and Stock Vested" table already in company disclosures.
>
> **If Using the Vesting Date, Options Should Be Valued Using the Spread Between the Strike Price and Market Price**
>
> If the Commission decides to use a vesting date[10] approach to options valuation, it should use the difference between the market price and the strike price (also called the "intrinsic value") on the vesting date, rather than a fair value estimate. Fair value option valuation methodologies such as Black-Scholes or the binomial method are financial models used for the purpose of developing an estimate of the company's accounting expense, which is already provided in the Summary Compensation Table. However, these models are not appropriate when determining the link between pay and performance with respect to a particular executive and their use may result in several anomalies. For example, at the date of vesting, an option may be under water – that is, the strike price is more than the current market price, meaning the option may not be exercised. The intrinsic value of the option to the executive for that fiscal year is zero. However, if a Black-Scholes valuation is conducted to estimate the value of the option over its remaining expected life, this may result in a number much greater than zero. In this case, how can an estimate of the future potential value of the option be described as "compensation actually paid?" The estimated grant-date value of the option has

[10] Compensation committees use vesting periods to fulfill a variety of purposes depending on the award vehicle. For performance shares, which vest based on achievement of specified performance objectives set at the beginning of the performance period, the vesting schedule represents the period over which the company measures performance and aligns with long-term strategic goals. A focus on long-term performance prevents companies from succumbing to "short-termism" and contributes to the economic health of the companies themselves and the economy as a whole. For restricted stock or options, the values of which are tied to stock price, vesting periods are used to retain key talent within the organization by tying their compensation to their continuing to work for and support company goals. Stock options are most likely to vest ratably over a period (e.g., with one-third vesting each year over three years; or 25% vesting each year over four years). Restricted stock is more likely to vest at the end of a longer term, e.g., three years, to reflect its retentive purpose. Executives are incented to make decisions that will increase long-term shareholder value, since leaving the company prematurely would typically result in forfeiture of unvested awards.

already been disclosed in the Summary Compensation Table as of grant; when the option is exercised, any actual gains experienced by the executive will be disclosed in the Options Exercise and Stock Vested Table. To add yet another estimated value of the option, this time at vesting date, serves no clear purpose.

The Proposing Release Contradicts the Fair Value Approach

The Commission itself has provided an equally persuasive rationale in the proposing release for why stock options should be valued using an intrinsic value approach at vesting. The proposing release states that "changes in the fair value of the award after vesting reflect investment decisions made by the executive rather than compensation decisions made by the registrant."[11] Since option pricing models, such as Black Scholes and binomial models, represent estimates of the present value of the future potential payouts of options, they measure the compensation and the investment value of the awards. Thus, if "compensation actually paid" is determined at the vesting date, and the SEC believes the decision of when to exercise an option is an investment decision, then the residual compensatory element during the remaining term of the option is both irrelevant and inconsistent.[12] This reinforces that under the Commission's approach, options should be valued using the spread as of the vesting date.

Consider Compensation "Actually Paid" Only When Restrictions on Compensation Lapse

The Commission has asked for input on when certain types of compensation should be considered actually paid, including stock options that have vested but are not yet exercisable and other compensation amounts such as salary or short- or long-term incentives subject to a mandatory deferral or vesting period. The Center believes that these amounts should be considered actually paid only when the restrictions on them lapse. Thus, the Center believes that stock options that have vested but are not exercisable due to post-vesting restrictions should only be considered "actually paid" based on the intrinsic value when the post-vesting restrictions lapse. The same concept would apply to portions of annual or long-term cash incentives subject to mandatory deferral, for example as part of a risk mitigation strategy. This aligns the concept of "compensation actually paid" with how awards are treated in practice.[13]

With regard to pensions, the Center continues to believe that the inclusion of actuarially determined service costs for pension participants should not be included in the definition of "compensation actually paid." A pension benefit is forfeitable once the participant is no longer employed by the company, unless the benefit is vested. Additionally, in the context of pay for performance, it makes little sense to include benefits that are not tied to performance in the calculation of "compensation actually paid."

Conclusion

In closing, as discussed above, we recommend that the Commission support a principles-based format which will allow companies to utilize already existing (and rigorous) pay for performance disclosures. The Center appreciates the opportunity to again provide our perspectives on the Commission's implementation of Section 953(a). We look forward to continuing to engage with the Commission on this issue and are ready to assist in any way that we can.

---

[11] 80 Fed. Reg. at 26,339

[12] Moreover, the intrinsic value is already used to determine the value of options for other disclosure purposes, including the value of accelerated vesting of awards disclosure regarding potential payments upon termination or change in control. Regulation S-K §402(j).

[13] July 6, 2015 Center on Executive Compensation comment letter on 2015 Proposal at 17-18.

Sincerely,

Ani Huang

Ani Huang
President and CEO
Center On Executive Compensation

Appendix 1

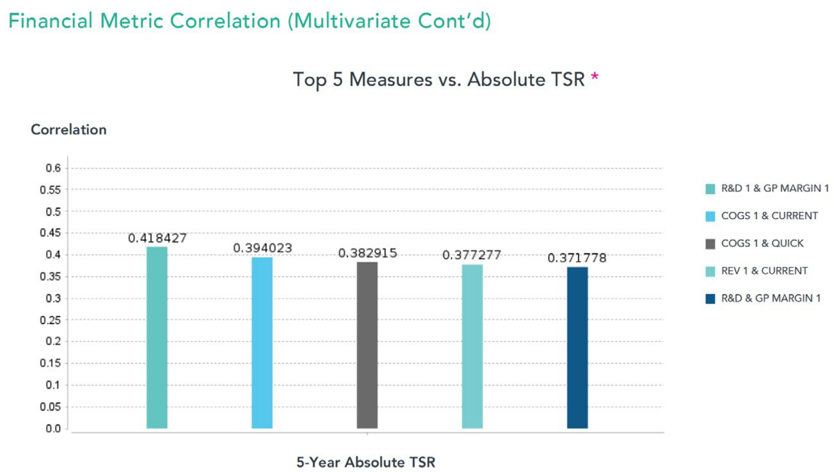
Center On Executive Compensation Metric Correlation Analysis

DESCRIPTION OF THE ANALYSIS

The Center conducted an analysis of performance metrics across six compensation peer groups representing a variety of industries, with the goal of determining what financial performance metrics were most closely correlated with changes in Total Shareholder Return (TSR) over time. Using multivariate statistical analysis, we looked at which pairs of metrics were the top five most highly correlated to changes in TSR over five years. The results are presented in the charts below.

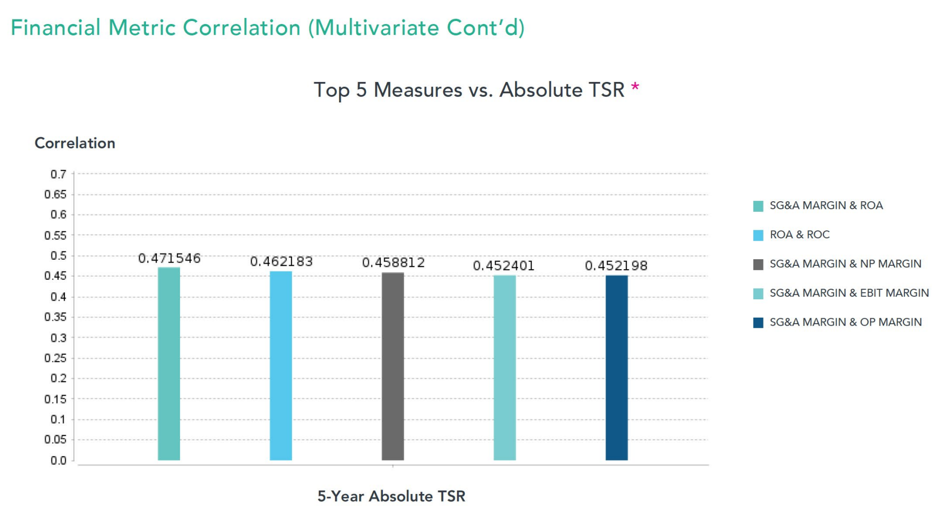
Peer Group: Food Producers

Number of companies: 15
Median Market Cap ($MM): $40,481.2



Peer Group: Pharmaceuticals

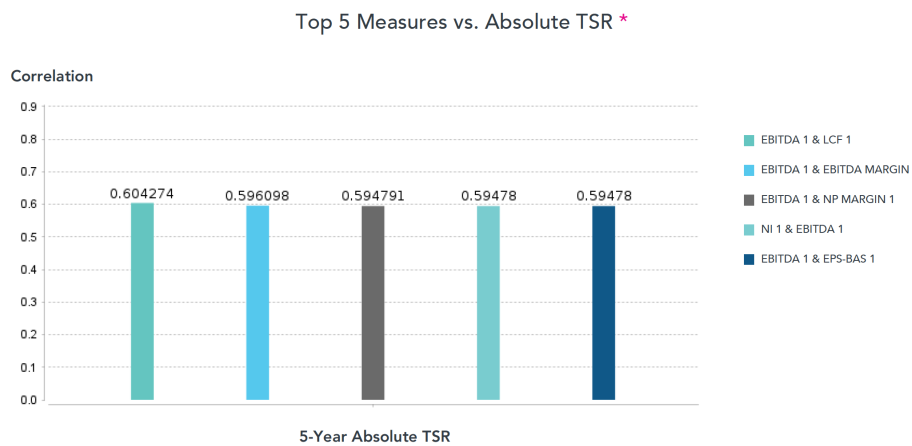
Number of companies: 15
Median Market Cap ($MM): $193,878



Peer Group: Technology

Number of companies: 15
Median Market Cap ($MM): $203,888.6

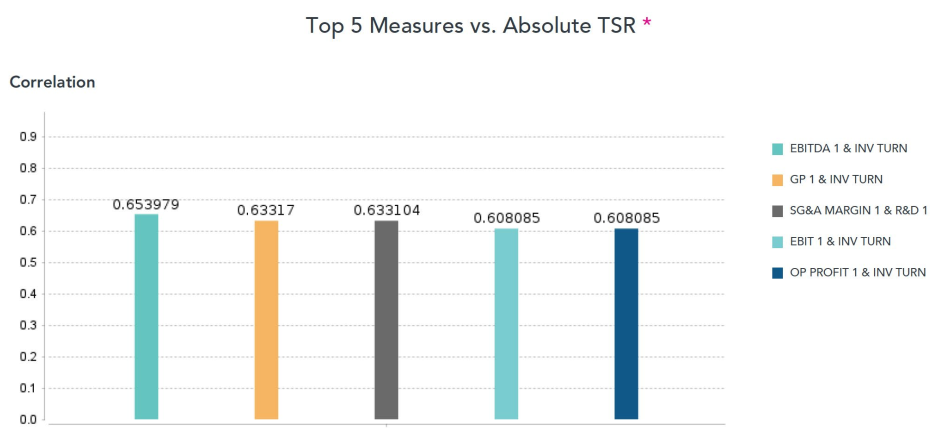
Financial Metric Correlation (Multivariate Cont'd)



Peer Group: Technology and Related Services

Number of companies: 14
Median Market Cap ($MM): $144,252.4

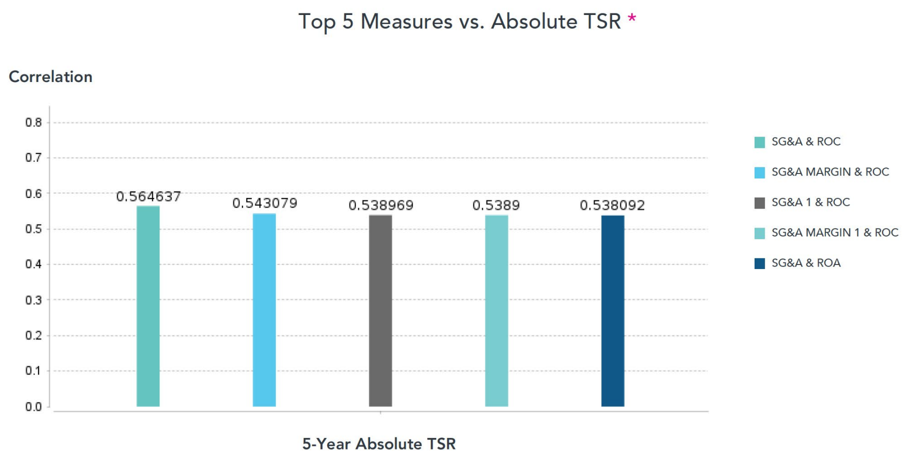
Financial Metric Correlation (Multivariate Cont'd)



Peer Group: Transportation and Logistics

Number of companies: 15
Median Market Cap ($MM): $25,600.7

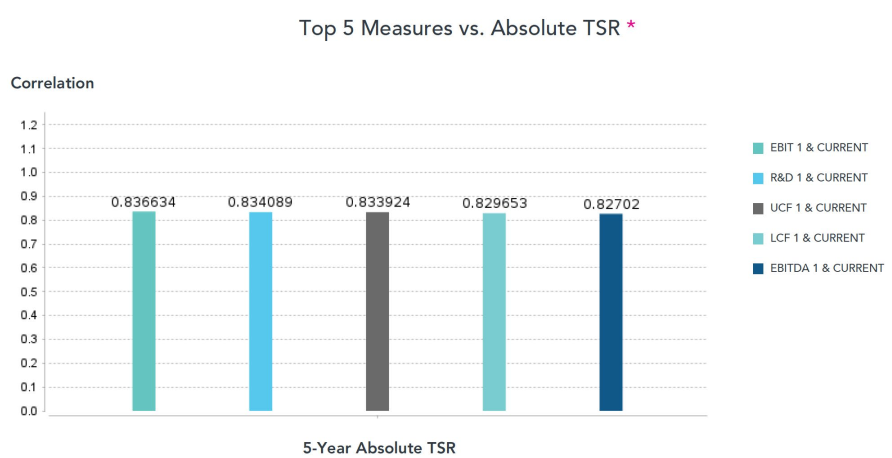
Financial Metric Correlation (Multivariate Cont'd)



Peer Group: Banks and Financial Services

Number of companies: 15
Median Market Cap ($MM): $113,813.4

Financial Metric Correlation (Multivariate Cont'd)



RESULTS AND COMMENTARY

No single metric appeared in the top five of the most highly correlated metric pairs across all six peer groups. Sixteen different financial metrics were represented in the thirty metric pairs, as shown in the table below.

Metric	Total # occurrences	% total	Food	Pharm	Tech	Tech & Related	Transport & Logistics	Banks & Fin Services
COGS	2	3.3%	2					
Current Ratio	7	11.7%	2					5
Earnings Per Share	1	1.7%			1			
EBIT/EBITDA	11	18.3%		1	6	2		2
Gross Profit/Margin	3	5.0%	2			1		
Inventory Turns	4	6.7%				4		
Levered Free Cash Flow	2	3.3%			1			1
Net Profit/Net Income	3	5.0%		1	2			
Operating Profit/Margin	2	3.3%		1		1		
Quick Ratio	1	1.7%	1					
R&D	4	6.7%	2			1		1
Return on Assets	3	5.0%		2			1	
Return on Capital	5	8.3%		1			4	
Revenue	1	1.7%	1					
SG&A	10	16.7%		4		1	5	
Unlevered Free Cash Flow	1	1.7%						1

Significantly, Net Income appeared only three times and in only two of the peer groups; and *it did not appear in either the number 1 or number 2 most highly correlated pair in any peer group.* Based on this analysis, we believe that requiring companies to show pay relative to Net Income and Pre-Tax Income will likely produce misleading results, as those metrics are not positively correlated to creating shareholder value over time; as such, there is no reason to believe that any pay for performance relationship should exist.

Methodology

The analysis was conducted using the Incentive Plan Analytics Calculator (IPAC), a product of Equilar, Inc. using data as of February 28, 2022. The IPAC multivariate correlation function was used to determine the five most highly correlated financial metrics pairs to five-year Total Shareholder Return, using six different compensation peer groups. The peer groups were generated using the Equilar Market Peers function.

IPAC multivariate correlation is calculated using the Multiple Linear Regression model. **Multiple linear regression** is the most common form of **linear regression** analysis. It is used to explain the relationship between one continuous dependent variable and two or more independent variables

Metrics
For purposes of the analysis, derivations of a core metric were counted as an occurrence of the core metric itself. For example, Gross Profit, 1-year Growth in Gross Profit, and Gross Profit margin were all counted as an occurrence of Gross Profit.

S*ources of Data* (from Equilar)

- All metrics and metric values used in the Financial Metric Correlation (both Single and Multivariate) function are from a financial data provider. Certain growth metrics are calculated by IPAC using raw data from a financial data provider.

- The independent variables in the "Top 5 Correlation" function calculation include financial metrics from a financial data provider and the 1-year change metrics calculated by IPAC. Change metrics measuring changes greater than 1 year are excluded from the Top 5 Correlation analysis.

- All TSR values are calculated using Equilar's methodology based on underlying data (i.e. stock prices and stock dividends) provided by a financial data provider.

- All metrics in the Metric Prevalence and the LTIP Effectiveness functions come from metrics disclosed in a company's most recent proxy.

- All data is updated real-time with the exception of Financial Metric Correlation data, which is refreshed by our financial data provider once a month.

Appendix 2

July 6, 2015, Center On Executive Compensation Comments on Proposed Rule Implementing Section 953(a) Dodd-Frank Wall Street Reform and Consumer Protection Act File Number S7-07-15

July 6, 2015

Mr. Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

RE: Comments on Proposed Rule Implementing Section 953(a) Dodd-Frank Wall Street Reform and Consumer Protection Act – File Number S7-07-15

Dear Mr. Fields:

The Center On Executive Compensation ("Center") is pleased to submit this set of comments to the Securities and Exchange Commission ("Commission") providing its perspective on the Commission's implementation of Section 953(a) of the Dodd-Frank Act, the pay versus financial performance disclosure requirement. Dodd-Frank Section 953(a) requires that the SEC promulgate a disclosure requirement which provides a "clear description" of compensation required to be disclosed under Item 402 of Regulation S-K, including a comparison of executive compensation "actually paid" to the financial performance of an issuer "taking into account any change in the value of the shares of stock and dividends of the issuer and any distributions." This letter provides the Center's perspective on the implementation of Section 953(a).

The Center is a research and advocacy organization that seeks to provide a principles-based approach to executive compensation policy from the perspective of the senior human resource officers of leading companies. The Center is a division of HR Policy Association, which represents the chief human resource officers of over 360 large companies, and the Center's more than 110 subscribing companies are HR Policy members that represent a broad cross-section of industries. These comments reflect the input of our Subscribers as well as their experiences in crafting executive compensation disclosures and in engaging with institutional investors on executive compensation matters.

Executive Summary

The Center supports meaningful disclosure of the relationship between pay and financial performance, but it strongly believes that the Commission's proposal will detract from a clearer understanding of pay for performance for investors. Thus, it favors a principles-based approach that will more effectively provide investors useful information for assessing the link between pay and performance. In sum, the Center believes the standardized, mechanical and prescriptive approach in the proposal:

- Fails to provide a clear picture of the pay for performance link and, as the release itself acknowledges, the new table has significant potential to create confusion and misunderstanding among shareholders, especially due to the way compensation actually paid is compared to total shareholder return. The proposal purports to address this by encouraging registrants to provide supplemental disclosure to debunk the misconceptions that result from the new table, but this does not remedy the fundamental flaw of the proposal's prescriptive approach.

- Despite clear statutory language linking compensation to financial performance, puts the SEC's stamp of approval not only on the notion that linking pay to performance based solely on the metric of total shareholder return ("TSR") is a meaningful approach to compensation but also on the notion that investors should rely on this measure when assessing the pay for performance link since the SEC seems to endorse it by mandating its disclosure. The reality, however, is that the Commission's focus on TSR runs counter to the text of section 953(a) and the latest research and developing practices of linking pay to financial performance measures that support the creation of long-term shareholder value. Further, investors' reliance on the proposal's TSR measure may distract investors from focusing on other metrics and considerations that are more important to evaluating pay for performance. In sum, the SEC's endorsement of TSR is misplaced.

- Sacrifices accuracy for comparability by forcing registrants to adhere to a standardized table, rather than encouraging comparability through improving investor understanding of the pay for performance connection at individual registrants. Comparability should not be determined by whether each company technically has to make the same disclosures. Instead, it should be determined by whether the information that is disclosed gives investors a clear understand of the pay-for-performance link at companies, which may require different companies to make different disclosures depending on their approach to compensation.

- Will generate costs in terms of misleading information and excess disclosure and engagement required to rectify misimpressions. These costs significantly outweigh the benefits of having the same information disclosed at each company, because the standardized disclosures are incompatible with significant differences in program design and timing differences that skew the pay for performance linkage. The only potential benefit identified by the rule is efficiency realized "by preventing duplicative analytical effort by shareholders," and then only to the extent that sophisticated shareholders would conduct the same analysis. There is no clear benefit identified with respect to improving competition or capital formation. The benefit of "preventing duplicable analytical effort" does not justify the costs of misleading and excess disclosure.

- Will encourage short-termism by focusing companies on increasing short-term TSR, rather than the achievement of performance metrics that drive long-term sustained shareholder value, which is the predominant focus for investors.

The Center's comments begin by discussing why the standardized and prescriptive approach in the proposed rule will lead to more confusion and misunderstanding than clarity and insight into the relationship between pay and financial performance. That is followed by an explanation of why a principles-based approach would be more effective in executing the statutory mandate of section 953(a) that will better serve the goal of allowing investors to better evaluate the pay for performance link. In the event the Commission decides to proceed with a prescriptive disclosure, the comments conclude with a set of recommendations to make a prescriptive approach more workable in practice.

I. The Proposed Pay Versus Performance Disclosure Undermines the Executive Compensation Disclosure Regime.

As proposed, the pay versus performance disclosure will provide at best suboptimal and at worst misleading information to shareholders. This is the result of the Commission's decision to require a standardized approach to the disclosure of the connection between registrant pay and performance, failing to incorporate sufficient flexibility to allow registrants to explain their individual circumstances without repeating disclosures already made in the CD&A. A principles-based approach to the disclosure would minimize the negative aspects of the Commission's proposal while facilitating an approach to comparability premised on investor understanding of each registrant's pay for performance alignment.

The Commission's decision to require a standardized approach involved several specific interpretive decisions made within the proposed rule, each of which is discussed in detail below:

1. The proposed rule mandates the use of a standardized tabular disclosure;
2. The proposed rule defines "compensation actually paid" in a way that does not accurately represent that term;
3. By using TSR as the only performance metric, the proposed rule imposes a one-size-fits-all approach to company performance, despite the use of multiple financial performance metrics by most companies;
4. The proposed rule requires the comparison of registrant TSR to peer group TSR despite the fact that this relationship is likely to be influenced by many factors other than the registrant's performance;
5. The proposed rule standardizes the time periods for measuring performance in a way that does not correspond to the specific time periods used for most pay vehicles, especially long-term incentives, and thus will not prove useful in comparing compensation actually paid to financial performance; and
6. The proposed rule requires non-Principal Executive Officer ("PEO") Named Executive Officer ("NEO") compensation to be included as an average.

The statutory text of Section 953(a) did not mandate any of these interpretive decisions and the Commission has wide latitude to make the needed changes to ensure the resulting pay versus performance disclosure requirement actually provides useful information which assists investors in making investment and voting decisions.

However, as proposed, the pay versus performance disclosure will result in the need for substantial additional remedial disclosure aimed at explaining why the mandated disclosure is not representative of the registrant's pay for performance relationship. To deliberately combine potentially misleading information with additional information which hopefully clears up any resulting misunderstandings will bloat a registrant's executive pay disclosures and create a high risk that material and useful information may be overlooked. Such a disclosure runs counter to the federal disclosure regime and good disclosure practice.

II. The Proposed Pay Versus Performance Table Does Not Provide Useful Information and Will Trigger Significant Additional Remedial Disclosure.

The Commission's proposed approach will require registrants to compare a total pay number for one year, derived by summing together different awards aimed at rewarding the accomplishment of differing and specific performance objectives over distinct and differing time frames, to a standardized performance measure, despite the fact that most companies use multiple performance measures in their pay plan designs. In addition, each year of "compensation actually paid" in the prescribed table will be compared to different performance periods of TSR, which are not likely to mirror those utilized by the registrant.

The resulting disclosure will not reflect the results of relevant and registrant-specific decisions made by the compensation committee regarding the forms of pay, performance criteria, and corresponding performance periods and vesting schedules which form the basis of a registrant's pay and performance connection. Thus, it will not provide useful information for shareholders in assessing the effectiveness of the relationship. As a result, to the extent the information in the disclosure is used, is it likely to mislead and confuse, especially if compared to other pay versus performance disclosures within a registrant's proxy statement or to the disclosure of another registrant, and do not reflect the performance that produced the compensation being compared.

The economic analysis accompanying the proposed rule raises these concerns, noting that by prescribing both the measure of pay and the measure of performance in a standardized format there exists an acute risk that the resulting disclosure may confuse shareholders by "bring[ing] attention to a particular relationship that may not be meaningful in the context of a given registrant."[1]

The inability of the proposed disclosure requirement to accurately convey how a registrant's pay compares to the performance that produced the payout will compel many registrants to provide supplemental disclosures to put into context the information that is required to be disclosed in the table. As acknowledged in the economic analysis, if left unexplained, the disclosure would in fact distort the linkage between the registrant's pay and performance and consequently there is risk for confusion among investors.[2] However, the analysis explains that "the possibility of confusion is mitigated by allowing registrants to provide supplemental measures of pay and performance in the proposed disclosure, as well as the ability of registrants to provide further explanatory disclosures."[3] It also acknowledges such clarifying disclosures "may be more likely to be provided when the proposed disclosure is perceived by the registrant to incorrectly indicate the misalignment of pay and performance."[4]

In other words, the proposed rule assumes that the ability provided in the proposed rule for registrants to include supplemental disclosures functions as a sufficient remedy of any misleading or contradictory information otherwise communicated by the proposed rule. Such

---

[1] Pay Versus Performance, 80 Fed. Reg. 26,329, 26,351 (May 07, 2015) (to be codified at 17 C.F.R. 229, 240, and 249).
[2] *Id*.
[3] *Id*.
[4] *Id*.

logic is clearly misaligned with the goal of disclosure in the federal securities laws. In essence, following this logic as a basis for a federal disclosure requirement endorses the concept that disclosing information that creates confusion or that does not clearly explain a registrant's compensation plan is acceptable so long as it is supplemented with clearer information which has a chance of rectifying any confusion. The securities disclosure regime should strive for clearer disclosure from the start, even if it does not permit a direct comparison between companies.

A. Standardized Approach to Disclosure Actually Undercuts Ability to Provide Investors a Clear Understanding of Registrant's Pay for Performance Link.

The proposed disclosure includes a new table, "Pay Versus Performance," premised on the same technical comparability as is used in the Summary Compensation Table. The Center supports the Commission's goal of comparability. However, the Center strongly disagrees with favoring a technical comparability of data (*i.e.*, having the same data in the same location by all registrants) over the disclosure of information that is usable and valuable and that better fosters an investor's understanding of the link between a CEO's pay and underlying performance. As discussed below, and as the release admits in many places, the many shortcomings of the mechanical approach to comparability detract from its usefulness.

For this reason, the Center strongly urges the Commission to focus on developing a rule premised on a different but more useful conception of comparability – one that allows investors to clearly understand the linkage between each registrant's CEO pay arrangement and the performance that drove it.[5] In short, comparability should not be determined by whether each company technically has to make the same disclosures. Instead, it should be determined by whether the information that is disclosed provides investors a clear understanding of the pay for performance link at each company, which may require different companies to make different disclosures, depending on their approach to compensation.

In the proposed rule, the Commission states the goal of the pay versus performance disclosure is to "provide further disclosures for shareholders to consider when making say-on-pay voting decisions, as well as when making other voting decisions on the compensation plans in which NEOs participate, and making decisions pertaining to the election of directors."[6] To accomplish this objective, the Commission adopted a two-pronged disclosure which combines a standardized table (ostensibly designed to foster comparability) with a correlating explanatory disclosure.

The Commission states that the rationale behind the two-pronged approach is to satisfy the statute's requirement that the disclosure not only present information but that it discuss the "relationship" between pay and performance.[7] Accordingly, registrants will be required to provide the standardized table alongside an additional explanatory disclosure which can take the form of a narrative, graphic, or any combination of the two so long as the disclosure compares:

---

[5] The Center is not opposed to a standardized tabular disclosure of pay for performance that also fosters clear understanding. For example, the Center strongly supports a realized pay disclosure that would allow for greater comparability among companies. See *Supplemental Pay Disclosure: Overview of Issues, Proposed Definitions, and a Conceptual Framework*, at 9-10 (last viewed 7/2/15) available at http://www.execcomp.org/Docs/Conference_Board_Supplemental_Pay_Disclosures_9-29.pdf.

[6] Pay Versus Performance, 50 Fed. Reg. at 26,333.

[7] *Id.*at 26,334.

1. Company PEO compensation "actually paid" to TSR; and
2. Company TSR to peer group TSR.

As detailed above, for the vast majority of companies, the Commission's push for rigid, mechanical comparability through the proposed pay versus performance table is highly impractical; it is nearly impossible for a one-size-fits-all approach to pay versus performance disclosure to capture the impact of the wide variety of decisions made by the compensation committee in approving compensation structures. These include:

- forms of pay, ranging from short-term cash (in the form of salary and annual incentives) to long-term performance shares, stock options and restricted stock;
- performance measures that drive annual and long-term incentives and range from financial measures such as revenue, profit and return to nonfinancial strategic measures;
- performance targets, which vary considerably among companies and industries based on business strategy, and
- vesting schedules for long-term incentives, with performance shares typically vesting all at once after three or more years, restricted stock often vesting after several years to encourage retention and stock options vesting in an equal amount each year over three or four years.

By forcing an overly technical approach to pay versus performance that does not actually fit the way companies view the linkage, the proposed rule ensures that each company discloses the same information in the same place. However, the proposal's prescriptive approach undermines the Commission's own stated objective as well as any goal of fostering *real* comparability (specifically, the ability of investors to understand and compare how different companies actually conceive of pay for performance and put their conception into practice). Any comparison based on the proposed approach will involve the use of information highly unlikely to reflect how the disclosing registrant's compensation programs are actually structured.

However, the aggregation of disparately located information in a new format will only provide a benefit to investors so long as the information is clear and will save shareholders time in evaluating executive compensation. As the proposing release indicates, there is no clear evidence to confirm that the proposal accomplishes this objective.[8] The result is a disclosure requirement which will impart real costs on both investors and registrants alike, especially that the majority of large companies now meet directly with their largest investors on executive pay matters annually.[9]

In lieu of forcing the same technical disclosure requirement on registrants where it is clearly not feasible or useful to investors to do so, the Commission's goal should be to provide a

---

[8] *Id.*at 26,350, 26,351 ("Whether or not shareholders will be interested in the prescribed measures is unclear. For example, as discussed above, there are challenges associated with measuring an executive's contribution to registrant performance that may lead to concerns with any performance measure.").
[9] *See, e.g.,* Shearman & Sterling, *Compensation Governance 2014 Survey* (last viewed 7/2/2015), available at http://digital.shearman.com/i/387079-corporate-governance-2014 ("2014 was a year of shareholder engagement, with 62% of the Top 100 Companies describing their engagement process.")

disclosure which facilitates a clear description of a registrant's pay versus performance connection – a connection that different registrants will view differently. Such a disclosure would actually provide valuable information and assist investors in accomplishing the Commission's stated objectives for the disclosure. Further, such a disclosure could enhance and supplement the existing disclosure regime, even potentially replacing existing pay versus performance disclosures leading to more streamlined executive compensation disclosure. A principles-based rule, as this comment letter addresses in more detail elsewhere, would achieve just this sort of disclosure.

B. The Likelihood of Miscommunication Inherent in the Proposed Disclosure Will Compel Additional Remedial Supplementary Disclosure.

As detailed above, the proposed pay versus performance disclosure will, in the vast majority of cases, only provide an accurate representation of a registrant's pay versus performance connection in instances of complete happenstance. Except in such cases of serendipity, to the extent investors rely upon the proposed disclosure, the potential for misinformation and confusion is significant. This is highly likely to compel registrants to include additional remedial disclosure aimed at explaining why the proposed disclosure does not convey accurate information about a registrant's executive pay policies. The disclosure will most likely explain both why the disclosure misrepresents the registrant's pay versus performance connection as well as how, in reality, the registrant pay versus performance connection works. The consequences of not providing remedial disclosure are that investors and others will misconstrue the connection between a registrant's pay and performance – exactly the opposite of the intent of section 953(a). However, even if registrants make the supplemental disclosures as the Commission assumes, [10] the proposal relies on the far from certain hope that investors will appropriately take heed of any registrant efforts in an explanatory or remedial disclosure to otherwise explain misinformation communicated in the proposed disclosure

C. The Proposed Prescriptive Disclosure Puts the SEC's Stamp of Approval on Use of TSR, Contrary to Developing Practices, and Would Encourage a Focus on Short-Term TSR, Rather Than Long-Term Value Creation.

By requiring the proposed pay versus performance disclosure to compare "compensation actually paid" to company and peer group TSR, the Commission not only puts its stamp of approval on TSR as a performance metric, encouraging a short-term focus by companies, it also creates a bias that information within the proposed disclosure is useful and informative, likely creating greater investor confusion.

The endorsement of TSR as a sole performance metric provides a good example of how the proposed disclosure may skew pay packages and misinform investors. The disclosure may have the unintended – and undesirable -- consequence of driving companies to use TSR to define performance in their own incentive plans[11] even if TSR is not the best suited metric to drive the

[10] *Id.*at 26,351.
[11] *Id.*

company's strategy and goals. The Commission's endorsement of TSR as the *de facto* metric for performance runs counter to developing practice in which consultants, registrants, researchers and investors alike have questioned whether TSR is overused and whether companies should refocus their measurement of performance on financial metrics that are aligned to business strategy.

Recent research on consistently high-performing companies in the S&P 1500 indicates that almost a third of companies who outperform their peers on a long-term basis use return metrics such as return on invested capital or return on equity.[12] A study conducted by the Investor Responsibility Research Center Institute found that there is no "silver bullet" performance metric that all companies should use and suggested companies should "move away from a dominant use of TSR" in favor of metrics that better drive future value creation.[13]

Further, although many investors may use TSR as one measure of performance in comparing returns between portfolio companies, they do not typically require or endorse the sole use of TSR as a performance metric within company incentive plans.[14]

The Commission's focus on TSR as a performance metric is also likely to encourage registrants to focus on increasing short-term TSR rather than concentrating on performance metrics that drive long-term sustainable value. This approach runs counter to the preferences of investors that compensation be linked to long-term value creation.

The Commission's endorsement of a framework for pay for performance comparison may also create additional confusion for investors – especially less sophisticated investors. In many cases, these investors will be faced with a choice of whether to believe the Commission's mandated disclosure (the new table) and the fact that pay ought to be compared primarily to TSR, or registrants' supplemental explanatory disclosure seeking to mitigate the apparent lack of

---

[12] Melissa Costa and Todd Lippincott, *Enduring High-Performing Companies Take the Road Less Traveled in Executive Compensation Design*, Towers Watson Executive Compensation Bulletin, July 14, 2014, (last viewed 7/2/15), available at http://www.towerswatson.com/en-US/Insights/Newsletters/Global/executive-pay-matters/2014/Executive-Compensation-Bulletin-Enduring-High-Performing-Cos-Take-Road-Less-Traveled-in-Exec-Pay,

[13] Investor Responsibility Research Center, *The Alignment Gap Between Creating Value, Performance Measurement, and Long-Term Incentive Design*, at 65 (last viewed 7/2/15) available at http://irrcinstitute.org/pdf/alignment-gap-study.pdf.

[14] *See, e.g.*, Council of Institutional Investors, Corporate Governance Policies (last viewed 7/2/15) available at http://www.cii.org/corp_gov_policies#exec_comp ("Multiple performance measures should be used in an executive's incentive program, and the measures should be sufficiently diverse that they do not simply reward the executive multiple times for the same performance. The measures should be aligned with the company's short- and long-term strategic goals."); BlackRock, "Time to Rethink Executive Incentive Programs," (last viewed 7/2/15) available at http://www2.blackrock.com/content/groups/australiansite/documents/literature/rethink-exec-incentives.pdf ("There is also a growing trend for LTIs to become increasingly complex and to include measures that are not necessarily the most appropriate, such as the ubiquitous relative total shareholder return (RTSR) metric. We argue those trends hinder LTIs' effectiveness…BlackRock believes that the use of multiple performance measures in a long-term incentive plan will avoid focusing management on a single performance measure and hence, diversify risk."); Glass Lewis, 2015 Proxy Paper Guidelines (last viewed 7/2/2015), available at http://www.glasslewis.com/assets/uploads/2013/12/2015_GUIDELINES_United_States.pdf ("There is also a growing trend for LTIs to become increasingly complex and to include measures that are not necessarily the most appropriate, such as the ubiquitous relative total shareholder return (RTSR) metric. We argue those trends hinder LTIs' effectiveness.")

a connection between pay and TSR and broaden the analysis. Although the release states that registrants can provide supplemental disclosures to mitigate such confusion, there is a question regarding the extent to which investors will rely on the supplemental information.[15]

D. The XBRL Tagging of the Proposed Data Table Increases the Risk Investors Will Ignore Remedial Supplemental Disclosure.

The XBRL tagging requirement in the proposed rule increases the likelihood that investors will overlook non-XBRL-tagged supplementary disclosure provided by a registrant which is necessary to clarify misinformation communicated by the machine-readable data required by the proposed disclosure. It is a logical assumption that investors will prioritize the examination of XBRL data due to the ease and speed of processing, regardless of the quality of that data, given the ever-increasing volume of executive compensation disclosures as well as the number of shareholder and management proposals investors are required to research and vote upon on an annual basis.[16]

The Center believes the end goal of making executive compensation disclosure easier to process and analyze is a worthwhile and important objective. However, as proposed, the specific data points required to be tagged in XBRL format are highly unlikely to provide an accurate reflection of registrant pay versus performance and thus will only serve to mislead investors and detract from other relevant disclosure which accurately communicates a registrant's executive pay policies.

E. The Need for Remedial Supplemental Disclosure Will Unnecessarily Lengthen Already Lengthy Disclosures.

The Center believes that section 953(a) provides an opportunity for the Commission to help build upon the more robust company-developed disclosures that have emerged since the 2006 disclosure changes and the advent of say on pay. The Center is concerned, however, that the staff's goal of providing a disclosure that is comparable among companies will not result in clear or useful information about individual registrants, absent substantial additional disclosures. As Chair White[17] and others have warned in recent years, excessive disclosure substantially increases the risk that investors will choose to ignore the information altogether. Even the proposed release acknowledges that "whether or not shareholders will be interested in the prescribed measures is unclear"[18] and that the most likely source of costs to shareholders is if the proposed amendments "increase the length and complexity of existing disclosures without significantly adding to the ease of interpretation."[19]

[15] 80 Fed. Reg. at 26,351.
[16] See n. 17 infra and accompanying text.
[17] The Honorable Mary Jo White, "The Path Forward on Disclosure," Speech to 2013 National Association of Corporate Directors Leadership Conference, Oct. 15, 2013, last viewed at http://www.sec.gov/News/Speech/Detail/Speech/1370539878806#.Ul_7RHBwqtg, ("When disclosure gets to be "too much" or strays from its core purpose, it could lead to what some have called "information overload" – a phenomenon in which ever-increasing amounts of disclosure make it difficult for an investor to wade through the volume of information she receives to ferret out the information that is most relevant.)
[18] 80 Fed. Reg. at 26,351.
[19] *Id.* at 26,363.

The threat of information overload is real. The pay for performance rule is one of three new executive compensation-related rules mandated by Dodd-Frank, and one of four that will lengthen the proxy statement. According to Equilar, in proxy statements among the S&P 100, Compensation Discussion and Analysis (CD&A) word counts grew from 7,773 words in 2009 to 8,922 words in 2014 – a 14.7% increase.[20] With respect to more updated information, the Center estimates that among S&P 500 companies, CD&A disclosures have grown by 2.5 pages from January 2011 to May 2015, an increase of 13.9%. The forthcoming pay ratio disclosure will add to this growth, in some cases substantially, and the clawback policy disclosure in Section 954 will expand disclosures as well.

III. The Section 953(a) Pay for Performance Disclosure Should Be Principles-Based Rather Than Prescriptive.

The Center believes that the Commission would eliminate the harmful effects of its proposed prescriptive, mechanical and standardized approach to the 953(a) disclosure on investor understanding of the link between pay and performance if the Commission adopted a principles-based approach to the disclosure. A principles-based disclosure:

- Would provide company-specific information that could be structured to compare consistent time periods for pay and performance;
- Would not be misleading and thus would minimize the confusion that is likely to lead to substantial duplication of disclosure already provided in the CD&A if the proposal is adopted;
- Would not place the Commission's imprimatur on specific performance metrics or pay arrangements, since it would be up to each company to disclose the performance metrics used and the performance that resulted;
- Could be structured so that the time period for pay would match the time period for performance; and
- Is consistent with the language of section 953(a).

The Commission has used a principles-based approach to disclosure in the CD&A, and as that disclosure has evolved it has become much more responsive to the information investors find the most useful in the format that they find helpful. The following section discusses why the Center believes the pay for performance disclosure should be principles-based and how that disclosure should be framed.

A. The Statutory Language of Section 953(a) Favors a Principles-Based Disclosure Approach.

The language of Section 953(a) makes it clear that the focus of the disclosure should be a comparison of pay versus financial performance *generally,* not merely pay versus total shareholder return. This reinforces a principles-based approach to the disclosure. Section 953(a) reads in pertinent part:

[20] Equilar, *2015 Innovations in CD&A Design: A Proxy Disclosure Analysis,* Page 30 (Last Viewed 7/5/15).

> The Commission shall, by rule, require each issuer to disclose … a clear description of any compensation required to be disclosed by the issuer under section 229.402 of title 17, Code of Federal Regulations (or any successor thereto), *including information that shows the relationship between executive compensation actually paid and the financial performance of the issuer*, taking into account any change in the value of the shares of stock and dividends of the issuer and any distributions.

The language states that the "clear description" referenced in the statute should be focused on the link between compensation actually paid and financial performance, not merely total shareholder return. The Commission's interpretation reverses the statutory language and puts the emphasis on the last phrase rather than financial performance generally.

In addition, since most registrants use a variety of financial performance measures in annual and long-term incentives, which make up the majority of executive compensation for large companies, the best way to facilitate a complete description is to develop a comparison of compensation to the financial performance measures used by the company. Clearly TSR should be compared to performance where it is a financial performance measure. However, the language "taking into account any change in the value of shares of stock and dividends … and any distributions" could also be read to refer to the impact on stock-price based performance measures such as earnings per share of actions such as buybacks and the payment of dividends. This is an issue about which certain investors are increasingly expressing concern. The language on stock price could also be read as a check on the payout of compensation linked to financial metrics, as several large sophisticated shareholders have urged incentive payouts be limited to target pay when total shareholder return is negative.[21] As noted above, several stakeholders representing multiple perspectives have urged registrants to rely less heavily on TSR as a performance metric and more on financial metrics related to value creation.

B. The Section 953(a) Pay for Performance Disclosure Is a Logical Extension of the Principles-Based Disclosure Embedded in the Compensation Discussion and Analysis.

The Center agrees that the pay for performance disclosure is an opportunity to build on practices that have developed in light of the say on pay mandate. For this reason, the Center favors a principles-based approach to the disclosure mandated by 953(a) because it is a natural extension of the information registrants are already required to disclose and explain in the CD&A and allows for a more nuanced and meaningful disclosure. The CD&A was developed

[21] *See, e.g.*, BlackRock "Our Approach to Executive Compensation," (last viewed 7/2/2015), available at http://www.blackrock.com/corporate/en-us/literature/fact-sheet/blk-responsible-investment-approach-exec-comp.pdf ("We do not believe that arbitrary limits on potential compensation are necessarily in shareholders' best interests if those limits have the potential to cap performance. However, we expect compensation committees to ensure that incentive plans do not incentivize excessive risk taking beyond the company's determined risk appetite and that rewards are reasonable in light of returns to shareholders."); Joann Lublin, "A Tougher Stand on CEOs With Bad Returns," *The Wall Street Journal*, February 5, 2015 ("Keen to avoid investor outcry over executive pay, a growing number of U.S. companies are limiting the upside for top leaders in down years for stock prices by restricting certain compensation when total shareholder return is negative.")

"in light of the complexity of and variations in compensation programs,"[22] that had developed between 1993 and 2006. In the 2006 adopting release, the Staff cautioned that relying on a standardized tabular approach "resulted in too many cases in disclosure that does not inform investors adequately."[23] Thus, the CD&A was designed to discuss what the compensation program was designed to reward, explaining each element of compensation, why the company chose to pay each element in light of its objectives, and how the amount for each element was determined.[24] This approach also permitted flexibility not inherent in a table to allow the disclosure "to continue operating effectively as future forms of compensation develop."[25]

C. The Pay for Performance Disclosure Takes the Principles-Based Approach in the CD&A One Step Further to Explain "What Happened."

Similar to the rationale behind the CD&A, the flexibility of a principles-based approach is necessary to ensure that the information required to be disclosed under section 953(a) is clearly explained and thus more likely to be understood by investors. Just as the CD&A directs registrants to disclose the "what, how and why" behind the company's decisions in granting compensation, the pay for performance disclosure mandated by Section 953(a) represents an extension of this approach and should help investors understand ow granted pay actually paid out in light of the established performance objectives. Much of the background information necessary to understand "how it turned out" is already disclosed under the CD&A's principles-based approach, and the same flexibility given to registrants in describing the decisions in awarding pay should be afforded them in explaining pay that resulted from performance.

Taking a consistent approach to describing pay for performance allows companies to describe how the structure and time frame of pay related to the period for performance in light of the business strategy and other performance the compensation committee sought to drive. The approach avoids forcing companies' customized pay programs into the box of a tabular disclosure that is likely to result in incomplete information or, even worse, misleading information that itself will require narrative disclosure to explain. Our Subscribers strongly believe that the prescribed narrative disclosure will simply repeat much of the disclosure already in the CD&A. A principles-based approach also avoids a mandated "boilerplate" disclosure, something the Commission has historically sought to avoid.[26]

D. The Experience With the Summary Compensation Table Illustrates the Shortcomings of Implementing a Standardized, Prescriptive Pay for Performance Table.

The proposed pay versus performance table seeks to achieve comparability among companies using accounting-based measures for equity and retirement pay and a singular

---

[22] Executive Compensation and Related Persons Disclosure, 71 FR 53158, 53160 (Sept. 08, 2006) (codified at 17 CFR Parts 228, 229, 232, 239, 240,245, 249 and 274).
[23] *Id*.
[24] *Id.* at 53,164.
[25] *Id.* at 53,160.
[26] *Id.* at 53,165. *See also* The Honorable Mary Jo White, "The Importance of Independence," A.A. Sommer, Jr. Corporate Securities and Financial Law Lecture, Fordham Law School, SEC.gov, Oct. 3, 2013, http://www.sec.gov/News/Speech/Detail/Speech/1370539864016#.Upn_TsTrzbw, (Last Visited July 5, 2015).

measure of performance – TSR. However, the experience with the use of the Summary Compensation Table illustrates why a prescriptive, mandated table is likely to create more confusion and unlikely to create the easy comparability sought by the Commission because substantial supplemental disclosure will be required to put the information disclosed in the table into context.

Since its revision in 2009, the Summary Compensation Table has provided an accounting expense-based comparable view of what a compensation committee intended to pay based on short-term compensation actually paid and the current value of long-term equity grants based upon equity valuation methodologies. While this accounting-expense-based view has been useful for investors in understanding the compensation committee's intent and comparing granted pay between companies, it has not been useful in comparing pay and performance.

- **Mixes Compensation Granted With Compensation Earned**. The key objection to using the Summary Compensation Table definition of pay when evaluating pay versus performance is that it reflects a mix of pay already earned (salary, bonus, non-equity incentives) and the accounting expense estimate of future potential pay from granted equity such as performance shares, restricted stock and stock options. Thus, while the Summary Compensation Table provides helpful information regarding the expense associated with the compensation committee's intended level of pay, the Summary Compensation Table definition is not as useful to investors in assessing pay for performance.
- **Uses Inconsistent Time Frames for Pay and Performance**. The Summary Compensation Table definition of total pay reflects the accounting expense estimate of equity granted in the first quarter of the fiscal year, which is then typically compared by investors and proxy advisory firms to company performance measured at the end of that fiscal year. Since the compensation committee could have had no idea of what year-end performance would be when it granted the equity award, comparing the grant-date value of the award to year-end performance does not enable investors to accurately assess the alignment of pay and performance. More importantly, stock awards are valued as of the grant date, which creates other timing mismatches that make it difficult for investors to align the time period for pay with the time period for performance by using the Summary Compensation Table data. For example, if a restricted stock grant is made in February 2015 with one-third vesting in each of the subsequent three years, the value of the restricted stock is determined in February, but proxy advisory firms attempt to compare that value to TSR as of year-end. The proposed pay for performance table duplicates the error, except that it would compare the value of stock that vested in February of 2016, for example, to TSR as of the end of that year.
- **Includes Non-Performance-Based Elements**. The Summary Compensation Table includes non-performance-based pay elements such as the present value of actuarial increases in pension value, which fluctuate based on changes in the executive's age and interest rate, are not within the control of either the compensation committee or the executive and are not actually paid to the executive at any point during the year.

Because of these shortcomings of the Summary Compensation Table, companies have devoted significant time and effort to developing clearer explanations of the link between pay and performance, including through the use of supplemental pay for performance charts and disclosures, especially realized pay[27] and realizable pay.[28] Registrants have focused on defining pay in a way that is consistent and then comparing it to financial and/or stock price performance over the time period that makes sense for their particular situations, rather than focusing on the accounting value of the awards.

A key feature of realized and realizable pay disclosures is the flexibility they allow companies in describing how pay and performance are aligned in a way that is accurate and appropriate for each company and thus more understandable for investors. Companies are able to provide a comparison and explanation of pay and performance over a time period that is consistent with the period during which the pay was earned. By contrast, the prescriptive, standardized approach proposed by the Commission does not link the time frames for pay and performance. The supplemental pay disclosures provide a more accurate picture of how the incentive plans function and the relationship between pay and performance and thus would be more useful to investors than a standardized, prescriptive table that requires substantial narrative disclosure to correct and explain.

E. The Commission Should Implement Section 953(a) Utilizing a Principles-Based Approach.

Recognizing the shortcomings of the proposed disclosure, in the final rule, the Center strongly urges the Commission to adopt a principles-based approach to the pay versus performance disclosure. Under a principles-based approach, the Commission can provide guidelines with regard to required elements of the disclosure while still permitting companies to craft the disclosure in a way which properly reflects a registrant’s pay versus performance connection and therefore provides more useful information to investors.

The Center recommends that a principles-based approach consist of a disclosure of each element of pay realized for the year in question, compared to both the performance metrics that generated the pay over the period during which the element was outstanding and the total shareholder return over that period,[29] with cross references to the CD&A and additional narrative as necessary to explain the pay for performance connection. For stock option exercises, the company would report the gain on the option over the period it was outstanding for the PEO and the stock gains realized by investors over that same period. As discussed above, the Center

[27] “Realized pay” disclosures compare all pay actually received during the performance period (cash compensation and performance shares actually earned, the value of restricted shares vested and the gain from the exercise of stock options during the period) on an element-by-element basis with the performance that drove it.
[28] “Realizable pay” disclosures compare aggregate pay over a three-year period to total shareholder return, measured over the same period. Realizable pay typically includes all cash compensation, the value of performance shares earned during the period (with performance shares valued as of the end of the period), and the intrinsic value of options and restricted stock granted during the period (also valued as of the end of the period). While a significant portion of realizable pay will be actually paid at a later date and may vary in value before that time, the use of realizable pay allows companies to show how pay varies with stock price over time, reflecting alignment with shareholders.
[29] For example, if a long-term incentive was outstanding for three years, performance and total shareholder return would also be compared over three years.

believes that pension costs should be excluded from the analysis, as should amounts falling under the "all other compensation" column of the Summary Compensation Table, which are not performance-based. The statutory text of Dodd Frank section 953(a) provides the SEC with wide latitude to construct definitions of compensation actually paid and company performance to properly implement a principles-based approach.

A principles-based approach carries many advantages that outweigh the prescriptive approach in the proposed rules, including:

- Enhanced investor information that would assist investors in say on pay voting, other compensation-related votes, and director votes.
- Increased efficiency compared to the proposed approach because it would reduce duplicative additional disclosure needed to explain the amounts in the tables, which will only be clear or accurate when paired with supplementary disclosures.
- Avoidance of the potential for gaming or short-termism where vesting dates may be shortened to align with shorter-term TSR instead of focusing on long-term value creation.

Additionally, as noted above, the use of a principles-based approach would make the pay versus performance disclosure consistent with the principles-based approach already endorsed by the Commission in the CD&A, and would better streamline disclosure requirements by providing structure to pay versus performance disclosures while eliminating excess prescriptive disclosures which investors would not find useful.

IV. The Commission's Definition of Compensation "Actually Paid" Will Confuse Investors About the Link Between Pay and Performance.

If the Commission decides to retain the prescriptive, standardized approach it proposed in the final rule, the Center has several recommendations to improve upon the approach, recognizing that the Center believes a principles-based approach is the better approach. Our comments focus on the definition of compensation actually paid, the use and time frame for disclosure of registrant TSR, the disclosure of peer group TSR, the disclosure of average named executive officer pay, and the repetition of Summary Compensation Table pay.

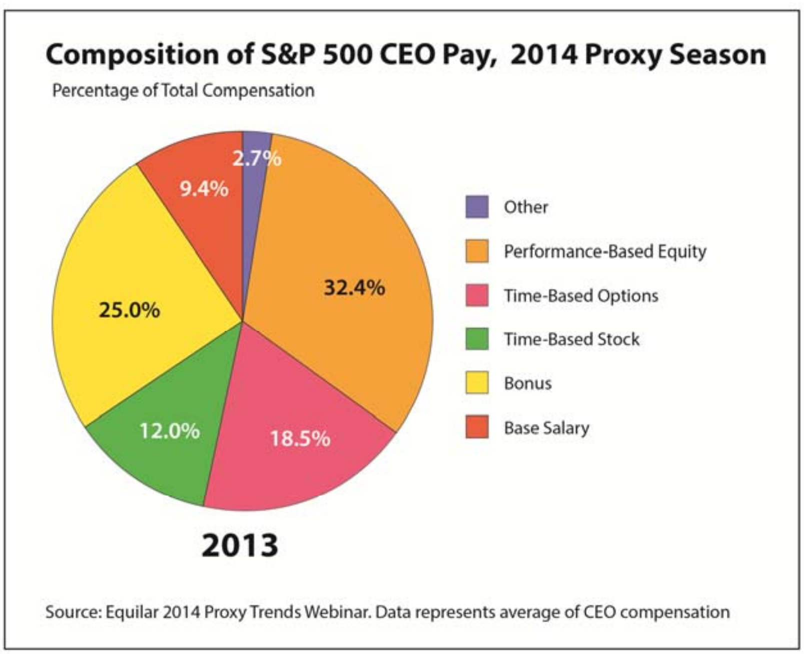
The proposed rule's definition of "compensation actually paid" is premised on accounting definitions of pay, even though the primary purpose of the disclosure is to compare pay and performance. Thus, similar to the Summary Compensation Table, the Commission's definition combines pay received, accounting estimates of pay, and potential pay that may never be received. As a result, the approach adopted by the Commission will provide incomplete information required for a full pay for performance assessment and will lead to further confusion on the part of shareholders.

To require companies to label the proposed table's mix of actual, potential and estimated pay as "actually paid" is fundamentally misleading for the purposes of comparing pay and performance. This is especially the case when it comes to the treatment of stock options and pensions and is likely to cause significant misperceptions by shareholders and other readers of the proxy who are likely to take the "actually paid" description at face value. If the Commission determines not to follow a principles-based approach to the pay for performance disclosure in section 14(i) as discussed above, the Center believes the best approach is for stock options to be valued using the intrinsic value (the spread between the exercise price and the market price) on the vesting date and for pension value to be excluded from the proposed table altogether and discussed in supplemental disclosures.

A. Existing Data Demonstrates Why the Most Representative Valuation of Long-term Incentives Is Essential for a Reasonable Pay for Performance Assessment.

Data on the composition of CEO pay packages demonstrates why establishing the most representative definition of "compensation actually paid," with a particular focus on the treatment of equity, is instrumental to developing a clear disclosure of section 953(a). According to Equilar, among S&P 500 CEOs, nearly two-thirds of average compensation (62.5%) is composed of long-term incentives, with another 25 percent composed of annual incentives. Stock options alone comprise 30% of average long-term incentives and 20% of total compensation. It is therefore important that all equity vehicles be valued consistently and in a way that provides the clearest view of pay for performance.

Consistent with the Commission's rationale that "compensation actually paid" should be defined differently than the valuation used for the Summary Compensation Table, the Center believes that the most logical approach in valuing equity compensation is to use the value realized by executives upon vesting of performance shares and restricted stock and the exercise of stock options. This makes the disclosure consistent with the existing "Option Exercises and Stock Vested" table. The approach also allows compensation realized from all equity awards to be compared to the time period during which those award were outstanding, providing a more logical and clearer linkage of pay and performance.



B. Proposed Definition of "Compensation Actually Paid" Unnecessarily Adds a Third Disclosed Valuation for Stock Options.

The Commission proposes to determine the value of "compensation actually paid" for stock options by updating the fair value estimate of options vested during the year using an option valuation method such as Black-Scholes (an estimate of the present value of future potential payouts from option exercises) as of the vesting date. Not only does this approach add a third valuation for options to company executive compensation disclosures, it contradicts the rationale the Commission has given for valuing stock options at the vesting date.

i. Compensation Realized From Option Exercises Provides Clearest Picture of Pay for Performance.

Under a principles-based approach, stock options should be valued using the amount realized to the executive when the options are exercised (*i.e.*, the difference between the market price and the exercise price). This approach represents the compensation value to the executive and can be compared to total shareholder return over the period the options were outstanding. It is also consistent with the "Option Exercises and Stock Vested" table already in company disclosures.

ii. If Using the Vesting Date, Options Should Be Valued Using the Spread Between the Strike Price and Market Price.

If the Commission decides to use a vesting date[30] approach to options valuation, it should use the difference between the market price and the strike price (also called the "intrinsic value") on the vesting date, rather than a fair value estimate. Fair value option valuation methodologies such as Black-Scholes or the binomial method are financial models used for the purpose of developing an estimate of the company's accounting expense, which is already provided in the Summary Compensation Table. However, these models are not appropriate when determining the link between pay and performance with respect to a particular executive and their use may result in several anomalies.

For example, at the date of vesting, an option may be under water – that is, the strike price is more than the current market price, meaning the option may not be exercised. The intrinsic value of the option to the executive for that fiscal year is zero. However, if a Black-Scholes valuation is conducted to estimate the value of the option over its remaining expected life, this may result in a number much greater than zero. In this case, how can an estimate of the future potential value of the option be described as "compensation actually paid?" The estimated grant-date

[30] Compensation committees use vesting periods to fulfill a variety of purposes depending on the award vehicle. For performance shares, which vest based on achievement of specified performance objectives set at the beginning of the performance period, the vesting schedule represents the period over which the company measures performance and aligns with long-term strategic goals. A focus on long-term performance prevents companies from succumbing to "short-termism" and contributes to the economic health of the companies themselves and the economy as a whole. For restricted stock or options, the values of which are tied to stock price, vesting periods are used to retain key talent within the organization by tying their compensation to their continuing to work for and support company goals. Stock options are most likely to vest ratably over a period (e.g., with one-third vesting each year over three years; or 25% vesting each year over four years). Restricted stock is more likely to vest at the end of a longer term, *e.g.*, three years, to reflect its retentive purpose. Executives are incented to make decisions that will increase long-term shareholder value, since leaving the company prematurely would typically result in forfeiture of unvested awards.

value of the option has already been disclosed in the Summary Compensation Table as of grant; when the option is exercised, any actual gains experienced by the executive will be disclosed in the Options Exercise and Stock Vested Table. To add yet another estimated value of the option, this time at vesting date, serves no clear purpose.

iii. The Proposing Release Contradicts the Fair Value Approach.

The Commission itself has provided an equally persuasive rationale in the proposing release for why stock options should be valued using an intrinsic value approach at vesting. The proposing release states that "changes in the fair value of the award after vesting reflect investment decisions made by the executive rather than compensation decisions made by the registrant."[31] Since option pricing models, such as Black Scholes and binomial models, represent estimates of the present value of the future potential payouts of options, they measure the compensation *and* the investment value of the awards. Thus, if "compensation actually paid" is determined at the vesting date, and the SEC believes the decision of when to exercise an option is an investment decision, then the residual compensatory element during the remaining term of the option is both irrelevant and inconsistent.[32] This reinforces that under the Commission's approach, options should be valued using the spread as of the vesting date.

C. Consider Compensation "Actually Paid" Only When Restrictions on Compensation Lapse.

The Commission has asked for input on when certain types of compensation should be considered actually paid, including stock options that have vested but are not yet exercisable and other compensation amounts such as salary or short- or long-term incentives subject to a mandatory deferral or vesting period. The Center believes that these amounts should be considered actually paid only when the restrictions on them lapse. Thus, the Center believes that stock options that have vested but are not exercisable due to post-vesting restrictions should only be considered "actually paid" based on the intrinsic value when the post-vesting restrictions lapse. The same concept would apply to portions of annual or long-term cash incentives subject to mandatory deferral, for example as part of a risk mitigation strategy. This aligns the concept of "compensation actually paid" with how awards are treated in practice.

D. Proposed Valuation of Pension Amounts Is Not "Compensation Actually Paid."

The Center agrees with the exclusion of the change in actuarial present value of defined benefit and pension plans from the pay for performance disclosure; however, the inclusion of actuarially determined service costs for pension participants is also problematic in that it does not constitute compensation "actually paid." Until the pension benefit is vested, it is forfeitable by the participant at termination from the company. In addition, although the Commission specifies that it believes the phrase "executive compensation actually paid" should include all compensation actually paid regardless of whether it is based on financial performance, the inclusion of elements of pay that are not tied to achievement of performance objectives and are

[31] 80 Fed. Reg. at 26,339.
[32] Moreover, the intrinsic value is already used to determine the value of options for other disclosure purposes, including the value of accelerated vesting of awards disclosure regarding potential payments upon termination or change in control. Regulation S-K §402(j).

outside of the control of the compensation committee or the executive does not make sense in the context of a pay for performance disclosure.

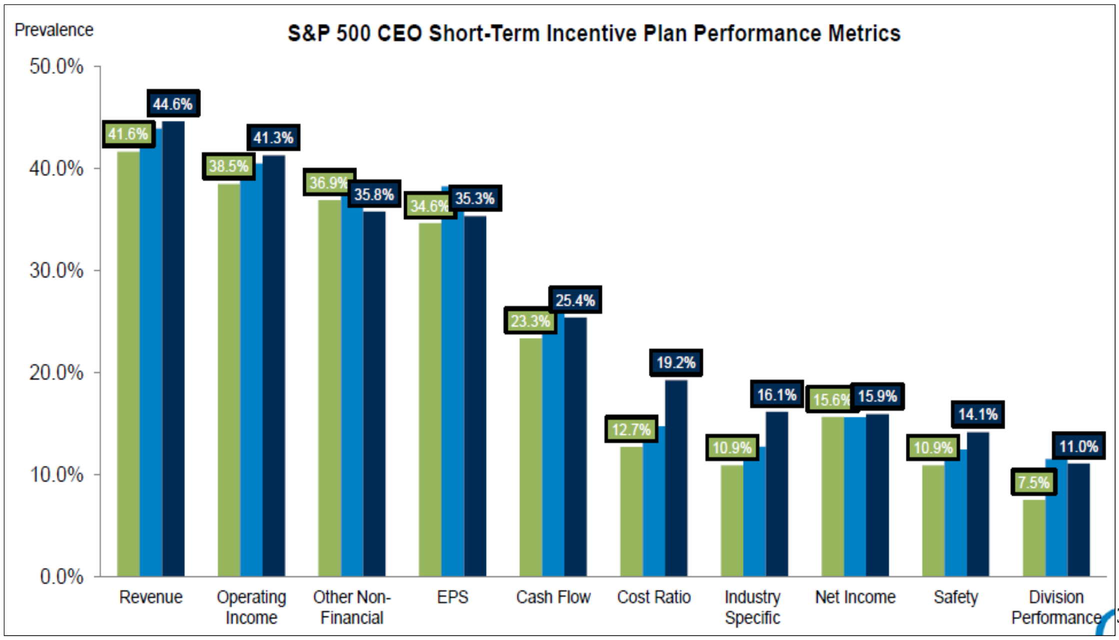
V. Performance Should Be Measured Using the Metrics That Drove Compensation and Should Not Be Limited Exclusively to Total Shareholder Return.

The proposed rule requires that companies define "performance" within the context of the pay for performance disclosure as total shareholder return (TSR). However, since the majority of CEO compensation for large companies is now in the form of incentive compensation and the majority of that is granted in performance shares that are driven by performance metrics, performance under the proposed rule should be defined as the performance that drove the pay.[33]

A. Most Companies Use Several Performance Metrics Designed to Drive Long- and Short-Term Business Strategy.

Companies use a variety of performance metrics for measuring annual and long-term performance. Among S&P 500 CEOs, the most common annual incentive metrics are revenue (45%) and operating income (41%), while the most common long-term incentive metrics are relative TSR (58%), EPS (27%) and return on capital or invested capital (18%).

[33] Compensation committees select different forms of equity when granting those incentives, based on the strategy of the company and the desired behavior the award is intended to incent. For S&P 500 CEOs, an average of about 50% of long-term incentives are granted in performance-based equity, which only vest if pre-established goals are achieved; 30% is granted in stock options and 20% granted in time-based restricted stock, which is stock that vests contingent on the executive's continued employment with the company, helping to retain that executive's skill set and talent within the company. For performance-based equity, the vesting period for each equity grant typically corresponds with the performance period over which the executive is measured; for most companies, this is three years (Fred Cook 2014 Top 250 Report, last visited 7/5/2015, http://www.fwcook.com/alert_letters/The_2014_Top_250_Report_Long-Incentive_Grant_Practices_for_Executives.pdf). Three years reflects the period of time over which most companies feel they can reasonably forecast performance and set appropriate goals; it is also a time period commonly used by investors when reviewing company performance.



[34]

[35]

It is important to note that although relative TSR has become a very common long-term metric in CEO pay plans, it is by no means used by all companies and even among companies that do use it, it is usually combined with other metrics that measure the operational or financial performance of the company. Among the S&P 1500, for example, 72% of companies use two metrics including TSR; the most common other metrics are EPS (24%) and Return on Capital or Invested Capital (22%).[36]

Where TSR is used in incentive plans, the way in which it is used differs greatly between companies. The majority (81%) of S&P 1500 companies use TSR as a metric within the plan, so that all or a portion of the incentive vests based on achievement of a pre-established TSR goal. However, 19% of companies use TSR as a modifier, either instead of or in addition to using it as a performance metric, where the award itself is earned based on achievement of operational or financial goals that support company strategy, but the final payout amount is adjusted up or down depending on TSR. As a third option, 14% of companies use TSR as a "circuit breaker," where even if company goals are achieved, incentives may not pay out unless a certain level of TSR is also achieved, thus ensuring that management does not receive a payout if shareholders are not similarly rewarded.[37] As noted above, a variety of stakeholders have recently criticized the overreliance on the use of TSR as a performance metric.[38]

[34] See Setting a High Bar What Does Incentive Plan Rigor Look Like, Equilar Webinar, available at https://www.youtube.com/watch?v=JS_TJsXmajk (last visited 7/2/2015)
[35] *Id.*
[36] Towers Watson 2015 Proxy Webcast, available at https://twmeetingcenter.webex.com/twmeetingcenter/lsr.php?RCID=0831908c9ece48bba794f7bc458b1f57 (last visited 7/2/2015);
[37] Towers Watson 2014 Proxy Webcast, available at http://www.media-server.com/m/p/m6xmuc7y (last visited 7/2/2015)
[38] See the discussion on Pages 7-8 above.

B. Performance Period for TSR in New Table Will Not Align With Period for Compensation Actually Paid.

More problematic even than the narrowness with which performance is defined in the proposed rule is the lack of alignment between the performance periods that are to be compared to annual "compensation actually paid." The proposed table calls for companies to compare five separate years of pay to five different lengths of cumulative TSR performance, resulting in a very confused and disjointed pay analysis.

For example, 2015 pay will be compared to five-year cumulative TSR; 2014 pay will be compared to four-year cumulative TSR; 2013 pay to three-year cumulative TSR and so on. For most employers, each year of pay will be a combination of cash and incentive awards with varying performance periods; annual incentives are typically based on one year of performance while long-term incentives are commonly based on between one and three years of performance, depending on when the vehicle vests. There does not seem to be a clear reason, then, for comparing the most recent year of pay to five-year performance and the least recent year of pay to one-year performance, when this does not reflect the performance periods of the awards that drove the pay vesting in a given year.

The comparison becomes even more complex because most companies grant time-vested equity in the first quarter of the year and it vests three years later in the first quarter of the year. Thus, the comparison of the vesting date value of restricted stock which vests, for example, in March, to cumulative TSR as of December 31 of that year will not necessarily match, as the stock price is likely to have changed since March.

In crafting the proposed release, it appears that the Commission, in an effort to reduce the imposition of new compliance burdens on companies, reused the information included in the stock performance graph. Unfortunately, the stock performance graph was never intended to compare pay and performance, only to show company performance by itself over time compared to a peer group or to an index. The inclusion of an annual figure of compensation actually paid, without modifying the TSR performance periods to be consistent over the five year period, renders the table essentially unusable.

C. Replace the Disclosure of Total Shareholder Return From the Performance Graph With a Rolling Three-Year TSR.

If the Commission decides to retain its prescriptive disclosure approach, the Center recommends that the final release replace the current formulation of TSR with a rolling three-year TSR for each of the five years disclosed in the proposed pay versus performance table. Roughly 60% of executive compensation is composed of long-term incentives and the majority of those awards vest over three years. Therefore, using three-year rolling TSR would provide the most relevant performance period for comparing "compensation actually paid." The approach is also consistent with the approach many investors currently take, as well as the period ISS uses for its relative degree of alignment test.

VI. Eliminate the Comparison of Compensation Actually Paid with Peer Group TSR.

The Center recommends that the comparison of company TSR to peer group TSR be eliminated in the final release. The inclusion of peer group TSR is not mandated by the statute and the comparison of company TSR and peer group TSR will not provide useful insight into the relationship between compensation actually paid and the company's performance. The disclosure is both duplicative and confusing.

Where companies use relative TSR as a performance metric or modifier, they are already required to disclose and explain how TSR is used, as well as the performance and the pay that resulted (including how the company compared to peer TSR when the metric is relative TSR). However, comparing company TSR to peer group TSR within the pay for performance disclosure will lead to little insight for investors because in many cases there will be no relationship between the two or there may be unlimited reasons why alignment does or does not occur unrelated to performance. In addition, the relationship may depend in large part on how well the company had been performing at the start of the five year period relative to peers, since performance tends to regress to the mean.

VII. The Disclosure of Compensation Information for Non-PEO NEOs Does Not Provide Useful or Beneficial Information for Evaluating Pay Versus Performance.

As proposed, registrants will be required to include the Summary Compensation Table and compensation "actually paid" value for both a registrant's principal executive officer (the CEO) as well as the average of the remaining named executive officers (the "NEOs"). However, providing disclosure on the compensation of the NEOs other than the CEO does not provide useful or beneficial information for evaluating a registrant's pay versus performance connection.

In executive compensation disclosure, for the purpose of evaluating the connection between registrant pay and performance there is an almost exclusive reliance on the comparison of CEO compensation and performance. The compensation of a registrant's CEO is viewed as being representative of the registrant's executive pay policies and "sets the tone" as to how the registrant approaches executive pay.

When NEO compensation is discussed, it is typically in the context of a comparison, usually as a ratio, to CEO pay.[39] This comparison is viewed as providing an important barometer on the registrant's corporate governance and succession planning practices, with a higher ratio viewed as potentially concerning. It is worth noting that this comparison is most ideally served through the Summary Compensation Table disclosure. The Summary Compensation Table disclosure shows the intent of a registrant's compensation committee in granting pay to each executive through an expense lens – how much the company intends to pay for the services of each individual executive role. This lens provides the most accurate viewpoint as to how the board views each executive compared to their peers and as part of the overall talent pipeline.

In addition to not adding value to the comparison of registrant pay versus performance, the proposed rules' use of the average of NEO compensation is problematic. The Commission's

---

[39] Institutional Shareholder Services (ISS), the largest proxy advisory firm, considers excessive internal pay disparity between a CEO and other NEOs a problematic practice. See http://www.issgovernance.com/file/policy/2015-us-comp-faqs.pdf at page 29 (last visited 7/2/2015).

decision to require an average of non-CEO NEO compensation was based on the premise that an average would prevent large fluctuations in the disclosed NEO compensation figure resulting from turnover and changes among the roster of a registrant's top five executives.[40] However, by doing so, the proposed rule creates an irrelevant number for the purposes of evaluating the link between a registrant's pay and its performance.

A registrant's compensation committee determines the compensation structure and level for each NEO individually in hopes of incentivizing the accomplishment of specific business objectives which drive shareholder value. By averaging the compensation of the NEOs, the proposed rule ignores this decision-making process and creates what essentially amounts to a random compensation number which may not reflect the intended or actual pay, actual role or expected individual contribution of any NEO. This number will then be compared to company performance as being reflective of the company's executive pay policies, creating high potential for misunderstanding and confusion.

The problems resulting from the use of average NEO compensation are compounded by frequent turnover and changes in the roster of NEOs. Rather than smoothing the compensation amount, the use of the average will attribute awards, such as non-performance-based "make-whole" awards intended to replace lost compensation for newly joining executives, intended for a single NEO to all NEOs. As a result, the hiring of one executive has the potential to significantly over-inflate the compensation attributed to all NEOs. This inflated average will then be taken at face value as being representative of a registrant's pay versus performance connection.

We recommend the Commission expressly limit the disclosure to only a registrant's PEO. This would create the most streamlined disclosure and lower the potential for confusion stemming from the inclusion of other NEOs. Furthermore, as detailed above, it is the PEO's compensation figure which is used almost exclusively to evaluate registrant pay and performance. Notably, the statutory text of Section 953(a) does not prescribe an executive population required to be in the disclosure. The Commission therefore has wide latitude to implement the disclosure as we have suggested. The compensation of NEOs would still be included in the Summary Compensation Table and likely other locations in the CD&A.

In the alternative, we would recommend that the Commission require only a registrant's Chief Financial Officer be included in the disclosure. A registrant's CFO is the most commonly compared compensation package to that of the registrant's CEO. Further, the CFO is a required disclosure in the Summary Compensation Table and is disclosed each year, as is the CEO, therefore addressing the Commission's concern regarding volatility of pay for NEOs.

If the Commission chooses to adopt the rule as proposed, clarification is needed with regard to how to calculate the compensation of an individual who serves both as a non-PEO Named Executive Officer and the PEO during a given year. As written, the proposed rule seems to result in a situation where that individual's pay may be counted twice for the purpose of creating the required disclosure. The double counting of an individual's pay cannot further the purpose of the disclosure.

[40] 80 Fed. Reg. at 26,336.

VIII. The Inclusion of Summary Compensation Table Pay in the Proposed Tabular Disclosure Will Detract from the Pay Versus Performance Analysis.

In the proposed rule, the Commission requires the Summary Compensation Table pay value be included in the proposed tabular disclosure. We recommend that the Commission remove this requirement from the final rule as the Summary Compensation Table does not provide a legitimate comparison for the purpose of evaluating registrant pay versus performance.

As detailed above, the Summary Compensation Table is inadequate for evaluating the connection between registrant pay and performance because it reflects a mix of pay already earned (salary, bonus, non-equity incentives) and the accounting expense of equity-based pay which may potentially be earned, but which is contingent on future company or individual performance and stock price appreciation and thus may never be realized.

Furthermore, the equity value represented in a specific year within the Summary Compensation Table represents the value of that equity as of the grant date. This is a stark contrast to executive compensation "actually paid" which is calculated by summing together cash and bonus compensation earned during the given year with the vesting date fair value of equity awards granted in different years, along with a recalculated pension value based on service costs. The differences render any comparison between the two compensation figures akin to comparing apples to oranges.

As a practical matter, the Summary Compensation Table value is already included in the proxy statement and creating another duplicative disclosure, particularly when it adds little to no value, is unnecessary and unhelpful. Additionally, the statutory text of Section 953(a) does not prescribe the inclusion of Summary Compensation Table pay, meaning that the Commission is under no obligation to include it in the pay versus performance disclosure requirement.

IX. Conclusion

The Center appreciates this opportunity to provide additional comments on the implementation and rulemaking related to Section 953(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act. If you have any questions about the Center's comments, please do not hesitate to contact me at [redacted].

Sincerely,

Timothy J. Bartl

Timothy J. Bartl
President, Center On Executive Compensation

cc: Securities and Exchange Commission:
Hon. Mary Jo White, Chair
Hon. Luis A. Aguilar, Commissioner

Hon. Daniel Gallagher, Commissioner
Hon. Kara M. Stein, Commissioner
Hon. Michael S. Piwowar, Commissioner