December 2, 2013

Ms. Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F St. NE
Washington, DC 20549-1090

Uploaded to: http://www.sec.gov/rules/proposed.shtml

Dear Ms. Murphy:

Re: **File No. S7-07-13 Release No. 33-9452 Pay Ratio Disclosure**

We are writing in response to the Securities and Exchange Commission (SEC) request for comments on its proposed rule for pay ratio disclosure (File No. S7-07-13 Release No.33-9452).[1] NEI Investments commends the SEC for its continuing efforts to enhance corporate governance practice and disclosure.

As a Canadian investment management company with approximately C$5.5 billion in assets under management, NEI Investments' approach to investing incorporates the thesis that companies integrating best environmental, social and governance (ESG) practices into their strategy and operations will build long-term sustainable value for all stakeholders and provide higher risk-adjusted returns to shareholders. We participate in this consultation as a Canadian investor with holdings in U.S. listed companies. As part of our program of corporate engagement, we provide feedback and undertake dialogue on compensation disclosure and practice at both Canadian and U.S. issuers in our holdings, including on the issues of excessive compensation quantum and compensation inequity within companies and in the economy as a whole.

In the following pages we respond to Question 60 of the release, which requests comment on alternatives to the SEC proposals, and Question 65, which requests comment on impact for investors. We outline the following:

- the issues we seek to address, and outcomes we hope to achieve, through engagement on equitable compensation;
- the types of disclosure that enable us to assess how companies are addressing the issue of equitable compensation;
- corporate engagement program activity with Canadian banks relating to equitable compensation, which may be relevant for the SEC's research and deliberations in the coming year.

[1] Securities and Exchange Commission (2013). *Pay Ratio Disclosure – Proposed Rule.* http://www.sec.gov/rules/proposed/2013/33-9452.pdf

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Comments

Equitable compensation: issues and outcomes

As an investment institution, we are concerned that excessively high executive compensation at the companies in our holdings could impact their performance.

Compensation disclosure in proxy circulars suggests that in setting the quantum, most companies rely heavily on horizontal comparisons with the pay of executives at peer companies. Experience over the past few decades suggests that this drives pay in an upward spiral, because all companies tend to increase pay every time a company compensates above the median for the group. Emerging research has encouraged us to question conventional wisdom about the competitive necessity of this model.[2] We query whether very high quantum of pay is the most effective way to motivate and retain talented, committed executives of high integrity, and seek to understand at what point increasing the quantum of pay becomes redundant or leads to diminishing returns.

We are concerned about the impact on organization-wide productivity and team cohesion at companies where the pay of top executives is rising much faster than that of other employees. We believe it is important to explore how high quantum executive compensation and increasing disparity between levels within the company affects employee retention, motivation and performance overall.

Finally, we are concerned that high pay is contributing to greater income inequality. There is widespread consensus among experts that income inequality not only has negative social consequences, but also harms the economy over the long term. The World Economic Forum identifies it as a top global risk with a potential to contribute to systemic financial failure. Canada, like most of its peers, is experiencing growing income inequality. Most of the income of the wealthiest Canadians is now derived from compensation, rather than other sources. This creates a link between income inequality and compensation quantum decisions. We recognize that compensation quantum is just one element in a complex of issues contributing to income inequality - but it is one that shareholders have influence over through “Say on Pay” votes. If income inequality generates systemic risk that could impact all companies in the economy, then institutional investors with holdings across the economy have a duty to respond.

Disclosure on equitable compensation

Disclosure about a company’s approach to avoiding excessive executive compensation quantum and ensuring equitable compensation is useful for our decision-making. We are already integrating such disclosure, where it is provided, into our compensation proxy voting decisions and our targeting of companies for follow-up engagement.

Alongside any pay ratio disclosure, companies should be encouraged to provide disclosure that allows shareholders to understand the role that the board and compensation committee play in oversight of compensation across the company, and what efforts are being made to ensure that executive compensation is perceived as reasonable and equitable by employees at other levels in the company, and by external stakeholders. Such disclosure would be welcome in advance of implementation of the pay ratio provision.

[2] See, for example: Charles M. Elson and Craig K. Ferrere. *Executive Superstars, Peer Groups and Over-Compensation – Cause, Effect and Solution.* IRRC Institute, 2012, http://irrcinstitute.org/projects.php?project=60

Increasingly, we are looking for evidence in the proxy circular as to whether the compensation committee is solely focused on setting executive compensation, or is undertaking oversight of human resources questions across the company, including strategy on equitable pay.

From our perspective, for the CEO-to-median worker pay ratio metric to provide real insight for investors, it is essential that companies should provide context on factors that influence the figure, including general levels of pay in the sector, the way the company is structured, and the extent to which it has operations in higher or lower pay jurisdictions.

Other metrics of potential interest for understanding pay equity within the company could include:

- The rate of increase in pay of senior executives compared to other workers (a metric that is being disclosed by companies in our U.K. holdings).
- The maximum ratio of pay differential between succeeding levels in the company's management hierarchy.
- Comparison of the pay of senior executives to pay at another level that is considered particularly significant in the context of the company, with explanation of why the metric has been chosen.
- Caps on executive pay based on a multiple of a pay metric that is considered significant in the context of the company, with explanation of why the metric has been chosen.

Another disclosure of interest is the extent to which all employees share the benefit when a company achieves good performance against the scorecard of metrics that generate bonuses for executives.

In considering whether a company is creating an environment of fairness that supports motivation, pay is not the only factor. We are interested in efforts to reduce disparity in benefits and perquisites, including medical plans and pension plans. We recognize that senior staff will inevitably be paid more than junior staff, and that strong perceptions of unfairness could also be created by providing significantly more generous benefits to those most able to pay for themselves. This issue is being explored by a number of companies with which we have undertaken dialogue.

Disclosure on equitable pay is emerging, but rare. This represents an important gap in investor-facing executive compensation reporting. Under current disclosure requirements, employees within the company are able to assess for themselves how executive pay and benefits differ from their own, and whether top-level pay is rising while their own pay stagnates – while investors lack information to assess if companies are managing this risk adequately.

For assessing whether executive compensation is excessive in relation to the pay situation in the economy as a whole, we believe comparisons with publicly-available economy-wide income data may be the most useful approach.

Engaging on equitable compensation at Canada's banks

In 2012, we filed a series of shareholder proposals at Canada's largest banks.[3] The proposals asked the banks to explore the risks of setting quantum based on horizontal comparison with executive compensation at peer companies, and the potential benefits of "vertical comparisons": comparing the compensation of top executives to pay levels of other employees in the company or society as a whole. We did not ask the banks to implement a specific vertical metric or introduce a specific cap on compensation at this time, but rather to explore possible options. We engaged the banks because they have a history of leadership in corporate governance issues, including on compensation practice and disclosure, and because they formed a well-defined group of peer companies. We were able to withdraw the proposals in early 2013 when each bank agreed to

[3] These proposals were co-filed variously by Mr. William Davis and the United Church of Canada.

explore the issues we had raised.[4] At the time of writing, several of the banks had already committed to disclose to shareholders in 2014 on their response to the request in the original shareholder proposal.

As it may be relevant for work on the implementation of the pay ratio provision, the SEC may wish to follow up on the outcomes of this activity in 2014.

Conclusion

We commend the SEC for its efforts to develop a workable rule to implement the pay ratio provision mandated by Section 953(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act. We would greatly value enhanced disclosure on equitable pay, and we are already integrating such disclosure to our assessment of executive compensation, to the extent that it is available. We suggest that:

- Alongside any pay ratio disclosure, companies should be encouraged to provide disclosure that allows shareholders to understand what role the board and compensation committee plays in oversight of compensation across the company, and what efforts are made to ensure that executive compensation is perceived as reasonable and equitable by employees at other levels in the company, and by external stakeholders. Such disclosure would be welcome in advance of implementation of pay ratio disclosure.
- In 2014, the SEC may wish to follow up on the outcomes of the Canadian banks' exploration of horizontal and vertical compensation metrics.

Should you have any questions with regard to this submission, please do not hesitate to contact Michelle de Cordova, Director, Corporate Engagement & Public Policy (mdecordova@NEIinvestments.com, 604-742-8319).

Sincerely,

NEI Investments

Robert Walker
Vice President, ESG Services & NEI Ethical Funds

CC:
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Mr. Randy Evans, Senior ESG Analyst, NEI Investments

[4] Further background on this engagement can be found here: NEI Investments/Ethical Funds (2013). *Executive Compensation Update – Quantum Shift.* https://www.neiinvestments.com/Documents/Research/ExecutiveCompUpdate_revisedMay15.pdf