

Electronic Comments Via Email

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

Re: File Number S7-07-15
Pay-Versus-Performance Disclosure

Dear Mr. Fields:

We are responding to the Commission's request for comments on the proposed Pay-Versus-Performance disclosure rule (as proposed, the Rule).

Frederic W. Cook & Co., Inc. provides consulting services to compensation committees, boards of directors and corporations with respect to the compensation of executives and directors. Our Firm's services are provided to companies in all industries and size categories. We have provided compensation consulting services to more than 2,900 companies since we were founded over 40 years ago, and we currently serve as the independent advisor to the board compensation committee at approximately 25% of the S&P 500 companies.

Our letter focuses on practical suggestions that we believe can reduce the compliance burden on public companies and also seeks clarity on certain technical aspects of the Rule. While our views have been informed by discussions with numerous clients, the comments in this letter represent the opinions of our Firm and should not be ascribed to any particular client.

In formulating our response, we determined that our comments lent themselves to organization by topic, as opposed to itemized responses to the Commission's "Request for Comment" list. However, our comments address many of the questions raised by the Commission, and we believe they are helpful in that regard.

Background

We believe the most valuable way to assess the Rule and uncover its inherent challenges and potential unintended consequences is to prepare representative disclosures using the Rule in its proposed form. In doing so, we partnered with five of our clients on this initiative. For purposes of this comment letter, we refer to such collective work as our "sample study." This exercise and the results thereof, in addition to our expansive knowledge of executive compensation programs and design, formed the basis of the comments that follow below.

The companies that comprise our sample study vary in size and industry, and maintain compensation programs with individual nuances. Despite these differences, many of the material findings from this exercise were common to the entire sample.

Overall we found that the burden imposed by the Rule varies by company with considerably more time and effort required for companies that grant stock options and/or have pension plans. We acknowledge that the time burden will be greatest the first year in which the final rule becomes effective, but we think disclosure preparation in future years would still be arduous and not without compliance challenges. More importantly, and based on our sample study, we do not believe the disclosure (prepared according to the Rule) will accurately portray the

relationship between executive compensation actually paid and the financial performance of the registrant (which was the directive of the statute), as will be described in more detail below.

Executive Compensation “Actually Paid”

We commend the Commission’s efforts to develop a standardized definition of compensation “actually paid.” However, we believe elements of the definition have the potential to create confusion and may be at odds with how most interested parties, including shareholders, would define actual pay.

The Equity Component. Although we acknowledge the need for a uniform definition of pay for purposes of the disclosure, and think it is important to retain a prescriptive approach in this regard, the Rule’s current directive to value and report equity at vesting leads to varying degrees of mismatch between the year in which pay is earned and the year to which it relates in the proposed table. Most executives receive annual equity awards and each award typically has a three- to five-year vesting period. In addition, performance-based equity awards are measured over a multi-year period, which will not correlate solely to the performance of the registrant in the year of payout. Accordingly, in any given year compensation “actually paid” will include increments from equity awards that were granted in years earlier but happen to vest in the current fiscal year. These vesting patterns (or payment streams) will not directly reflect the compensation committee’s approach to setting executive pay in the reporting year under the Rule.

As an example, when one of our sample companies prepared a pro forma of the table, it concluded that a supplemental disclosure would be necessary to show the mismatch between performance years and payment years:

“In the first year of disclosure, only three years of performance would be disclosed. Meanwhile, company equity values disclosed as compensation actually paid are affected by performance for seven years. For example, 2008 performance drove the 2009 grant decisions, and the value of those 2009 awards will be controlled by company performance in 2009, 2010, and 2011. The same is true for awards granted in the other years disclosed below.”

Year	Salary & Bonus Perf. Year	Compensation Actually Paid			Period for Which Performance is Displayed
		Type	Equity Granted	Perf. Years	
2014	2014	Perf. Share	In '12 for PY11	'12, '13, '14	2014
		Stock Option	In '11 for PY10	'11, '12, '13	
2013	2013	Perf. Share	In '11 for PY10	'11, '12, '13	2013
		Stock Option	In '10 for PY09	'10, '11, '12	
2012	2012	Perf. Share	In '10 for PY09	'10, '11, '12	2012
		Stock Option	In '09 for PY08	'09, '10, '11	

* Note that company practice is for options to vest 100% on third anniversary from grant and performance shares to vest, if at all, at the conclusion of a three-year performance period based on certain performance criteria

In addition:

- Calculating the fair value of stock options as of each vesting date will be a time-consuming and tedious process. This will be especially true for companies with pro-rata vesting schedules, particularly if there are multiple vesting tranches in any given year as is common in certain industries.
- Disclosing stock option value at vesting is misleading since the executive does not include the option value in income (and is not subject to tax) at the time of vesting unless the option is exercised immediately (this is also the case if restricted stock units are paid later than the vesting date, which sometimes occurs). The value of the option is commonly subject to future potential gains or losses after the vesting date.

Notwithstanding the aforementioned problems with this approach, we are not recommending a different manner of valuing equity via this letter; we offer the comments above solely to illustrate the limited usefulness of the Rule.

On a technical level, the Rule is also unclear in part. As such, we request clarification on the following items:

- The Rule does not appear to prescribe the manner in which revised input assumptions must be determined.
 - For example, if an option has a ten-year term and an expected life of six years at the time of grant, what is the revised expected term when it vests on a cliff basis at the third anniversary? Is it three years (i.e., the original six-year expected life minus three) or 4.2 (i.e., the original six-year expected life times the portion of the full term that remains)?
- The Rule does not explicitly explain what constitutes “materially different” assumptions for purposes of the additional disclosure requirement: “For the value of equity awards added pursuant to paragraph (v)(2)(iii)(C), disclose in a footnote to the table...any assumption made in the valuation that differs materially from those disclosed pursuant to Instruction 1 to Item 402(c)(2)(v) and (vi)...”
 - For example, one company in our sample study determines the expected life of an award at the grant date based on the methodology referred to by the SEC in Staff Accounting Bulletin No. 110: $((\text{vesting term} + \text{original contractual term}) / 2)$. If this company used the same approach but updated the calculation to reduce the remaining term by time elapsed, would this trigger a need for additional disclosure? In other words, does “materially different” assumptions refer to the process used to select the assumptions or the actual assumptions themselves? If the answer is the latter, we acknowledge that each assumption would need to be disclosed as all companies will be using inputs that they did not use at the original time of grant, but perhaps not if the former. Moreover, if each assumption must be disclosed, the list of footnotes could be extensive for companies that grant options with ratable vesting.
- How should a registrant disclose the fair value of an equity award that vested during the reporting year but for which payout is still subject to compensation committee certification of performance results?
 - For example, a performance period ends and the related performance share vests on 12/31/14, but the compensation committee will certify the performance results in March of 2015. Does the registrant report the award for 2014 or 2015?
- How should a registrant disclose the fair value of an equity award if the award vests before the actual payout is determined?
 - For example, suppose a performance share vests 50% at the end of year two and the remaining 50% at the end of year three with the entire award settled at the end of year three. Is a registrant required to disclose the vested 50% portion for the fiscal year in which such tranche vested (when the ultimate payout is undetermined), or wait until year three to report the entire earned award? Based on a strict reading of the Rule, we assume the 50% vested tranche is reported for the year in which it vests, but the final rule needs to clarify this point and we would recommend that no reporting occur until the award is vested in full. If the SEC’s view is that you must report the vested amount before you know how much is ultimately earned (which is how the Rule treats options), the SEC needs to explain what value should be used for the vested amount and, as will almost always be the case, what adjustment should be made when the actual earned amount becomes known.

The Pension Component. We did not develop substantive observations from our sample study on the pension component under the Rule because the majority of this work was completed by pension actuaries. It is

our understanding that the actuaries working with the clients in our sample study may be submitting separate commentary on this topic.

Executives Covered by the Rule

Based on the intent of the Rule, we believe the covered named executive officers (NEOs) are the NEOs as reported in a registrant's proxy statement for each year that is subject to the reporting requirement, as opposed to only the current fiscal year NEOs with historical data reported for each such officer. However, we request that the final rule be more explicit. If our assumption is correct, then each year a registrant need only populate the current year compensation data, and the historical years would remain untouched (other than the first reporting year when the entire table needs to be created). If we are incorrect and the table is supposed to report NEOs only from the current year, registrants could have a year in the table without a principal executive officer (PEO) and potentially no average of other officers, which is not helpful.

The Rule proposes that if more than one person served as the PEO, the compensation for these individuals would be aggregated "because this reflects the total amount that was paid by the registrant for the services of a PEO." This rationale is only acceptable in the case of an external successor. The compensation of an internal promotion PEO (where prior to appointment as PEO he or she was an NEO during the same year), for services performed during the portion of the year that he or she was not serving as PEO, should not be aggregated and reported as PEO compensation (i.e., only the portion of compensation attributable to PEO services should be aggregated with the other PEO from the same fiscal year). Furthermore, in the case that an internal promotion PEO was not previously an NEO in the same year, the compensation received for services he or she performed during the portion of the year that he or she was not serving as PEO should not be reportable at all under the Rule. All of these considerations need to be clarified in the final rules.

An additional complication related to aggregating PEO compensation is that in the year of PEO transition the registrant will likely have to report hiring awards for the new PEO (that often reflect consideration for future services and make-whole awards in recognition of compensation forfeited at a prior employer), as well as severance payouts for the exiting PEO (that were likely negotiated at an earlier date). Both entry and exit carry the potential for heightened compensation, the majority of which is not directly correlated to the performance of the current fiscal year, which in turn may exacerbate the misleading nature of the disclosure and require companies to further supplement the table.

Financial Performance Measure

There is an inherent problem with the Rule's use of total shareholder return (TSR) as the performance measure. The Rule's approach presumes when a reader compares the reported compensation "actually paid" and TSR for a particular year, that a meaningful correlation between pay and performance can be discerned, but there will typically be a disconnect between actual compensation and the TSR period reported (e.g., long-term incentive awards are earned over a multi-year period that may not align with the TSR measurement period).

Apart from the challenge mentioned above, the final rule needs to clarify whether TSR to be reported in the table is annual TSR (i.e., five separate and distinct, one-year periods) or cumulative TSR (i.e., one-year TSR for the earliest year in the table, two-year TSR for year two, etc.). The Rule as drafted potentially creates ambiguity as it references both annual reporting and also cumulative TSR over a measurement period.

We think the SEC was attempting to require cumulative TSR, which is the method we applied to our sample study. The basis for our assumption is the fact that the Rule mandates TSR be calculated in the same manner as under Item 201(e) of Regulation S-K, and Item 201(e) reports cumulative TSR. We note, however, that annual TSR appears to be more consistent with the general approach of the Rule to report compensation and compare it to performance on an annual basis. In addition, under an annual TSR approach, companies would be able to build on the table each year without having to recreate significant portions of it.

- If the intent is to report cumulative TSR, the SEC needs to clarify and revise certain language in the Rule.
 - The Rule states that “the term ‘measurement period’ is the period beginning at the ‘measurement point’ established by the market close on the last trading day before the registrant’s earliest fiscal year in the table, through and including the end of the registrant’s last completed fiscal year.” That definition means the measurement period is the entire time frame covered by the table, which works for cumulative TSR as of the end of the most recent year, but does not work for the other years reported in the table. We assume the SEC intended to define the measurement period as the measurement point established by the market close on the last trading day before the registrant’s earliest fiscal year in the table, *through and including the end of the applicable fiscal year that is being reported* (i.e., each year/row in the table).
 - If the intent is to report cumulative TSR, the SEC should further clarify what happens when a company shifts peers during the five-year period. Does the registrant only use the most recent peer group and then calculate the returns for this group on one-, two-, three-, four-, and five-year periods? We assume that would be the approach, but we also note this method is problematic because (1) it would not align pay decisions with the performance group used by the compensation committee in that particular year; (2) registrants would be precluded from building off the prior year’s table by simply eliminating the oldest year once the phase-in period is complete (i.e., changes to the peer group under this approach would require an entire rework of the peer group TSR column); and (3) focus on only the most recent peer group would theoretically enable companies to “cherry pick” peers to influence the comparisons.
- If the intent is to report annual TSR, we assume a registrant is to use the peer group that was in place for each reported year in the table (i.e., each year’s computation would use each year’s peer group), but we request the SEC clarify this point if applicable.

Peer Group Issues

Pursuant to the Rule, a registrant “shall use the same index or issuers used for purposes of Item 201(e)(1)(ii) or, if applicable, the companies it uses as a peer group for purposes of Item 402(b).” The Rule is unclear with respect to peer group selection in several ways:

- Peer groups often change from year to year for a variety of reasons, including factors outside the company’s control (e.g., merger transactions). Is the registrant to apply the peer group in place for each year in the comparison (potentially five different peer groups) or use the current year group and report its performance over the last five years?
 - If TSR is to be reported on an annual basis, then we think the logical (and preferred) answer is to report the peer group as it existed for each year in the comparison. This would ensure greater alignment between the peers in place at the time of compensation decisions with the TSR performance period. Similar to our comment above regarding the constituents of the NEO group, under our recommended approach registrants would only have to populate the peer group TSR data for the current year (as opposed to revising the entire column each year in the event that the peer group changed). However, if our interpretation is correct, there could be some challenges in the first year of disclosure (e.g., if a 2013 peer was acquired in 2014, performance of such peer in 2013 is likely not available when creating the table in 2015). The final rules should also address this issue.
 - If TSR is to be reported on a cumulative basis, then we think the logical (and preferred) answer is to report only the current peer group (the group in place for the most recent fiscal year).

- Can a registrant choose any peer group mentioned in the CD&A pursuant to Item 402(b) or just the peer group used for benchmarking executive compensation? The SEC Release No. 34-74835 frequently refers to the benchmarking peer group, but the Rule itself points to Item 402(b). Note that Item 402(b) governs the CD&A generally, and while the CD&A should disclose any peer group used for benchmarking, it also must include other material information about the compensation program, which may include the use of other peer groups. Companies often disclose multiple peer groups in the CD&A; for example, a benchmarking peer group and a financial performance peer group used to measure vesting of performance-based equity awards.
- If the requirement is to use the benchmarking peer group, must the group be the one that was used in connection with the applicable reporting year compensation, or must it be the most current one, or can it be either? Companies often disclose more than one benchmarking peer group in the CD&A (e.g., if changes were made to the group during the year).
- The Rule allows a registrant to use the index or issuers used for purposes of Item 201(e)(1)(ii). If use of the stock performance graph group is an alternative, why preclude the index under Item 201(e)(1)(i) (broad equity market index that includes companies whose equity securities are traded on the same exchange or are of comparable market capitalization, which must be the S&P 500 if the registrant is a member)?

Our sample study also indicates that the requirement to weight the returns of each component issuer of the group according to the respective issuers' stock market capitalization skews the results in unexpected (and inconsistent) ways. We calculated the peer group TSR for each company in our sample both with and without this weighting requirement and found that weighting the peers by market capitalization caused the peer group TSR to be higher than the simple average TSR in certain years and lower in other years; these swings also changed from year to year within each company, across companies, and with respect to the magnitude of the differences. In other words, there was no clear or logical pattern to the impact of this requirement. Moreover, the weighted average TSR computation in the Rule is different from the simple average or percentile TSR comparisons typically used to measure the earn-out of relative TSR performance-based equity awards. This key difference in methodology presents an opportunity for confusion among shareholders in cases where the company has a relative TSR performance share program. For example, a registrant might describe the outcome under an equity incentive award based on 45th percentile performance while the pay-versus-performance table tells a different story.

Form of Disclosure – The Explanation

By requiring a registrant to provide a clear description of the relationship between the executive compensation actually paid and its TSR, the Rule assumes that trends can in fact be identified over the multi-year period that is covered by the table. However, due to the various issues described above and the results of our sample study, there rarely are such trends. As a result, the companies in our sample study struggled to identify a meaningful relationship between the compensation amounts being disclosed and each year's financial performance, and instead found themselves explaining why no such relationship exists.

Furthermore, it appears as though the Rule is asking for a “clear description” of pay versus performance on a one-year basis (in other words, for each year in the table, explain the relationship). The Rule states: “provide a clear description...for each of the registrant's last five completed fiscal years.” This approach does not create helpful results, as companies need a longer view to explain their compensation and performance story. To illustrate, following are some excerpts of the “explanations” from our sample study. They all begin with a version of:

“We are required to present this information in the following format as prescribed by the SEC, which is different from the way we consider elements of compensation internally. The SEC also requires a clear description of (1) the relationship between executive compensation actually paid and cumulative TSR, and (2) the relationship between our TSR and the TSR of our peer group...”

Then, the remainder of the explanation for each company attempts to explain the disconnect between a year of high pay and a different year of high performance:

COMPANY A

“The primary component of our executives’ Compensation Actually Paid is equity-based long-term incentives, which generally vest in the first quarter of the year. Therefore, TSR performance in a given year has a larger effect on the following year’s Compensation Actually Paid than in the given year of TSR measurement. Further, our long-term incentive awards generally vest over a three-year period, which does not uniformly align with the periods over which TSR is computed in the table below. In addition, our CEO’s 2014 Compensation Actually Paid includes the value of larger, promotion-related TSR awards. For these reasons, the year-over-year change in Compensation Actually Paid to our CEO and the average of our other NEOs is not consistently aligned with our TSR performance. However, Company TSR exceeded the peer group weighted average as of each fiscal year end.”

COMPANY B

“In 2012, our TSR was 94%, more than 4x the peer group weighted average of 17.0%. In spite of this level of outperformance, Compensation Actually Paid in 2012 was lower than Total Compensation. In the next two years, Compensation Actually Paid exceeded Total Compensation because the value of stock awards vesting in each year was substantially higher than at grant, due largely to the high level of TSR in 2012.”

COMPANY C

“There is no observed correlation between compensation actually paid and absolute TSR over the last three completed fiscal years or in any particular year. The annual decline in compensation actually paid is due to our triennial grant frequency and the front-loaded grants of performance shares in 2013 and stock options in 2014, rather than a correlation with absolute TSR performance. Over that same period, our TSR was lower than the peer group TSR in 2014 and 2015 but higher in 2013.”

COMPANY D

“For each of the last three completed fiscal years, there is no observed correlation between compensation actually paid and the Company’s TSR. Over that same period, TSR for the Company underperformed the chosen peer group in 2012 and 2014 but outperformed in 2013...For each of the last three completed fiscal years, compensation actually paid is lower than compensation as reported in the Summary Compensation Table (SCT) for the Company’s executive officers. The primary reason for this difference is that the Company began granting performance-based restricted stock units (PSUs) in fiscal year 2012. The grant date fair value of these PSUs is reported in the SCT for each of the last three completed fiscal years, but no awards have vested during that same time period.”

In one out of five cases in our sample study, a relationship between pay and performance was observed:

COMPANY E

“Over the three completed fiscal years observed, higher year-over-year TSR growth (from 2012 to 2013) was associated with an increase in compensation actually paid for both the PEO and the average of the non-PEO named executive officers. Lower year-over-year TSR growth

(from 2013 to 2014) was associated with a decrease in compensation actually paid for the PEO and approximately flat compensation actually paid for the average of the non-PEO named executive officers (+1%)...For each of the last three completed fiscal years, compensation actually paid is higher than compensation as reported in the Summary Compensation Table (SCT) for all of the Company's executive officers. The primary reasons for this difference are (1) the Company's strong TSR performance over this period, which contributed to fair value at vesting for both stock options and performance shares that exceeded the grant date fair value of stock options and performance shares granted three years prior to vesting, and (2) the above-target vesting of the 2010-2012, 2011-2013 and 2012-2014 performance share cycles, which vested at 107%, 112% and 133% of the target shares, respectively, based on the Company's return on equity versus pre-established goals."

Other Observations

The Rule limits the ability to evaluate pay-for-performance due to one key missing component, pay data for the peer companies. For example, one company raised its PEO pay from \$4 million to \$5 million in a year where TSR lagged the peer group. No conclusion can be drawn about pay relative to the peer group because the reader does not know what the peer companies paid each of their respective PEOs during the same period. In this example, the company could have raised PEO pay to align him or her with the market. The table does not capture this fact. That said, we are not recommending the Rule be expanded to require disclosure of peer group pay, as the burden and complexities to collect such data would be too extreme. We raise this point, however, to illustrate the proposed disclosure's lack of meaningful value, particularly on a relative basis.

One potential solution to this problem would be the removal of the peer TSR detail from the table. Doing so would shift the focus of the disclosure to purely a company specific analysis, simplify the table and the related explanation, and eliminate most of the issues we have raised regarding peer group selection and relative TSR data. We note that no other required proxy tables include peer or any other form of relative data.

Finally, we agree with the SEC's approach to refrain from proposing a specific location within the proxy or information statement for the disclosure. As such, we urge the SEC retain this part of the Rule, as mandating the disclosure be part of the CD&A would wrongly imply that a compensation committee considered the reported factors when making pay decisions. Even with the disclosure located elsewhere in the proxy statement, there is a risk that shareholders' say-on-pay and director votes will be influenced by this depiction of historical pay and historical performance, as opposed to the current compensation program.

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We appreciate the Commission's consideration of our comments. We are available to answer or clarify our comments and would welcome the opportunity to discuss our letter in greater detail.

Very truly yours,

Frederic W. Cook & Co., Inc.

Samantha Nussbaum
Lou Taormina