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Sent via electronic mail

March 3, 2022

John Byrne, Special Counsel, in the Office of Small Business Policy

Dear John:

Subject: File No. File Number S7-07-15
Reopening of Comment Period for Pay Versus Performance
Comments from Pay Governance – February 7, 2022
John Ellerman [Partner Emeritus], Ira T. Kay [Managing Partner], and Mike Kesner [Partner]

Thank you for providing Pay Governance, LLC ("Pay Governance" or "we") and others with the opportunity to provide commentary on the Proposed Pay Versus Performance disclosure requirements.

Pay Governance is one of the largest independent advisors to corporate boards on executive compensation matters. We provide advice to companies that "balances the inherent tension" in motivating executives to maximize the value for all stakeholders and address other constituencies' interests, including the proxy advisory firms, which have a significant impact on "Say on Pay" votes and other corporate governance matters.

The SEC's proposed "Pay Versus Performance" disclosures, if designed properly, could be very valuable in shaping shareholders' and other parties' views of companies' compensation policies, corporate governance practices, and board of directors' effectiveness. However, the new proposal, like the 2015 proposal, is highly controversial given the wide-ranging views on what constitutes compensation, performance, and the time frame for measuring this relationship.

We have divided our comments into three sections. **Part I** includes an Executive Summary of our comments, Part II includes our comments on the 2022 Proposal., and **Part III** summarizes our comments of the 2015 Proposal. Please note that throughout this comment letter we refer to the SEC's proposal as the **pay for performance ("P4P") rules,** as the **Dodd-Frank legislation ("Dodd-Frank") and** SEC's use of the phrase **"**pay *versus* performance" suggests the two are in opposition.

Part I: EXCUTIVE SUMMARY

Pay Governance's combined comments and observations of the 2015 and 2022 proposals, along with a summary of our recommendation that the SEC consider performance-adjusted pay are summarized below.

1. **OVERALL CONCLUSION--DETERMINING ALIGNED PAY AND PERFORMANCE ("P4P")**: Pay Governance strongly endorses using the proxy tables and CD&A as tools to demonstrate to shareholders the alignment of executive compensation with shareholder value creation. This alignment is very important to shareholders, especially given another Dodd-Frank mandate requiring non-binding say on pay votes, as P4P alignment can signal that the board of directors and management team are managing the company effectively. This is especially true if total shareholder return ("TSR") and compensation are strongly aligned over multiple years and business cycles. In order to be useful for shareholders and other

parties to properly evaluate pay and performance alignment**, the measurement periods for evaluating both performance and actual pay should be the same.**

However, the SEC's proposed definition of compensation actually paid (CAP) and **performance period methodology does not achieve this objective.** This is primarily, but not solely, due to companies' prevalent and significant usage of performance stock units ("PSUs") to deliver long-term incentive award opportunity. PSU grants typically vest 3 years from the date of grant, thus there is NO performance period included in the SEC's proposal that properly compares performance for the completed PSU performance cycles from grant to vest/payout. There is a similar issue for time-vested shares (RSUs) and stock options. There is no perfect solution to the timing mismatch between pay and performance.

We believe and have demonstrated that alternative measures of performance-adjusted pay (described below) are superior pay metrics for testing this alignment and addresses this issue. Our experience with clients is that the boards of directors greatly appreciate the P4P analysis using performance-adjusted pay in addition to the amounts reported in the Summary Compensation Table ("SCT").

2. **PROPOSED P4P RULES:** In 2022, the SEC announced the re-opening of its 2015 proposed rules on public company P4P disclosure mandated under Dodd-Frank. The new release includes two significant changes from the original proposal but does little to alleviate the concerns expressed in our original comment letter, and potentially, muddies the waters even further as discussed throughout this comment letter.

3. **ADVANCES IN P4P ASSESSMENTS:** The SEC's 2022 release notes that "executive compensation practices related to company performance have continued to develop and evolve." Pay Governance has also observed a sharp increase in the sophistication of institutional shareholders in assessing pay for performance when determining their say on pay votes and other governance-related decisions since the SEC's 2015 proposed rules were issued. We find that these shareholders use their own proprietary P4P models, companies' disclosures of P4P, and detailed P4P analyses prepared by the two major proxy advisory firms in their decision-making. The SEC's proposal, in contrast, appears to be out of step with these more sophisticated approaches of relating pay and performance.

4. **COMPENSATION ACTUALLY PAID ("CAP") DOES NOT ALIGN WITH THE PERFORMANCE PERIOD:** We have several concerns about the SEC's proposed methodology using CAP to test the alignment of P4P. CAP solely reflects amounts vesting in a given year. Our issue is that CAP is mostly not aligned with the performance period in which it was earned, thus distorting the true economic underpinnings of the payout and the reliability of the test of P4P alignment. As noted above, this is particularly acute for PSUs where typical vesting occurs in the year following the completion of the performance period. To illustrate assuming a 3-year PSU plan, a PSU is granted on February 15, 2022, and earned based on relative TSR from January 1, 2022, to December 31, 2024. The earned shares (if any) vest on February 15th, 2025. The SEC proposal requires the PSUs vesting in 2025 be compared to performance ending in 2025, and whether it is one year's data or rolling five-year data, the mismatch in the performance period and payout could yield a significant amount of allegedly "misaligned" payouts. A similar P4P alignment issue occurs with stock options, as focusing on just the stock options that vest during the year, ignores a significant amount of potential compensation that may have accrued during the relevant performance period. These amounts may show up in a later period when the stock price has not increased at a similar rate, suggesting to the readers of the proxy that sizable compensation was earned even though current year TSR and/or financial results do not support such a compensation outcome. While we understand the SEC is bound by the statutory language in Dodd-Frank to use compensation actually paid, we note that the vesting of stock options represents potential compensation and is only

compensation actually paid to the executive upon exercise of vested stock options. Moreover, the use of the Black-Scholes value of vested stock options, which considers future stock price performance rather than the "in-the-money" value of stock options (i.e., FMV minus exercise price) further departs from the true amount of compensation actually paid and creates the potential for additional P4P alignment issues.

5. **ESG/STAKEHOLDER**: In addition, as pointed out in the release, this is further complicated by the current important movement by companies toward linking ESG metrics and stakeholder values to executive compensation. Stakeholder value changes may take time to show up in TSR, and in the short-term, could adversely impact a company's financial results as it invests in new technologies, training, and R&D.

6. **OTHER POTENTIAL DEFINITIONS OF Dodd-Frank's "COMPENSATION ACTUALLY PAID"**: There are several possible definitions of performance-adjusted pay the SEC could select to determine P4P—including realized pay, incentive payout alignment, and realizable pay (the SEC noted in the 2015 proposed rules there is no common definition of realizable pay, however, the variations are modest, and the SEC could decide which should be used for this purpose). While Pay Governance endorses relative comparisons of pay and TSR to peers, we believe that CAP is not an ideal compensation metric. Based upon our firm's research, we believe that some of the alternative definitions of performance-adjusted pay would be a better pay definition for this type of comparison instead of CAP. These alternative definitions of performance-adjusted pay also have their limitations, and do not precisely reflect "compensation actually paid". However, the SEC's definition of CAP includes the Black-Scholes value of vested but unexercised stock options, which does not literally reflect "compensation actually paid." We believe several other definitions that meet the Dodd-Frank definition including realizable pay are arguably the optimal metric for these P4P purposes –see below for an S&P 500 performance-adjusted pay study.

   Pay Governance and many of its clients have used various performance-adjusted pay definitions over the last 12 years to demonstrate to compensation committees, management teams, investors, and the public/media the degree of alignment of the companies' pay and performance. For example, we often use realizable pay, which includes the sum of base salary, actual bonus payouts and equity grants made during the measurement period. Equity grants are adjusted to reflect operating performance compared to goals and are valued at the stock price at the end of the measurement period. There are other definitions of performance adjusted pay that could meet the Dodd-Frank standard better than CAP but with better a-priori theoretical alignment with performance than CAP. In addition, several of these definitions facilitate peer comparisons as an important context for investors, which is absent in the SEC's proposal. Similar methodologies—both realized and realizable pay, have been incorporated into shareholder voting analyses by ISS and Glass Lewis and large institutional shareholders. While not perfect, we believe that several of these pay definitions are superior to CAP when evaluating P4P alignment. In the following table we summarize the results of one of our studies of a substantial sample of S&P 500 companies and comparisons of performance, performance-adjusted pay, and SCT pay. We note that the TDC Opportunity (defined as the sum of base salary, target annual incentive, and grant date value of long-term incentives) is essentially identical for both high and low performing TSR companies.

   However, the performance-adjusted pay shows a large difference in the value of pay due to differences in operating and stock price performance.

S&P 500 Realizable Pay and TSR Performance Study — (Pay Governance study)

Sample	# Of Companies	3-year TSR	Three-year Realizable TDC	Three-year TDC Opportunity	Realizable as % of Opportunity
High Performers	140	80%	$35.9M	$26.8M	129%
Low Performers	140	18%	$21.2M	$25.9M	87%
Overall	280	45%	$27.2M	$26.2M	104%

Part II: SUMMARY OF COMMENTS ON 2022 PROPOSED RULES

Background and Context

On January 27th, 2022, the SEC announced the re-opening of its 2015 proposed rules on public company pay for performance (P4P) disclosure mandated under Dodd-Frank. The new release includes two significant changes from the original proposal, but these changes do not address the major concerns expressed in our original comment letter regarding the need to align compensation actually earned with the underlying performance period.

Our comments on the 2022 release address both the expansion of the P4P table to include financial metrics and the addition of a supplemental table that lists in descending order the key measures that drive compensation outcomes.

Expanding the P4P Table to Include Financial Metrics

The SEC proposes adding pre-tax net income and net income to the main P4P table and would allow issuers to add a “Company Selected Measure”. The SEC notes that the inclusion of financial metrics is needed to provide shareholders with a broader picture of the financial performance of the company rather than just relying on TSR, a view with which we generally agree.

Inclusion of Pre-Tax Net Income and Net Income

Mandating the use of pre-tax net income and net income because they are familiar to investors and are easily found in the GAAP financial statements is not enough to overcome the major shortcomings of both metrics. First and foremost, neither of these metrics is among the most-commonly used to determine incentive pay, thus, any correlation of compensation actually paid with these measures would be low or happenstance. Second, when pre-tax net income and net income are used to determine incentive pay, they are almost always adjusted for unusual items that distort the company’s operating performance. For example, if a company makes a large acquisition, it is likely pre-tax net income and net income will increase. Incentive payouts often exclude the impact of acquisitions and divestitures on the reported GAAP results.

Third, the use of absolute measures in dollar values provides little to no context to evaluate performance let alone pay for performance. The original and current proposals require companies to report their cumulative TSR and the TSR of their peers (i.e., growth metrics), which allows for a relative comparison of performance. The SEC's proposal does not include a requirement to report the peers' pre-tax net income and after-tax income, and therefore omits important perspective investors need when evaluating performance. To illustrate, if net income is declining each year, but the peers' net income is declining at a much faster rate, investors may be willing to support higher executive pay, as the company is outperforming its peers. Further, if the SEC's desired metric is dollars of profit, it cannot be compared at all between/among companies. To illustrate, the companies in a peer group often have revenues ranging from 50% to 250% of the subject company. Thus, a much larger company could have significantly higher net income, but far lower margins or returns on invested capital. A percentage growth rate in net income and pre-tax net income might provide some insight on relative financial performance, but it is well-known in the corporate sector that a GAAP growth rate is of very-limited value for temporal or inter-company comparisons and that stocks trade much more highly correlated with non-GAAP metrics than GAAP, as that is what sell-side analysts use.

Fourth, pre-tax net income and net income are essentially the same metric with the major difference being the companies' effective tax rates. Thus, it is unlikely these overlapping measures will provide investors with a more fulsome picture of company performance the SEC intends with the new rule.

Fifth, and finally, not including the peer groups' compensation also omits an important investor perspective, namely, how does compensation earned compare to the company's peers? To illustrate, if a company's pay is increasing, but is still well below its peers, investors may be far more willing to support increases in pay to ensure the management team is not vulnerable to recruitment by competitors. Conversely, if compensation is well above peers, but performance is far below peers, investors may have reason to question the P4P alignment.

Addition of a Company Selected Metric

We believe allowing companies to include a company selected metric ("CSM") is a welcome addition to the P4P disclosure, however, we still have significant reservations about its usefulness given the current format of the P4P table, namely: 1) the mismatch of time frames and the SEC's definition of CAP and 2) the lack of relative financial performance and pay levels described in the previous sections. Putting aside those reservations, allowing companies to select a financial metric that is most important to the company in determining earned compensation will allow companies to show how earned compensation tracks with that measure. A major weakness in the proposed disclosure is that companies must use the same CSM for all five years included in the table, yet the financial metrics used to support a company's objectives are often subject to change during the prescribed timeframe for the P4P disclosure. Thus, the current year's CSM may have only been in place for a portion of the 5-year performance period displayed in the table. For example, a company may have been focused on return on invested capital (ROIC) the first two years of the 5-year period covered by the table, but once ROIC was stabilized, the focus shifted to revenue growth. Based on the proposed disclosure, the company would be required to show its reported revenue for each of the five years, but compensation for at least two of those years (and even more if ROIC was included in the performance shares) would not have been linked to revenue and could easily show a false-negative misalignment of P4P. This perverse outcome could occur for both objectively high- and low-performing companies.

We suggest the SEC allow companies to select the metric that was used to determine pay for a given period, rather than use the same metric for all five years if it was not applicable or relevant during a portion of the 5 years represented in the table.

We also believe Pay Governance's P4P methodology does a far better job of comparing P4P as it allows for comparisons based on the time frame the metric was used and can easily accommodate various definitions of performance-adjusted compensation.

The New "Top 5" Metric Table

The SEC has proposed including an additional table in the P4P section of the proxy that lists the companies' top 5 metrics used to drive compensation outcomes. The SEC release explains the need for this supplemental table as follows:

"There is no existing rule that specifically mandates disclosure of the performance measures that actually determined the level of recent NEO compensation actually paid. Tabular disclosure of a list of the five most important performance measures that drove compensation actually paid may be useful to investors in addition to the more detailed disclosure relate to the consideration of the registrant's corporate performance and individual performance in the design of NEO compensation required in the CD&A"

It would appear the rationale described above is partially valid as it relates to the discussion of long-term incentive payouts, but inconsistent with both our understanding of the proxy rules and first-hand observations of hundreds if not thousands of proxies where the overwhelming practice is full disclosure of performance metrics and the resulting payouts of the annual incentive plan. **We believe that instead of adding a simple table that lists the top 5 metrics, the SEC should instead provide additional guidance on the disclosure of the payout calculations for the annual and long-term incentive plan to improve the transparency of performance outcomes and the corresponding payouts.**

An example of the annual incentive plan disclosure that clearly reflects the performance and corresponding payout is shown below (company names redacted).

EXAMPLE 1

2020 Annual Performance-Based Variable Compensation Results and Payout
FINANCIAL BUSINESS RESULTS

As noted above, financial goals are set considering multiple factors with the recognition that there are some items that cannot be easily predicted, and over which management has less control, such as foreign exchange rates and certain raw materials price changes. As part of the variable compensation plan design, certain pre-determined adjustments may be made by the Compensation Committee to actual financial results in order to account for these elements. The Compensation Committee may also conclude that additional adjustments are appropriate based upon unforeseen factors it deems extraordinary, non-recurring or otherwise material.
The chart below shows for each financial performance measure, the 2020 Corporate financial targets set by the Compensation Committee and the actual performance achieved. The overall Corporate payout factor for financial performance was 116.5% of target variable compensation.

Financial Measure	Target ($ millions)	Actual ($ millions)	Weight	Achievement	Payout
Sales*	28,070	27,297	25%	71%	17.9%
Net Income*	4,372	4,382	50%	103%	51.2%
Operating Cash Flow	6,833	7,429	25%	189%	47.4%

* For the annual variable compensation program, sales and net income are measured in accordance with GAAP subject to certain adjustments that the Compensation Committee approves.

* For the annual variable compensation program, sales and net income are measured in accordance with GAAP subject to certain adjustments that the Compensation Committee approves.

Below are two examples of long-term incentive plan disclosure for completed performance cycles ending in 2020, that clearly describe actual long-term performance, and the corresponding payout (company names redacted)

EXAMPLE 2

Company B: 2018-2020 PSU Grant

The three-year performance measurement period for PSUs granted in 2018 ended on December 31, 2020. At its February 2021 meeting, the Compensation Committee certified a conversion ratio of 0 for both types of PSUs granted in 2018, resulting in each NEO receiving no shares of Company B stock in connection with this grant. The threshold, target, maximum and actual performance are shown below:

Factor	Threshold	Target	Maximum	Actual
Relative TSR	25th Percentile	50th Percentile	75th Percentile	7th Percentile
Consolidated Free Cash Flow	738,000,000	923,000,000	1,108,000,000	504,000,000

EXAMPLE 3

Company A: Fiscal Year 2019-2021 PSU Performance Results and Payment

PSUs for the fiscal 2019–2021 were earned based on adjusted EPS and relative TSR performance compared to goals established at the beginning of the three-year performance cycle.

Adjusted EPS was measured for each of the three years and on a cumulative three-year basis. Adjusted EPS performance for fiscal 2019, 2020, 2021 and cumulative fiscal 2019- 2021 was equally weighted at 25% for each of these periods. The adjusted EPS goals are set forth in the table below.

Performance Level	Adjusted EPS Achieved (CAGR)	Award Earned (as a % of Target)
Threshold	5%	25
	10%	50
Target	15%	100
	20%	150
Maximum	25%	200

The total award earned based on the four adjusted EPS measurements was then modified based on Company A three-year relative TSR performance compared against the S&P 500 as set forth below.

TSR Performance Relative to the S&P 500	Adjustment to Earned Award
At or Below 25th Percentile	Decreased by 25%
In between 25th and 75th Percentile	No Adjustment
At or Above 75th Percentile	Increased by 25%

The fiscal 2019-2021 PSU payout of 0% of target was approved by the Compensation Committee in November 2021 for the performance period of October 1, 2019, to September 30, 2021. Company A's relative TSR performance of 24th percentile for the three-year performance cycle resulted in no adjustment to final payout.

Performance		Adjusted EPS for Incentive Compensation					
Levels	Growth Goals	Base	2019	2020	2021	Cumulative	Payouts % Of Target
Threshold	5.0%	$2.92	$3.07	$3.22	$3.38	$9.67	25
	10.0%	$2.92	$3.21	$3.53	$3.89	$10.63	50
Target	15.0%	$2.92	$3.36	$3.86	$4.44	$11.66	100
	20.0%	$2.92	$3.50	$4.20	$5.05	$12.75	150
Maximum	25.0%	$2.92	$3.65	$4.56	$5.70	$13.92	200
Adjusted EPS (1)			$2.53	$2.84	$3.31	$8.69	0
Resulting Annual Payout			0%	0%	0%	0%	
3 Year Payout			0%	0%	0%	0%	0%
TSR Modifier							-25%
Projected Payout							0.0%

Part III Summary of Pay Governance's 2015 Comment Letter

Pay Governance LLC recommends that the SEC reconsider the following key points and recommendations made in our June 15, 2015, comment letter on the proposed P4P disclosure rules:

1. **TIMING MISMATCH**: As discussed above, the SEC's proposed rules could often result in a mismatch of the timing of compensation actually paid ("CAP") and total shareholder return (TSR). The proposed rule with alternatives for TSR measurement seem to present a fundamental temporal mismatch between the measures of actual pay and TSR. What will be reported as CAP is a 1-year actual pay figure compared to some measure of a cumulative TSR that may or may not relate to the period of performance that determined the reported CAP equity awards.

2. **VESTING MISMATCH**: With respect to the above, there are problems with the calculation of award values on the vesting dates for performance shares and stock options. There may be misalignment between the vesting/delivery of performance shares each year with the corresponding cumulative TSR reported for that period having no bearing on the earn-out of such awards. There is variation among companies on the treatment of the disclosure of performance shares which could further make SCT and peer group comparisons misleading.

3. **STOCK OPTION VALUE**: Further, the use of Black-Scholes option values on vesting date as "actual compensation paid" is highly misleading as Black-Scholes considers future appreciation over the term of the stock option, whereas the P4P tables are based on year-end stock prices. This is particularly apparent when an underwater stock option (i.e., exercise price exceeds the FMV of the stock) is assigned a value on vesting date which cannot be realized by the option holder. We agree that an underwater stock option with several years remaining on its term has economic value, but it is misleading to compare actual performance to potential future value when assessing the relationship of P4P. We recommend that the SEC adopt intrinsic value of options if the vesting measurement date is a requirement

4. **DIFFERENT STOCK PRICES**: The rules now require three different stock price measurement dates for equity award valuation or TSR measurement, further exacerbating the misalignment of pay and performance timing. These three different measurement dates are: (1) Summary Compensation Table (SCT) data based upon the accounting value of an equity award's stock price on the date of grant; (2) CAP data based upon an equity award's stock price on the date of vesting; and (3) the pay for performance table for calculation of TSR based upon stock price at the conclusion of the fiscal year

5. **INCLUSION OF SCT**: We suggest that SCT total compensation be used with caution as it is a blend of targeted and actual pay. The primary reason to include SCT compensation in the table is to develop a judgment of whether and by how much a compensation committee's targeted pay is aligned with the CAP earned by executives. However, due to the many problems associated with the varying measurement dates, vesting dates, etc., it will be very difficult for shareholders or their advisors to gain factual insights to the data. More important, SCT compensation—except for the annual cash bonus/incentive--has limited connection with the pay for performance precept, as it is deliberately and appropriately influenced by market data.

6**. PEER GROUP**: Pay Governance LLC believes that some shareholders and their advisors will attempt to evaluate CAP data for a registrant's peer group of companies to make comparisons of relative TSR which is included in the new table. We believe that this type of analysis will not provide an apples-to-apples comparison between companies due to the timing of proxies, differences in company interpretations as to when performance shares vest, and different reporting periods.

7**. REALIZABLE PAY**: While Pay Governance LLC endorses relative comparison of pay and TSR to peers, we believe that CAP is not an ideal compensation metric. Based upon our firm's research, we believe that realizable pay is a better pay vehicle for this type of comparison. Realizable pay has its limitations but is the optimal metric for these purposes (see section of this comment letter that discusses realizable pay).

8**. EMPHASIZING TSR**: We believe that requiring TSR as the primary performance metric for the pay for performance table and disclosure is valid but not perfect. We endorse that the SEC is allowing registrants to use other performance metrics for reporting purposes. This would allow for inclusion of industry-relevant metrics to enhance comparability but also has many challenges.

9. **CEO TRANSITIONS**: The rules require including the aggregate CAP for both CEOs in a transition year. This is not a useful pay amount to compare to cotemporaneous TSR and to the SCT and could further obfuscate the comparison between executive compensation and TSR. A preferable alternative would be to

require companies to disclose CAP for the outgoing CEO, since the performance and vesting periods for vested award values for the outgoing CEO are more likely to overlap with the TSR measurement period

CLOSING

Pay Governance appreciates the opportunity to comment on the SEC's proposed P4P rules and would welcome the opportunity to meet with the SEC staff to further detail our realizable pay methodology and clarify the issues with the proposed rules raised in this letter.

Respectfully,

John Ellerman
Partner Emeritus

Ira T. Kay
Managing Partner
New York Office
[redacted]

Michael S. Kesner
Partner
Chicago Office
[redacted]