March 10, 2022

Ms. Vanessa Countryman, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-0609


Dear Ms. Countryman:

On behalf of our more than 23,000 members, the undersigned leaders of the National Association of Corporate Directors (NACD) are pleased to offer our current view of the Securities and Exchange Commission’s (SEC’s) Pay Versus Performance Rule, originally proposed in 2015 and recently reopened for comment.

With this letter, we are building on an earlier NACD comment submitted July 10, 2015. First, in concert with that original comment, we suggest a change in the name of the rule to “Pay in Relation to Performance” rather than “Pay versus Performance,” as the term “versus” implies an intrinsic disconnection.

We continue to agree with key principles animating the SEC’s proposed rule, including the importance of aligning time horizons for pay and performance, the inclusion of executives beyond the CEO, and the role of director discretion. On the other hand, we still object to the use of total shareholder return (TSR) as a sole measure of performance, and we urge longer time horizons when using TSR. If the SEC officially equates performance with TSR measured over a three-year period, this will force CEOs to focus heavily on that particular metric at the risk of abandoning others. While nonfinancial measures do affect TSR, they do not do so in neat annual or three-year periods. For this reason, we call upon the SEC to grant boards as much discretion as possible in setting performance goals, in measuring performance, and in disclosing performance. With respect to this last point, please consider our remarks on nonfinancial metrics:

“In NACD’s view, the SEC must provide a framework that accommodates all industries and company sizes to meet the intent of the regulation without adverse consequences. TSR can be a valuable data point, but so can ROIC [return on invested capital] and other measures. As we stated in our 2013 Perspectives paper, “while the baseline definition of ‘performance’ should include total shareholder return (TSR), an isolated emphasis on TSR can result in excessive focus on quarterly financial numbers and encourage short-term thinking” (p. 3). Furthermore, the TSR measure is subject to manipulation by one-off capital actions, such as one-time dividends, share repurchase announcements, spin-offs, and significant increases in debt. Thus it is possible that the SEC’s proposal, while well-intentioned, may have some unintended negative consequences for companies and their long-term shareholders.
“In the interest of avoiding over-reliance on any single metric, companies may choose to include other financial and non-financial performance measures that they believe to be relevant. Such criteria include not only TSR but also other financial measures (including so-called accounting measures) and nonfinancial measures (such as those related to customer satisfaction, environmental sustainability, talent and human capital, and so on).”

We stand by that view more firmly now than ever. Since we wrote our 2015 comment, numerous empirical studies have provided evidence to support the importance of nonfinancial measures as predictors of long-term corporate value. A 2021 research review by Tensie Whelan et alia of the Stern Center for Sustainable Business at New York University (NYU) compared 1,000+ studies published between 2015 and 2020 on various environmental, social, and/or governance issues and found that most of them (58%) showed a positive correlation between these nonfinancial measures and stock returns, and few (8%) showed a negative correlation. Others were mixed or neutral. For more focused evidence, we commend your attention to the following research:

- **Customer satisfaction.** A May 2016 study by CFI Group’s Claes Fornell and coauthors found that companies with higher customer satisfaction returned more to shareholders over the long term.

- **Environmental sustainability.** A 2021 study by Guido Giese et alia of MSCI Research showed that “companies with better transition risk profiles outperformed their riskier counterparts, after controlling for well-known equity risk and return factors.” Furthermore, the NYU study mentioned earlier showed strong results for climate studies, with 65 percent of lower-carbon companies showing “positive or neutral performance compared to conventional investments.”

- **Human capital.** In an October 2019 comment to the SEC, the Human Capital Management Coalition urged the Commission to mandate more disclosure of human capital management (HCM) metrics, stating that their “value-relevance . . . is consistently demonstrated in financial research.” (Subsequently the SEC did pass a rule, effective November 9, 2020, requiring a company’s 10-k to include a description of the registrant’s human capital resources “to the extent such disclosures would be material to an understanding of the registrant’s business taken as a whole.”)

These studies and others make it clear that equating performance with TSR alone is shortsighted. If a CEO achieves a goal increasing customer satisfaction, reducing carbon footprint, and/or showing improvement in human capital metrics over a period of time, this should be factored into the assessment of his or her performance for that same period. So too should financial measures other than TSR, as noted in our original comment.

In our view, the SEC should not only permit companies to include nonfinancial metrics in their assessment of executive performance but encourage them to do so and provide useful templates for consistent disclosure on a voluntary basis. The SEC should not let complexity be a barrier. We would be happy to recommend templates. Pay for performance is nothing new to the NACD
director community. It has been the North Star for compensation committees since our founding days.

Sincerely,

Peter R. Gleason, President and CEO

William McCracken, Chair

National Association of Corporate Directors
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