March 10, 2022

Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549

Re: File Number S7-07-15, Reopening of Comment Period for Pay Versus Performance.

Dear Ms. Countryman:

The Society for Corporate Governance (the "*Society*") appreciates the opportunity to provide comments on the U.S. Securities and Exchange Commission's (the "*SEC*" or "*Commission*") Reopening of Comment Period ("*Reopening Release*")[1] for the Notice of Proposed Rulemaking (the "*Proposed Rules*")[2] that amends the Commission's disclosure rules to require a description of how executive compensation actually paid by an issuer related to the financial performance of that company pursuant to Section 953(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "*Dodd-Frank Act*").[3]

Founded in 1946, the Society is a professional membership association of more than 3,500 corporate and assistant secretaries, in-house counsel, outside counsel, and other governance professionals who serve approximately 1,600 entities, including 1,000 public companies of almost every size and industry.

Section 953(a) of the Dodd-Frank Act added Section 14(i) to the Securities Exchange Act of 1934[4] (the "*Exchange Act*"), which requires the SEC to adopt rules requiring issuers to disclose in any proxy or consent solicitation materials for an annual meeting of the shareholders a clear description of any compensation required to be disclosed under Item 402 of Regulation S-K.[5] This includes providing 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, dividends of the issuer, and any distributions.

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[1] Reopening of Comment Period for Pay Versus Performance ("Reopening Release"), File Number S7-07-15, 87 Fed. Reg. 5939 (Jan. 27, 2022).
[2] Pay Versus Performance, 80 Fed. Reg. 26329 (May 7, 2015); *see also* Section 953(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, P.L. 111-203, 124 Stat 1376 (2010).
[3] Id.
[4] 15 U.S.C. 78a *et seq.*
[5] 17 CFR § 229.402

I. The Society Continues to Emphasize the Concerns Raised in Our 2015 Comment Letter.

On July 7, 2015, the Society responded to the Proposed Rules in a separate comment letter ("*2015 Comment Letter*").[6] While we have not repeated all of our concerns and positions from that letter here, our previous letter remains applicable and should be read in conjunction with the responses below, which are meant to address the SEC's latest set of questions. As a reminder, here are a few of the concerns raised in the 2015 Comment Letter:

- Meaningful comparability among compensation programs and performance measures across all issuers is not possible or desirable;
- "Executive compensation actually paid" for stock options should be based on the exercisable value, not fair value, on the vesting date;
- "Executive compensation actually paid" should exclude severance payments and signing incentives;
- Any required disclosure regarding peer groups should be eliminated;
- The aggregation requirement for multiple Principal Executive Officers' compensation during a transition year needs to be modified;
- Pay-for-performance data should not be required to be tagged in XBRL format; and
- Clarification that the "no greater prominence" requirement refers only to size of the pay versus performance table and not to any supplemental disclosures.

Additional details regarding these points can be found in our 2015 Comment Letter.

II. The Society Supplements its 2015 Comment Letter by Addressing the SEC's New Request for Comments.

A. Additional prescriptive measures of performance such as net income or pre-tax net income suffer from the same deficiencies as a prescriptive TSR metric and should not be included in the final rule.

The Proposed Rules and Reopening Release[7] contemplate prescriptive disclosure comparing a registrant's compensation program to its total shareholder return ("*TSR*"), peer group TSR, pre-tax net income, net income, and a company-selected measure. While we support the voluntary disclosure of important performance measures, which may change over time as a result of changes in the market environment or shareholder feedback, we believe the Proposed

[6] *See* Society Comment Letter re: Pay for Performance, Release No. 34-74835, File No. S7-07-15 (July 7, 2015), https://www.sec.gov/comments/s7-07-15/s70715-67.pdf

[7] The SEC released the Proposed Rules almost seven years ago and the Reopening Release contemplates significant changes to the Proposed Rules. Given the significant time that has passed since the original Proposed Rules, we recommend the SEC use the feedback received in response to the Reopening Release to reevaluate the Proposed Rules and prepare a new proposed regulation for all stakeholders to review and provide comments, rather than jumping directly to issuing a final rule proposal.

Rules and Reopening Release would not be productive by requiring comparisons between a company's compensation program and prescriptive performance measures, such as TSR, peer group TSR, pre-tax net income, and net income.

1. *Prescriptive performance measures may be inappropriate for certain companies and may not accurately capture company performance.*

A one-size fits all approach to measuring performance ignores the reality that two companies are rarely identically situated and therefore, financial performance has different meanings from company to company. The SEC itself observed that financial performance is a broad term that can mean different things to different issuers.[8] As we noted in our 2015 Comment Letter, "each company's equity reacts uniquely, in magnitude, speed and duration, to its own financial performance, the performance of its peers, the behavior of the overall market, and microeconomic factors."[9] Because of these, and many other factors, the relevance of specific metrics varies by company. For instance, TSR and net income may be relevant for a large, well-established company, but would be unhelpful for a tech start-up.

Even more, we believe that certain performance measures, like TSR, may not accurately reflect company performance. TSR can, and has, overemphasized stock price changes, which may not correlate to long-term company performance. A recent example of this is the phenomenon of significant investment by retail investors in "meme stocks," which are generally created when stock of an underperforming company accumulates a large following on various social media platforms, like Reddit and Twitter.[10] These meme stocks often experience massive fluctuations in stock price, which have little to do with the company's underlying profits, revenue, or other financial performance factors.[11]

This phenomenon highlights just one drawback of requiring the disclosure of TSR. Such a primary focus may incentivize – and essentially pressure – executives to do whatever is necessary to run up their company's stock price, which is a short-term mindset. The short-term nature of TSR is one of the many reasons why stock options have fallen out of favor with many institutional investors.

Because TSR does not always accurately reflect a company's long-term performance, we believe the SEC should allow companies to choose the most appropriate measures of performance – which may be revenue growth, adjusted EBITDA, net income, or some other financial metric. As discussed further below, the company and its compensation committee are in the best position to determine how to define performance and the meaning of each measure.

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[8] 80 Fed. Reg. at 26331.

[9] *See* Society Comment Letter Re: Pay for Performance, at 3.

[10] "7 New Meme Stocks That Retail Investors Can't Get Enough Of," *Business Insider* (Nov. 12, 2021), https://markets.businessinsider.com/news/stocks/7-newest-meme-stocks-retail-investors-cant-get-enough-of-1030970937.

[11] *GameStop Stock Report*, Simply Wall St (Feb. 22, 2022), https://simplywall.st/stocks/us/retail/nyse-gme/gamestop?blueprint=1885535&utm_medium=finance_user&utm_campaign=integrated-pitch&utm_source=yahoo#executive-summary.

Forcing companies to layer TSR into their executive compensation decisions may obscure a company's overall performance and is not in its investors' long-term interest.

We support the SEC's recognition in the Reopening Release that there are other useful and appropriate measures of company performance in addition to or in lieu of contemplated prescriptive performance measures.[12] By proposing that companies may wish to select an alternative performance measure, we believe the SEC is acknowledging that prescriptive measures, like TSR, pre-tax net income, and net income, may not be sufficient barometers of performance for all companies. We recommend the SEC provide flexibility to companies to select their own performance measures, which would allow for more diversity in incentives. Thus, the SEC should expand the flexibility contemplated in its Reopening Release by allowing companies to determine the most appropriate company performance measures. This would obviate the concerns raised in this letter with respect to prescriptive performance measures.

2. Prescriptive company performance measures inappropriately promote conformity of incentive compensation programs and undermine compensation committees' responsibility for compensation.

Mandating disclosure of company performance with respect to any prescriptive metric inappropriately encourages issuers to utilize such performance measures in their short-term and long-term incentive compensation programs such that their disclosures will comply with SEC mandated performance measures. Consider the case of a company that designs its incentive program around annual revenue goals that are critical to achieving its growth goals. If that company were required to report how its compensation program compares to its TSR, peer group TSR, pre-tax net income and net income, its compensation committee likely would replace some or all of its short-term and long-term performance metrics so that the company's disclosure would more closely align with the SEC's mandated measures. Inevitably, many companies may gravitate toward pay programs incorporating some or all of these SEC-selected mandatory performance measures.

Instead, we suggest that the SEC leave judgements as to how to incentivize executives to compensation committees and how to evaluate company performance to investors. Thus, we recommend the final rule proposal remove all prescriptive disclosure requirements concerning company performance to preserve the role of compensation committees and investors as the appropriate determinators of the most important measures of company performance.

3. Uniformity in performance measures stifles innovation in incentive compensation design.

The use of prescriptive performance measures in evaluating pay versus company performance will likely reduce innovation in the design and evolution of incentive compensation programs as companies may feel compelled to utilize whichever metrics are set forth in the final rule to demonstrate closer alignment between pay and performance. Even assuming that TSR, net income, and pre-tax net income are the best performance measures available today to

[12] Reopening Release at 15.

measure company performance, there is no guarantee that such measures will continue to be viewed as such in the future. We saw this firsthand throughout the COVID-19 pandemic. Industries were impacted in vastly different ways and many companies made adjustments to performance measures in an effort to more *accurately* reflect performance. For example, the hospital and airline industries saw the most significant declines in income in 2020, respectively seeing a $323.1 billion loss and a $35 billion loss,[13] while the fitness equipment industry has experienced a $20.31 billion[14] boom since the start of the pandemic. Beyond the pandemic, it is often the case that industries experience cycles that require adaptive performance measures.

As new metrics for evaluating performance continue to evolve, companies' incentive compensation programs will continue to change with the advent of such means of performance measurement. Hard wiring into a final rule any one set of performance measures will serve as a disincentive for companies to adopt new, improved, or adaptive performance measures in its pay programs, leaving them stale and unresponsive to an ever-changing market and business climate.

4. New developments in compensation programs and pay-for-performance evaluation since the 2015 proposal show that a TSR-based pay-for-performance mandate is not needed.

The Reopening Release asked whether additional requirements would better reflect the mandates of Section 953(a) by "providing investors with additional decision-relevant data"[15] and whether there had been other developments that should affect the SEC's consideration of the Proposed Rules.[16] Importantly, over the past decade "decision-relevant data" has become readily available to investors through Bloomberg and other data platforms. U.S. proxy advisory firms already provide in-depth pay for performance evaluation on most, if not all, publicly traded companies. These evaluations generally include an assessment of a company's pay program compared to its TSR performance. As a result, even if we were to assume that TSR is an appropriate performance measure, disclosures concerning executive pay compared to a company's TSR performance are already widely available and disseminated to investors. Thus, the Proposed Rules would not add any meaningful information for investors.

Further, if the SEC believes any disconnect between company pay and executive performance can be corrected by investors having access to specific TSR information, either: (i) the market should have already corrected such imbalance because of the availability of TSR information; or (ii) if such imbalance continues today despite the prevalence of data relating to TSR, the prescriptive TSR-based disclosure regime contemplated by the Proposed Rules does not work to address those concerns. In our view, a more flexible, principles-based final rule would allow companies to provide investors with pay versus performance information not readily available and that each company has determined is relevant given its size, industry, compensation practices, and other characteristics.

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[13] "The 10 Industries That Have Been Impacted the Most by COVID – 19" (March 17, 2021), https://finance.yahoo.com/news/10-industries-impacted-most-covid-110042511.html.
[14] "5 Industries that Have Thrived During Covid" (July 9, 2021), https://www.econotimes.com/5-Industries-that-Have-Thrived-During-Covid-1612559.
[15] Reopening Release at 7.
[16] Reopening Release at 28.

B. If the SEC decides to mandate disclosure of a particular company performance measure, it should solely mandate TSR disclosure.

If, however, the SEC opts to require companies to disclose their performance pursuant to a single prescribed performance measure, we recommend the final rule proposal require disclosure related to TSR and not include any additional prescribed metrics. While prescribing any one particular performance measure is not optimal, if one common metric must be chosen, TSR is at least a metric that investors and companies are familiar with seeing and calculating. Therefore, if the SEC decides to require companies to disclose their performance according to a prescribed metric, we recommend that it utilize TSR. For the TSR calculation, we recommend that for each year in the TSR table, the TSR reflected in that year be the company's and peer group's TSRs calculated over the performance period applicable to the awards actually paid and reflected for such year (e.g., for a company with a three-year performance period, the TSR reflected for year 2 in the table would be the cumulative TSR of the company and peer group over the three-year performance period for the awards reflected as paid in year 2 in the table).

Even if TSR disclosure is mandated, we do not think it is useful for investors for the Commission to prescribe any additional mandatory metrics. If companies are required to disclose TSR and then permitted to add other relevant metrics, we anticipate each company will include such additional measures (e.g., revenue, EBITDA, etc.) in order to present their pay versus performance alignment in a way that is most relevant given the company's specific make-up and characteristics.

III. The SEC Should Modify the Periods Over Which PEO and Company Performance Should be Reported from a Five-Year Period to a Three-Year Period.

The final rule proposal should provide for a three-year disclosure period. A three-year period, rather than five years, provides more accurate and meaningful disclosure, and is consistent with information investors are accustomed to reviewing and relying upon.

A three-year disclosure period provides a more meaningful comparison of long-term incentive programs for several reasons. First, as the group of named executive officers ("*NEO(s)*") may change, a three-year period adequately aligns executive compensation that is attributable to the executives. The SEC recognized this in its Proposed Rules, noting that the proposed approach "may not necessarily align a particular executive's compensation with the time period during which the registrant's performance may be attributed to the executive."[17] For example, the identities of a company's NEOs often change due to turnover in executive roles. This was particularly true during the COVID-19 pandemic. According to a recent report, the succession rate of CEOs among companies in the Russell 3000 and the S&P 500 significantly increased between the first and second half of 2020.[18] Executive turnover rates, however, are not just a product of the COVID-19 pandemic. In fact, the combined turnover rate for CEOs, chief

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[17] Proposed Rules (see request for comment 23).

[18] "New Study Shows How and Why Covid Has Impacted CEO Turnovers" (June 23, 2021), https://www.forbes.com/sites/edwardsegal/2021/06/23/how-and-why-covid-has-impacted-ceo-turnovers/?sh=472a5ad0330b.

financial officers, and chief operating officers was 17.5% in the year prior to the start of the COVID-19 pandemic.[19] Thus, the group of NEOs are more likely to be consistently in place during a three-year performance period, providing a more accurate comparison group than a five-year performance period.

Second, a three-year period more closely aligns with the typical long-term incentive ("*LTI*") performance period. A 2021 report detailing the LTI practices and trends of the 250 largest companies in the S&P 500 found that 89% of companies measure performance-based LTI over a three-year period (consistent with 2019 and up 3% since 2015), compared with only 1% of companies that measure over a five-year period.[20]

Finally, a three-year period aligns with the period of disclosure in the Summary Compensation Table ("*SCT*"), which the SEC itself has noted is the "cornerstone of the SEC's required disclosure on executive compensation."[21] Specifically, the SCT "sets out the total compensation paid to the company's chief executive officer, chief financial officer and three other most highly compensated executive officers for the past *three fiscal years*."[22] Absent an especially strong reason for departing from the time frame, this three-year disclosure period should override the speculative benefits of a longer five-year period.

IV. The SEC Should Not Mandate a Top-Five List of Performance Measures Utilized in Determining Executive Compensation.

As a threshold matter, nothing contained within the Dodd-Frank Act requires, or even contemplates, the disclosure of the top-five performance measures a company utilizes in determining executive compensation. We do, however, understand the importance of investors having access to information that companies use to make compensation decisions. Fortunately, this information is already readily available in the Compensation Discussion and Analysis ("*CD&A*") section of a company's proxy statement where companies are required to disclose the material factors used when setting and designing compensation.

The CD&A rules under Item 402(b) of Regulation S-K require companies to disclose *all material* factors of the "compensation awarded to, earned by, or paid to the named executive officers."[23] The CD&A rules elaborate on this principle by requiring disclosure of:

> (*i) the objectives of the registrant's compensation; (ii) what the compensation program is designed to reward; (iii) each element of compensation; (iv) why the registrant chooses to pay each element; (v) how the registrant determines the amount (and, where applicable, the formula) for each element of pay; (vi) how each compensation element*

[19] "Turnover Rate of CEOs, CFOs and COOs at Companies: United States from 2000 to 2019," https://www.statista.com/statistics/1097586/turnover-of-c-suite-executives-in-the-united-states/
[20] *"2021 Top 250 Report,"* FW Cook (Dec. 2021) at 8, https://www.fwcook.com/content/documents/Publications/12-29-21_FWC_2021_Top_250_Final.pdf.
[21] U.S. Securities and Exchange Commission, Executive Compensation, https://www.sec.gov/answers/execcomp.htm.
[22] *Id*.
[23] 17 CFR § 229.402.

and the registrant's decisions regarding that element fit into the registrant's overall compensation objectives and affect decisions regarding other elements; and (vii) whether and, if so, how the registrant has considered the results of the most recent shareholder advisory vote on executive compensation required by section 14A of the Exchange Act (15 U.S.C. 78n-1) or § 240.14a-20 of this chapter in determining compensation policies and decisions and, if so, how that consideration has affected the registrant's executive compensation decisions and policies.[24]

Since the CD&A rules were first introduced, companies have continued to improve upon and provide comprehensive disclosures including in-depth insight into their compensation-setting practices through these CD&A disclosures. Executive compensation disclosures have significantly evolved from baseline formulaic disclosures to become more sophisticated in nature, with detailed discussions and graphical representations explaining the various elements of a company's pay program and the purpose of such compensation features. With these CD&A requirements already in place, asking companies to arbitrarily select the five most important performance metrics used to determine compensation actually paid is duplicative and unnecessary.

Not only is it duplicative, but a top-five disclosure requirement also presents challenges to issuers that may base compensation decisions on fewer than (or more than) five performance metrics. Moreover, this proposed requirement does not account for the fact that many companies give multiple performance metrics equal weight, as would have already been described in the CD&A. Take, for example, a company that bases its incentive compensation on EBITDA, revenue, and TSR, all weighted equally. Because the company's incentive compensation is based on only three equally weighted metrics, it would create unhelpful and potentially misleading disclosure to: (i) require the company to select two additional performance metrics that may or may not actually be utilized; and (ii) arbitrarily rank the three performance metrics that are utilized when no one metric is really of any more importance than the other two.

Thus, such prescriptive disclosure would not be helpful for most investors, who can already find the company's performance methodology and the reasoning behind its measures in the CD&A.

Thank you for the opportunity to provide you with our comments on pay versus performance disclosure. The Society welcomes the opportunity to further discuss the recommendations set forth in this letter. If you have any questions, please do not hesitate to contact us.

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[24] *Id*.

Respectfully submitted,

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