Americans for Financial Reform Education Fund

March 18, 2022

Vanessa A. Countryman
Securities and Exchange Commission
100 F St. NE
Washington, DC 20549

Re: Reopening of Comment Period for Pay Versus Performance (File No: S7-07-15)

Dear Secretary Countryman,

The Americans for Financial Reform Education Fund (AFREF) appreciates the opportunity to comment on the proposal of the Securities and Exchange Commission (the Commission) to implement Section 953(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, relating to executive compensation for financial performance. AFREF enthusiastically welcomes the Commission's actions to implement this important statutory requirement.

Section 953(a) of the Dodd-Frank Act added Section 14(i) to the Securities Exchange Act of 1934 (Exchange Act). This section mandates that the Commission adopt rules requiring issuers to disclose, in proxy or consent solicitation material for an annual shareholder meeting, "a clear description" of executive compensation, "including 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 and dividends of the issuer and any distributions."[1]

The Commission published a proposed rule to implement this statutory mandate in 2015, and reopened the comment period earlier this year to give the public an opportunity to consider developments since the initial publication date and to respond to additional requests for comment. AFREF supports the Commission's proposed rule, which would increase the transparency of executive compensation and better equip shareholders to make informed

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[1] Dodd-Frank Wall Street Reform and Consumer Protection Act, Section 953 (2010), *available at* https://www.govinfo.gov/content/pkg/PLAW-111publ203/pdf/PLAW-111publ203.pdf.

decisions in pay for performance votes. Below, we make recommendations on how to answer some of the questions posed by the Commission in the proposed rule, taking into consideration potential pitfalls.

Potential Pitfalls

1. Although Including Total Shareholder Return (TSR) Is Appropriate, A Hyperfocus on This Metric Can Result in Incentives that Are Risky to the Long-Term Financial Health of the Issuer and Exacerbate Inequality.

Including TSR in the disclosures is appropriate, as section 953(a) of the Dodd-Frank Act mentions "taking into account any change in the value of the shares of stock and dividends of the issuer and any distributions."[2] However, history teaches us that a hyperfocus on TSR can result in short-termism that puts the long-term financial health of an issuer at risk. CEOs and other named executive officers already have strong incentives to prioritize maximizing short-term TSR above all else, in part because of how executive compensation packages have evolved over time. In 1984, equity-based compensation did not account for any part of the median executive's compensation at S&P 500 companies; by 2001, it accounted for 66%.[3] In 2012, the 500 highest-paid public company executives received, on average, 83% of their compensation from stock options and stock awards.[4] Meanwhile, the CEO to worker compensation ratio has exploded—from 20 to 1 in the 1960s to more than 300 to 1 today.[5] Putting TSR front and center on pay versus performance disclosures runs the risk of further entrenching incentives to maximize short-term TSR at the expense of all else including worker compensation, which could serve to further polarize executive and worker compensation.

Focusing on short-term TSR can also incentivize financial engineering tactics like stock buybacks, which can both obfuscate the underlying financial health of the issuer and come at the expense of critical investments. By reducing the number of outstanding shares, stock buybacks drive up share prices without creating value for the real economy. Therefore, while stock buybacks increase the value of shares—which is reflected in TSR, they are not necessarily a reflection of strong financial fundamentals.

In the 2010s, corporations spent a whopping $6.3 trillion on stock buybacks.[6] Stock

[2] *Id*.
[3] Lynn Stout, *The Shareholder Value Myth: How Putting Shareholders First Harms Investors, Corporations, and the Public*, 21, Berrett-Koehler Publishers, 1st Edition (May 7, 2012).
[4] William Lazonick, "Profits Without Prosperity," Harvard Business Review, Sept. 2014, *available at* https://hbr.org/2014/09/profits-without-prosperity.
[5] Lawrence Michel, "CEOs were paid 351 times as much as a typical worker in 2020," Economic Policy Institute, Aug. 21, 2021, *available at* https://www.epi.org/publication/ceo-pay-in-2020/.
[6] Lenore Palladino & William Lazonick, "Regulating Stock Buybacks: The $6.3 Trillion Question," Roosevelt Institute, May 2021, *available at* https://rooseveltinstitute.org/wp-content/uploads/2021/04/RI_Stock-Buybacks_WorkingPaper_202105.pdf.

buybacks come at the expense of investments in human capital, workers' wages and benefits, research and development, customer experience, infrastructure improvements, and climate action plans, among other longer-term investments that contribute to equitable and sustainable economic growth over time.[7] Indeed, studies have found that stock buybacks are correlated with layoffs and wage stagnation.[8] During the pandemic, companies bought back $521 billion shares of stock.[9] That money could have been used to protect and support workers through personal protective equipment, hazard pay, and paid sick leave.

Lastly, a hyperfocus on short-term TSR and profits can incentivize risky behavior, as the world experienced during the 2008 financial crash.[10] It can also incentivize risky underinvestment in safety. For example, a fatal mine disaster in West Virginia followed years of compensation tied to cutting safety expenses, and two Boeing airline crashes followed CEO compensation tied to cost-cutting.[11]

2. Company-Selected Performance Measures Can Be Misleading.

Companies have chosen misleading metrics to justify excessive executive compensation in the past. A recent Starbucks compensation metric serves as a notable example. After investors rejected a $50 million bonus to Chief Executive Officer Kevin Johnson,[12] Starbucks revamped his bonus to have it partly tied to the reduction of plastic straws.[13] Though such a bonus structure was developed by Starbucks to show investors that it is trying to be more environmentally conscious, studies have found that plastic straws only account for about 0.025%

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[7] William Lazonick, "Profits Without Prosperity," Harvard Business Review, Sept. 2014, *available at* https://hbr.org/2014/09/profits-without-prosperity; William Lazonick, Mustafa Erdem Sakinç, & Matt Hopkins, "Why Stock Buybacks Are Dangerous for the Economy," Harvard Business Review, Jan. 7, 2020, *available at* https://hbr.org/2020/01/why-stock-buybacks-are-dangerous-for-the-economy.

[8] Lenore Palladino, "Financialization at work: Shareholder primacy and stagnant wages in the United States," Competition and Change, Jun. 22, 2020, *available at* https://journals.sagepub.com/doi/abs/10.1177/1024529420934641; William Lazonick, "Stock buybacks: From retain-and-reinvest to downsize-and-distribute," Brookings Institute Center for Effective Public Management, Apr. 17, 2015, *available at* https://www.brookings.edu/research/stock-buybacks-from-retain-and-reinvest-to-downsize-and-distribute/.

[9] Bob Pisani, "Stock buybacks surge to likely record highs, but a tax from Congress poses a threat," CNBC, Oct. 27, 2021, *available at* https://www.cnbc.com/2021/10/27/stock-buybacks-surge-to-likely-record-highs-but-a-tax-from-congress-poses-a-threat.html; "Tax Corporate Stock Buybacks that Enrich Executives and and Worsen Inequality," 1, Americans for Financial Reform & Take On Wall Street, Nov. 2021, *available at* https://ourfinancialsecurity.org/wp-content/uploads/2021/11/AFR-TOWS-buyback-tax-FS-11-21.pdf.

[10] Bartlett Naylor, "White Collar Crime Pays," 8-13, Public Citizen, Jul. 2020, *available at* https://www.citizen.org/article/white-collar-crime-pays/.

[11] *Id*. at 19-22.

[12] Jonathan Maze, "Starbucks Shareholders Deliver A Rare Rebuke On Compensation," Restaurant Business Magazine, Mar. 18, 2021, *available at* https://www.restaurantbusinessonline.com/financing/starbucks-shareholders-deliver-rare-rebuke-compensation.

[13] Patrick Temple-West, "US companies add environmental and social targets to executive bonuses," Financial Times, Feb. 20, 2022, *available at* https://www.ft.com/content/86102111-3361-43e6-8e86-3dc6dfe7bb6f.

of the plastic in the ocean.[14] Therefore, Starbucks's plastic straw reduction was not doing enough in the movement toward meaningful environmental pollution reduction. Without guardrails, the "Company-Selected Measure" contemplated by the Commission's proposed rule runs the risk of misleading investors and serving as a rationalization for excessive executive compensation.

Recommendations

1. Require TSR to be a Five-Year Cumulative and Rolling Average.

Question 21 of the proposed rule asks for input on the TSR time periods to be disclosed. We recommend a five-year cumulative and rolling average as described in the proposed rule: "the TSR for the first year would be the average TSR over the five years preceding and including the first year, the TSR for the second year would be the average TSR over the five years preceding and including the second year, etc."[15] Calculating TSR to cover a longer period of time would start shifting incentives away from short-termism and toward long-term financial health and growth. Additionally, a TSR that covers a longer period of time is more likely to dilute the distorting effects of financial engineering.

2. Require Stock Buyback Disclosures for the Timeframes Covered by Reported TSR.

Because stock buybacks increase share price by reducing the number of outstanding shares without any concrete, underlying value creation, information about stock buyback programs should be disclosed alongside TSR. These disclosures would provide necessary context for investors to evaluate the extent to which TSR may or may not be related to performance, and could mirror the ones the Commission is already contemplating requiring in a separate rule.[16]

3. Require Disclosure of All Performance Measures That Determine Executive Compensation, or at Least Five.

Question 13 of the proposed rule asks whether the Commission should require registrants to disclose all of the performance measures that actually determine named executive officer compensation. We believe that all measures should indeed be disclosed. However, if the Commission decides against going this route, we recommend requiring disclosure of the five

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[14] Sarah Gibbens, "A brief history of how plastic straws took over the world," National Geographic, Jul. 1, 2018, *available at* https://www.nationalgeographic.com/environment/article/news-plastic-drinking-straw-history-ban.
[15] Securities and Exchange Commission, "Reopening of Comment Period for Pay Versus Performance," 27, File No. S7-07-15, Jan. 27, 2011, *available at* https://www.sec.gov/rules/proposed/2022/34-94074.pdf.
[16] Securities and Exchange Commission, "Share Repurchase Disclosure Modernization," File No. S7-21-21, Dec. 15, 2021, *available at* https://www.sec.gov/rules/proposed/2021/34-93783.pdf.

most important performance measures used by the registrant in order of importance, as contemplated elsewhere in the proposed rule.[17]

It is important to avoid having a singular "Company-Selected Measure" because of the ease with which one measure could mislead investors, as discussed above. Requiring disclosure of all or at least five of the performance measures actually used to link compensation to performance would minimize the risk of misleading investors, and would paint a more holistic picture of company priorities for investors to evaluate.

4. Encourage Inclusion of Standardized Environmental, Social, and Governance (ESG) Measures in Company-Selected Performance Measures.

Question 7 of the proposed rule asks, in part, whether company-selected measures should only be financial performance measures, or whether other measures, such as ESG measures, should be allowed. The Commission should allow *and* encourage the inclusion of ESG measures in company-selected measures, as they are of increasing importance to investors and positively tied to financial performance and long-term financial health.

In recent years, investors have called attention to the importance of ESG measures in evaluating investment opportunities. A survey conducted by UBS found that 78% of surveyed asset owners incorporate ESG factors into their investment decisions.[18] Besides informing their investment decisions, investors have also been engaging in significant shareholder activity on these issues, demanding greater transparency and action on ESG factors. In 2020, there were 93 environmental and social shareholder proposals—a number that increased to 121 in 2021.[19]

In addition to investor interest, the Commission should encourage the use of ESG measures because of their correlation with financial performance. A recent meta-study conducted by the NYU Stern Center for Sustainable Business and Rockefeller Asset Management found that: ESG factors are positively correlated with financial performance; ESG initiatives at corporations drive better financial performance; ESG-driven improvements to financial performance grow over time and are most prominent over long time horizons; and ESG investing provides protection from downturns.[20]

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[17] Securities and Exchange Commission, "Reopening of Comment Period for Pay Versus Performance," 10-11, File No. S7-07-15, Jan. 27, 2011, *available at* https://www.sec.gov/rules/proposed/2022/34-94074.pdf.
[18] Dennis Fritsch, "ESG: Do you or Don't you?" 8, Responsible Investor Research & UBS, 2019, *available at* https://www.ubs.com/campaign/res/ubs_extfront_prod/responsible-investor-ubs-esg-do-you-or-dont-you_.pdf.
[19] *Peter Reali, Jennifer Grzech, and Anthony Garcia, Nuveen,* "ESG: Investors Increasingly Seek Accountability and Outcomes," Harvard Law School Forum on Corporate Governance, Apr. 25, 2021, *available at* https://corpgov.law.harvard.edu/2021/04/25/esg-investors-increasingly-seek-accountability-and-outcomes/.
[20] Tensie Whelan, Ulrich Atz, Tracy Van Holt and Casey Clark, "ESG and Financial Performance: Uncovering the Relationship by Aggregating Evidence from 1,000 Plus Studies Published between 2015 - 2020," NYU Stern Center for Sustainable Business and Rockefeller Asset Management, Aug. 2021, *available at* https://www.stern.nyu.edu/sites/default/files/assets/documents/ESG%20Paper%20Aug%202021.pdf

In order to protect against greenwashing and the use of misleading or incomparable ESG metrics, the Commission should require that ESG pay for performance measures be standardized in alignment with other Commission proposals currently or soon under consideration, including potential enhanced disclosure requirements around climate change and human capital management.

5. Require Company-Selected Performance Measures to be Transparent, Consistent, and Not Easily Manipulated.

For company-selected performance measures to be meaningful to investors, they must be transparent, consistent, and not easily manipulated by those whose performance is being evaluated. They must be transparent, meaning that the process for arriving at the measures and the justifications for the measures should be made clear to shareholders. Measures must be consistent, meaning that the goal posts should not change mid-stream—for example, if the measure was to cut greenhouse gas emissions by 10%, the goalpost should not change to 5% later in the performance year. Lastly, measures must not be susceptible to being easily manipulated by the executive being evaluated—for example, in the way that executives can engage in stock buybacks to increase share price without making substantive changes to their businesses.

We thank the Commission for engaging in this important rule-making process to implement the pay versus performance statutory requirement. We appreciate the Commission's consideration of our recommendations to make the rule as effective as possible at facilitating informed shareholder pay for performance voting, while avoiding incentivizing risky behavior and fostering inequality. For further discussion, please contact Natalia Renta at

Sincerely,

Americans for Financial Reform Education Fund