CENTER FOR CAPITAL MARKETS COMPETITIVENESS

TOM QUAADMAN
VICE PRESIDENT

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[redacted]

June 30, 2015

Mr. Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549

Re: **Proposed Rules on Pay Versus Performance; 17 CFR Parts 229 and 240; Release No. 34-74835; File No. S7-07-15; RIN 3235-AL00**

Dear Mr. Fields:

The U.S. Chamber of Commerce[1] ("Chamber") created the Center for Capital Markets Competitiveness ("CCMC") to promote a modern and effective regulatory structure for capital markets to fully function in a 21st century global economy. To achieve this objective it is an important priority of the CCMC to advance strong corporate governance structures for capital markets to fully function in a 21st century economy. The CCMC welcomes the opportunity to comment on the proposed rule issued by the Securities and Exchange Commission ("SEC" or "Commission") on April 29, 2015, in the release entitled Pay Versus Performance ("the Proposal") which seeks to implement Section 953 (a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").

The CCMC believes that a Pay Versus Performance disclosure can assist investor decision making, but the Proposal fails to do so. The Proposal in its current form will increase the complexity of disclosures—counter to the SEC's current efforts to promote disclosure effectiveness—fails to provide investors with decision useful information on compensation or performance and may incentivize short-termism. Rather, the CCMC believes that the Pay Versus Performance disclosure should follow

[1] The U.S. Chamber of Commerce is the world's largest business federation, representing the interests of more than three million businesses and organizations of every size, sector, and region.

a principles-based format allowing companies to describe the performance metrics they use and to explain their processes for establishing compensation guidelines in a way that best expresses how pay and performance are aligned for their individual circumstances. The CCMC also believes that the Commission should consider how proxy advisory firms should consider the Proposal in light of the Staff Guidance, Legal Bulletin No. 20 issued on June 30, 2014. Finally, the Chamber believes that smaller issuers should be exempt from the proposal.

The CCMC's concerns are discussed in greater detail below.

Discussion

1. At a Time When the Commission Is Focused on Improving Disclosure Effectiveness, the Proposal Only Increases Complexity

In the eight decades since the securities laws were enacted, public company disclosure requirements have increasingly expanded and become more complex, as evidenced by the voluminous annual and quarterly reports filed today.[2] This expansion and increased complexity of disclosure has contributed to the phenomenon of "disclosure overload", whereby investors are so inundated with information it becomes difficult for them to determine the most salient factors they need to make informed voting and investment decisions. Retail investors are particularly vulnerable, as they often do not have the resources to help them make sense of the detailed SEC filings of the companies they invest in. In fact, we believe the disclosure overload phenomenon is the leading contributor to why retail shareholder participation has dropped to levels as low as five percent at some annual shareholder meetings. In a very real way, information overload has led to the disenfranchisement of retail shareholders at many public companies.

[2] For example, a 2012 report by Ernst & Young estimated that the average number of pages in annual reports devoted to footnotes and Management's Discussion and Analysis ("MD&A") has quadrupled over the last 20 years. Should this trend continue, companies would be devoting roughly 500 pages to MD&A by the year 2032. The Ernst & Young report can be found at: http://www.ey.com/Publication/vwLUAssets/ToThePoint_BB2367_DisclosureOverload_21June2012/$FILE/TothePoint_BB2367_DisclosureOverload_21June2012.pdf

Retail shareholders aren't alone. A recent study by Professor David Larcker of Stanford University found that 55% of institutional investors surveyed[3] felt the typical public company proxy statement was too long and 48% believe the typical proxy statement is too difficult to read and understand.

The Chamber has welcomed the efforts by Chair White and Corporation Finance Director Higgins to start a Disclosure Effectiveness project to address these long-outstanding issues. Last year the Chamber released a report discussing these issues and outlining steps the Commission should take to improve and streamline disclosure.[4] However, we are concerned that the Proposal conflicts with the apparent objectives of the Disclosure Effectiveness project. Rather than provide Pay Versus Performance disclosure in a simple, easy-to-understand format, the Proposal relies on an intricate table, largely comprised of duplicative information found elsewhere in the proxy statement or annual report, that itself incorporates a series of byzantine calculations and draws false comparisons that most investors will struggle to place in proper context.

Additionally, as will be explained in further detail below, we believe that the Proposal will fail to provide investors with decision-useful information to understand the companies in which they invest. On the contrary, the Proposal will, we believe, layer more complex disclosures into the proxy statement and make it even more difficult for investors to decipher and understand the surrounding information in that disclosure document.

2. **Total Shareholder Return under Item 201(e) of Regulation S-K ("TSR") is an Imprecise Measure of Performance that Few Companies Use When Setting Executive Compensation.**

The Proposal would require the use of Total Shareholder Return ("TSR") as the primary measure of performance for companies for purposes of the new Item 402(v) disclosure, foregoing other metrics that companies utilize when evaluating

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[3] The investors surveyed had a total of $17 trillion under management. The study can be found at: http://www.gsb.stanford.edu/faculty-research/publications/2015-investor-survey-deconstructing-proxy-statements-what-matters.
[4] The study on Corporate Disclosure Effectiveness can be found at: http://www.centerforcapitalmarkets.com/wp-content/uploads/2014/07/CCMC_Disclosure_Reform_Final_7-28-20141.pdf.

performance and establishing compensation guidelines for executives. The Proposal would mandate the use of TSR without providing any compelling evidence that it is a metric commonly used by companies to measure performance or in setting compensation. While boards of directors may consider shareholder return when setting performance targets for the principal executive officer (PEO) and other senior executives, most do not calculate this return in the way that Item 201(e) of Regulation S-K contemplates. Instead, they typically use specialized metrics more appropriate for their respective industries, geographies and peer groups.

Additionally, the Proposal ignores the many shortcomings of TSR. By way of example, the exclusive use of TSR does not take into account special company-specific factors that affect compensation decisions or the myriad of reasons that compensation may not have a direct or immediate positive correlation with performance, such as when a company chooses to take a more long-term view of operating results when setting executive compensation, or when an underperforming company in dire need of a turnaround decides to provide a more generous compensation package to attract a new principal executive officer who possesses much-needed skills and expertise. Companies may feel pressure to put off investments in important strategic initiatives, new products and equipment that are in shareholders' long-term best interests because they do not generate immediate returns.[5] The CCMC agrees with the concern that placing undue emphasis on TSR risks overemphasizing short-term performance at the expense of creating long-term value for shareholders.[6]

The goal of the Proposal should be to provide material information that is useful to investors. However, setting TSR as the benchmark is likely to confuse many investors by incorrectly leading them to believe that it is the sole and most applicable metric that companies use (or should use) as they establish compensation policies when in fact most companies appropriately consider a variety of factors when determining executive compensation.[7] If TSR were adopted as the mandated metric, investors may place undue weight on TSR as they make investment decisions, even

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[5] The Chamber has raised these concerns on short-term decision making including the use of quarterly earnings guidance.
[6] *See* Commissioner Daniel M. Gallagher's Dissenting Statement at an Open Meeting Proposing Mandated Pay versus Performance Disclosures (Apr. 29, 2015).
[7] The proposed calculation also deviates substantially from the calculation of total compensation in the summary compensation table that appears elsewhere in the proxy statement, which would further exacerbate investor confusion.

though a particular company may not actually use TSR at all in setting compensation. One unintended consequence of a Commission endorsement is that more companies may begin managing to TSR or make more widespread use of it in setting executive pay.

Further, the requirement that a company disclose the TSR of its peers and the relationship between company and peer TSR would not provide meaningful disclosure as it fails to account for the fact that market conditions or internal firm strategy may affect each peer's stock performance differently and that a company is not in the best position to explain the rationale for a peer's stock price change without greater insight into their overall financial performance. Further, in attempting to explain a peer's TSR, a company may face potential liability for publicly making assumptions regarding another company's performance.

Given these significant drawbacks, we believe such a rigid use of TSR is inadvisable.

Although the Proposal permits companies to provide supplemental disclosure regarding the factors they take into consideration when establishing executive compensation, we believe this approach is backwards. Item 402(v) should not require companies to calculate a hypothetical metric that they do not rely on in setting pay, and then compel them to discuss all the reasons why the hypothetical metric is of little or no applicability to them. A more straightforward approach, and the one favored by the CCMC, would be to require companies to discuss the criteria that are actually important to them, along with how the PEO performs over time against that metric.

The Commission itself made many of these points in 2006 when it adopted the current Compensation Discussion and Analysis ("CD&A") framework. In the CD&A adopting release, the Commission stated:

> We remain of the view that the Performance Graph [which graphically displays TSR] should not be presented as part of executive compensation disclosure. In particular, as noted above, the disclosure in the Compensation Discussion and Analysis regarding the elements of corporate performance that a given company's policies consider is intended to encourage broader discussion than just that of the relationship of executive

> compensation to the performance of the company as reflected by stock price. Presenting the Performance Graph as compensation disclosure may weaken this objective. Accordingly, we have decided to retain the requirements for the Performance Graph, but have moved them to the disclosure item entitled "Market Price of and Dividends on the Registrant's Common Equity and Related Stockholder Matters."[8]

We do not see any compelling reason to now depart from this carefully considered position.

3. The Calculation of Compensation "Actually Paid" to the PEO and Other Named Executive Officers ("NEOs") Is Not An Accurate Measure of Compensation.

The proposed calculation of compensation "actually paid" includes a variety of adjustments that fail to provide an accurate measure of the total amount paid by companies to the PEO and other NEOs. Most significantly, the calculation would include the value of equity compensation on the date vested instead of on the date granted. By including the value of equity compensation on the date vested, the calculation does not result in an accurate representation of actual compensation received by the PEO and NEOs. The switch to using the fair value of equity compensation on the grant date to the fair value on the date vested can distort the Pay Versus Performance relationship by making it appear that compensation is higher in years when awards vest as opposed to years when they were granted, although the latter is likely to correlate more with performance. Said differently, there is no logical relationship between the accounting value of an award during a particular year and a given company's results of operations in that year.

The inclusion of the service cost of an executive's pension benefits into the calculation of compensation "actually paid" does not accurately reflect how many boards of director's view pay for performance or determine year-end compensation in light of company performance. An executive cannot monetize any pension benefit

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[8] Release Nos. 33-8732A; 34-54302A; IC-27444A; *Executive Compensation and Related Person Disclosure*, at 44 (Aug. 29, 2006).

until he/she becomes eligible to receive such benefit post-employment and pension benefits are typically not intended to be performance-based. In addition, due to fluctuating actuarial assumptions applicable to service costs, such costs for any given year would not reflect the performance of the company and can distort the "actually paid" calculation.

Few boards of directors conceptualize compensation "actually paid" in the way that the Proposal does. In many cases, boards and compensation committees also base compensation decisions on executive performance over several years rather than a single one. Thus, the Proposal effectively requires the comparison of two numbers (i.e., compensation "actually paid" and TSR) that are largely irrelevant to the compensation calculus made by most corporate boards and their compensation committees, in many cases over time horizons that differ significantly from those employed by those boards and compensation committees.

If the Commission wants to ensure that the Pay Versus Performance disclosure gives investors accurate insight into executive compensation decisions, it should require companies to disclose the metrics they actually use without reference to an artificial metric like TSR that few use for this purpose. The CCMC believes that a more principles-based approach would better reflect the fact that compensation policies are not homogeneous, and therefore the metrics used to evaluate them should reflect that variety. Such an approach would also be consistent with the narrative style currently embodied in CD&A disclosure. In sum, the Commission should provide more flexibility and allow registrants to choose other measurements of performance that are better able to capture the complexities of these decisions, instead of requiring the use of TSR.

4. **Aggregation of Compensation for Multiple NEOs and PEOs and inclusion of Severance and Sign on Payments in Compensation "Actually Paid" Does Not Accurately Depict the Pay Versus Performance Relationship.**

Companies hire and evaluate senior executives using criteria that are constantly evolving based on the goals and strategies of the company at a given time. Compensation packages are often heavily negotiated and may vary significantly for different executives within the same company. Therefore, the Proposal's requirement that compensation be aggregated for multiple PEOs and NEOs who serve during the same year will distort the compensation picture and blur the relationship between pay and performance.

Because the criteria used by a company to evaluate the performance of one PEO may not be the same for a successor PEO, aggregating the compensation data for multiple PEOs who serve in a single year will not allow for a nuanced presentation of these differences. Additionally, aggregation of the data could suggest relationships between pay and performance that are inaccurate. For instance, if one PEO departs late in the year, and a new PEO begins with only a few weeks of the fiscal year remaining, the new PEO would not have had much time to impact performance in a measurable way, but his or her compensation would be included along with the prior PEO's compensation and used to demonstrate the relationship between compensation and performance. Also, given the fact that a departing PEO may receive severance payments and an incoming PEO may receive signing bonuses and relocation assistance, in years when a PEO leaves, compensation will be higher than usual and aggregating the data will not allow investors to appreciate the meaningful differences between the compensation of each PEO. It should also be noted that the role and duties of PEOs vary by company and this should be taken into account also.

Such severance and sign on payments for departing/incoming PEOs or other NEOs should not be included in the calculation of compensation "actually paid" given the one-time nature of such amounts and the fact that the payments are not intended to be reflective of the company's annual or even three-year performance. Instead, such payments are either reflective of an executive's career with the company or are incentive payments to recruit a qualified executive to a high ranking position within the firm. In either case, the inclusion of these one-time amounts would distort the pay for performance picture and not provide shareholders with an accurate view of how the board determined pay in light of performance.

Although some of these shortcomings can be explained through supplemental disclosure, we believe it would be preferable to avoid investor confusion altogether by requiring disclosure for each PEO separately and removing severance or sign on payments from the calculation of compensation "actually paid".

Aggregating data on the other NEOs presents its own set of problems. First, most investors focus their attention on the PEO and place less emphasis on the compensation of other executive officers, which calls into question the fundamental need for the disclosure in the first place. Second, because there is often more frequent turnover year-over-year in the ranks of the other NEOs as well as greater variability in their pay, any effort to use aggregated data for them will be hampered by the inherently high level of volatility that will be associated with the average number. Finally, in contrast to the PEO, not all NEOs are in a position to impact overall performance of the company. NEOs often include executives who hold positions in accounting, financial reporting, legal and other administrative functions that have limited ability to impact a company's results of operations, which further calls into question the usefulness of any effort to correlate their pay to a company's performance. Therefore, the CCMC believes Pay Versus Performance disclosure should be limited to the PEO alone.[9]

5. **Requiring XBRL Tagging of Data Would Be Costly and Provide Little (if Any) Benefit to Investors.**

While the CCMC shares the Commission's desire to make information more accessible to investors, we believe the benefit for investors of XBRL tagging would be minimal at best. Notwithstanding the high hopes many had for the use of XBRL when it was first incorporated into Commission reporting in 2009, there is little to no indication that investors have found XBRL tagging of data to be particularly useful. In our experience, institutional investors typically utilize their own proprietary data entry and analysis systems to assess companies' performance, and retail investors generally do not use XBRL-tagged data to compare companies at all. Furthermore, we are aware of several providers of XBRL analytical tools for SEC disclosures that have had to scale back operations or cease doing business entirely because there is no demand for their services. Before expanding any XBRL tagging requirement, the Commission should first produce data showing that a significant number of investors are actually using XBRL disclosures to make investment decisions.

The Proposal requires separate tagging of each value in the proposed table and block-text tagging of the footnote disclosure and of the disclosure of the relationship

[9] Section 953(a) of the Dodd-Frank Act does not include any requirement to discuss NEOs.

among the measures. At the present time, none of the other data in proxy or information statements are required to be tagged, and no standard tagging taxonomy exists. Given the variability in inputs into the compensation "actually paid" calculation across companies and the high likelihood of the development of custom tags by individual companies, there is likely to be little comparability in XBRL tagging among companies. This lack of comparability undermines the premise of XBRL tagging.

Additionally, mandating that companies use XBRL tagging of data would add further time and expense to the preparation of proxy statements by reporting companies. Currently, when companies use XBRL tagging, it increases the time needed to prepare filings and often involves the engagement of third-party XBRL tagging services. The cost of these XBRL services varies widely and in some cases can cost up to tens of thousands of dollars. The added time necessary to complete the tagging would add an additional burden to companies already racing to meet tight filing and proxy distribution deadlines, particularly for those companies relying on notice-and-access delivery who are required to file definitive proxy materials forty days prior to the annual meeting date. In light of the fact that the burdens imposing this requirement on companies appear to far outweigh any benefit to investors, we do not believe the Commission should require XBRL tagging of data in the Pay Versus Performance disclosure.

6. **Item 402(v) Disclosure Would Be Burdensome for Smaller Reporting Companies.**

The requirements of the Proposal would prove to be disproportionately burdensome and costly for smaller reporting companies. Although the Proposal provides for scaled disclosure for smaller reporting companies and provides a phase-in period, we believe these minor accommodations still do not do enough to limit the unduly adverse effect this proposed disclosure will have on smaller reporting companies. The requirements of XBRL tagging of data, performing new calculations for TSR (a burden not currently borne by smaller reporting companies) and compensation "actually paid," and providing additional narrative disclosure will prove time-consuming and costly even for larger companies, so the effect on smaller reporting companies, notwithstanding any scaled disclosure, would be significant.

More fundamentally, executive compensation issues are less acute at smaller reporting companies. We are not aware of any crisis—real or perceived—in executive compensation practices at smaller reporting companies. We believe smaller reporting companies should therefore be exempt from providing Pay Versus Performance disclosure.

7. The Proposal Would Further Entrench Proxy Advisory Firms

Proxy advisory firms currently develop voting policies and make recommendations on executive compensation and total shareholder return. Some of the activities of proxy advisory firms have been controversial, and the Chamber has previously been critical of proxy advisor policies including "one size fits all" recommendations, a lack of due process around the development of voter policies and recommendations, failure to link recommendations with the economic interests of the firm's clients and failure to disclose specific conflicts of interests. In 2014 the SEC Staff issued Staff Legal Bulletin No. 20 to address some of these issues, as well as the concerns of other stakeholders.

In September 2014, the Chamber filed a comment letter with Institutional Shareholder Services ("ISS") on its policies for the upcoming proxy season and raised serious concerns with the ISS recommendations on Pay Versus Performance.[10] The Chamber's letter raised concerns that the ISS view on Pay Versus Performance did not accurately look at CEO pay and also failed to develop and construct information in a manner that was beneficial to investors. We believe that these points are important for two reasons. First, ISS's treatment of the Pay Versus Performance issue has some of the same flaws as the Proposal. Second, once the Proposal is adopted, proxy advisory firms' recommendations on executive compensation under Item 402(v) will be a significant factor in how companies draft their Pay Versus Performance disclosures in practice and whether shareholders support a company's advisory vote on executive compensation (Say-on-Pay).

Therefore, we believe it is important for issuers and investors to understand both how the SEC views the role of proxy advisory firms in the implementation of the Proposal and how Staff Legal Bulletin No. 20 will apply to ensure executive

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[10] The Chamber September 2, 2014, letter to ISS is attached as Appendix A.

compensation matters on the topic of Pay Versus Performance are reviewed by proxy advisory firms in a balanced manner.

Conclusion

Thank you for considering our views on the Proposal. The Pay Versus Performance rules mandated by the Dodd-Frank Act can be enacted in a way that provides necessary flexibility, creates fewer burdens on companies (particularly smaller reporting companies), and avoids unnecessary investor confusion. Unfortunately, the Proposal in its current iteration does not achieve these objectives. The CCMC believes that our concerns with the Proposal can be easily addressed and that the Commission should modify the Proposal to create a Pay Versus Performance reporting regime that balances the desire to provide useful information to investors with the need to accurately reflect the complexities of companies' compensation policies.

We stand ready to assist the Commission in this effort.

Sincerely,

Tom Quaadman

APPENDIX A

CENTER FOR CAPITAL MARKETS
COMPETITIVENESS

TOM QUAADMAN
VICE PRESIDENT

1615 H STREET, NW
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September 2, 2014

Mr. Gary Retelny
President
Institutional Shareholder Services
702 King Farm Boulevard
Suite 400
Rockville, MD 20850

Re: 2015 ISS Policy Survey

Dear Mr. Retelny:

The U.S. Chamber of Commerce ("Chamber") is the world's largest business federation, representing more than 3 million businesses and organizations of every size, sector, and region. The Chamber created the Center for Capital Markets Competitiveness ("CCMC") to promote a modern and effective regulatory structure for capital markets to function fully and properly in a 21st century economy. In furtherance of this objective, a chief priority of the CCMC is to advance an accountable and transparent corporate governance regime.

The CCMC appreciates this opportunity to comment on Institutional Shareholder Services Inc.'s ("ISS") 2015 Policy Survey ("Survey").[1] This letter supplements our online responses to the Survey, electronically submitted today. Our comments focus on U.S. capital markets; our supplemental comments are organized by reference to the Survey questions that focus on U.S. corporate governance issues.

The CCMC is concerned that the development of the Survey lacks a foundation based on empirical facts and creates a one-size-fits-all system that fails to take into account the different unique needs of companies and their investors. We

[1] *See* ISS, 2015 ISS Policy Survey, available at https://www.surveymonkey.com/s/2015_ISS_Policy_Survey.

believe that these flaws with the Survey can adversely affect advisory recommendations negatively impacting the decision making process for the clients of proxy advisory firms. The CCMC is also troubled that certain issues presented in the Survey, such as Pay for Performance, will be the subject of Securities and Exchange Commission ("SEC") rulemakings in the near future. While we have provided commentary to those portions of the Survey, we believe that their inclusion in the survey is premature pending the completion of those rulemakings.

Our concerns are discussed in greater detail below.

Discussion

The CCMC has, for many years, sought to advance a cooperative dialogue with key interested parties, including proxy advisors, institutional investors, investment portfolio managers, and corporate issuers, to improve the functionality of proxy advisory services. The focus of the CCMC's efforts is to ensure that potential benefits of a well-functioning proxy advisory industry are not outweighed by the potential systemic failures proxy advisory firms. Such failures could occur if the recommendations of proxy advisors are subject to conflicts of interest and could also arise if proxy advisors apply one-size-fits-all methodologies, offer check-the-box proxy voting policies, and engage in other practices that fail to acknowledge the inherently company-specific requirements of corporate governance.[2]

To advance these goals, the CCMC in 2013 issued the Chamber Best Practices and Core Principles, outlining principles and transparent processes for advisory firms, corporate issuers and investors. We believe, as is discussed below in greater detail, that the Survey fails to meet the universally-embraced goals the Chamber Best Practices and Core Principles seek to advance.

[2] To follow-up on an active dialogue that the Chamber had fostered with corporate secretaries and ISS to correct some of these flaws, the Chamber, in 2010, wrote to ISS and the SEC with a proposal to inject transparency and accountability into this system by creating Administrative Procedure Act-like processes for voting policies and recommendations. *See, e.g.*, Memorandum from U.S. Chamber of Commerce to ISS (Aug. 4, 2010), available at http://www.sec.gov/comments/s7-14-10/s71410-268.pdf. This would have allowed for an open dialogue in which all stakeholders could have participated, and would have better informed ISS of circumstances material to the interests of its clients. To date, ISS has not acted or commented on these recommendations. *See also*, Chamber, *Best Practices and Core Principles for the* Development*, Dispensation, and Receipt of Proxy Advice* (March 2013) ("Chamber Best Practices and Core Principles"), available at http://www.centerforcapitalmarkets.com/wp-content/uploads/2010/04/Best-Practices-and-Core-Principles-for-Proxy-Advisors.pdf.

General Concerns with Survey

Before addressing the Survey's specific questions, several observations are in order vis-à-vis the Survey's design, content, and likely impact on the ability of investment advisers to fulfill their fiduciary duties to vote portfolio securities in the economic best interests of their clients.[3]

Many investment advisers use proxy advisory firms' advice as one of many data points to develop voting positions, and in doing so meet their fiduciary responsibilities. Our general concerns with the Survey, as outlined in this section of our letter, do not pertain to those investment advisers. Rather, we are concerned with the impact of the Survey as it pertains to those investors who rely exclusively on, and effectively outsource their voting functions to, proxy advisory firms.

It is both surprising and very troublesome that the Survey does not contain a single reference to the paramount concern of investors and portfolio managers—public company efforts to maintain and enhance shareholder value—and seeks to elicit only abstract philosophies and opinions, completely eschewing any pretense of an interest in obtaining hard facts and empirically-significant data. This confirmation—that ISS' policies and recommendations are based solely on a miniscule sampling of philosophical preferences, rather than empirical data—is itself a matter that requires, but does not yet receive, appropriate disclosure and disclaimers on ISS research reports.[4]

[3] *See SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 194 (1963). *See also*, Securities and Exchange Commission ("SEC"), STAFF LEGAL BULLETIN No. 20 (IM/CF), "*Proxy Voting: Proxy Voting Responsibilities of Investment Advisers and Availability of Exemptions from the Proxy Rules for Proxy Advisory Firms*" (June 30, 2014) ("*SEC Staff Guidance*"), available at http://www.sec.gov/interps/legal/cfslb20.htm.
A similarly stringent standard applies to pension fund advisers subject to ERISA. *See, generally*, "Proxy-voting May Not Be Solely for the Economic Benefit of Retirement Plans," Dep't of Labor, Office of Inspector General—Office of Audit, Employee Benefits Security Administration, Report No. 09-11-001-12-121 (Mar, 31, 2011) ("*EBSA IG Report*"), available at http://www.oig.dol.gov/public/reports/oa/2011/09-11-001-12-121.pdf.

[4] *See SEC Staff Guidance*, *supra*, n. 3, Answer to Question 3. The SEC Staff Guidance advises that proxy advisory firms should update investment adviser clients on any considerations appropriate to investment advisers' consideration of the nature and quality of services provided by the proxy advisory firm. The Guidance also clearly identifies investment advisers' responsibility to ensure that votes they cast are in the best interests of their clients. *Id.*, Answer to Question 1. It follows, then, that investment advisers casting votes based in whole or in part on proxy advisory firm recommendations must receive, and proxy advisory firms must provide, assurances that the policies and analysis underlying voting recommendations have a close nexus with enhancing shareholder value, *see In re Manarin Inv. Counsel,*

As fiduciaries, investment advisers owe duties of care and loyalty to their clients,[5] duties that extend to their exercise of proxy voting discretion.[6] The SEC recently reconfirmed that, to fulfill their fiduciary duties, investment advisers must adopt and implement procedures ensuring that proxies are voted in the best interests of their clients—that is, that portfolio securities are voted to further shareholder value.[7] It therefore follows ineluctably that, to the extent an investment adviser's voting decisions are predicated in part on the recommendations of proxy advisory firms, the investment adviser must have a reasonable basis to conclude that the proxy advisory firm's recommendations are firmly based upon the criterion of furthering shareholder value.

As past experience demonstrates, ISS' voting recommendations are based on policies that are supported primarily, if not exclusively, by the results of its policy surveys.[8] The current policy survey clearly reinforces that conclusion. But, investment advisers cannot fulfill their fiduciary obligations to clients by basing voting decisions on proxy advisory firm opinions that make no reference to, much less that do not even deign to establish, a causal connection between the proxy advisory firm's recommendation and the enhancement or furtherance of shareholder values.[9]

Ltd., et al., Inv. Adv. Act Rel. No. 3686 (Oct. 2, 2013) ("*Manarin*"), available at https://www.sec.gov/litigation/admin/2013/33-9462.pdf or, in the event such assurances cannot be given, that investment advisers are made aware of that fact.

[5] *See*, *e.g.*, *SEC v. Capital Gains Research Bureau*, *supra*, n. 3 (recognizing fiduciary duties of care and loyalty owed by investment advisers to their clients).

[6] *See* SEC, "*Proxy Voting by Investment Advisers*," Investment Advisers Act Rel. No. 2106 (Mar. 10, 2003), ("*IA Proxy Voting Rule Adopting Release*"), available at http://www.sec.gov/rules/final/ia-2106.htm.

[7] *See SEC Staff Guidance*, *supra*, n. 3, Answer to Question 1. *See also IA Proxy Voting Rule Adopting Release, supra n. 6,* at I (Investment advisers' "enormous voting power gives advisers significant ability collectively, and in many cases individually, to affect the outcome of shareholder votes and influence the governance of corporations. Advisers are thus in a position to significantly affect the future of corporations and, as a result, *the future value of corporate securities held by their clients*.") (emphasis supplied).

[8] *See* ISS, Benchmark Policy Consultation, Auditor Ratification (U.S.) ("*ISS Auditor Ratification Policy Proposal*"), available at http://www.issgovernance.com/file/files/Auditorratification-US.pdf.

[9] The SEC has held an investment adviser's policies and procedures on affiliated brokerage transactions "not reasonably designed" to ensure "transactions were fair to shareholders, where the policies and procedures did not require any actual empirical investigation into the commissions charged by other broker-dealers for similar transactions, as one means of verifying their "reasonableness." *See Manarin*, *supra* n. 4, at ¶23. *See also*, *EBSA IG Report*, *supra*, n. 3.

These deficiencies make manifest that those investment advisers that rely in whole or in part upon ISS research and voting recommendations, cannot fulfill the fiduciary duties they owe their clients if they cast proxy votes:

- solely in reliance on ISS recommendations based on ISS policies
- that are supported solely or primarily by the results of ISS' opinion surveys, and
- ISS' policy is premised on an underlying rationale devoid of empirical research, rendering the policy devoid of any nexus between the voting decision and enhancement of shareholder values.[10]

The Survey, therefore, does not (indeed, cannot) provide ISS with any basis for arguing that its proxy voting policies reasonably facilitate the ability of SEC-registered investment advisers to fulfill their critical fiduciary obligations or comply with applicable regulatory standards.[11]

Discussion

Pay for Performance

2A. Which of the following statements best reflects your organization's view about the relationship between goal-setting and award values?

Other. The formulation of the responses to this question denies respondents' the ability to provide thoughtful responses to the complex issue of executive compensation. As indicated by the first response option, companies' compensation programs must take into account the need to attract and retain leadership talent. But, the second option also embodies important views on compensation that CCMC has

[10] *See EBSA IG Report*, *supra*, n. 3, at p. 4. ("EBSA's proxy-voting requirements in 29 CFR 2509.08-2 require whoever is voting proxies (generally named fiduciaries and investment managers) to consider only those factors that relate to the economic value of the plan's investment and not subordinate the interests of the participants and beneficiaries to unrelated objectives. According to the regulations, any objectives or considerations, or social effects unrelated to the plan's economic interests cannot be considered.").

[11] *See IA Proxy Voting Rule Adopting Release*, *supra*, n. 6.

embraced—that compensation should be tied to executive contributions to their company's performance and, therefore, shareholder returns, on an adjusted basis, while also taking into account that some circumstances affecting company performance are beyond executives' ability to control.[12]

The Survey's approach to this issue is overly simplistic—it assumes that compensation should be tied to absolute returns, without accounting for—or even considering—exogenous factors. For example, in a stagnant economy, companies may be compelled to reduce revenue goals to account for reduced demand, market-wide. In such cases, shareholder returns relative to the overall market are closely linked to their company's ability to obtain a piece of a smaller economic pie, and executive talents and leadership are even more important than they are in good economic times. Thus, a reflexive reduction in compensation during stagnant economic circumstances often would not serve shareholders' interests and, indeed, might prove deleterious.

The third response option correctly reflects the need for a board's and compensation committee's exercise of discretion in designing compensation programs that incentivize executives to create long-term shareholder value. Of course, the exercise of discretion is not unlimited, since directors and compensation committee

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12 The Chamber first articulated its Principles on Corporate Governance, Investor Responsibility and Executive Compensation in 2009. *See* Chamber, Letter to Treasury Secretary Geithner (Feb. 6, 2009) ("*Chamber Principles on Corporate Governance, Investor Responsibility and Executive Compensation*"), available at http://www.centerforcapitalmarkets.com/wp-content/uploads/2010/04/ExecutiveCompensationSecretaryGeithnerFeb62009.pdf

The Chamber Principles have four fundamental premises:

- Corporate governance policies must promote long-term shareholder value, but should not constrain reasonable risk-taking or innovation;
- Long-term strategic planning should be the foundation for managerial decision-making;
- Executive compensation should be premised on the enhancement of shareholder value through the combination of individual accomplishment, corporate performance, adherence to board risk management guidelines and regulatory compliance; and
- Robust and transparent management-shareholder communications.

These Principles have been referenced in numerous CCMC comment letters on corporate governance and executive compensation addressed to the SEC and other regulators.

members are legally obligated to design (and disclose to shareholders) compensation programs that further shareholder interests.[13]

> **2B.** *Is there a threshold at which you consider that the magnitude of a CEO's compensation should warrant concern even if the company's absolute and relative performance have been positive, for example, outperforming the peer group?*

Other. Pay magnitude can be a relevant factor in setting executive compensation, but only if the magnitude is unrelated to value creation. All criteria employed by compensation committees should be focused, ultimately, on preserving and enhancing shareholder value. The imposition of a "threshold" at which pay magnitude "warrants concern," irrespective of performance, represents the imposition of a non-performance-based pay criterion, in contravention of ISS' professed pay for performance philosophy.[14]

The question and answer options reflect ISS' "one-size-fits-all" approach to executive compensation, by providing two answer options that suggest extreme polar opposite views on compensation, and two answer options that imply reliance on inflexible tests, all of which do not appropriately account for the need to consider shareholder interests in light of the relevant facts applicable to each company. The first answer option implies that the magnitude of compensation will always be irrelevant. While we embrace the view that non-salary compensation should not be subject to either a floor or a ceiling, pay magnitude is an appropriate ancillary consideration, since the magnitude of executive compensation should reflect a strong relationship to value creation.

The fourth answer option implies the imposition of a "one-size-fits-all" cap on compensation that, as ISS has recognized in the past, would negatively affect

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[13] *See*, *e.g.*, RR Donnelley, "Annual Meeting Handbook 2014 Edition," at pp. 20-27 (2014), available at http://www.lw.com/WebShareRedirect.aspx?id=7056&sharetype=1.

[14] *See*, *e.g.*, *ISS 2014 Summary Guidelines*, at p. 38 (March 2014), available at http://www.issgovernance.com/file/2014_Policies/ISSUSSummaryGuidelines2014March12.pdf (describing ISS' "global principle" regarding pay for performance as one that "encompasses overall executive pay practices, which must be designed to attract, retain, and appropriately motivate the key employees who drive shareholder value creation over the long term").

shareholders' economic interests.[15] The second and third answer options imply that compensation limits should be somewhat flexible, based on absolute company performance or performance relative to the company's peer group. These are appropriate considerations, and CEO compensation programs should consider the company's absolute and relative performance, among many factors.

Moreover, this survey question is a solution in search of a problem, given that shareholders have overwhelmingly supported their companies' compensation programs.[16]

> **2C.** *If you chose "Yes" above (that pay magnitude may be a cause for concern, irrespective of performance factors), are any of the following appropriate tool(s) for determining excessive pay magnitude?*

Decline to Answer. Each of the answer options offered proposes tools that may, depending on the specific circumstances, be reasonable considerations for determining the "excessiveness" of CEO compensation. However, the utility of this question would depend on ISS reading the responses objectively, rather than elevating policy goals as the prism for its interpretation of the data. A high multiple of CEO compensation relative to that of other named executives (Option 2) could be a negative factor for some shareholders, but a high multiple could also have positive consequences for shareholders—for example, if the CEO's compensation motivates other non-CEO company executives to remain with the company and strive to outperform peers in their service to the company.

> **2D.** *With respect to evaluating the say-on-pay advisory vote, how does your organization view disclosed positive changes to the pay program that will be implemented in the succeeding year(s) when a company demonstrates pay-for-performance misalignment or other concerns based on the year in review?*

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[15] *Id.*, at p. 51 ("Vote against shareholder proposals seeking to set absolute levels on compensation or otherwise dictate the amount or form of compensation").

[16] The average voting support for U.S. companies' say-on-pay proposals was 92% in 2013 and 2014. *See* Sullivan & Cromwell, 2014 Proxy Season Review, at p. 27 (June 2014), available at http://www.sullcrom.com/siteFiles/Publications/SC_Publication_2014_Proxy_Season_Review.pdf

Option 1. Option 1 suggests that prospective changes to a company's pay program may substantially mitigate current year "concerns." CCMC believes that prospective positive (or negative) changes to a company's compensation program can, on a case-by-case basis, substantially mitigate current year "concerns." For example, a company may have pre-existing legacy employment agreements containing what may seem to be "problematic provisions" to which the company is contractually committed. In such cases, a commitment to eliminate such provisions in the future might appropriately be considered favorably. Moreover, to the extent that a company intends to make what shareholders deem improvements to its compensation program, the company should be afforded time to execute those improvements in a thoughtful manner. By not crediting companies with positive future improvements (Option 3), ISS would effectively be encouraging hasty decisions, which could prove detrimental to the interests of shareholders.

> **2E.** *If you chose either the first or second answer in the question above (prospective pay program changes can mitigate current concerns), should shareholders expect disclosure of specific details of such future positive changes (e.g., metrics, performance goals, award values, effective dates) in order for the changes to be considered as a potential mitigating factor for pay-for-performance or other concerns for the year in review?*

No. The requirement that specific details of prospective changes be immediately disclosed could encourage hasty (and ill-advised) decisions. Companies should be *encouraged*, as a matter of best practice, to provide shareholders with as much detail as is prudent under all the relevant circumstances.

Unilateral Adoption/Amendment of Bylaws

> **3A.** *Where a board adopts without shareholder approval a material bylaw amendment that diminishes shareholders' rights, what approach should be used when evaluating board accountability (in potentially voting against directors for adopting changes to governing documents without prior shareholder approval)?*

Option 1. Boards, subject to applicable law, should be free to adopt bylaw/charter amendment(s) that, in the proper exercise of their business judgment, further shareholders' best interests. State laws, in some circumstances, empower directors to amend governing documents without shareholder approval,[17] in recognition of the fact that directors are bound by their fiduciary duties to shareholders, and often must be able to take swift and decisive action to further shareholder interests.[18] When exercising this authority, boards are legally and pragmatically obligated to explain to their shareholders the rationale behind their actions on shareholders' behalf.

3B. *If you chose "It depends" in question 3A, what factors would you consider (in potentially voting against directors for adopting changes to governing documents without prior shareholder approval)?*

Decline to Answer. Each of the factors listed may, in certain circumstances, be apt factors to use in assessing the appropriateness of *any* board action; we reiterate our concern, however, about the lack of detail in the response options, which could lead to unwarranted and deleterious ISS conclusions. For example, the third answer option enables respondents to indicate whether *unspecified* "other governance concerns" should be taken into account in evaluating whether boards should be permitted, in ISS' view, to amend company governing documents without shareholder approval. The omission of what "other governance concerns" ISS's response option encompasses could permit ISS to interpret Survey responses that select this option to justify vote recommendations based on ISS' amorphous belief that "other governance concerns" are present.

3C. *If you chose "It depends" in question 3A, would the following bylaw/charter amendments without shareholder approval be a concern (in potentially voting against directors for adopting changes to governing documents without prior shareholder approval)?*

Other. Every company, proxy vote, and board action or resolution must be assessed by reference to the specific factual context presented. It is inappropriate to establish "one-size-fits-all" policies for evaluating whether certain board actions raise concerns, without considering the particular reasons for the board's decision.

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[17] *See*, *e.g.*, DEL. CODE ANN. Tit. 8, §242 (2014), available at http://delcode.delaware.gov/title8/c001/sc08/index.shtml. *See also*, DEL. CODE ANN. Tit. 8, §109 (2014), available at http://delcode.delaware.gov/title8/c001/sc01/.
[18] *See*, *e.g.*, *Air Products & Chemicals v. Airgas, Inc.*, 16 A.2d 48 (Del. Ch. 2011).

3D. *Should directors be held accountable if shareholder-unfriendly provisions were adopted prior to the company's IPO (in potentially voting against directors for adopting changes to governing documents without prior shareholder approval)?*

No. Directors should not be "held accountable" for actions that occurred prior to the company's IPO. Any governance provisions adopted by a company prior to its IPO must, by law, be fully disclosed to shareholders in the IPO. If such provisions were deemed by shareholders to have a materially negative impact on the value of the shares, they presumably were aware of this before making their investment in (or subsequent to) the IPO, and the fact that they purchased in or after the IPO is itself the best indication that, whatever concerns those actions may have raised, they were not sufficient to discourage shareholder investments.

Boardroom Diversity

4A. *In general, how does your organization consider gender diversity when evaluating boards?*

Option 4. Diverse board membership is an important and legitimate consideration but, as with other criteria, cannot be viewed or assessed in a vacuum, as ISS' Survey implies. The Chamber is a forceful advocate for promoting and empowering women business leaders to achieve their personal and professional goals by increasing opportunities for women to serve on corporate boards and in the C-suite; mentoring women at all stages of their careers; and building a network for women entrepreneurs to encourage peer-to-peer networking, education, and professional growth.[19] Diversity is one of many appropriate considerations to be used in evaluating a board. That said the most important consideration in evaluating a board is whether the board effectively promotes shareholder value. If the board would be more effective by increasing the overall diversity of its membership, it should do so. However, the positive effects that may or may not be achieved through greater diversity are highly situation specific, and cannot be reduced to a simple formula or "one-size-fits-all" voting policy.

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[19] *See*, *e.g.*, Chamber of Commerce, CENTER FOR WOMEN IN BUSINESS, available at http://www.uschamberfoundation.org/center-women-business.

Equity Plans

5A. *As a general matter, what weight (relative out of 100%) would you view as appropriate for each of the categories indicated below (notwithstanding that some factors, such as repricing without shareholder approval, may be 100% unacceptable)? Amounts in each box should be entered as an integer and tally 100.*

Decline to answer. Plan cost, features and prior related company practices are all important factors that should be considered when evaluating an equity plan. Nevertheless, by requiring respondents to provide a generic relative weight to each of these three factors, the question erroneously assumes that, in all situations, the relative weight of each factor will always be the same.

While the CCMC supports the use of a "balanced scorecard" approach to assessing equity plans specifically, and corporate governance more broadly, we are concerned that ISS' adoption of a new approach to equity plan analysis, if not thoroughly and effectively communicated to public companies and the investing public, will foster uncertainty that ultimately will benefit ISS' corporate consulting business at the expense of companies and their shareholders.

Risk Oversight/Audit

6A. *How significant are the following factors when evaluating the board's role in risk oversight in your voting decision on directors (very significant, somewhat significant, not significant)?*

Decline to Answer. Each of the factors listed is potentially relevant in determining a board's effectiveness in risk oversight. However, the fundamental issue presented by the question is whether ISS is qualified to make an informed, unbiased, judgment and vote recommendation in the wake of "well-publicized failures of boardroom risk oversight." In the question's preamble, ISS makes mention of several events that purport to be examples of "well-publicized failures of boardroom risk oversight," without defining that term or attempting to establish a nexus between alleged directorial failures and resulting events.

In order to ensure that its vote recommendations are appropriate and focused on enhancing shareholder value, ISS must ensure, on a case-by-case basis, that negative vote recommendations reflect a balanced and objective view of all relevant facts that

- An actual failure of the part of the board or its members caused, significantly contributed to, or exacerbated the underlying company event;
- The board did not take reasonable and remedial steps in the wake of the troublesome event to ameliorate its consequences; and
- Only a leadership change will promote shareholder value.

Vote recommendations must not be driven by media hysteria, but rather by well-developed facts.

6B. *In making informed voting decisions on the ratification of the outside auditor and the reelection of members of audit committees, how important (very important/somewhat important/not important) would the following disclosures be to you?*

Decline to Answer. The accounting profession is highly regulated, and corporate outside independent auditors are required to be selected by independent directors serving on audit committees, subject to rigorous regulatory standards.[20] ISS' apparent direction on the issue of auditor ratification conflicts with the conclusions of numerous governmental and industry policymakers, which have repeatedly rejected "one-size-fits-all" strictures, particularly regarding auditor tenure, which figures prominently in the Survey's question. With this question, ISS apparently is creating a predicate for expansion of its ill-conceived proposed auditor tenure policy to a number of other audit-related issues.[21] In effect, ISS is seeking to substitute its own judgment for that of Congress,[22] the PCAOB, [23] the

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[20] *See* Sarbanes-Oxley Act, §301, codified as Securities Exchange Act §10A(m), 15 U.S.C. §78j-1, incorporating mechanisms aimed at enhancing the independence of audit committees.

[21] *See ISS Auditor Ratification Policy Proposal*, *supra*, n. 8.

[22] Congress has explicitly rejected the idea of mandatory audit firm rotation three times in little over a decade. *See* GOP.gov, Legislative Digest, H.R. 1564, available at http://www.gop.gov/bill/113/1/hr1564. *See also*, JOBS Act, §104 "Auditing Standards", available at http://www.gpo.gov/fdsys/pkg/BILLS-112hr3606enr/pdf/BILLS-

Government Accountability Office,[24] and a majority of institutional investors.[25]

Cross-Market Companies

7A. *Which of the following best describes your organization's view on how ISS should generally evaluate such companies?*

Option 3. Shareholder voting issues require a case-by-case analysis that elevates considerations of shareholder value over check-the-box, "one-size-fits-all" voting policies. Depending on the context, every company's voting issues raise different considerations from those of other companies (even those in the same industry), and portfolio managers are obligated to cast votes based solely on the best interests of their investors. The question's focus on whether U.S. or non-U.S. proxy voting guidelines should be applied in a given case reflects ISS' mechanical and slavish reliance on "one-size-fits-all" voting policies, and ignores the need for every portfolio manager to ensure that its vote is premised on verifiable linkages between specific voting decisions and the enhancement of shareholder value.

112hr3606enr.pdf; and the Audit Integrity and Job Protection Act, H.R. 1564, available at http://business.cch.com/srd/h1564_rh.pdf.

[23] PCAOB, Auditor Independence and Auditor Rotation Concept Release (Aug. 16, 2011), available at http://pcaobus.org/Rules/Rulemaking/Docket037/Release_2011-006.pdf. *See also*, GAO, Comment on PCAOB Concept Release (Dec. 14, 2011), available at http://www.gao.gov/products/P000031 ("*2011 GAO Letter*") ("[T]he root causes of audit deficiencies are complex, vary in nature, and . . . may not have necessarily resulted from a lack of objectivity or professional skepticism . . . . Even if [there were a clear link between] a lack of independence or objectivity . . . [and] audit quality problems, it is *unclear that such a problem would be prevented or mitigated by a mandatory audit firm rotation requirement*") (emphasis supplied).

[24] *See* GAO, *Required Study on the Potential Effects of Mandatory Audit Firm Rotation*, at p. 6 (Nov. 21, 2003) ("*2003 GAO Study*"), available at http://www.gao.gov/new.items/d04216.pdf ("GAO believes that mandatory audit firm rotation may not be the most efficient way to strengthen auditor independence and improve audit quality considering the additional financial costs and the loss of institutional knowledge of the public company's previous auditor of record, as well as the current reforms being implemented. The potential benefits of mandatory audit firm rotation are harder to predict and quantify, though GAO is fairly certain that there will be additional costs") (but, left the issue open to further study). *See also*, *2011 GAO Letter*, *supra* n. 23.

[25] *See* Ernst & Young, *Respondents to PCAOB Overwhelmingly Oppose Mandatory Audit Firm Rotation* (Jan. 5, 2012), available at http://www.ey.com/Publication/vwLUAssets/TechnicalLine_BB2256_AuditFirmRotation_5January2012/$FILE/TechnicalLine_BB2256_AuditFirmRotation_5January2012.pdf. Academic research confirms investors' dim view of audit firm rotation, given observed negative market reactions to forced audit firm rotation. *See*, *e.g.*, J. Carcello & L. Reid, *Investor Reaction to Mandatory Audit Firm Rotation* (Jan. 23, 2014), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2384152.

Conclusion

CCMC appreciates this opportunity to comment on ISS' 2015 Survey. However, as discussed above, we believe the Survey is fundamentally flawed, since it seeks to elicit opinions that have no clear nexus to the enhancement of shareholder value. Proxy votes cast in reliance on proxy voting policies based upon this Survey cannot—by definition—be reasonably designed to further shareholder values. We would be happy to discuss the issues raised in this letter with your or the appropriate staff, if you would find that helpful.

Sincerely,

Tom Quaadman