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Re: **Pay Versus Performance (Rel. No. 34-74835); File No. S7-07-15**

July 2, 2015

VIA E-MAIL: rule-comments@sec.gov

Mr. Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Dear Mr. Fields:

Thank you for the opportunity to comment on the Securities and Exchange Commission's proposed rule amendments to implement Section 953(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. Section 953(a) amends Section 14 of the Securities Exchange Act of 1934 (as amended, the "Exchange Act") to add:

> (i) DISCLOSURE OF PAY VERSUS PERFORMANCE.—The Commission shall, by rule, require each issuer to disclose in any proxy or consent solicitation material for an annual meeting of the shareholders of the issuer a clear description of any compensation required to be disclosed by the issuer under section 229.402 of title 17, Code of Federal Regulations (or any successor thereto), 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. The disclosure under this subsection may include a graphic representation of the information required to be disclosed.

Below we respond to several of the questions posed in the proposing release, available at: http://www.sec.gov/rules/proposed/2015/34-74835.pdf.

1. **The final rule should allow registrants to disclose in the table alternative performance measures in addition to TSR, and should provide registrants with the flexibility to determine the period over which TSR is measured.**

The proposing release asks: "*Should we allow registrants flexibility in choosing the relevant measure of performance they are required to disclose? Besides TSR, what other measures* *of financial performance take into account any change in the value of the shares of stock and dividends and distributions of the registrant, as required by the statute? Are there metrics other than TSR that measure a company's performance and meet the requirements of the statute? If so, would they result in disclosures that are more or less meaningful than TSR? How is corporate performance measured today? How is this information incorporated into investment decisions?*" (Question 35)

The proposing release cites a report by the Senate Committee on Banking, Housing and Urban Affairs, which notes that the pay-versus-performance disclosure rules "were not intended to be overly prescriptive and that Congress recognized that there could be many ways to disclose the relationship between executive compensation and financial performance of the registrant." We believe that, consistent with this intent, the final rule should allow registrants to disclose in the table alternative performance measures in addition to TSR, and should provide registrants the flexibility to determine the period over which TSR is measured.

a. The final rule should allow registrants to disclose in the table alternative performance measures in addition to TSR.

We recognize that TSR will satisfy the statutory requirement that financial performance take into account any change in the value of the shares of stock and dividends and distributions of the registrant. But the statute does not mandate the use of TSR as the sole, or even the primary, measure of financial performance. Many registrants and investors believe that TSR is not necessarily the best measure of financial performance for a variety of reasons, including that stock price may reflect industry or market conditions more than a registrant's individual performance. Consequently, many registrants do not use TSR as a (or the) measure of financial performance in making compensation decisions.[1] For example, we found that, of the 50 registrants in the S&P 100 that received at least 95% support on say-on-pay in 2014, only three considered TSR when determining their NEOs' annual bonuses, and even those three only considered TSR as one of several performance metrics.

We believe that the final rule should allow a registrant to disclose in the table one or more alternative performance measures (in addition to TSR) that the registrant uses to determine NEO compensation. Such alternative measures could include, for example, return on equity, return on invested capital, cash flow, net income, earnings per share or revenues,[2] which a

[1] See, e.g., Investor Responsibility Research Center Institute (IRRCi), *The Alignment Gap Between Creating Value, Performance Measurement, and Long-Term Incentive Design* (2014) (noting that TSR as a measure of performance "obscures more than it reveals" because "fund flows, central bank policies, macroeconomics, geo-political risks, and regulatory changes" are factors impacting TSR that are "beyond the control of executive management"). The IRRCi report is available at http://www.irrcinstitute.org/pdf/alignment-gap-study.pdf.

[2] According to a 2015 Meridian report, these performance metrics (along with TSR) are among the most common metrics used by registrants to determine NEO compensation. The Meridian report is available at http://www.meridiancp.com/wp-content/uploads/2015-Trends-and-Developments-in-Executive-Compensation.pdf.

registrant may determine best incentivize its NEOs to create long-term value for shareholders. Given the range of performance measures that registrants consider in making compensation decisions, we believe that allowing registrants to disclose in the table such alternative performance measures would provide for better disclosure of the relationship between the registrant's pay and performance, including how the registrant's compensation committee considered the matter.

b. The final rule should provide registrants with the flexibility to determine the period over which TSR is measured.

Registrants should be permitted to disclose TSR as measured on either an annual or a multi-year basis. Registrants that elect to disclose TSR as measured on a multi-year basis should be permitted to determine the number of years and whether to measure TSR on a static basis (i.e., with each year's TSR measured over a period that begins on the same date) or a rolling basis (i.e., with each year's TSR measured over the same number of preceding years).

Take, for example, a registrant that is required to disclose its TSR for each of 2013 through 2015. If at the market close on December 31 of each of 2010 through 2015, the registrant's share price is $15, $22, $20, $30, $24 and $27, respectively, and the registrant did not pay dividends during these years, the registrant could determine to disclose TSR as measured on any of the following bases:

	Annual	**Three-Year Static**	**Three-Year Rolling**
2015	12.5% (($27 – $24) / $24)	35% (($27 – $20) / $20)	35% (($27 – $20) / $20)
2014	–20% (($24 – $30) / $30)	20% (($24 – $20) / $20)	9.1% (($24 – $22) / $22)
2013	50% (($30 – $20) / $20)	50% (($30 – $20) / $20)	100% (($30 – $15) / $15)

Some registrants may determine that disclosing TSR on a multi-year rolling basis would help avoid confusing investors by creating the misperception of a disconnect between pay and performance that may result from disclosing TSR on a multi-year static basis (in the direction of either seeming to reflect that the registrant is over- or under-paying for performance) if the share price at the beginning of the first year happened to be at a particularly low or high point. Other registrants may conclude that investors would prefer that TSR be disclosed on an annual basis, as this would be consistent with the requirement that compensation be reported on an annual basis and make it easier to align the information in the table with the remainder of the compensation disclosure. Registrants could be required to clearly disclose the TSR methodology that they are using and the rationale for the approach, along with the rationale for any change in approach from year to year.

If (per our comment 3 below) the final rule requires disclosure of compensation "actually paid" for only one year, the final rule nevertheless should permit registrants to disclose TSR on a multi-year basis, as compensation paid in a year may be based on performance over multiple years.

2. The final rule should not require disclosure of the relationship between registrant and peer group TSR.

The proposing release asks: *"Should we require disclosure of TSR on an absolute basis, as well as disclosure of peer group TSR, as proposed? Why or why not?"* (Question 39)

The proposed rule requires disclosure of the relationship between registrant and peer group TSR, with smaller reporting companies exempted from the requirement. We believe that the final rule should not require such disclosure for any registrants, as it is not mandated by the statute and may be confusing or possibly misleading.

The requirement to disclose the relationship between registrant and peer group TSR would burden registrants without providing meaningful information to shareholders. A registrant generally selects its peer group merely to serve as one benchmark among many factors to consider and does not use the peer group in a strict manner to set pay. For that reason, a peer group may include companies that are both larger and smaller than the registrant, and if a registrant has many lines of businesses, the group may include companies across several industries. The peer group TSR of a large group of companies may blend many different stock prices, which may be affected by the macro economy and industry developments as much as by factors specific to an individual registrant, thereby rendering peer group TSR a poor measure against which to assess the registrant's performance.

If peer group TSR is required to be included in the table, and particularly if that TSR is quite different from the registrant's own TSR, the registrant likely would consider it important to explain to investors the reason for that difference but would be hampered by not being in a position to have the information needed to evaluate and explain another company's stock price performance and/or executive compensation program. In terms of burdens, a registrant that has multiple peers may find it necessary to follow analyst and other reports regarding its peers so that the registrant could at least attempt to understand changes in its peers' TSR. In any case, registrants would be concerned about any potential assumption of legal liability for disclosure regarding such changes.

3. The final rule should require disclosure of compensation "actually paid" only for one year or, alternatively, for three years for all registrants.

The proposing release asks: *"Does a five-year disclosure period (for registrants other than smaller reporting companies) and a three-year disclosure period (for smaller reporting companies), as proposed, provide meaningful pay-versus-performance disclosure? Should the timeframes be shorter or longer? For example, should we require only three years of disclosure for all registrants consistent with the time period required by the Summary Compensation Table for registrants other than smaller reporting companies? What impact would a different time period have on the disclosure and its usefulness to shareholders?"* (Question 42)

Although the statute does not require the pay-versus-performance disclosure to be provided for multiple years, the proposed rule mandates a five-year disclosure period (three years for smaller reporting companies). We believe that the final rule should limit this requirement to one year. This would be useful to investors by aligning the period with the disclosure period for the say-on-pay vote, as the vote is focused on executive compensation that was paid for the most recent fiscal year. As the Commission noted in the proposing release, the disclosure would be "useful to shareholders when they are deciding whether to approve the compensation of the NEOs through the say-on-pay advisory vote."

Alternatively, if the Commission believes that pay-versus-performance disclosure should be provided for multiple years, the final rule should limit the disclosure period to three years for all registrants (and not just smaller reporting companies). This would align the disclosure period for pay versus performance with that of the Summary Compensation Table that has traditionally been a key focus for investors.

In its proposing release on executive compensation disclosure in 2006, the Commission considered eliminating the TSR performance graph and thereby a five-year disclosure period related to executive compensation. The Commission found the requirement for the graph to be "outdated, particularly since the disclosure in the Compensation Discussion and Analysis regarding the elements of corporate performance that a given company's policies might reach is intended to allow broader discussion than just that of the relationship of compensation to the performance of the company as reflected by stock price."[3]

Due to commenters who advocated for the performance graph as an easily accessible and standardized presentation format at that time, before such information became more easily accessible online, the Commission ultimately decided to retain the graph while being of the view that the "Performance Graph should not be presented as part of executive compensation disclosure."[4] The five-year TSR performance graph is now a requirement in only the annual report to investors, and a registrant can provide it voluntarily in its proxy statement. We are not aware of any reason for the reinclusion of five-year TSR performance graph disclosure in a registrant's proxy statement at this time.

4. **The final rule should require disclosure for only the principal executive officer. Alternatively, the final rule should require disclosure for only the PEO and those NEOs who served for the entire year.**

The proposing release asks: "*Should we require disclosure for only the PEO? Would information about the non-PEO NEOs be meaningful or useful for investors? Would information about the PEO's compensation provide adequate information to investors about the pay-versus-performance alignment of other NEOs? Would limiting the scope of disclosure to the PEO result in meaningful cost savings to registrants, for example by limiting the extent to which they must perform recalculations of compensation actually paid . . . or*

[3] Executive Compensation and Related Party Disclosure, Exchange Act Release No. 38655, Fed. Reg. at pages 21–22 (Jan. 27, 2006).

[4] Executive Compensation and Related Person Disclosure, Exchange Act Release No. 33-8732A, Fed. Reg. at page 44 (August, 29, 2006).

average calculations? Would limiting the disclosure to the PEO affect the usefulness of the information for investors?" (Question 20)

a. The final rule should require disclosure for only the PEO.

The statute does not expressly require disclosure for all NEOs, and we believe that the Commission could, consistent with the statute, limit the required disclosure to the PEO. Providing disclosure for NEOs other than the PEO would increase the burden on registrants, as registrants generally have only one (or at most two) PEOs for any given year but typically have at least four (and may have up to seven or more) other NEOs for that same year.

As we have seen over the years with the say-on-pay vote, we believe investors are interested primarily in PEO compensation. Providing disclosure for the other NEOs would not provide investors with much meaningful additional information, as the compensation paid to the other NEOs typically is based on the compensation paid to the PEO. Because the other NEO information in the table is averaged, the usefulness of the information is already limited, and we query whether it justifies the cost of producing the information.

b. Alternatively, the final rule should require disclosure for only the PEO and those NEOs who served for the entire year.

Alternatively, the final rule should require disclosure for the NEOs who served as executive officers for the entire year. NEOs who serve for only part of a year may receive additional compensation that would distort the disclosure and reduce comparability. For example, new hires may receive one-time equity awards that are intended to make them whole for awards forfeited on leaving their prior employment, and terminated NEOs may receive severance and accelerated vesting of equity. Consistent with this, when a registrant has more than one PEO for any given year, the final rule should permit registrants to exclude one-time payments made in connection with the hiring of the new PEO or the termination of the former PEO.

5. The final rule should provide that an equity award becomes "vested" when the NEO is first able to monetize the award.

The proposing release asks: *"For equity awards that require exercise, is our proposal to consider them "actually paid" when vested the appropriate point in time for purposes of Item 402(v) disclosure? If not, please explain. Should we instead require that for an award that requires exercise to be considered "actually paid," it must also be exercisable, making the valuation date the date on which the award is both vested and exercisable? Is there an alternative approach we should consider?"* (Question 32)

The proposed rule requires that the amount disclosed as "actually paid" for a year include the fair value on the vesting date of equity awards for which all applicable vesting conditions were satisfied during such year. Registrants may grant equity awards that are deemed to be vested for certain purposes (e.g., tax or accounting) but that may nonetheless remain subject to forfeiture until a later date. For example, an award of restricted stock units may be subject to mandatory deferral and possible downward adjustment under a registrant's risk mitigation policy until the underlying shares are delivered, which may be several years after the award is deemed vested for tax purposes. Or, an NEO who has met an age and service requirement as of the grant date of a stock option may be eligible to retire without immediately forfeiting the option, but with the option not becoming exercisable unless and until a non-compete period expires without breach. As a result, the same stock option granted to two different NEOs (one retirement-eligible and one not) could be deemed to vest on different dates.

The final rule therefore should provide that an equity award becomes “vested” on the date that the NEO is first able to monetize the award. For example, the following equity awards would become “vested” on the following dates:

- a stock option, on the date that the option becomes exercisable;
- a restricted stock unit award, on the date that the shares are delivered;
- a restricted stock award, on the date that the shares are no longer subject to transfer restrictions.

In addition, we think it would be reasonable for registrants to regard any compensatorily acquired shares that are delivered, but are unable to be sold pursuant to company policies, such as a stock ownership commitment, as being not “vested.”

6. The final rule should not require disclosure of vesting date valuation assumptions.

The proposing release asks: *“Should we require disclosure of vesting date valuation assumptions if they are materially different from those disclosed in a registrant’s financial statements as of the grant date, as proposed? Would the disclosure of these assumptions provide meaningful information to shareholders?”* (Question 29)

Equity awards are valued based on assumptions such as stock price, the likelihood that any performance conditions will be attained and, for appreciation awards such as stock options, expected term, volatility and risk-free interest rate. As such assumptions inevitably change over time, often significantly so, requiring disclosure of vesting date valuation assumptions if materially different from grant date valuation assumptions means that such disclosure would almost always be required. Preparing these assumptions would require burdensome complex calculations, often requiring the involvement of an outside professional firm, and would result in lengthy disclosure (e.g., for registrants that grant several types of awards or awards that vest on multiple dates). And disclosing the assumptions would not provide meaningful information to investors because it is the assumptions as of the grant date (rather than the vesting date) that a registrant’s compensation committee typically considers in granting equity awards. We therefore believe that the final rule should not require disclosure of vesting date valuation assumptions.

Alternatively, if the final rule provides (per our comment 5 above) that an equity award becomes “vested” on the date that the NEO is first able to monetize the award, then the final rule could require disclosure of the assumptions used to calculate the amount disclosed as “actually paid”—i.e., the amount that the NEO would have received had the NEO monetized the award on that date. These assumptions would be limited to number of shares and stock price and, for appreciation awards, exercise price.

7. The final rule should not require that the pay-versus-performance disclosure be tagged in XBRL format.

The proposing release asks: *"Should we require that the data be tagged in XBRL format, as proposed?….Should we require that, as proposed, disclosure about the relationship between executive compensation and registrant performance be tagged? Why or why not?"* (Question 13)

We believe that the final rule should not require that the data and the disclosure about the relationship between executive compensation and registrant performance be tagged in XBRL format. As XBRL tagging is not required for any other disclosure in proxy or information statements, requiring XBRL tagging for the pay-versus-performance disclosure would give the disclosure undue prominence and fail to provide the context for a full discussion of executive compensation disclosure that is important for investors to understand the compensation decisions that were made.

Moreover, requiring XBRL tagging would burden registrants when they should be focused on finalizing the substance of their executive compensation disclosure in time to meet their filing deadlines. This is especially true for registrants that are trying to meet the notice and access deadline of at least 40 days prior to the annual meeting.

In any event, we believe that the XBRL-tagged information likely would not be used by most investors. For example, a study conducted by Columbia Business School found that most registrants surveyed doubted that their investors were using the XBRL data in their filings.[5] If this were the case for quantitative information that is easier to standardize, such as information required to comply with U.S. generally accepted accounting principles, we believe it may be all the more true for more tailored, contextually sensitive information, such as executive compensation disclosure.

8. Form 10-K should be revised to make it clear that the pay-versus-performance disclosure will not be deemed to be incorporated by reference.

The proposing release specifies that the pay-versus-performance disclosure will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the registrant specifically incorporates it by reference. Item 11 of Form 10-K, however, requires registrants to furnish the information required by Item 402 of Regulation S-K. Therefore, to make it clear that that the pay-versus-performance disclosure will not be deemed to be incorporated by reference into Form 10-K, Item 11 should be revised by adding the following underlined text:

[5] Trevor S. Harris & Suzanne G. Morsfield, Columbia Business School Center for Excellence in Accounting and Security Analysis, *An Evaluation of the Current State and Future of XBRL and Interactive Data for Investors and Analysis* (2012), available at http://www4.gsb.columbia.edu/filemgr?&file_id=7313146.

> Furnish the information required by Item 402 of Regulation S-K (§ 229.402 of this chapter) (other than paragraph (v) thereof) and paragraph (e)(4) and (e)(5) of Item 407 of Regulation S-K (§ 229.407(e)(4) and (e)(5) of this chapter).

* * *

We appreciate the opportunity to participate in this process, and would be pleased to discuss our comments or any questions the Commission or its staff may have, which may be directed to Ron Aizen, Ning Chiu, Kyoko Takahashi Lin or Jean M. McLoughlin of this firm at 212-450-4000.

Very truly yours,

Davis Polk & Wardwell LLP.