PUBLIC CITIZEN

215 Pennsylvania Avenue, SE • Washington, D.C. 20003 • 202/546-4996 • www.citizen.org

July 6, 2015

Secretary
United States Securities and Exchange Commission
Washington, D.C. 20549

Re: Section 953(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act

File No. S7-07-15

Dear Secretary,

On behalf of more than 400,000 members and supporters of Public Citizen, we write to express our views on the Securities and Exchange Commission's (SEC) proposed rule to implement Section 953(a) of the Dodd-Frank Wall Street Reform Act. Many of Public Citizen's members are retail investors and are keenly concerned with executive compensation.

Generally, we support the Commission's proposal. The Commission appropriately retains the current pay disclosure requirements as provided in the prevailing summary compensation table (SCT). We agree with the Commission's interpretation for disclosure of compensation "actually paid." We do support the proposed mandatory use of total shareholder returns as a performance metric. At the same time, we ask that two additional metrics be required: 1. Disclosure of the financial metrics that the company actually uses; and 2. A metric that measures the firm's long-term performance.

Overview

Congress approved the Dodd-Frank Wall Street Reform and Consumer Protection Act against a backdrop of financial calamity that Wall Street visited on the global economy in no small part because of mis-constructed compensation structures. Much must be done to repair these structures. We urge the Commission to work more vigorously with the prudential banking regulators to finalize a new proposed rule for Section 956, the core banker pay reform, which is intended to decouple risky executive behavior from incentive compensation. We are disturbed by reports that the SEC has failed to work cooperatively with these regulators.

As shareholders legally control public companies, they should enjoy reasonable tools to exercise those ownership prerogatives. Selecting board members and voting on the pay they approve for senior executives already count as serviceable venues for the exercise of control. Without disclosure as to how the board's pay decisions accords with the firm's financial performance, however, the exercise of this control can be frustrated.

The purpose of Section 953(a) is to provide investors with a means of measuring senior management pay in the context of firm performance.[1] This provision derives from a troublesome trajectory of senior executive pay that absorbs increasing percentages of shareholder capital. By any measure, CEO and senior management pay has escalated—beyond the pace of average wages, beyond any rise in corporate income, beyond share prices. Any investor favors a company that economizes on its expenses, which applies to resources spent for the CEO and named executive officers. Yet the legal ability of a shareholder to bridle CEO pay is limited, shareholders even lack a convenient means of assessing whether management pay accords with performance. Some publicly traded companies do discuss compensation philosophy and offer metrics by which they measure performance,[2]but without a consistent performance standard, it is difficult for investors to assess the validity of compensation levels at a single company or across peers. Together with Section 953(b), measuring pay in the context of performance will better equip investors to make informed evaluations.[3]

Comment on the Proposed Rule

On April 29, 2015, the Commission proposed a rule to implement Section 953(a) that would require public companies to provide new disclosures annually regarding the relationship, over a

---

[1] S. Rep. No. 111-176, at 135 (Apr. 30, 2010), http://www.banking.senate.gov/public/_files/Comittee_Report_S_Rept_111_176.pdf.

[2] Following amendment to IRS Section 162(m), pay above $1 million may not be deducted unless it is performance based on standards that are subjected to a performance test. Typically, however, such tests allow the board to vary the award using its discretion. See, for example, the 2003 Proxy Statement of Goldman Sachs here: http://www.sec.gov/Archives/edgar/data/886982/000095012303002098/y82715def14a.htm. Because of this "discretion," Goldman Sachs notes, "we cannot determine the amount that would have been paid to any person."

[3] Compelling congressional testimony on the issue addressed in 953(a) came from the Council of Institutional Investors, an amalgam of pension funds and other investors that collectively serve as stewards of some $3 trillion in beneficiary capital. The Senate report references this testimony and in it, the Executive Director of the Council stated: " Of primary concern to the Council is full and clear disclosure of executive pay. As U.S. Supreme Court Justice Louis Brandeis noted, "sunlight is the best disinfectant." Transparency of executive pay enables shareowners to evaluate the performance of the compensation committee and board in setting executive pay, to assess pay-for-performance links and to optimize their role of overseeing executive compensation through such means as proxy voting.. See "Protecting Shareholders and Enhancing Public Confidence by Improving Corporate Governance: Hearing Before the S. Subcomm. on Securities, Insurance, and Investment of the Comm. on Banking, Hous., & Urban Affairs, 111th Cong. (July 29, 2009) (testimony of Ann Yerger, Exec. Dir. of the Council) (emphasis added), http://www.banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=e64b1840-5e6e-4a88-a8f6-3f01b2462404 See" S. Rep. No. 111-176, at 135 (Apr. 30, 2010), http://www.banking.senate.gov/public/_files/Comittee_Report_S_Rept_111_176.pdf

five-year period, between executive compensation actually paid and the financial performance of the company. The purpose of the rule, according to the SEC, is to elicit disclosure so as to provide greater transparency and allow shareholders to be better informed when they vote to elect directors and in connection with advisory votes on executive compensation.

Actual pay

Under the proposed rule, new item 402(v) of Regulation S-K would require public companies to provide in proxy statements tabular disclosure showing the following information for each year covered by the table. The proposed disclosure would relate to the named executive officers for whom disclosure is required in the current year's Summary Compensation Table. This includes total compensation reported in the Summary Compensation Table ("SCT") for the principal executive officer ("PEO") and the average of the reported amounts of total compensation for the remaining named executive officers identified in the SCT.

This also includes compensation actually paid to the CEO and the average of the compensation paid to the remaining named executive officers. For this purpose, compensation actually paid is determined by adjusting the total compensation as disclosed in the SCT to reflect (i) for pension benefits, only the annual pension service cost for services provided in the year, and (ii) for equity awards, only the fair value of awards that vested during the year.

Compensation actually paid will be determined by adjusting the amount of total compensation, as reported in the SCT to reflect pension benefits and equity awards actually paid during the year. The proposed rule would require disclosure of the amount of such adjustments for each year, in a footnote to the table shown above. Pension amounts will be adjusted by deducting from total compensation the change in pension value and adding back the actuarially determined service cost for services rendered during the applicable year. Equity awards will be adjusted by deducting from total compensation the amounts reported in the SCT for grant date fair value of stock awards and option awards, and adding back the fair value, on the vesting date, of awards that vested during the year. To the extent that assumptions used to determine the fair value of awards on their vesting date differ materially from assumptions used in determining grant date fair value as disclosed in the company's financial statements, the company would be required to disclose such different assumptions with the pay for performance disclosures.

We support this interpretation of compensation "actually" paid. The Commission appropriately rejects the interpretation that what is "actually" paid is the same as "realized" pay.[4] We firmly believe there is no policy basis and certainly no statutory basis in 953(a) for such weakening. The statute clearly states that compensation "actually paid" be disclosed "under section 229.402 of title 17, Code of Federal Regulations [CFR]." Section 229.402 carefully details the compensation information actually paid required of public companies, including the value of stock-based awards made each year (even when the cash may only be realized in years beyond

[4] The Conference Board, Supplemental Pay Disclosure: Overview of Issues, Proposed Definitions, and a Conceptual Framework, The Conference Board Working Group on Supplemental Pay Disclosure 2 (2013), http://paygovernance.com/wp-content/uploads/2013/11/Supplemental_Pay_Disclosure-1.pdf.

the grant date). There should be no confusion about what “actually paid” means. The compensation required under CFR section 229.402 is different than “realized pay.” Realized pay addresses the exercise of stock options in a given year from awards that may have been given in previous years. Realizing such awards when the CEO exercises options in a given year does not reflect how the Board of Directors viewed the performance of that year. Rather, the exercise of options simply reflects the personal decisions of the CEO or other senior managers, which presumably stem from considerations of personal cash wishes, personal tax issues, or other personal circumstances completely unrelated to firm performance. The Conference Board itself recognizes this as a “limitation” of realized pay.5 The title of 953(a) is “Pay Versus Performance.”

Performance metrics

The commission proposed to use, as a performance metric, cumulative total shareholder return (“TSR”), determined in accordance with the definition of TSR in Item 201(e) of Regulation S-K. The proposed rule also requires disclosure of the TSR of the companies in a peer group, using the peer group identified by the company in its stock performance graph or in its compensation discussion and analysis (“CD&A”).[4] Under the proposed rule, the new tabular disclosures would cover the last five fiscal years.

We support the proposed use of TSR. This accords with the statutory language that provides that the financial performance should be “taking into account” any change in the stock price. Most companies already use TSR. [6]

Importantly, this statutory language is not exclusive. The statute does not say that the performance discussion should be exclusive limited to share price change. In fact, the liberal construction of the wording clearly provides an opportunity for consideration of concepts outside the box of share price.

We ask the Commission to require two additional metrics. First, we ask that companies be required to post any financial performance metric they actually use to determine CEO pay.[7] Tax law already requires that firm’s use shareholder-approved performance metrics to qualify for a deduction as a business expense any compensation paid beyond $1 million for each of the named executive officers. One of the problems with this requirement is that companies amend these performance standards over the years without any accessible summary of prevailing performance measures. We also understand that many companies don’t actually use concrete financial metrics to determine CEO pay. In these cases, we ask the commission to require a simple declaration in the table to that end, namely, that the company does not bind pay to strict financial metrics. Where firms lack such a consistent metric, acknowledgement of that would be instructive. For example, JP Morgan does not post any clear connection between what the board decided to pay

[5] The Conference Board, Supplemental Pay Disclosure: Overview of Issues, Proposed Definitions, and a Conceptual Framework, The Conference Board Working Group on Supplemental Pay Disclosure 2 (2013), http://paygovernance.com/wp-content/uploads/2013/11/Supplemental_Pay_Disclosure-1.pdf.

[6] See Equilar survey (August 2014), available at: http://www.equilar.com/publications/41-measuring-long-term-performance.html

[7] The SEC Keeps Screwing Up, by Eleanor Bloxham, Fortune (June 2015) available at: http://fortune.com/2015/05/28/sec-keeps-screwing-up/

CEO Jamie Dimon and the firm's performance. The board does apparently believe shareholders are interested in the subject enough to devote pages 30 through 44 to this very question, This 15 page discussion includes many charts and numerous normative declarations. However, nowhere in the confines of these 15 pages does the board provide the kind of concrete information that would allow an investor to determine numerically how the CEO's pay was determined. One could not forecast what the CEO would be paid next year based on company financial results. Still, the board would have the company owners understand that the CEO compensation is appropriate.

"Mr Dimon has generated more profit per dollar of compensation paid than other CEO in our financial services peer group." (Such an accomplishment is especially noteworthy given that the firm has more than 240,000 employees who, by extrapolation, apparently generated little or no value as measured by company earnings.)

Under the cold lens of professional compensation analysts, however, the board is squandering shareholder money on Dimon. Institutional Shareholder Services, a firm employed by owners of some 20 percent of JP Morgan's outstanding stock, graded Dimon's pay package an "F." The analysts found: "The Company paid more compensation to its named executive officers than the median compensation for a group of companies. . . The CEO was paid more than the median CEO compensation of these peer companies. Overall, the Company paid more than its peers, but performed moderately worse than its peers."[8]

By requiring the board to disclose that it does not use metric but rather divines a figure based on qualitative judgment, a JP Morgan shareholder could be spared the 15 pages.

Second, we ask that the commission require firms to adopt a financial metric that the company believes addresses long term performance. We believe the permissive construction if the statutory language invites the commission to address this compelling problem with CEO pay today. Prevailing pay structures can promote short-termism. Companies engage on short-sighted activity such as buybacks, or even accounting gimmickry to goose the stock price at a time that favors stock-incentivized managers. That doesn't serve patient investors or the economy.

A number of practitioners, professors and other observers have proposed various means of accomplishing this.[9] The IRRC Institute, for example, address the use of return on invested capital. The researchers found that executive management that determines investments that create innovation from new products, new markets, and new business models that drive future revenue growth and positive returns on capital are rarely compensated with these decisions as determinants.[10]

---

[8] "Proxy Paper: JP Morgan," published by Institutional Shareholder Services. (April 2015)

[9] See, for example, McKinsey & Co discussion, (2014) available at: http://www.mckinsey.com/insights/corporate_finance/measuring_long-term_performance

[10] "Corporate Economic Performance," IRRC Institute, (2014) Available at: http://irrcinstitute.org/news/deep-misalignment-between-corporate-economic-performance_pr_11_17_14.php; or, Lucian Bebchuk, "Long Term Performance and Executive Compensation, (2010), available at: http://www.irrcinstitute.org/pdf/Harvard%20Paper%202%20-%20Paying%20for%20Long%20Term%20Performance.pdf;

Rather than dictate a specific metric, we ask the SEC to mandate a metric supplemental to the TSR of a company's own choosing that it contends would capture long-term performance. The SEC should mandate that it be based on publicly available data so that it can be compared with those measures at other firms, and that these peer firm results also be disclosed (to spare individual investors from conducting this analysis.) If the firm develops a better analysis, it can add this new metric while retaining its previous metric for five years, so as to prevent the firm from annually choosing a metric convenient for overpayment.

XBRL Tagging

The Commission requires companies to include an exhibit in which the required pay-for-performance information has been tagged in an interactive data format using XBRL. This requirement would be phased-in for smaller reporting companies, so that they would not be required to comply with the tagging requirement until the third annual filing in which the pay-for-performance disclosure is provided. This aspect of the proposed rule represents the first time the SEC will have mandated XBRL tagging for information contained in proxy statements.

We commend this requirement. XBRL standardizes digital/computer reporting, providing for better comparison analysis. As this rule relates to comparisons, XBRL is an obvious requirement.

We appreciate the Commission's attention to these comments. For questions, please contact Bartlett Naylor at [redacted], or [redacted].

Sincerely,

Bartlett Naylor
Financial Policy Advocate