Hay Group, Inc.
111 E. Wacker Drive
Suite 1250
Chicago, IL 60601-4402
USA

tel +1.312.228.1800
www.haygroup.com

July 6, 2015

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

Re: File Number S7-07-15 – Comment Letter on
<u>Pay-versus-Performance Disclosure Proposals</u>

Dear Mr. Fields:

The Securities and Exchange Commission ("Commission") has proposed rulemaking to amend Item 402 of Regulation S-K to implement Section 14(i) of the Securities Exchange Act of 1934 ("Exchange Act"), as added by Section 953(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Act"). In accordance with specific and general requests for comments contained in the proposed rulemaking, Hay Group offers its comments on certain aspects of the proposed rules. We focus in particular on areas that we believe would (a) improve clarity (and reduce ambiguity) in the proposals and (b) lessen the burdens that certain of the proposals would impose on covered issuers.

Hay Group is a global, full-service human resource consulting firm with 86 offices in 49 countries. Our comments are based on a review and analysis of the proposed rules and reflect our views (after considering feedback received from clients).

1. <u>General comments</u>

We found some of the proposed rules to be overly rigid and/or to extend beyond what the Act requires. As a possible counterbalance, we applaud the Commission for identifying an extensive number of Requests for Comment (most with multiple questions) which show that the Commission is open to input from knowledgeable parties. We suggest that the Commission would best serve shareholders' interests (a) by giving due consideration to limiting its rulemaking to areas either required by the statute or where the statute is unclear as to what may be required and (b) by recognizing the potential impact of any required disclosure on an issuer's programs.

Specifically, we believe the Commission should not add requirements that are not necessary to implement the statutory disclosure mandates (e.g., comparing pay-versus-performance using a peer group, discussed under part 3 below). Rather, where reasonably practicable, we suggest that the Commission provide guidelines regarding the manner in which registrants may comply with the rules rather than "bright line" rules that may result in disclosures that are not relevant to a registrant or may confuse shareholders. At a time when many companies are struggling with the costs and time expended in regulatory compliance, we believe that the Commission should re-examine any proposed requirement which imposes burdens on issuers beyond what is called for by the statute.

2. Measure of performance: required use of TSR

Section 953(a) of the Act, in relevant part, calls for the disclosure of "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 shares of stock and dividends of the issuer and any distributions.*" The Commission proposes to use total shareholder return ("TSR") "as the measure of financial performance … for purposes of pay-versus-performance disclosure." In essence, the required use of TSR as the measure of financial performance is ascribed by the Commission to compliance with the above italicized language.

The Commission recognizes that many companies use financial measures other than TSR and, before establishing the standard of TSR usage, considered suggestions that registrants be allowed to "choose the performance measure best-suited for their company." Further, in Request for Comment 34 the Commission asks whether registrants should be required to use TSR. In addition, the Commission inquires whether the required use of TSR would "result in shareholders or management focusing too much on this single measure or emphasizing short-term stock price improvement over the creation of long-term shareholder value?" The Commission also notes (immediately preceding Request for Comment 34) that registrants are "permitted to provide supplemental measures of financial performance so long as any additional disclosure is clearly identified, not misleading and not presented with greater prominence than the required disclosure."

TSR is not an appropriate measure of performance in every industry, in part because TSR can be an overly volatile a measure of performance. Moreover, in certain industries TSR is heavily influenced by external market forces over which management has little control. For example, energy, semiconductor and biotech companies all require upfront investment that can negatively impact TSR. Accordingly, these industries rarely use TSR as a performance metric for purposes of compensation, and thus it is inappropriate to require them to use it for purposes of comparing compensation to performance. It would be more beneficial to shareholders if companies were allowed to determine their respective measures of performance under guidelines prescribed by the rules rather than being required to use one universal, and often inapplicable, metric.

The required use of TSR as the disclosed measure of performance is another step towards the "one-size-fits-all" approach of recent legislation, regulation and proxy advisor assessment regarding executive compensation. To the extent that the disclosure requirement causes companies to substitute TSR for existing metrics in compensation design, it can result in a homogenization of executive pay programs that may not be in the best interests of shareholders. (We note that the Commission also appears troubled by this potential result as evidenced by its Request for Comment 36.) Executive pay programs are best designed to suit a company's particular business and support its business strategy, using whichever financial measure(s) that the organization's board of directors and management (with input from shareholders) determine most appropriate; this may or may not focus on (or even include) TSR.

In view of the foregoing, we believe that shareholders would be best served by an approach that permits a registrant to use the financial metric(s) most relevant to its business strategy, along with a discussion of its rationale for such choice. However, we understand the Commission's view that the above italicized statutory language restricts the Commission's ability to allow a measure other than one like TSR (others have suggested a few other measures such as return on equity). Faced with this hurdle, we believe that the required use of TSR is somewhat mitigated by a company's ability (as specifically permitted by the Commission) to provide supplemental measures that better show a company's financial performance.

3. Use of peer groups and relative TSR

The statutory language (including the key portion noted in the first paragraph of part 2 of this letter) does not directly address the use of peer groups or relative TSR through peer group comparisons. We note that the Commission states, in Request for Comment 22, that its "proposal is designed, in part, to enhance comparability across registrants" and then asks whether such comparability across registrants is "relevant or necessary in determining which compensation elements should be covered by the pay-versus-performance disclosure?" While comparability across registrants arguably provides for increased (although not necessarily better) use of information required to be disclosed, it is not mandated by the statute.

Since the use of peer groups and relative TSR based on such peer groups are not required by the Act, and since there are many unclear aspects in using a peer group (e.g., if an issuer identifies more than one peer group in its proxy's Compensation Discussion & Analysis, can it choose which one to use?), we suggest that the use of relative TSR in pay-versus-performance disclosures be made optional with the issuer and not mandatory. Instead we believe that it would be appropriate (and compliant with the statute) for an issuer to be permitted to satisfy the performance component of the disclosure by using TSR (subject to our comments in part 2 above of this letter) coupled with a narrative on the relation of pay to TSR performance. A registrant which believes that supplementing its disclosure using a relative TSR comparison would have that flexibility.

In addition, relative TSR, while providing a data point, does not provide shareholders and other interested parties with the clarity that the Commission intends. First, even within the same industry, registrants do not have the same peer group, so comparing TSR against peers will not allow shareholders to make direct comparisons between companies. Second, peer groups typically are examined annually, and often change, so the year-over-year analysis of relative TSR loses relevance and can lead to confusion. Third, looking at TSR alone, certain members of the peer group may outperform others through their executives' focus on riskier behaviors and decisions (which facts are unlikely to be known to the registrant).

4. Time period for disclosure of pay-versus-performance

As noted by the Commission, Section 14(i) of the Exchange Act "does not specify the time period that the pay-versus-performance disclosure must cover." Accordingly, we believe it is most appropriate to look to the timeframes imposed in existing rules governing executive compensation disclosure. We note that a registrant (other than a smaller reporting company) currently is required to disclose compensation for each of its last three completed fiscal years in the Summary Compensation Table ("SCT") of its annual proxy statement. Instead of using time periods that are consistent with such longstanding disclosure requirements, the Commission proposes a disclosure period of five years (three years for smaller reporting companies). However, in the questions under Request for Comment 42, the Commission asks whether the timeframes should be "shorter or longer?"

Absent an especially strong reason for departing from consistency with the three-year period in the SCT, we believe that the additional costs to registrants of a longer (five-year) period for a pay-versus-performance evaluation and disclosure should trump the speculative benefits of a longer period. While we understand the Commission's view that a five-year period *could* provide a more "meaningful period" for evaluating the relationship of pay-versus-performance) than a three-year period, either timeframe commonly will have a "disconnect" in evaluating pay-versus-performance. Regardless of the time period used for measuring performance for such disclosure (i.e., TSR under the Commission's proposals), it often will not align with the period over which compensation is actually earned. For example, base salary and annual incentives are earned over a one-year period, time-based equity awards typically vest over three or four-year periods, and performance-based vesting is commonly based on a three-year measurement period. Thus a five-year time period does not necessarily provide a better assessment of pay-versus-performance.

The Commission explicitly recognizes this disconnect in Request for Comment 23, stating that under its proposal, "the disclosure may not necessarily align a particular executive's compensation with the period during which the registrant's performance may be attributed to the executive." In view of a five-year period's lack of consistency with the timeframes for the SCT and the increased costs that companies would incur (even with the Commission's proposed phase-in of a five-year period), we are skeptical that disclosure would be sufficiently enhanced by (generally) using five years so as to outweigh these other important considerations. Similarly, some clients have expressed to us a concern that the Commission's proposal would unnecessarily impose additional compliance time demands and the attendant costs without improving clarity of any pay-versus-performance disclosures.

5. <u>Executives covered by pay-versus performance disclosures</u>

Although the Commission observes that "Exchange Act Section 14(i) does not specify which executives must be included in the disclosure of 'executive compensation actually paid'", the proposed rulemaking requires that a company's "named executive officers" be included in the pay-versus performance disclosure. The Commission notes that named executive officers are "the executive officers for whom … compensation disclosure is required in the Summary Compensation Table…." As discussed above in part 4 of this letter (regarding the time period to be used for pay-versus-performance disclosure), we understand and are supportive of the rationale for consistency with the SCT regarding the identification of covered executives.

In Request for Comment 20, the Commission asks whether disclosure should be required only for a company's Principal Executive Officer ("PEO"). No doubt the Commission recognizes that a company's PEO is the executive most responsible for, and most able to impact, the company's financial performance; also, investors and proxy advisory firms have largely focused on the compensation of PEOs. In balancing these factors, the Commission determined (and we agree) that the identification of covered executives should be consistent with the SCT.

6. <u>Requirement of tagging new table in XBRLformat</u>

In Request for Comment 13, the Commission asked whether there should be a requirement that the proposed tabular disclosure be tagged in the XBRL format. The rationale provided by the Commission for this proposed requirement is that XBRL tagging "would permit data to be analyzed more quickly by investors and other end-users … and would facilitate comparisons among public companies."

As mentioned by some of our clients, XBRL (or other format) tagging would impose additional costs on covered registrants that is not mandated by the Act. Another concern is that the XBRL tagging requirement could be a precedent for a further expansion of tagging without due consideration of companies' compliance costs; this is a potential "slippery slope" leading to a tagging of more and more of proxy statement information. In response to the first question contained in Request for Comment 15, if the Commission determines to retain the proposed XBRL tagging requirement, we suggest that smaller reporting companies be exempt from the requirement in order to avoid imposing additional burdens on companies that often are the least able to bear such costs.

***

Hay Group appreciates this opportunity to provide comments regarding the proposed rulemaking on "pay-versus-performance."

Very truly yours,

Hay Group

By:

William M. Gerek
Senior Principal and Regulatory Expertise Leader,
Board Solutions