FINANCIAL SERVICES ROUNDTABLE

Via http://www.sec.gov/rules/proposed.shtml

July 6, 2015

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

Re: Pay Versus Performance, Securities Exchange Act Release No. 74835 [File No. S7-07-15]

Dear Mr. Fields:

The Financial Services Roundtable ("FSR")[1] appreciates the opportunity to respond to the proposed "Pay Versus Performance"[2] rules (the "Proposal"), which would implement section 953(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act").[3]

Section 953(a) of the Dodd-Frank Act directs the Securities and Exchange Commission (the "Commission") to adopt rules that require issuers to disclose the relationship between executive compensation actually paid and the issuer's financial performance.[4] The Proposal follows the Commission's prior actions to implement other mandates governing executive

[1] As *advocates for a strong financial future,*™ FSR represents the largest integrated financial services companies providing banking, insurance, payment, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. FSR member companies provide fuel for America's economic engine, accounting directly for $92.7 trillion in managed assets, $1.2 trillion in revenue, and 2.3 million jobs.

[2] SEC. & EXCH. COMM'N, Pay Versus Performance [File No. S7-07-15], 80 Federal Register 26330 (May 7, 2015) (the "Proposing Release"), *available at* https://www.sec.gov/rules/proposed/2015/34-74835.pdf.

[3] Section 953(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Public Law No. 111-203, 124 Stat. 1376, 1903-04 (July 21, 2010) (the "Dodd-Frank Act").

[4] *Id.*

compensation disclosure under the Dodd-Frank Act, including the so-called "say-on-pay" rule[5] adopted in 2011, and the "Pay Ratio Disclosure" rule[6] proposed in 2013.

FSR supports meaningful disclosures to investors and market participants. However, we are concerned that certain aspects of the proposed pay-versus-performance disclosure régime (the "Proposed Disclosure") that we discuss in our letter may have the unintended effect of misleading and confusing investors. In our comments, we address particular concerns and also recommend alternative approaches (including a principles-based approach) and certain adjustments that we believe will enhance the efficacy of the Commission's approach to implementing the pay-versus-performance provision of the Dodd-Frank Act.

I. Executive Summary

The following presents a summary of FSR's comments:

- FSR urges the Commission to adopt a principles-based approach in the final Pay for Performance Disclosure Régime, which would allow the company to furnish more relevant disclosure to investors because the definitions of "pay" and "performance" would be more closely tailored to the company's unique facts and circumstances.

- FSR urges the Commission to limit the Proposed Disclosure to the principal executive officer because the principal executive officer's compensation is generally of the most interest to investors. However, if the Commission were to mandate disclosure concerning "Named Executive Officers" as presently defined in Item 402(a)(3), FSR supports the Commission's determination not to expand the Proposed Disclosure beyond the named executive officers as presently defined, which will benefit investors by eliminating potentially confusing disclosures. The determination not to expand the existing definition of named executive officers also would lessen the compliance burdens imposed on the company, which do not have any corresponding benefit to investors or the public interest.

- The Commission's method of defining "performance"[7] places too much emphasis on a measure that is influenced by many factors that are beyond management's influence or control.

- Under the principles-based approach that we advocate, companies would be afforded the flexibility to define "actual pay" using the metrics that are most relevant, which

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[5] SEC. & EXCH. COMM'N, Shareholder Approval of Executive Compensation and Golden Parachute Compensation, Securities Act Release No. 9178 [File No. S7-31-10], 76 Federal Register 6010 (Feb. 2, 2011), *available at* http://www.sec.gov/rules/final/2011/33-9178fr.pdf (implementing section 951(a) of the Dodd-Frank Act).

[6] SEC. & EXCH. COMM'N, Pay Ratio Disclosure, Securities Act Release No. 9452 [File No. S7-07-13], 78 Federal Register 60560 (Oct. 1, 2013), *available at* http://www.gpo.gov/fdsys/pkg/FR-2013-10-01/pdf/2013-23073.pdf (implementing section 953(b) of the Dodd-Frank Act).

[7] SEC. & EXCH. COMM'N, Pay Versus Performance [File No. S7-07-15], 80 Federal Register 26341 (May 7, 2015) (the "Proposing Release"), *available at* https://www.sec.gov/rules/proposed/2015/34-74835.pdf.

for some companies may be based on income reported to the Internal Revenue Service on the executive's Form W-2.

- The Commission's method of defining "pay"[8] would not allow an investor to compare with ease the executive compensation disclosures of public companies.

- Other Responses to the Commission's Request for Comment

  - FSR urges the Commission to provide an express exemption from the Pay Versus Performance Disclosure Régime for any subsidiary of a publicly traded entity, which would remove any doubt concerning the Commission's intention to exclude certain subsidiaries from coverage by the rule.

II. Introduction

By a majority vote[9] on April 29, 2015, the Commission proposed the Pay Versus Performance rule to implement section 14(i) of the Securities Exchange Act of 1934 (the "Exchange Act"),[10] as added by section 953(a) of the Dodd-Frank Act ("section 953(a)"). In section 953(a), Congress directed the Commission to adopt rules requiring that public companies provide a clear description of "any compensation required to be disclosed" pursuant to Item 402 of Regulation S-K,[11] "including information that shows the relationship between executive compensation actually paid and the financial performance of the issuer."[12] The Commission proposed to amend Regulation S-K to add new Item 402(v), which would require presentation of the following disclosure information in a tabular format:

(1) Executive compensation actually paid to the principal executive officer, and the total compensation reported in the Summary Compensation Table for the principal executive officer;

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8 *Id.* at 26337.

9 Commissioners Daniel M. Gallagher and Michael S. Piwowar dissented from the Commission's decision to propose the Pay Versus Disclosure rule. *See* COMM'R DANIEL M. GALLAGHER, Dissenting Statement at an Open Meeting Proposing Mandated Pay versus Performance Disclosures (Apr. 29, 2015), *available at* http://www.sec.gov/news/statement/dissent-proposing-mandated-pay-versus-performance-disclosures.html; COMM'R MICHAEL S. PIWOWAR, Statement at Open Meeting on Pay versus Performance (Apr. 29, 2015), *available at* http://www.sec.gov/news/statement/statement-pay-versus-performance.html. Among the objections Commissioners Gallagher and Piwowar raised were: (a) the Commission's prescriptive approach to the definition of "pay," which may not be the most meaningful definition for the broader segment of public companies; (b) the mandate to disclose information for all named officers is excessive given that the tone of the company's compensation program is set by the compensation of its chief executive officer; and (c) the Commission's use of "total shareholder return" to measure "performance" may encourage an overemphasis on short-term performance at the "expense of long-term shareholder value creation." *Id*.

10 15 U.S.C. § 78n (2012).

11 17 C.F.R. § 229.402 (2013).

12 Section 953(a) of the Dodd-Frank Act.

(2) An average of the executive compensation actually paid to the remaining named executive officers, and an average of the total compensation reported in the Summary Compensation Table for the remaining named officers;

(3) The company's cumulative total shareholder return; and

(4) The cumulative total shareholder return of the companies in a peer group chosen by the company.

FSR agrees with the Commission's preliminary view that the Proposed Disclosure is appropriately required only in proxy statements on Schedule 14A[13] and information statements on Schedule 14C,[14] because these are the circumstances when shareholder action is being taken with respect to the election of directors or executive compensation. FSR recommends that the Commission confirm this interpretative position in any final rule to implement section 953(a).

As proposed, the company also would be required to describe (1) the relationship between executive compensation actually paid and the registrant's Total Shareholder Return; and (2) the relationship between the company's Total Shareholder Return and the Total Shareholder Return of its peer group. This additional disclosure would be placed after the table and could be presented as a narrative, in a graphic form, or as a combination of the two.

FSR generally is concerned that the Commission has proposed an overly-prescriptive, "one-size-fits-all" disclosure régime to implement section 953(a), which would obscure important differentiations that the company believes are present in the total compensation program for its principal executive officer.

Although the Commission also proposes to require pay-versus-performance disclosures for the company's named executive officers, FSR believes that any evaluation of compensation based on a company's financial performance would more appropriately be restricted to the company's principal executive officer—rather than expanded to the named executive officers as the Commission proposes. In this regard, we note that the principal executive officer's compensation generally is of greatest interest to investors.

Finally, we note that the Commission's proposal also would: (a) over-emphasize short-term results due to the presence of the proposed Total Shareholder Return metric that appears to be focused on a company's one-year financial performance;[15] and (b) not allow investors to easily compare among public companies the proposed method of "pay".

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[13] 17 C.F.R. § 240.14a-101 (2012).

[14] Schedule 14C [codified at 17 CFR § 240. 14c-101] works in conjunction with Schedule 14A to require the disclosure generally of information prescribed by Schedule 14A to the extent that the item would be applicable to any matter to be acted on at a meeting if proxies were to be solicited. Schedule 14C implements Section 14(c) of the Exchange Act [codified at 15 U.S.C. § 78n(c)], which created disclosure obligations for companies that choose not to, or otherwise do not, solicit proxies, consents, or other authorizations from some or all of their security holders entitled to vote.

[15] In this regard, it is unclear whether the Commission intends for companies to calculate "Total Shareholder Return" on a year-by-year basis or cumulatively.

III. FSR urges the Commission to adopt a principles-based approach in the final Pay for Performance Disclosure Régime, which would allow the company to furnish more relevant disclosure to investors because the definitions of "pay" and "performance" would be more closely tailored to the company's unique facts and circumstances.

FSR generally is concerned that the Commission has proposed an overly-prescriptive, "one-size-fits-all" disclosure régime to implement section 953(a), which would obscure important differentiations that the company believes are present in the total compensation program for its principal executive officer. As the Commission acknowledged, Congress did not intend to require an "overly-prescriptive" approach because "there could be many ways to disclose the relationship between executive compensation and financial performance of the registrant."[16] In our view, the Commission's attempt to force comparability in executive compensation data would create confusion for investors, and require the company to develop more complicated narrative disclosures in an attempt to offset the misconceptions likely created by the required tabular data.

Like the Compensation Discussion and Analysis[17] disclosures, a principles-based approach could mandate certain parameters that must be addressed in the disclosure (*e.g.*, covered executives, time period, *etc.*) that can facilitate meaningful comparisons while balancing the inherent challenge of defining "pay" and "performance" for any given company.

We believe the Proposed Disclosure is likely to confuse and mislead the typical individual investor, who lacks the more sophisticated analytical tools institutional investors have available to evaluate the compensation of the company's principal executive officer in light of the various metrics and performance goals explained in the company's Compensation Disclosure and Analysis. As a consequence, the company would be required to present expanded disclosures to supplement the Proposed Disclosures, as a means to ensure that investors have complete information with which to evaluate the company's financial performance *vis-à-vis* the principal executive officer's compensation during the relevant measuring period. However, much of the supplemental disclosures would simply be a repetition of portions of the Compensation Discussion and Analysis.

Finally, FSR believes a principles-based approach to disclosure would provide a better alternative to meeting the mandate in section 953(a) because it would minimize the potential for confusing investors, and eliminate the need for a company to present supplemental disclosure explaining its data. We note that under a principles-based approach, a company could include certain data to provide a level of comparability across public companies in its industry sector (*e.g.*, covered time period, covered executives, *etc.*). Therefore, FSR recommends that the Commission adopt a principles-based approach in the final Pay Versus Performance Disclosure Régime, which would allow the company to furnish more relevant disclosure to investors

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[16] *See* Proposing Release at note 7 (citing REPORT OF THE SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS To Accompany S.3217, S. REP. NO. 111-176, AT 135 (2010)).

[17] 17 C.F.R. § 229.402(b) (2013).

because the definitions of "pay" and "performance" would be more closely tailored to the company's unique facts and circumstances.[18]

FSR further recommends that the Commission limit the time period covered by the Proposed Disclosure to the three-year period currently in effect for disclosures on the Summary Compensation Table,[19] instead of the proposed five-year period. This change would have the benefit of helping investors better understand and evaluate the Proposed Disclosure, because the data points would be aligned with existing executive compensation disclosures presented in the Summary Compensation Table.

IV. FSR urges the Commission to limit the Proposed Disclosure to the principal executive officer.

The Commission proposes to require that the company furnish the Proposed Disclosure concerning the company's named executive officers. FSR believes the expansion of the disclosure to include other named executive officers will add cost and complexity with limited relevance to investors because the principal executive officer's compensation generally is of greatest interest to investors.

We note that a company is more likely to have (a) "outliers" among its named executive officers (either high or low compensation); (b) transitional issues arising due to departures and new hires; or (c) compensation that is linked to the financial performance of a specified business unit—rather than the financial performance of the company as a whole. FSR, therefore, urges the Commission to limit the Proposed Disclosure to the principal executive officer.

If the Commission, nonetheless, were to include in the final Pay Versus Performance rule disclosures related to the named executive officers, FSR supports the Commission's determination not to expand the Proposed Disclosure beyond the "named executive officers" as presently defined in Item 402(a)(3) of Regulation S-K, because the elimination of potentially confusing disclosures would benefit investors. In this regard, we note that creating a broader group of "named executive officers" would impose a substantial compliance burden on companies without any corresponding benefit to investors or market participants. Moreover, a different definition of "officer" could lead to confusing disclosures.

V. The proposed definition of "performance" tied exclusively to "Total Shareholder Return" is not an appropriate measure of a company's financial performance.

The proposed *Total Shareholder Return* metric does not adequately measure management performance or operational or business performance, because many of the factors that impact Total Shareholder Return (*e.g.*, general market and industry trends) are beyond the influence or control of the company's management. Moreover, a company's executives could be incentivized to adopt business decisions and compensation practices that prioritize short-term stock price movements over long-term shareholder value creation. In addition, the company also may adopt

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18 We note that Commissioners Gallagher and Piwowar also expressed support for a principles-based disclosure régime. *See supra* note 9.

19 17 C.F.R. § 229.402(c) (2013).

compensation packages that more directly link pay to short-term movements in the market price of its common stock. Finally, another inherent problem with the Total Shareholder Return metric is that it can be highly dependent on the starting point. For example, if the "snapshot" beginning date occurs in a particular peak or valley in the company's stock price, the disclosure could overstate or understate the following years of Total Shareholder Return performance.

We also are concerned that the Commission's use of Total Shareholder Return could interfere with meaningful disclosures—particularly to retail investors, which could have the unintended effect of misleading and confusing investors. Unlike companies in less regulated industries, FSR notes that bank management has even less control over corporate transactions that would effect returns to shareholders in the form of share repurchases or dividends, which transactions are subject to approval by the bank's prudential regulators implementing their enhanced supervisory authority under the Dodd-Frank Act.

FSR notes the high likelihood that retail investors (who generally have access to less sophisticated metrics) would consider Total Shareholder Return an important metric in aligning pay-versus-performance and, accordingly, would fail to consider the company's supplemental disclosures, which may be the more relevant financial metrics. For example, the company could disclose in its supplemental disclosures its performance relative to the specific financial metrics that determine payouts under its incentive plans.

In this regard, the Dodd-Frank Act neither prescribes nor mandates the use of Total Shareholder Return as the sole measure of a company's financial performance. In keeping with our support for a principles-based approach, FSR urges the Commission to afford the company greater flexibility to determine the most relevant measure(s) of performance that would demonstrate its annual and long-term executive compensation strategy and philosophy.

Finally, FSR recommends that the Commission not include any requirement for disclosure of peer group Total Shareholder Return in the final rule. We note that disclosure of a "peer-group" metric is not authorized under the Dodd-Frank Act; can create additional challenges given the "starting point" problem discussed above; and—particularly for larger companies—establishment of a relevant peer group with enough size to be statistically significant can be difficult.

VI. The proposed method of defining "actual pay" is not a meaningful method to compare companies.

a. FSR urges the Commission to apply a principles-based approach to the definition of "pay."

Given the potential for misleading disclosures, FSR urges the Commission to reconsider how compensation "actually paid" to the principal executive officer and the named executive officers should be determined. In our view, the proposed computation of "actual pay" is unnecessarily complicated, and does not represent what an individual investor would think was "actually paid" to an executive.[20]

We believe it is highly unlikely that the typical individual investor would expect that the company's disclosures of *actual pay* would include the "accounting value" of vested stock awards (as opposed to the amount of cash or the value of securities actually received upon exercise of the awards) or unexercised stock options. Consequently, disclosure of these items in "actual pay" would overstate and misrepresent the "actual pay" received during the relevant fiscal year by the principal executive officer or the named executive officers.

We further note that the Commission's proposed calculation of actual pay seems to contradict the statutory language, and adds complexity not intended by Congress. In section 953 of the Dodd Frank Act, Congress very clearly referenced the "Summary Compensation Table" total in subsection (b), but did not do so in subsection (a), where Congress chose not refer to the Summary Compensation Table total, and instead used the phrase "actually paid". Given the close proximity of these two provisions, and the difference in statutory language, we submit that Congress did not intend that compensation for this purpose would be determined by reference to the Summary Compensation Table.

Under the principles-based approach that FSR advocates, companies would be afforded the flexibility to define "actual pay" using the metrics that are most relevant. For example, while some companies may determine that income reported to the Internal Revenue Service on the executive's Form W-2 (or, for executives who do not report their income in the United States of America, the amount reported to the applicable tax authority) would be the most relevant metric for determining actual pay, other companies may develop alternative metrics that the board and management believe would be more appropriate under all of the facts and circumstances.

b. Multiple Principal Executive Officers

When a company has more than one principal executive officer in a given year, FSR recommends that the Commission afford the company the flexibility to annualize the compensation of the principal executive officer serving at the end of the fiscal year.

The amounts for each principal executive officer should not be aggregated, because the aggregated amount would not be comparable to amounts reported at peer companies with only one principal executive officer, and the amount would not necessarily be consistent with the company's standard compensation practices for years when only one person serves in the principal executive officer role. For example, using the aggregate amount could include both "new hire awards" (for the new principal executive officer) and "severance payments" (for the outgoing principal executive officer), which will tend to overstate the total compensation for the position. There is real potential for misleading investors because these payments may not be directly correlated to the company's performance in the current fiscal year, which would likely require the company to prepare supplemental disclosures. Thus, aggregate disclosures could have the unintended effect of misleading investors because it could distort the company's

[20] Under the proposed calculation, the company would take the total amount reported on the Summary Compensation Table total, deduct unvested stock and option awards and pension values, and add back the fair value of vested awards and the value of the pension accrual for the fiscal year.

executive compensation philosophy and practices in any fiscal year in which the company had multiple principal executive officers.

c. Performance-Based Equity Awards

FSR is concerned that the definition of executive compensation “actually paid” in respect of performance-based equity awards would lead to potentially misleading disclosure, because any future payout would not correlate solely to the company’s performance for the year in which the awards are paid and the disclosure is required to be made. In this regard, we note that companies generally impose vesting periods of between three and five years for annual equity award programs. Thus, for any particular fiscal year, compensation actually paid to the company’s executive officers necessarily will include certain payouts from equity awards granted in prior years that vest in the current fiscal year. However, the resulting vesting patterns would not directly reflect the principles the compensation committee used to set executive compensation in the reporting year. Thus, to avoid potentially misleading disclosure, a company may be required to prepare supplemental disclosures that would explain the “mismatch” between performance years and payment years.

Consequently, FSR urges the Commission to clarify in the final Pay Versus Performance rule that the grant or vesting of performance-based equity awards should not be treated as compensation that is *actually paid*.

d. Stock Option Awards

FSR notes that the proposed definition of executive compensation “actually paid” as it relates to the grant or vesting of stock options would be inappropriate because the named executive officers would not actually receive any compensation until they exercise their respective options. We further note that at the time of stock options vest, an executive officer would not include the value of the particular option(s) or be subject to tax on these grants absent the executive’s decision to exercise the option(s) immediately. Consequently, any requirement that the company disclose the value of stock option awards absent exercise by the holder would be misleading.

Like the Summary Compensation Table option award value at grant date, this proposed option amount is still valued in accordance with accounting guidance and requires multiple valuation assumptions. We note that the use of the vesting date for valuation also may lead to sharp increases in any year during which significant option awards vest. Moreover, the volatility can make it difficult for investors to understand the relationship between pay and performance. Finally, the proposed definition could lead to undesirable changes in compensation practices, such as changing the timing of stock option grants or vesting practices that may impact disclosure. Similarly, including vested stock options that have not yet been exercised would misrepresent the actual pay received by the principal executive officer or named executive officer because he could later exercise the options at a much higher or much lower stock price. Accordingly, FSR asks the Commission to clarify that stock option awards should not be included in calculating compensation actually paid until the principal executive officer or named executive officer has exercised the option(s) and has received the resulting cash or securities.

VII. Other Responses to the Commission's Request for Comment

a. FSR urges the Commission to provide an express exemption from the proposed "Pay Versus Performance" disclosure régime for any subsidiary of a publicly traded entity.

In discussing the value of the Proposed Disclosure for informing shareholder votes related to executive compensation, the Commission stated that it proposes to require the disclosures "only . . . in a registrant's proxy or information statement."[21] This statement implies that a company that is a subsidiary (a "Reporting Subsidiary") of another entity that itself is a publicly traded company would not be subject to the Proposed Disclosure Régime. We note that the Commission historically has allowed modifications to the disclosure requirements for a Reporting Subsidiary.[22] Accordingly, FSR believes an express exemption from the Pay Versus Performance rule would be appropriate based on prior precedent, as well as to clarify the ambiguity present in the Proposing Release.

In modifying its disclosure requirements, the Commission has recognized that where a publicly traded parent has disclosed the compensation payable in respect to its executive officers pursuant to the requirements of Item 402, there is no need for a Reporting Subsidiary—which has no public shareholders but offers other securities that otherwise require registration under the Federal securities laws—to disclose the compensation payable to the executive officers of the Reporting Subsidiary.

We submit that a similar logic should apply to the Proposed Disclosures. FSR notes that without the context of the other executive compensation disclosure, the Reporting Subsidiary's pay-versus-performance disclosure will likely be more confusing than helpful to investors. Additionally, since the Reporting Subsidiary's reporting would almost universally cover an employee population that is smaller than that of its publicly traded parent and may pertain to a different principal executive officer, separate pay-versus-performance disclosure for the Reporting Subsidiary may confuse investors of the public parent, who may not appreciate the different bases for the reporting. FSR, therefore, urges the Commission to provide an express exemption from the Proposed Disclosure Régime for any Reporting Subsidiary.

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[21] *See* Proposing Release, "Section II.B.1. Application and Operation of Proposed Item 402(v)," 80 Federal Register at 26333.

[22] Form 10-K, General Instruction I, "Omission of Information by Certain Wholly-Owned Subsidiaries" [17 C.F.R. § 249.310].

FSR appreciates the opportunity to submit comments on the Proposal. If it would be helpful to discuss FSR's specific comments or general views on this issue, please contact [redacted], or Felicia Smith, Vice President and Senior Counsel for Regulatory Affairs [redacted]

Sincerely yours,

Rich Foster

Richard Foster
Senior Vice President and Senior Counsel
for Regulatory and Legal Affairs
Financial Services Roundtable

With a copy to:

The Honorable Mary Jo White, Chair
The Honorable Luis A. Aguilar, Commissioner
The Honorable Daniel M. Gallagher, Commissioner
The Honorable Kara M. Stein, Commissioner
The Honorable Michael S. Piwowar, Commissioner

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