

March 3, 2022

Vanessa A. Countryman  
Secretary  
US Securities and Exchange Commission  
100 F Street NE  
Washington, DC 20549-1090

**Re: Reopening of Comment Period for Pay Versus Performance**

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Dear Ms. Countryman,

Dimensional Fund Advisors LP (“Dimensional”) welcomes this renewed opportunity<sup>1</sup> to provide the US Securities and Exchange Commission (the “Commission”) with our views on the Commission’s 2015 Pay Versus Performance rule proposal (the “2015 Proposal”).<sup>2</sup> Together with its advisory affiliates, Dimensional has approximately \$679 billion in global assets under management<sup>3</sup> and is committed to serving as a responsible steward of the assets entrusted to us. We strive to protect and enhance shareholder value by advocating for stronger governance practices at the companies<sup>4</sup> we invest in on behalf of our clients. Executive compensation is a perennial stewardship priority for Dimensional because of our belief that poorly designed compensation packages can result in excessive compensation and motivate poor strategic decision-making by management, leading to pay that is not aligned with shareholder interests.

Dimensional supports executive compensation that is clearly linked to a company’s performance and designed to align the interests of executives and shareholders. Because we believe that compensation should be based on rigorous and transparent metrics that display a clear link between pay and long-term performance, we agree that the Commission should require public companies to disclose multiple financial performance measures, and we support the Commission’s proposal to require a table of the most important performance measures that drove compensation actually paid, as determined by each company. We also believe that if a company identifies an environmental, social, or governance (“ESG”) metric as one of the most important metrics impacting executive pay, then information about how those metrics are used should be clearly disclosed.

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<sup>1</sup> *Reopening of Comment Period for Pay Versus Performance*, Release No. 34-94074 (Jan. 27, 2022) (the “Reopening Release”).

<sup>2</sup> *Pay Versus Performance*, Release No. 34-74835 (Apr. 29, 2015).

<sup>3</sup> As of December 31, 2021.

<sup>4</sup> Throughout this letter, we use the terms “companies” and “registrants” interchangeably to refer to the public companies that would be subject to the Commission’s proposed rules.

**I. We support requiring disclosure of multiple financial performance metrics, and we encourage the Commission to require public companies to disclose the metrics actually used to link compensation to company performance.**

In the 2015 Proposal, the Commission proposed that companies use cumulative total shareholder return (“TSR”) as the measure of financial performance for purposes of the pay versus performance disclosure. While TSR is a commonly used metric for this purpose, requiring disclosure of TSR as the sole metric of performance could have the unintended effect of confusing investors. Even in the best situation, TSR measures how well management does relative to the market’s expectation. If the best management team in the world continues to excel but falls a bit short of the extraordinary level expected by the market, the TSR will reflect that disappointment. The worst management team in the world can deliver a high TSR just by exceeding the market’s low expectation of the team’s performance. In addition to this fundamental flaw, TSR is a noisy measure. Many factors outside executives’ control impact shareholder returns, such as marketwide or industry-specific trends. For example, in 2021, the energy sector returned 56% while the overall market returned only 26%.<sup>5</sup> The greater TSR of energy companies in 2021 was largely due to the increase in demand for oil and the surge in oil prices, rather than the actions taken by energy company executives. Comparing a company’s TSR to its peers mitigates, but does not eliminate, the effect of outside factors on TSR. For these reasons, we believe TSR should not be relied on to show the link between pay and performance.

**A. Disclosure of multiple financial performance metrics would provide a fuller picture of company performance.**

We believe that a better approach would be for the Commission to require registrants to disclose multiple financial performance metrics. In the Reopening Release, the Commission recognizes that disclosure of multiple metrics “may broaden the picture of financial performance”<sup>6</sup> and proposes to require companies to disclose three new metrics in addition to TSR: (1) pre-tax net income, (2) net income, and (3) a measure chosen by the registrant that, in the registrant’s assessment, represents the most important performance measure used by the registrant to link compensation actually paid to company performance (the “Company-Selected Measure”).

While we do not object to companies disclosing net income or pre-tax net income in their pay versus performance tables, in many cases, disclosure of these metrics may not add much to an investor’s understanding of the relationship between executive compensation and the financial performance of the company. Net income can be subject to one-time charges related to discontinued operations, extraordinary adjustments, or unusual charges to depreciation and amortization, which can introduce noise to the relationship between pay and performance. Furthermore, whether net income is an appropriate measure of performance depends on the

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<sup>5</sup> We use the return of the Russell 3000 Index as a proxy for the overall market as compared to the performance of energy companies within the Russell 3000 Index.

<sup>6</sup> Reopening Release at 13.

company's strategy. For example, if a struggling company hires a new CEO to help turn the business around, that CEO might close certain business lines, sell off assets, discontinue certain products, or invest in research and development. These decisions could result in low or negative net income, even though the strategies may ultimately pay off for shareholders over the long term. Because the relevance of net income as a measure of performance can depend on a company's strategy, we encourage the Commission not to require all companies to show net income and pre-tax net income.

**B. Disclosure of Company-Selected Measures—rather than prescribed metrics—would benefit investors.**

Instead, we strongly encourage the Commission to require public companies to disclose multiple metrics that, in the registrant's assessment, represent the most important performance measures used by the registrant to link compensation actually paid to company performance. Just as the Commission recognizes merit in proposing to require disclosure of one Company-Selected Measure, we believe disclosure of multiple Company-Selected Measures would provide a more complete picture of how pay relates to performance at an individual company. In our view, a registrant's compensation committee is best positioned to decide which combination of metrics is aligned with the company's business model, strategy, and operations. Requiring disclosure of those company-specific metrics would provide investors with better information and more transparency into each company's specific executive compensation structure.<sup>7</sup> In contrast, prescribing the metrics that *all* companies must disclose is likely to generate useful disclosure for some companies and irrelevant and possibly misleading disclosure for others. Disclosure of Company-Selected Measures would also complement the Commission's proposal to require companies to include a table disclosing the most important performance measures that drove compensation paid, which we discuss further in Section II of this letter.<sup>8</sup>

In our experience, a well-designed compensation package for public company executives typically employs more than one financial metric, as incorporating multiple metrics reduces the risk of executives gaming a single measure of performance at the expense of long-term shareholder value. That said, if the Commission requires companies to disclose multiple Company-Selected Measures in lieu of net income and pre-tax net income as we suggest, then we would also encourage the Commission to clarify that a company would only need to disclose the Company-Selected Measures that it actually considered. In other words, if the Commission requires

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<sup>7</sup> We note that although additional requirements could increase reporting costs, we believe requiring disclosure of multiple Company-Selected Measures should not add significant costs for companies, as companies would already be calculating these metrics in order to use them to link pay to performance. We also believe that in most cases, companies are likely to have already disclosed such metrics in other filings.

<sup>8</sup> If the Commission agrees to require companies to disclose multiple Company-Selected Measures instead of net income and pre-tax net income, then this may render the Commission's proposal to require a table disclosing the most important performance measures unnecessary, because companies would be disclosing the same measures in both tables. By requiring companies to disclose multiple Company-Selected Measures, the Commission could streamline the disclosure by combining the two tables into one.

disclosure of three Company-Selected Measures, a company that considered only two measures would need to disclose only those two.

We recognize that the Commission and some market participants may have concerns that allowing companies to choose the metrics they disclose would reduce comparability of metrics across companies and could enable companies to cherry-pick measures that support larger realized pay. To alleviate these concerns, the Commission could require registrants other than smaller reporting companies to disclose the peer group metric for each Company-Selected Measure, similar to the Commission's current proposal to require disclosure of peer group TSR.<sup>9</sup> The Commission could also require registrants that change a measure year-over-year to explain why there was a change and to report results under the previously reported measure.

In addition, the Commission could provide general guidance describing characteristics of metrics that investors may find useful. For example, measures of profits that are less subject to one-time adjustments, relatively comparable across companies, comprehensive, and closely tied to shareholder value can provide investors with a fuller picture of executive performance. Such metrics tend to be higher on the income statement as compared to net income. Scaling such measures of profits, such as dividing by book value or assets, can also provide investors with insight into how management uses the company's resources and allow for comparability across companies of different sizes. Use of standard GAAP metrics is generally preferable to non-GAAP metrics, as large non-GAAP adjustments result in less transparency for investors and may lead to artificially high executive pay. We strongly encourage the Commission to allow companies to disclose the metrics they actually use; however, if the Commission determines it is in the best interest of investors to require all registrants to disclose the same metric, we believe that a metric higher up on the income statement—such as EBITDA or free cash flow—might be more informative.

Ultimately, we believe the most useful metrics for investors will be the measures that each company actually uses to link pay to performance, and thus we encourage the Commission to allow companies to disclose multiple Company-Selected Measures rather than to require all companies to disclose the same metrics.

***II. We support the Commission's proposal to require companies to include a table disclosing the most important performance measures that drove compensation actually paid.***

We also believe that investors will benefit from disclosure of the most important performance measures that drove compensation actually paid (the "Most Important Measures Table"), because it would provide clarity on what metrics—in hindsight—impacted compensation. As noted in the Reopening Release, existing disclosure of the relationship between executive

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<sup>9</sup> Proposed Item 402(v) of Regulation S-K.

compensation and performance in a company's Compensation Discussion and Analysis ("CD&A") tends to be prospective in nature.<sup>10</sup> Requiring a backward-looking Most Important Measures Table would enable investors to compare what companies say will impact pay (in the CD&A) with what actually impacted pay (in the Most Important Measures Table), and companies could be held accountable for any discrepancies.

Requiring registrants to list and rank the measures that actually drove compensation would also be useful because at many companies, compensation has become overly complex. When a company discloses a laundry list of factors that can affect compensation, it can be extremely difficult for investors to ascertain what actually drove pay in any given year. For example, a company might state that its CEO's pay is made up of an earnings component (50%) and a performance component (50%). That performance component might then be broken down into divisional targets (10%) and cross-divisional targets (90%), with cross-divisional targets consisting of ESG and "other," and with "other" being further broken down into market position, innovation, customer orientation, and reputation. Because of the proliferation of this layered approach to compensation design, we also suggest that the Commission clarify in the adopting release that companies should describe with specificity the measures included in their Most Important Measures Tables.

In the Reopening Release, the Commission also notes that, if a registrant considers fewer than five performance measures, the registrant would only need to disclose the measures it actually considers. We agree and encourage the Commission to reiterate in the adopting release that the Most Important Measures Table is not meant to suggest a minimum number of measures that companies should consider in setting compensation but is instead the maximum to be disclosed in the table.

**III. If ESG metrics are among the most important measures driving executive compensation at a company, then information about how those metrics are used should be clearly disclosed.**

Finally, if a company links executive compensation to ESG metrics, then additional information about the metrics used should be clearly disclosed. It can be challenging to link ESG metrics to executive pay in a quantifiable and transparent manner. At some companies, the ESG metrics tied to executive compensation are well-defined and clearly relevant to the company's financial performance. For example, the CEO of a mining company might have part of their compensation determined by their performance against industry-standard occupational health and safety metrics, as poor performance on these metrics could result in regulators shutting down operations. But, in our experience, it is much more common to see companies link executive pay to ESG metrics that are ill-defined or inherently difficult to quantify, which gives companies the ability to increase executive pay even if the executives are failing to increase shareholder value as

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<sup>10</sup> Reopening Release at 11-12.

measured by financial or return metrics. Clear disclosure of (1) how performance is measured against the metric, (2) the data and methodology for calculating the metric, (3) the weight given to the metric in determining compensation, and (4) why the metric is aligned with shareholder interests enables investors to assess whether a company is artificially increasing executive pay based on ESG factors.

Separately, we believe that companies should not be required or encouraged to incorporate ESG metrics in determining executive pay. Material ESG issues can impact shareholder value, but as we have noted above, there are challenges associated with linking ESG metrics to executive pay, as ESG metrics are often subjective. To the extent ESG issues are financially material to a particular company, it is reasonable to expect that those issues will already be covered by measures of financial performance, which tend to be objective, quantifiable, and have an established connection with shareholder value.

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If we can be of further assistance, please do not hesitate to contact Stephanie Hui, Vice President and Counsel, at [REDACTED] or [REDACTED]. We would welcome the opportunity to present an expanded discussion of our thoughts on these issues.

Sincerely,



Will Collins-Dean  
Chair of the Investment Stewardship Committee,  
Senior Portfolio Manager and Vice President



Kristin Drake  
Head of Investment Stewardship and Vice President