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Tax and Domestic Economic Policy

March 4, 2022

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

Re: File No. S7-07-15; Release No. 34-94074: *Reopening of Comment Period for Pay Versus Performance*

Dear Ms. Countryman:

The National Association of Manufacturers (“NAM”) appreciates the opportunity to provide comment to the Securities and Exchange Commission (“SEC”) on Release No. 34-94074,<sup>1</sup> the reopening of the comment period for File No. S7-07-15, the Commission’s 2015 proposed rule on pay versus performance.<sup>2</sup>

The NAM is the largest manufacturing trade association in the United States, representing manufacturers of all sizes and in all 50 states. Manufacturing is a capital-intensive industry, requiring significant investments for equipment purchases and research and development (“R&D”). Manufacturers often turn to the public capital markets to finance these pro-growth activities, which set the stage for economic expansion, innovation, and job creation. The NAM supports tailored disclosure obligations for public companies that enable businesses to communicate decision-useful data to investors without diverting critical resources from company growth nor overwhelming shareholders with immaterial, duplicative, or irrelevant information.

During congressional consideration of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”), the NAM urged lawmakers to focus their efforts on strengthening the U.S. financial system rather than imposing costly new regulations on manufacturers that had nothing to do with the financial crisis. The NAM opposed the inclusion of the Section 953(a) pay versus performance disclosure requirement in Dodd-Frank, and we continue to have concerns about the provision given the likelihood that, once implemented, it will impose significant costs on public companies without providing new or useful information to investors. Nevertheless, we understand that the SEC is working to discharge its statutory mandate, and we are hopeful that the Commission’s ongoing consideration will result in a final rule that avoids to the largest extent possible duplicative, confusing, or costly disclosure obligations.

The NAM raised similar concerns in response to the SEC’s 2015 pay versus performance proposal, noting that the proposed rule would “add an additional and duplicative layer of disclosure and burden to manufacturers without providing any significant benefit to shareholders.”<sup>3</sup> The Reopening Release

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<sup>1</sup> *Reopening of Comment Period for Pay Versus Performance*, 87 Fed. Reg. 5751 (2 February 2022). Release No. 34-94074, available at <https://www.govinfo.gov/content/pkg/FR-2022-02-02/pdf/2022-02024.pdf>.

<sup>2</sup> *Pay Versus Performance*, 80 Fed. Reg. 26330 (7 May 2015). Release No. 34-74835, available at <https://www.govinfo.gov/content/pkg/FR-2015-05-07/pdf/2015-10429.pdf>.

<sup>3</sup> NAM Comments on File No. S7-07-15 (6 July 2015). Available at <https://www.sec.gov/comments/s7-07-15/s70715-40.pdf>.

acknowledges that some 2015 commenters felt that the proposed rule would “misrepresent[ ] or provid[e] an incomplete picture of how pay relates to performance,”<sup>4</sup> but the SEC does not appear to be considering any steps to right-size the proposed reporting requirement nor to reduce the associated compliance costs. Rather, the SEC is apparently considering amendments to the 2015 proposal that would broaden the disclosure requirement, making it more expansive, confusing, and costly.

The NAM respectfully encourages the SEC to reconsider the approach to pay versus performance articulated in the 2015 Proposing Release and the 2022 Reopening Release. Manufacturers urge the SEC to re-propose a pay versus performance rule that allows for principles-based disclosure of information about executive pay, company performance, and the relationship between the two. The NAM believes that any final rule should focus disclosures on company-selected performance metrics actually used to determine pay and allow for reporting that aligns the timeframes for performance and the associated compensation. The final rule should also be structured such that the proposed Pay Versus Performance Table does not undermine the existing Summary Compensation Table. This principles-based approach will streamline companies’ compliance obligations and ensure that investors are receiving useful information about both pay and performance.

**I. The SEC should re-propose an amended version of the 2015 proposed rule in order to allow commenters to fully understand and provide feedback on the significant policy changes considered by the Reopening Release.**

As a matter of first course, the NAM believes that a release to reopen a comment period is not the appropriate forum to propose significant changes to a proposed rule. Generally, a reopening announcement simply invites commenters to weigh in with new data or perspectives on the initial rule proposal. The SEC’s Reopening Release, however, proposes significant alterations to the underlying rule—including multiple new reporting requirements. The Release frames these amendments as options the SEC is “considering,” but in reality they function as substantive proposals in their own right. Yet the SEC has not actually proposed a new rule to effectuate these amendments, nor conducted the requisite economic analysis necessary for commenters to understand their impact. If the SEC wishes to solicit comment on these new ideas, the NAM respectfully encourages the Commission to propose a rule to that effect, allowing for the economic analysis required under the Administrative Procedure Act (“APA”) and enabling commenters to understand the new requirements in the full context of the proposed reporting regime.

If the SEC does take the appropriate step of re-proposing the 2015 rule with the 2022 Commission’s preferred modifications, the NAM also encourages the SEC to more fulsomely consider the concerns raised by the NAM during the 2015 comment period. Specifically, we would hope that a re-proposed rule would allow public companies the “flexibility to present information they determine would be most useful to their shareholders...in a manner that they conclude would best serve their investors.”<sup>5</sup> A principles-based disclosure requirement can appropriately fulfill Dodd-Frank’s statutory mandate by allowing for a discussion of the relationship between performance measures actually used by public companies (rather than SEC-mandated metrics) and compensation “actually paid” to company executives.

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<sup>4</sup> Reopening Release, *supra* note 1, at 5753.

<sup>5</sup> NAM 2015 Letter, *supra* note 3, at 2.

## II. The NAM opposes SEC-mandated, one-size-fits-all performance disclosures, including 2015’s TSR benchmark and 2022’s pre-tax net income and net income metrics.

In our 2015 comment letter, the NAM raised concerns with the 2015 proposal’s “overemphasis” on total shareholder return (“TSR”) as the sole arbiter for company performance.<sup>6</sup> As we said at the time, TSR prioritizes “short-term stock prices instead of long-term performance and growth.”<sup>7</sup> For example, investments in R&D and capital spending on new equipment contribute to overall growth and productivity but may or may not be reflected in short-term TSR evaluations. On the other hand, short-term factors outside of a company’s control, like commodity prices, stock market trends, currency fluctuations, and interest rate shifts, may impact TSR despite a lack of relevance to executive performance. In 2015, the NAM asked the SEC to reconsider its overreliance on the one-size-fits-all TSR metric and instead to allow shareholders to “consider the many factors that go into the design of executive compensation packages.”<sup>8</sup>

The Reopening Release acknowledges that there exist significant “differences across companies in terms of performance measures that companies or investors care about” and that 2015 commenters, like the NAM, had raised “questions about whether a ‘one size fits all’ benchmark is appropriate for all companies.”<sup>9</sup> Yet the SEC still appears poised to require TSR reporting—alongside the disclosure of *additional* one-size-fits-all performance metrics. According to the Reopening Release, the SEC is “considering requiring disclosure” of both pre-tax net income and net income in addition to TSR, while also mandating that companies provide a “clear description of the relationship” between all three measures and executive compensation.<sup>10</sup> While the NAM appreciates that the SEC has acknowledged that TSR is not the sole metric that businesses or investors use to evaluate company performance, the appropriate response to this concession would be to remove the TSR mandate from the proposed reporting requirement—not to maintain the mandate while also requiring disclosure of two new measures that, similarly, may or may not paint an accurate or useful picture of company performance.

In addition to the costs associated with the expanded Pay Versus Performance Table envisaged by the Reopening Release, the main risk of requiring one-size-fits-all performance reporting is that the resulting disclosures could be misleading to investors. The Reopening Release notes that the SEC’s review of Compensation Discussion and Analysis (“CD&A”) disclosures of just 20 Fortune 500 companies found *more than 100* unique performance measures utilized to set executive compensation and evaluate executive performance.<sup>11</sup> Further, the Reopening Release notes that “almost all” of these 100-plus performance metrics were “company-specific or adjusted measures.”<sup>12</sup> Why, then, would the Commission mandate one-size-fits-all reporting of just three SEC-selected metrics? Such a requirement would fail to capture the breadth and depth of the performance measures actually utilized by companies, especially those that are company-specific or adjusted to enhance their relevance to a given company’s performance. It also would represent a *de facto* SEC endorsement of just those three metrics, encouraging companies to utilize them irrespective of their

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<sup>6</sup> *Id.* at 4.

<sup>7</sup> *Ibid.*

<sup>8</sup> *Id.* at 3.

<sup>9</sup> Reopening Release, *supra* note 1, at 5753.

<sup>10</sup> *Ibid.*

<sup>11</sup> *Id.* at 5753 fn. 14.

<sup>12</sup> *Ibid.*

relevance to a business's performance and sending the misleading message to investors that executive compensation should always align with the SEC's preferred performance factors.<sup>13</sup>

As established by Dodd-Frank, the goal of the pay versus performance disclosure requirement is to "show[ ] the relationship between executive compensation actually paid and the financial performance of the issuer."<sup>14</sup> The SEC's reliance on three one-size-fits-all metrics as the government-approved arbiters of a company's financial health would undercut this goal and lead to misleading disclosures that do not actually describe the relationship between pay and performance. Also, the proposed rule's focus on annual pay when many executive compensation packages are driven by long-term incentives ("LTI") further underscores a critical disconnect between the proposed disclosures and how company management is actually compensated. The NAM respectfully encourages the SEC to reconsider its proposed TSR mandate, as well as the pre-tax net income and net income mandates described in the Reopening Release. The NAM urges the SEC to instead adopt a principles-based reporting framework that allows for the disclosure of performance metrics that are utilized by companies and thus are relevant to investors' understanding of how executive compensation packages are constructed.

**III. The SEC should allow pay versus performance disclosures to be based on company-selected metrics, without additional SEC mandates or arbitrary lists and rankings.**

In addition to the one-size-fits-all TSR, pre-tax net income, and net income reporting requirements, the Reopening Release would add an additional column to the Pay Versus Performance Table to require the disclosure of a "company-selected measure" that is "the most important performance measure (that is not already included in the table) used by the registrant to link compensation actually paid during the fiscal year to company performance."<sup>15</sup> The NAM appreciates that the SEC has acknowledged that allowing businesses to choose their own performance metrics rather than imposing specific mandates will result in "useful disclosure" for investors.<sup>16</sup> However, it may not be straightforward for companies to isolate which performance measure is the "most" important given the diversity of metrics utilized and the often-complex way in which they impact executive compensation. We also remain concerned that the company-selected measure would appear in the Pay Versus Performance Table alongside the three SEC-selected metrics that may or may not provide useful disclosure. Additionally, we respectfully encourage the SEC not to take steps to limit what metrics are considered "appropriate" company-selected measures—but rather to allow companies maximum flexibility to report relevant and useful data on their compensation practices.

The Reopening Release also envisages a new table that would require companies to rank their top five measures used to link compensation to performance. While the NAM appreciates the SEC's acknowledgement that many factors influence company performance, and thus executive compensation, a simplistic ranking of the top five performance measures would result in unsophisticated and misleading disclosures that do not accurately capture the complex nature of company performance evaluations and the resulting executive compensation determinations. The

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<sup>13</sup> In addition to the one-size-fits-all nature of the TSR, pre-tax net income, and net income requirements, the structure of the proposed framework may lead to disclosures that do not appropriately align, from a timing perspective, company performance and the associated executive compensation. For example, in the event of changes to a company's CEO or NEOs, the five-year lookback requirement will necessitate the inclusion of compensation data that does not represent the current management team's roles and performance.

<sup>14</sup> *Dodd-Frank Wall Street Reform and Consumer Protection Act*. P.L. 111-203 (2010).

<sup>15</sup> Reopening Release, *supra* note 1, at 5753.

<sup>16</sup> *Ibid.*

top five ranking under consideration in the Reopening Release is thus extremely unlikely to provide useful information to investors.

The NAM believes that the appropriate approach to implementing Dodd-Frank’s pay versus performance mandate would be to require companies to report *solely* on a company-selected metric (or, as appropriate, company-selected *metrics*) and to provide a description of the relationship between said metric(s) and executive compensation actually paid. The SEC should also allow flexibility for companies to provide accurate reporting about compensation plans driven by LTI, which may not fit neatly into an annual-metric-driven disclosure framework. Put simply, there is limited utility in requiring companies to disclose TSR, pre-tax net income, and/or net income if those measures are not used in determining executive compensation or evaluating executive performance. Similarly, there is no need for companies to rank the performance measures they utilize, nor to set an arbitrary standard that five metrics be disclosed. Allowing companies to disclose and explain just the metrics that they *actually use* would align with the statutorily mandated comparison to compensation *actually paid*. A company-driven approach would also avoid regulatory bias in favor of certain performance measures, preclude one-size-fits-all mandates, reduce compliance costs for public companies, and—most importantly—ensure that the information disclosed is actually useful to shareholders.

#### **IV. The SEC should define “compensation actually paid” to include equity awards when granted rather than at vesting.**

The pay versus performance rule proposed in 2015 would calculate “executive compensation actually paid” by adjusting the compensation disclosures contained in the Item 402 Summary Compensation Table to “include the value of equity awards at vesting rather than when granted.”<sup>17</sup> The Reopening Release does not indicate that the SEC is considering any changes to this methodology.

The NAM opposes the 2015 proposed rule’s approach to equity awards, which are an extremely common component of executive compensation packages. Performance-based equity grants are usually designed to reward performance from the fiscal year in question; they are often granted after performance is evaluated for that year, though they may take a number of years to vest. For investors to understand the relationship between company performance and executive compensation, they need information about compensation that is actually tied to a company’s performance in the given year. It is irrelevant to an executive’s performance in 2022 if she had a significant equity grant in 2017 that happened to vest after five years. Yet the proposed “compensation actually paid” calculation for 2022 would incorporate the 2017 award and ignore any granted-but-not-yet-vested awards from 2022. This disconnect between the timing of compensation disclosed and the company performance that led to said compensation would result in misleading disclosures that do not fulfill Dodd-Frank’s stated goal of helping investors understand the relationship between pay and performance.

Dodd-Frank’s requirement that pay versus performance disclosures capture compensation “actually paid” does not require this illogical result. The SEC has the freedom under the relevant statutory text to define “actually paid” to include the value of equity awards when granted, as in the Summary Compensation Table. The NAM respectfully encourages the SEC to avoid misleading and mistimed disclosure obligations by allowing the “compensation actually paid” columns in the Pay Versus Performance Table to align with the compensation data in Item 402’s Summary Compensation Table—including the addition of equity awards when granted rather than at vesting. In addition to more accurately reflecting the nature of performance-based equity awards, aligning the Pay Versus Performance Table with the Summary Compensation Table will reduce investor confusion and

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<sup>17</sup> 2015 Proposing Release, *supra* note 2, at 26332.

ensure that companies are reporting on identical metrics whenever they make compensation disclosures.

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The NAM remains concerned that Dodd-Frank's pay versus performance reporting requirement will lead to costly and duplicative disclosures that create significant investor confusion. As the SEC works to fulfill its statutory obligation to implement Section 953(a), the NAM respectfully urges the Commission to take steps to mitigate these risks of the Dodd-Frank mandate. The NAM believes the SEC should pursue a principles-based disclosure regime based on company-selected metrics—which will allow investors to understand the relationship between pay and performance without undercutting the pay data included in the Summary Compensation Table nor confusing shareholders with irrelevant, mistimed, or one-size-fits-all performance measures.

The NAM looks forward to working with the SEC to ensure that any final rule appropriately links performance metrics actually used by issuers and compensation “actually paid” to executives, as required by Dodd-Frank. A re-proposed rule based on this approach will allow the SEC to carry out its statutory obligations while avoiding regulatory bias, eschewing one-size-fits-all requirements, reducing compliance costs, and providing maximally useful information to investors.

Sincerely,

A handwritten signature in black ink, appearing to read 'Chris Netram', with a stylized flourish extending from the end.

Chris Netram  
Managing Vice President, Tax and Domestic Economic Policy