Ceres Accelerator
for Sustainable Capital Markets

March 4, 2022

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

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

Dear Ms. Countryman:

On behalf of Ceres and our Ceres Accelerator for Sustainable Capital Markets, we are pleased to submit comments on the Commission's proposed changes to the Pay versus Performance Rule that the Commission originally proposed in 2015.

Ceres is a nonprofit organization working with the most influential capital market leaders to solve the world's greatest sustainability challenges. The Ceres Accelerator for Sustainable Capital Markets works to transform the practices and policies that govern capital markets in order to reduce the worst financial impacts of the climate crisis. We also support the Investor Network on Climate Risk and Sustainability, which consists of 217 investors that collectively own or manage over $49 trillion in assets, who advance leading investment practices, corporate engagement strategies, and policy and regulatory solutions to address sustainability risks and opportunities. Ceres is a founding partner of the Investor Agenda, the Net Zero Asset Managers Initiative and the Paris Aligned Investor Initiative, which includes investors focused on sustainable investments within their portfolios and other assets.

Based on our discussions with investors and a review of research reports and surveys, it is clear that investors rely upon information about executive compensation in making their investment and voting decisions.[1] Accordingly, Ceres is keenly interested in the relationship between executive compensation and corporate performance on ESG (environmental, social, and governance) issues, in particular performance relating to climate change.

[1] Ceres and BlackRock, "21st Century Engagement: Investor Strategies for Incorporating ESG Considerations into Corporate Interactions," (March 2017), https://www.ceres.org/sites/default/files/reports/2017-03/21st%20Century%20Engagement%20-%20Investor%20Strategies.pdf, 32.

<u>Ceres views</u>:

1. **There has been a significant increase in the use of ESG metrics in setting executive compensation**.

As described in the rule proposal, the SEC has reopened the comment period for the pay-versus-performance disclosure rule. The Proposed Rules were first set forth in a release published in the Federal Register on May 7, 2015 (Release No. 34-74835). The SEC explains that it has reopened the comment period to allow interested persons another opportunity to analyze and comment upon the Proposed Rules "in light of developments since the publication of the Proposing Release."[2]

We appreciate the SEC's efforts in this regard because there have indeed been significant changes in this area, including developments relating to ESG issues. Performance-based long-term incentive plans have grown in quantity and variety, including developments relating to linking compensation to climate and other ESG matters. According to a review by the consulting firm Semler Brossy of public disclosures made between March 2020 and March 2021, 57% of companies in the S&P 500 included an ESG metric in either the annual or long-term incentive plan. The firm's report stated: "Over time we anticipate that ESG metrics will become more common across all public companies, regardless of size, as the practice of the largest companies often influence the rest of the market."[3]

A recent Willis Watson Towers report also discussed these developments. It found that "[m]ost of the largest companies in North America and Europe already incorporate ESG metrics into executive pay plans." Further, the report stated, "board members see ESG issues as a business risk. Consumer behaviors are increasingly influenced by how companies respond to key ESG issues such as climate change and diversity, equity and inclusion. Talent seeks to make environmental and social impact at their work. There is ample evidence suggesting that companies with a strong ESG profile outperform their competitors." And, importantly, "board members rank environmental and climate issues as their number one ESG priority for the next three years."[4]

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[2] 87 Fed. Reg. 5751 (Feb. 2, 2022).

[3] John Borneman, Tatyana Day, Olivia Voorhis, Semler Brossy Consulting Group, "2021 ESG & Incentives Report," *Harvard Law School Forum on Corporate Governance*, (July 8, 2021), https://corpgov.law.harvard.edu/2021/07/08/2021-esg-incentives-report/.

[4] Willis Towers Watson, "ESG and Executive Compensation: Hearing from board members globally," *Willis Towers Watson,* (April 2021), https://www.willistowerswatson.com/-/media/WTW/Insights/2021/04/ESG-and-Executive-Compensation-Report-2021.pdf?modified=20210419083740.

Ceres has likewise regularly reported on trends in this area. For example, a 2015 Ceres report evaluated over 600 U.S companies and found that 24 percent tied ESG performance to executive compensation, up from 15 percent in 2012.[5] More recently, Ceres stated, "The number of companies tying executive compensation to sustainability metrics that go beyond compliance continues to increase and gain relevance in driving performance improvements." As one example, Ceres cited the Alcoa Corporation: "According to the Alcoa's 2019 proxy statement, in 2018 the company linked 30% of its annual cash-based incentive goals to sustainability metrics, up from 20% in 2017. Priority metrics covered safety (15%), GHG emission reductions (5%) and diversity metrics, including a goal of increasing female representation in the company's workforce globally (10%)."[6]

Ceres has long supported and encouraged these developments. Ceres' position has been that executives should be held accountable for sustainability goals by the board and be incentivized to via clear, transparent and publicly disclosed compensation packages, where achieving the sustainability goals has a meaningful impact on the proportion of compensation awarded.

Accordingly, the SEC is clearly on target when it asks in question 22 of the Proposing Release, "How have environmental, social and governance related metrics changed and/or developed since the Proposing Release?" and, further, "How should we contemplate such changes in our consideration of the disclosures discussed above and in the Proposing Release?" We believe that it is essential that the final rule reflects the substantial investor demand for information on ESG-related compensation plans.

2. **The proposal would provide greater clarity as to what companies are doing with respect to ESG-linked compensation.**

The SEC's proposal would require that companies disclose three new financial performance measures, in addition to total shareholder return, in a supplemental table with clear descriptions of the relationship between the measures, including a company-selected measure that the company finds represents the most important performance metric not already shown in the table for evaluating the link between compensation actually paid and company performance over the period. Also, the proposal would require disclosure of the five most important company performance metrics that inform compensation decisions during the period. Further, companies

[5] Veena Ramani, "View from the Top: How Corporate Boards Can Engage on Sustainability Performance," *Ceres*, (October 2015), https://www.ceres.org/sites/default/files/reports/2017-03/ceres_viewfromthetop.pdf.
[6] Ceres, "Ceres Roadmap 2030," Senior Management Accountability, *Ceres*, https://roadmap2030.ceres.org/sbi-expectation/senior-management-accountability.

would have to substantiate the relationship between pay and performance through a clear description.

These requirements would provide greater transparency in this area.[7] Companies currently disclose metrics they use for incentive purposes in the Compensation Discussion & Analysis section of the proxy statement, but there is no consistency in how these metrics are disclosed, and the number of disclosed metrics varies considerably -- some companies may disclose one or two while others might list five or more. In addition, we think it would be helpful for disclosure to cover a period longer than a one year period, which is what companies typically disclose today.

Investors need this information to effectively evaluate management performance and to determine whether to engage with company management, and the proposed disclosure requirements would provide investors with a better understanding of which performance measures most strongly impact actual compensation paid and of whether compensation programs appropriately incentivize executives. As noted in a commentary, "[t]his component also functions to reduce the risk of misrepresenting or providing an incomplete picture of pay versus performance alignment."[8]

We do, however, suggest that the Commission make clear in the final rule that the company should disclose as much quantitative information as possible, including any metrics, targets and thresholds that the company uses in determining compensation. At the same time, the Commission should explain that qualitative information that is used for compensation purposes, which might include ESG information, can also be included in the list of five disclosure items. Further, we would support the Commission urging companies to disclose whether they considered climate change as a compensation-related factor and to explain their determination in that regard; given the importance of climate change to investors we think it warrants an explicit mention either in the final rule or in the adopting release. Ceres is part of the Net Zero Asset Managers Initiative, which includes investors representing $57.4 trillion dollars who have made

[7] We note that our support for the proposal relates to the proposed requirement for disclosure of the five most important metrics that impact compensation. We have no views on other aspects of the proposal, such as the requirement that companies disclose five years of information (three years might be sufficient) or the requirement regarding three new financial performance measures.

[8] Daniel Laddin and Louisa Heywood, Compensation Advisory Partners, "SEC Re-Opens Comment Period for Pay vs. Performance Proposed Rules," *Harvard Law School Forum on Corporate Governance* (February 18, 2022), https://corpgov.law.harvard.edu/2022/02/18/sec-re-opens-comment-period-for-pay-vs-performance-proposed-rules/.

net zero commitments.[9] Including climate as a factor in compensation plans is a vital tool for these investors.

One series of questions raised in the Proposing Release warrants additional discussion. The Release asks: "Should we specifically limit any Company-Selected Measure only to those measures that relate to the financial performance of the registrant? Or should we allow the Company-Selected Measure to be any measure that could be disclosed under the existing CD&A requirements, including financial performance measures; environmental, social and governance related measures; or any other measures used by the registrant to link compensation actually paid during the fiscal year to company performance?"[10]

The premise of these questions seems to be that ESG factors do not "relate to the financial performance of the registrant." We understand why the Commission might view ESG as being different from more traditional measures of financial performance, such as shareholder return or net income, but investors are interested in ESG precisely because, as many studies have shown, it does relate to a company's financial performance. In particular, investors have spoken clearly that climate is a significant issue for them. The comments to the SEC in response to the March 15, 2021 climate disclosure request for information bear this out.[11] There was an overwhelming response from investors that climate information is critical to their decision-making. Moreover, and significantly, the Lazard Climate Center, which has analyzed more than 16,000 global companies from 2016 through 2020, found "a significant relationship between carbon dioxide emissions and a company's price-to-earnings ratio."[11]. Accordingly, ESG (and likely other financially-related factors such as innovation or operational improvements) can reasonably be viewed as relating to the "financial performance" of the issuer.

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We appreciate the opportunity to comment on the proposed rule. Please contact the undersigned for any additional information.

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[9] Ceres, "At COP26, U.S. investors, corporates and government leaders announce plans to raise their climate ambition, support stronger policy" (November 2, 2021), https://www.ceres.org/news-center/press-releases/cop26-us-investors-corporates-and-government-leaders-announce-plans.

[10] 87 Fed. Reg. at 5756.

[11] Gabriel Rosenberg, Margaret Tahyar, and Betty Huber, *Davis Polk & Wardwell LLP,* "Commenters Weigh in on SEC Climate Disclosures Request for Public Input" (July 24, 2021), https://corpgov.law.harvard.edu/2021/07/24/commenters-weigh-in-on-sec-climate-disclosures-request-for-public-input/.

Latham & Watkins, "Climate Disclosures and the SEC," (October 8, 2021), https://www.lw.com/thoughtLeadership/Climate-Disclosures-and-the-SEC.

Respectfully submitted,

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