Private and Confidential

June 30, 2015

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

Subject: File Number S7-07-15

Dear Mr. Fields:

In late April, the Securities and Exchange Commission (SEC) released proposed rules to Item 402 of Regulation S-K of the Securities Exchange Act of 1934, as added by Section 953(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), requiring companies to disclose the relationship between executive compensation actually paid ("CAP") and the company's financial performance. The proposed rules, which were released to the public on April 26, are subject to a 60-day comment period. Pay Governance LLC, a management consulting firm with expertise in executive compensation, would like to submit our comments to the SEC for consideration in clarifying and improving the rules as initially proposed by the SEC.

The SEC has presented 64 questions regarding the proposed rules. Pay Governance LLC has noted that there is considerable overlap from question to question in certain instances. In preparing our response, we have bundled together certain questions in order to provide a single, comprehensive response expressing our point of view about the particular rule or rules. In the text which follows, we have identified the applicable question or questions posed by the SEC with our responses immediately following.

Due to the length of our response, we have developed an "Executive Summary" to highlight the key points to our response. The Executive Summary is a summary of our recommendations and is placed at the front of our letter.

Executive Summary

Pay Governance LLC recommends that the SEC consider the following key points and recommendations in our review of the proposed pay for performance rules and regulations:

1. **TIMING MISMATCH:** The SEC's proposed rules result in a mismatch of the timing of compensation actually paid ("CAP") and total shareholder return (TSR). All interpretations of the proposed rule for TSR measurement seem to present a fundamental temporal mismatch

John Ellerman, Member

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between the measures of actual pay and TSR. What will be reported as CAP is a 1-year actual pay figure compared to some measure of a cumulative TSR that may or may not relate to the period of performance that determined the reported CAP equity awards. In addition, some interpretations of the proposed rules suggest that the TSR value displayed for a given year would change in subsequent proxies. Since CAP for any year is permanently “frozen,” there could be substantial changes in a pay-for-performance conclusion for the same year. This creates a significant limitation on the utility of CAP in pay for performance analysis (see responses to questions 5, 6 and 7).

2. **VESTING MISMATCH:** With respect to the above, there are particular problems with the calculation of award values on the vesting dates for performance shares and stock options. There may be misalignment between the vesting/delivery of performance shares in a given year with the corresponding cumulative TSR reported for that period which had no bearing on the earn-out of such awards. There is variation among companies on the treatment of the disclosure of performance shares which could further make SCT and peer group comparisons misleading (see responses to questions 5, 6, 7 and questions 29, 30, 31, 32, and 33).

3. **STOCK OPTION VALUE:** Further, the use of Black-Scholes option present values as “actual compensation paid” is a misnomer because it is possible for the CAP data to include a Black-Scholes value for an underwater stock option due to the vesting measurement requirement in the rules. It also could overvalue the current value of an in-the-money option. In lieu of Black-Scholes value, we recommend that the SEC adopt intrinsic value of options if the vesting measurement date is a requirement (see responses to questions 21 and 23).

4. **DIFFERENT STOCK PRICES:** The rules now require three different stock price measurement dates for equity award valuation or TSR measurement, further exacerbating the misalignment of pay and performance timing. These three different measurement dates are: (1) Summary Compensation Table (SCT) data based upon an equity award’s stock price on the date of grant; (2) CAP data based upon an equity award’s stock price on the date of vesting; and (3) the pay for performance table for calculation of TSR based upon stock price at the conclusion of the fiscal year (see responses to questions 5, 6, and 7).

5. **INCLUSION OF SCT:** We disagree with the requirement for companies to include the compensation total from the SCT into the pay for performance table that also includes the CAP data. SCT total compensation is a blend of targeted and actual pay. The only reason to include SCT compensation in the table is to develop a judgment of whether a compensation committee’s targeted pay is aligned with the CAP earned by executives. However, due to the many problems associated with the varying measurement dates, vesting dates, etc., it will be impossible for shareholders or their advisors to gain factual insights to the data. More important, SCT compensation has limited connection with the pay for performance precept, as it is deliberately and appropriately influenced by market data (see responses to questions 5,6,7, 21, and 23).

6. **PEER GROUP:** Pay Governance LLC believes that some shareholders and their advisors will attempt to evaluate CAP data for a registrant's peer group of companies to make comparisons of relative TSR. We believe that this type of analysis will not provide an apples-to-apples comparison between companies due to the timing of proxies, differences in company interpretations as to when performance shares vest, and different reporting periods (see response to question 12).

7. **REALIZABLE PAY:** While Pay Governance LLC endorses relative comparison of pay and TSR to peers, we believe that CAP is not an ideal compensation metric. Based upon our firm's research, we believe that realizable pay is a better pay vehicle for this type of comparison (see attached Viewpoint). Realizable pay has its limitations, but is the optimal metric for these purposes (see responses to questions 12, 21, and 23).

8**. SOLELY TSR:** We believe that requiring TSR as the single performance metric for the pay for performance table and disclosure is inappropriate and that the SEC should allow registrants to use other performance metrics for reporting purposes. This would allow for inclusion of industry-relevant metrics to enhance comparability (see response to question 34).

9. **CEO TRANSITIONS:** The rules require including the aggregate CAP for both CEOs in a transition year. This is not a useful pay amount to compare to cotemporaneous TSR and to the SCT, and could further obfuscate the comparison between executive compensation and TSR. A preferable alternative would be to require companies to disclose CAP for the outgoing CEO, since the performance and vesting periods for vested award values for the outgoing CEO are more likely to overlap with the TSR measurement period (see response to question 19).

Detailed Responses to Specific SEC Questions

The following text includes our detailed responses to selected questions posed by the SEC.

> ***Questions 5, 6, and 7***……*Should we require registrants to provide, as proposed, a table that includes the Summary Compensation Table compensation, in addition to the values of the prescribed measures of executive compensation actually paid and registrant financial performance used for the pay-versus-performance disclosure? Why or why not? Should we further prescribe the format of the proposed disclosure to promote comparability across registrants? For example, should we require that registrants present the percentage change in actual executive compensation paid and registrant/peer group financial performance over each year of the required time period graphically or in writing? Are there other format requirements we should consider? Should we provide further guidance on how to present the information in a way that promoted comparability? Are there ways our proposed table can be improved? If we were to require a graphic presentation of the disclosure, should we specify requirements for this presentation so that each registrant provides comparable disclosure? Or should we allow registrants to determine the appropriate graphic*

presentation, if any? How should such a graph describe the relationship between executive compensation actually paid and registrant performance?

Pay Governance Response – We do not recommend that the total compensation reported in the Summary Compensation Table (SCT) be added to the pay-for-performance disclosure of compensation actually paid with corresponding company performance. In our judgment, including the SCT data would result in redundancy, would add a second figure which is not representative of compensation actually paid ("CAP"), and could result in possible confusion to shareholders for several reasons. We assume that the SEC wants to facilitate a comparison of the SCT compensation (representing the compensation committee's pay decisions for a given year) to CAP and TSR. The total compensation figure included in the SCT is a blend of actual and target pay: it includes actual cash compensation (base salary and bonus actually paid) plus the expected value of long-term incentive compensation based upon accounting fair value as of the date of grant. In a sense, this SCT compensation figure largely portrays "targeted pay" and is much different than compensation actually paid as now defined by the SEC. Another problem with the inclusion of SCT total compensation in addition to the newly defined CAP data is the potential disparity of the two summary compensation figures for non-performance related reasons. Some companies elect to front-load long-term incentive grants in certain situations, thereby increasing the amount of SCT total compensation reported in the year of grant while depressing it in subsequent years. Further, different stock vesting schedules will also yield large differences between CAP and SCT pay data. For a number of legitimate reasons, the reported CAP data when compared to the SCT total compensation may be of considerable variance. We believe that this will further confuse the shareholder.

One issue that needs further clarification is the manner in which total shareholder return (TSR) is calculated and over which reporting period for purposes of the new disclosure rules. The proposed rules contain conflicting language relating to the period over which TSR is to be calculated. The proposed rules indicate that TSR is to be calculated in the same manner and for the same period as Item 201e (the current regulations that detail the proxy stock performance graph):

- The current 201(e) rules refer to a measurement period that begins as of the market close on <u>the last trading day before the beginning of the registrant's fifth preceding fiscal year;</u>

- However, the proposed Item 402(v) rules refer to a measurement period that <u>begins on the last trading day before the registrant's earliest fiscal year in the table</u>.

Pay Governance LLC acknowledges that there are several possible interpretations of these seemingly conflicting rules.

- The difference in language is intended to facilitate the transition provisions of the pay-for-performance rules, which would only require TSR to be calculated for a 3-year period in companies' initial disclosures (and 4 years in the 2nd year of disclosure, after which the full 5-year period would be in effect). We believe that this is a reasonable interpretation that would explain the apparent discrepancy in language.

- The proposed Item 402(v) rules are intended to evaluate performance over the most recent 5-year period, which appears to be the most literal interpretation of the proposed rules. Under this interpretation disclosed TSR figures would be similar to the following Table A (transition period has been ignored for purposes of this illustration):

Year	TSR/Item 402(v) interpretation
2015	5-Year Cumulative (12/31/2010-12/31/2015)
2014	4-Year Cumulative (12/31/2010-12/31/2014)
2013	3-Year Cumulative (12/31/2010-12/31/2013)
2012	2-Year Cumulative (12/31/2010-12/31/2012)
2011	1-Year Cumulative (12/31/2010-12/31/2011)

  Given the explicit reference to the "earliest fiscal year in the table," coupled with the transition relief referred to above, Pay Governance believes that this was the SEC's intent. Nevertheless, this approach complicates comparisons by causing the starting point for TSR measurement to change each year.

- Another interpretation suggests that the measurement of TSR would use a rolling 5-year period, similar to the following Table B (again, transition period is ignored):

Year	TSR/Item 201(e) interpretation
2015	5-Year Cumulative (12/31/2010-12/31/2015)
2014	5-Year Cumulative (12/31/2009-12/31/2014)
2013	5-Year Cumulative (12/31/2008-12/31/2013)
2012	5-Year Cumulative (12/31/2007-12/31/2012)
2011	5-Year Cumulative (12/31/2006-12/31/2011)

  This interpretation would seem inconsistent with the SEC's explicit reference to the "earliest fiscal year in the table" and therefore, Pay Governance does not believe that this was the SEC's intent.

Related to the determination and disclosure of TSR is the comparative CAP figure to be disclosed in the table. All interpretations of the TSR measurement seem to present a fundamental temporal mismatch between the measures of the CAP data and TSR. The proposed rules refer to the disclosure of pay received during a given fiscal year, whereas the comparative TSR is a cumulative metric. As a result, the disclosures will include information similar to that shown in Table C below:

Year	Compensation Actually Paid	TSR/Item 402(v) interpretation
2015	"Actually Paid" in 2015	5-Year Cumulative (12/31/2010-12/31/2015)
2014	"Actually Paid" in 2014	4-Year Cumulative (12/31/2010-12/31/2014)
2013	"Actually Paid" in 2013	3-Year Cumulative (12/31/2010-12/31/2013)
2012	"Actually Paid" in 2012	2-Year Cumulative (12/31/2010-12/31/2012)
2011	"Actually Paid" in 2011	1-Year Cumulative (12/31/2010-12/31/2011)

As proposed, this presents two interpretative challenges:

- Because of differences in the time periods encompassed by CAP and TSR, these figures will be, at best, difficult to interpret and compare. CAP measured in a fiscal year could potentially include vested performance stock awards from different grants that have unique performance goals. Performance stock awards have a combination of performance periods (e.g. 1, 2 or 3 years) and vesting (immediate or scaled over one or more years) For example, in 2015 executives may become vested in and earn performance share awards that reflect relative TSR performance for the three-year performance period of 2013 through 2015. However, the proposed table will illustrate TSR for the 5-year cumulative period of 2011 through 2015. Or, in another example of misalignment, 2015 CAP in the above table could show vested performance shares granted in multiple prior years (e.g. 2011 or 2012). In our judgment, this results in a mis-alignment between compensation earned and vested (CAP) with the actual performance period for the award. This lack of timing alignment will be problematic for a realistic assessment of pay and performance, and can only be clarified by substantial footnotes to the pay-for-performance table by the registrant. As discussed later in this response, there is also varying practice to the reporting of vested and earned performance share awards by registrants in their proxy disclosures. All of these disclosures will be misaligned because the definition of pay-versus-performance as proposed is determined by three potential disparate dates of the reporting of stock price: (1) SCT compensation is based upon the stock price of equity awards at the date of grant; (2) The CAP data is based upon the stock price of equity awards at the date of vesting; and (3) the SEC proposed calculation for TSR is based upon the stock price at the end of the fiscal year. As a direct result, the proposed pay for performance table will not have any credible alignment of pay actually delivered and a company's TSR performance that determined the amount of the equity award.

- In addition, some interpretations of the proposed rules suggest that the TSR value displayed for a given year would change in subsequent proxies. Since CAP for any year is permanently "frozen," there could be substantial changes in a pay-for-performance conclusion for the same year. This creates a significant limitation on the utility of CAP in pay for performance analysis.

> ***Question 8.*** *Should we provide sample charts or other examples of graphic presentations that would comply with proposed item 402(v)? If so, please provide examples.*

Pay Governance Response – Pay Governance believes that recommended example graphs would be a very beneficial addition to the proposed rules and regulations. We recommend that the proposed table be uniform with prescribed columns and rows, and that the SEC couple the proposed table with one or more example graphs that registrants could replicate in meeting the new rules and regulations. Such example graphs will ensure more consistency in registrant disclosures and enable shareholders to have a better and uniform understanding of the reported data. Registrants will also appreciate the provision of example graphs so that they can more easily comply with the SEC's disclosure rules.

> ***Question 12.*** *Would the proposed tabular disclosure of the values of the executive compensation and registrant financial performance enhance comparability across registrants? Are there other formats that would be more useful in that regard?*

Pay Governance Response – As noted in our response to question 8 above, everyone will benefit from having a singular uniform table with consistently-reported data from company to company. The inclusion of a prescribed graph of the tabular data will add clarity to the shareholder's understanding of the pay for performance disclosure. The SEC should make every attempt to develop a singular reporting format and disclosure consistent to all registrants to enable shareholders to clearly understand and interpret the data reported. Multiple and/or alternative formats will only add confusion to the disclosure should the SEC allow various alternative approaches to be reported.

Pay Governance LLC believes that some shareholders and proxy advisors will attempt to compare CAP data of a registrant company to the CAP of the registrant's TSR peers. This analysis will be impossible to simulate given the timing of proxy disclosure, differences in company interpretations of performance share vesting and different reporting periods. We do not believe it will be a valid comparison of pay and performance. While we endorse the relative comparison of pay and TSR to peers, we believe that CAP is not the ideal compensation metric and that realizable pay is a better pay vehicle for this type of comparison (see response to questions 21 and 23 below).

> ***Question 19.*** *Should we require separate disclosure for the PEO, as proposed? Should we require, in instances where a registrant had more than one PEO in a given year, that the amounts for each PEO be added together, as proposed? Under our executive compensation disclosure rules, if an individual served in the capacity of PEO during any part of a fiscal year for which executive compensation disclosure is required, information about the individual's compensation for the full fiscal year is required to be disclosed. Should the compensation amount for the pay-versus-performance disclosure include only compensation received as the PEO? Should we require separate disclosure for each individual who served as a PEO during the required time period of disclosure? Are there alternative approaches we should consider? For example, where a registrant had more than one PEO in a given year, should we permit*

registrants the flexibility to choose instead to annualize the compensation of the PEO serving at the end of the fiscal year?

Pay Governance Response – The proposed rules require including the aggregate CAP for both the outgoing and incoming CEOs in a year of CEO transition. This is not a useful pay amount to compare to cotemporaneous TSR and to the SCT for a number of reasons. Aggregating pro-rated compensation for outgoing and incoming CEOs may not represent full-year compensation for the role since equity award grants to a new CEO may be either delayed until the first full year of service, or front-loaded for multiple years at the time of appointment. Additionally, compensation for outgoing CEOs may include the full vesting of equity awards upon retirement or even cash severance amounts depending upon the nature of the transition. Thus, the pay versus performance disclosure for companies with CEO transitions would not be comparable to disclosures for companies without such transitions.

A preferable alternative to the proposed aggregation of CEO compensation in years of CEO transition may be to allow companies to disclose CAP for the outgoing CEO. Such a principles-based approach would present CAP for the CEO responsible for performance during the TSR measurement period, for which equity performance and/or vesting periods are more likely to overlap with the TSR measurement period.

Questions 21 and 23*. Does our proposed definition appropriately capture the concept of "executive compensation actually paid?" Why or why not? Are there elements of compensation excluded by our proposed definition that should not be? Alternatively, does the proposed definition include any items that should be excluded? If so, which ones and why?*

Pay Governance Response – Pay Governance disagrees with the SEC's proposed definition of CAP. Our preference would have been for the SEC to adopt the commonly-accepted definitions of either realizable pay or realized pay with respect to the proposed disclosure. In particular, realizable pay is a definition of compensation actually earned or accrued at a point in time that is clearly understood and accepted throughout the business community. Realizable pay also has a strong match temporally with TSR disclosed and strong correlation with TSR as we have found through our research of CEO pay and performance. During the past two years, many registrants have elected to voluntarily report realizable pay in their proxy disclosures to address the alignment of total executive compensation and company performance, and proxy advisory firms have adopted realizable pay in their analyses.

The SEC's decision to adopt a new definition of executive compensation actually paid adds further confusion and debate to the subject of executive compensation levels. In today's marketplace, there are now five different definitions of "total executive compensation:" (1) the new SEC 402(v) total ("CAP"); (2) the total executive compensation as disclosed in the proxy SCT; (3)"realizable pay;" (4) "realized pay"; and (5) total executive compensation as defined by Institutional Shareholder Services (ISS). It has been our consulting experience that companies internally use "target compensation" which is comprised of base salary, target annual bonus and target long-term incentive compensation. These various definitions of total executive compensation add to the misunderstanding due to the complexity of executive pay and require frequent reference to the elements of compensation considered in each definition.

One element of the SEC prescribed 402(v) total executive compensation earned definition is the required calculation of accounting fair value as of the vesting date of equity awards. In particular, the proposed rules prescribe that the registrant use the Black-Scholes model or other broadly-accepted option valuation models to estimate the accounting fair value of a particular equity award upon its vesting date. We do not believe that this estimate of an equity instrument's fair value represents "compensation actually paid." Black-Scholes and other option pricing models are used to estimate the present value of expected future gains from an equity award based upon a set of reasonable assumptions at a particular point in time. A Black-Scholes calculated value is not compensation actually paid. In fact, a stock option may be "underwater" (i.e., the strike price exceeds the current fair market value price of the stock) and yet Black-Scholes will yield a positive present value for an underwater stock option. Additionally, the use of Black-Scholes could result in an overvaluation of an in-the-money option. No executive is going to elect to exercise an underwater stock option – further illustrating the fallacy of representing a Black-Scholes value as executive compensation actually paid. In lieu of requiring a Black-Scholes or other pricing model valuation on the vesting date, Pay Governance recommends that the SEC adopt intrinsic value as of the vesting date for 402(v) reporting purposes. Intrinsic value is the gain in market value of an equity instrument from the grant date to vesting date (i.e. spread between the option exercise price and fair market value of a share). In our judgment, intrinsic value is a more realistic approximation of the compensation earned if one accepts the premise that vesting date triggers compensation actually paid.

The new 402(v) definition of total executive compensation earned requires that registrant include other elements of compensation reported in the "All Other Compensation" column of the SCT. Included in this element of disclosure will be a new requirement for the actuarial calculation of the annual service cost for all defined benefit pension plans (both qualified and non-qualified plans). Current disclosure rules require registrants to report various other elements of compensation in the All Other Compensation column of the SCT, including such items as reimbursement for an executive's moving and relocation expense, security alarm services for the executive's residence, reimbursement for an executive's annual physical examination, and other miscellaneous expense reimbursements. We recommend that the All Other Compensation element from the SCT be excluded from the definition of executive compensation actually earned since this form of compensation is often a one-time expense reimbursement and variable from company to company.

> ***Questions 29, 30, 31, 32, and 33***. *Should we value equity awards at vesting date fair value as proposed? Should we instead value equity awards at grant date fair value as currently required by Item 402(c)(2)(v) and (vi) or fair value at some other point in time? If so, why? Should we require disclosure of vesting date valuation assumptions if they are materially different from those disclosed in a registrant's financial statements as of the grant date, as proposed? Would the disclosure of these assumptions provide meaningful information to shareholders? What concerns, if any are presented if we require equity awards to be valued at vesting date fair value as opposed to grant date fair value? Would any concerns be*

mitigated by the inclusion in the table of the total compensation amount as provided in the Summary Compensation Table? Should any other components of compensation, such as registrant contributions to defined contribution plans, also be included only after any applicable vesting conditions have been satisfied? For equity awards that require exercise, is our proposal to consider them "actually paid"" when vested the appropriate point in time for purposes of Item 402(v) disclosure? If not, please explain. Should we instead require that for an award that requires exercise to be considered "actually paid," it must also be exercisable, making the valuation date the date on which the award is both vested and exercisable? Is there an alternative approach we should consider? Are there other specific elements of compensation in the Summary Compensation Table that we should exclude or modify for purposes of the pay-versus-performance disclosure called for under proposed item 402(v)?

Pay Governance Response – As noted in our responses to questions 5, 6, 7, 21 and 23 above, we disagree with the SEC's decision to include both 402(v) compensation and SCT compensation in the new table reporting the registrant's TSR versus the peer group TSR. As discussed earlier, and most importantly, the SEC has proposed a rule which mismatches the stock price used – vesting date stock price is different from the stock price used for annualized TSR. Further, the total compensation data reported in the SCT is not "compensation actually paid" and should not be construed as such—it is a mix of actual pay and grant-date fair value (target) pay. Our firm also disagrees with the notion of calculating a new Black-Scholes value at the vesting date and representing such data as compensation actually paid. If the SEC insists upon using the concept of vesting as the trigger date for determination of compensation actually paid, then the value of an equity award at the time of vesting should be the equity instrument's intrinsic value. However, this modification does not correct the mismatch of stock price measurement noted above.

There are particular problems with the vesting of performance shares (performance vesting shares) relative to SCT and TSR. As discussed earlier, the proposed rules note that companies should use the "Stock Vested Table" for these calculations. Our firm has noticed that registrants vary in their disclosure practice of performance shares vested and earned based upon plan language and legal advice. For example, for a performance share grant covering the 3-year performance period of 2012-2014, the reporting of such awards may include two different reporting dates if the shares are delivered in early 2015: (1) many companies will disclose the vesting and delivery of awards in the 2015 proxy; (2) whereas other companies may disclose the delivery of awards in the 2016 proxy. In either case, there is a substantial mismatch of the reporting of long-term compensation earned (CAP) with the annualized TSR. This variation in treatment could lead to incomparability of CAP results and TSR performance across companies.

Question 34 and 35*. Should we require registrants to use TSR as the performance measure? Would the comparability across registrants resulting from this proposal benefit shareholders? Would prescribing the use of TSR hinder registrants from providing meaningful disclosure about the relationship between executive pay and financial performance? Would requiring the use of TSR result in shareholders or management focusing too much on this single measure of performance or emphasizing short-term stock price improvement over the* *creation of long-term shareholder value? If so, are ways we could mitigate that risk? Should we allow registrants flexibility in choosing the relevant measure of performance they are required to disclose? Besides TSR, what other measures of financial performance take into account any change in the value of the shares of stock and dividends and distributions of the registrant, as required by the statute? Are there metrics other than TSR that measure a company's performance and meet the requirements of the statute? If so, would they result in disclosures that are more or less meaningful than TSR? How is corporate performance measured today? How is this information incorporated into investment decisions?*

Pay Governance Response – We agree that exclusively disclosing absolute company performance in the table is too limiting for evaluation of pay versus performance. While TSR is an appropriate performance metric for purposes of measuring pay for performance, requiring exclusive use of TSR precludes the use of metrics that may enhance comparability across peer companies in a single industry. TSR is a single measure of shareholder financial returns which is universal across all industry sectors. But, we believe that requiring TSR as the exclusive performance metric for the pay for performance table and disclosure is limiting and inappropriate. Furthermore, it does not allow for a company to select a measure that may be more relevant to the company's situation. A principles-based approach may be more appropriate to allow companies flexibility to choose measures that reflect industry and situation. As the SEC is allowing for supplemental disclosures related to the table, we can expect companies to include measures more reflective of industry characteristics. However, the SEC has stated that such supplemental disclosure must not be more prominent in the proxy than the disclosure required by Item 402(v).

Question 46*. Should the pay versus performance disclosure be required to use annual data from the five most recently completed fiscal years, as proposed, or aggregated data for the five most recently completed fiscal years? If the years are aggregated, should the relationship between pay and performance be demonstrated across peers because it can no longer be demonstrated over time? Alternatively, should the pay versus performance comparison be presented for the last completed fiscal year and in aggregate for the five most recently completed fiscal years? If so, please explain why a different period and different level of aggregation than proposed would be more informative to shareholders or otherwise more appropriate.*

Pay Governance Response – Pay Governance has already provided an extensive response to this issue in our response to SEC questions 5, 6, and 7 in this letter. Regardless of whether the TSR data is cumulative or aggregated, there will be a major disconnect between the CAP data reported with TSR results because of the disparate timing between long-term equity compensation determination and multi-year TSR results. This is the direct result of the fact that companies have inherent differences in the performance periods and vesting schedules designed within their long-term equity incentive plans. There will be a lack of alignment between the equity incentive values in the CAP data and the performance period over which the equity incentives were vested and earned. Further, the SEC's insistence to use three different measurement dates for pay-versus performance disclosure adds a further lack of alignment between company performance and CAP, attributable specifically to the CAP methodology. The only way in which to improve the disclosure for the pay for performance table, as proposed, is the requirement for registrants to extensively footnote the CAP data with the corresponding TSR and vesting periods associated with particular long-term equity awards.

> ***Question 46.*** *Is it appropriate to apply the Plain English principles to the pay versus performance disclosure? If not, please explain.*

Pay Governance Response – The rules and regulations proposed by the SEC for the pay for performance disclosure are complex, lengthy, and cumbersome. Every attempt should be made to apply the Plain English principles to this disclosure for the direct benefit of shareholders and the financial community.

> ***Question 54.*** *Are there alternatives to the proposals we should consider that satisfy the requirements of Section 14(i) of the Exchange Act?*

Pay Governance Response – The SEC has made a strong attempt to develop pay for performance disclosure as an integral part of the shareholder reporting process. There are no simple prescriptions for this issue given the complexity of executive compensation program design. Presently, the registrant devotes an approximate 25 pages of the annual proxy to disclose its executive compensation program and the pay of the Named Executive Officers. We would encourage the SEC to remain cognizant of this fact and make every effort to keep executive compensation reporting straight-forward and easy for the shareholder to interpret and understand.

Final Remarks

Pay Governance LLC sincerely appreciates this opportunity to comment upon the SEC's proposed rules and regulations for the pay for performance disclosure requirements of the Dodd-Frank Act. Should you have questions about our comments, would you please contact any one of the four Pay Governance LLC Members listed below.

Sincerely,

PAY GOVERNANCE LLC

John Ellerman (email[redacted]

Lane Ringlee (email: [redacted])

Bentham Stradley (email: [redacted])

Ira Kay [redacted])

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Does the SEC's New "Compensation Actually Paid" ("CAP") Help Shareholders Accurately Assess Pay- For-Performance?

By: Ira Kay and Blaine Martin

Key Takeaways

- *The SEC's proposed CAP disclosure was intended to facilitate a pay-for-performance comparison by investors. Its definition does not chronologically align executive stock grants to the performance period for the calculation of total shareholder returns. As a result, the SEC's methodology does not facilitate an accurate assessment of pay-for-performance.*
- *CAP for 3 years as of 2014, for example, includes pro-rata vesting tranches of equity awards that could have been granted in 2009, 2010, 2011, 2012, and 2013. In comparison, TSR is measured over the 2012-2014 period.*
- *We illustrate the problems inherent in the SEC's methodology using a real-world anonymous example.*
- *Such misalignment is inherent in the CAP methodology. Thus the SEC's suggestion that a time-series comparison of CAP and TSR can help investors to understand the alignment of pay and performance is not valid.*
- *Instead, realizable pay, which provides an updated value of equity awards granted in the preceding three years, provides a better view of pay-for-performance alignment for investors.*

Introduction

On April 29, 2015, the SEC released proposed rules on public company pay-for-performance disclosure mandated under the Dodd-Frank Act. Pay Governance has analyzed the proposed rules and the implications for our clients' proxy disclosures and pay-for-performance explanations to investors. We are concerned about the validity of describing a company's pay-for-performance alignment using the disclosure mandated under the SEC's proposed rules, and its implications for Say on Pay votes.

The disclosure of "compensation actually paid" (CAP) as defined by the SEC may prove helpful for investors and other outside parties to estimate the amount of compensation *earned* by executives, in contrast to the compensation *opportunity* as disclosed in the Summary Compensation Table (SCT). However, the SEC's proposed rules are explicitly intended to compare executive compensation earned with company stock performance (TSR), per the relevant section of the Dodd-Frank legislation.[1] If the rules are intended to help shareholders understand the linkage between executive compensation programs and stock performance, then the technical nuance of the proposed methodology may be problematic.

The most apparent problem with comparing CAP and company TSR is that the CAP figure, which includes the value of equity awards vesting in each year, includes multiple equity grants that may have been granted one, two, three, four, or more years before the TSR measurement period. This depends heavily on the vesting schedule or performance period of equity awards. This mismatch in the timing of the stock grants and TSR significantly limits the utility of CAP in pay-for-performance analysis.

[1] ISS uses a modified version of SCT pay for their relative degree of alignment pay-for-performance model.

This viewpoint explores this concern by modeling a real-world CEO CAP disclosure table for the 3-year period allowed under the SEC's disclosure transition relief. While this example is based on a real public company and CEO, identifying data have been withheld to protect confidentiality.

Pro-Forma SEC Mandated Table

The table below is a pro-forma version of the SEC mandated CAP table representing a 3-year period. Our pro-forma table focuses only on the CEO to simplify discussion and analysis, but results would be similar for all other named executive officers.[2]

	CEO Compensation ($000's)		Total Shareholder Return (Cumulative)		
Year	Compensation Actually Paid	Summary Compensation Table Pay	Company TSR	Peer Group TSR	TSR Period
2014	$5,010	$9,144	**20%**	**97%**	**3-year**
2013	$3,145	$8,326	-7%	61%	2-year
2012	$20,163	$20,828	0%	19%	1-year
Total	**$28,318**	**$38,298**			

Potential Narrative Disclosure

The proposed rules require a narrative discussion of the *relationship* 1) between CAP and company TSR, and 2) between company TSR and peer TSR. In the case of our example, the narrative below attempts to describe these relationships:

> *In the three year history of CEO compensation in the SEC-mandated table above, CAP was significantly below Summary Compensation Table pay in 2013 and 2014. CAP in 2012 approximates SCT pay, but 2012 was an unusual year for the Company due to a CEO transition, and the CAP value in 2012 includes severance and vested equity awards for our departing CEO, in addition to annual compensation for our new CEO. The disclosed level of CAP was delivered commensurate with 3-year cumulative TSR of 20%, which was below the 3-year TSR for the peer group of 97%. Additional information on company pay-for-performance alignment is provided in the Compensation Discussion and Analysis.*

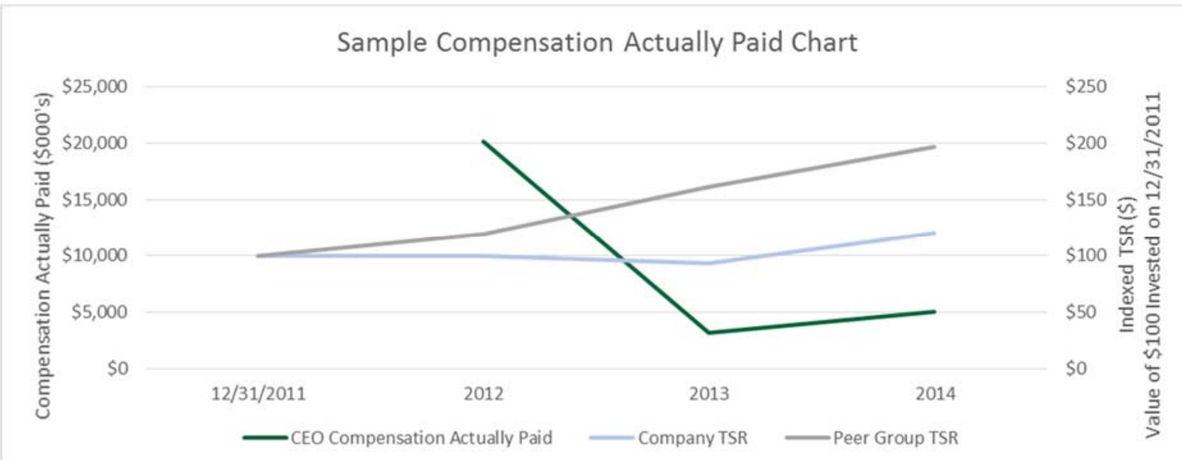
The SEC's proposed disclosure rules suggest that the SEC believes that a comparison of the year-over-year change in CAP, company TSR, and peer group TSR would help investors to understand pay-for-performance alignment. This expectation is potentially problematic because CAP is composed mostly of the equity awards that vest in a particular year, *many of which were not granted during the TSR performance period (e.g., a 3-year award granted in 2009, which vests in 2012)*. Vested equity awards are valued using the stock price on the date of vesting, and not the year-end stock price (as used for TSR calculation purposes), further contributing to the CAP/TSR timing disconnect. The methodology is further complicated by the SEC's requirement that companies disclose the aggregate CEO CAP for years in which a CEO transition occurred mid-year. Thus, it is *unlikely* that CAP would track company stock performance based on these nuances in the SEC-mandated methodology.

[2] The pro-forma disclosure provided, including the TSR period, is based on our good-faith interpretation of the proposed SEC regulations. The disclosure format may change pursuant to the SEC's final rules, and subsequent Q&A provided by the SEC.

As a result, our pro-forma narrative focuses not on the year-to-year change in CAP, but on the relationship between CAP and summary compensation table pay (pay opportunity) and the relationship between 3-year company TSR and 3-year peer group TSR. While the comparison of 3-year CAP and summary compensation table pay is not perfect because the two values do not represent the same equity awards, it is nearly meaningless to compare CAP to TSR without reference to either pay opportunity or peer company compensation. Companies may also wish to consider disclosing a peer group comparison of CAP levels, although such an analysis would have to lag one year behind the disclosure year based on availability of peer group CAP disclosure.

Graphical Comparison Alternative

The SEC proposed rules suggest that companies may wish to provide a time series line chart which would plot CAP, Company TSR, and Peer Group TSR. We provide an example of such disclosure below:



As described above, the SEC may believe a time-series comparison will tell the story of CEO pay relative to company TSR, and Company TSR to peer group TSR. However, in this test scenario, an investor may conclude that CAP has decreased since 2012 while company stock performance remained relatively flat versus peer company returns. While those facts are true, the 2012 CAP values are inflated due to a CEO transition in 2012, and the chart does not demonstrate the reality that the value of the new CEO's equity awards have tracked company stock price performance. Additionally, the chart does not illustrate that CAP was significantly lower than pay opportunity in 2013 and 2014, or have a reference for CAP relative to peer companies. Without some context for pay, comparing CAP to company and peer group TSR performance is not particularly helpful to investors.

Realizable Pay as a Supplemental Disclosure

Fortunately, the SEC proposed rules allow for supplemental analyses of pay-for-performance alignment in the proxy statement, as long as that analysis is not disclosed more prominently than the required CAP disclosure.

Our research demonstrates that realizable pay is the best methodology for companies to assess and communicate the pay-for-performance alignment of their executive compensation programs. Unlike CAP, realizable pay tracks the change in value of equity awards over the same three-year period for TSR. Thus, 2012, 2013, and 2014 equity grants are valued on 12/31/2014 in our example below. Further, realizable pay is directly comparable to Summary Compensation Table pay since it generally represents an updated valuation of the equity awards provided in 2012, 2013, and 2014. In contrast, CAP measures the value of stock vested in each year, so the equity value for the pro-forma 3-year CAP disclosure includes the portion of awards vesting ratably from grants in 2009, 2010, 2011, 2012, and 2013. Realizable pay compares both pay and performance to competitive peer group levels, because comparing company TSR to peer TSR without the same comparison for pay tells an incomplete story at best. As a result, any peer competitive analysis of realizable pay would lag one year behind the most recent fiscal year since competitive peer data would not be available until the follow year.

	CEO Compensation			Total Shareholder Return (Cumulative)			
Year	Company Realizable Pay	Median Peer Realizable Pay	Company Realizable Pay Percentile Rank	Company TSR	Peer Group TSR	TSR Percentile Rank	TSR Period
2014	$11,147	$8,190	71st	**20%**	**97%**	**2%**	**3-year**
2013	$8,492	$11,602	23rd	-7%	61%	Lowest	2-year
2012	$7,217	$16,920	9th	0%	19%	2%	1-year
Total	**$26,856**	**$36,712**	**19th**				

The table above presents an analysis of realizable pay for our pro-forma example. We ranked the company realizable pay and TSR relative to the peer group and found that the company's 3-year CEO compensation is currently valued at the 19th percentile of the peer group, aligned with performing at the 2nd percentile of the peer group for TSR.

This approach shows how the CEO's equity award values track company stock price. In well-aligned pay programs, CEO realizable pay is typically ranked low relative to peers when TSR is underperforming peers, and is typically ranked high when TSR is outperforming peers. The example above, and research on hundreds of companies over the years, show alignment between CEO pay and company performance more clearly, consistently, and reliably than can be expected using the SEC's CAP disclosure.[3]

Conclusion

Our pro-forma analysis of the SEC's proposed mandated CAP disclosure reveals major technical and practical problems with the SEC's proposed approach to mandatory pay-for-performance disclosure. If the intention is to help investors understand the pay-for-performance linkage of company executive compensation programs with company stock returns, disclosures complying with the proposed regulations may provide a hazy or even coincidental understanding of pay-for-performance linkage at best. Based on these findings, we believe that supplemental disclosure, and the use of realizable pay in particular, will be critical in communicating the alignment of executive pay programs with the financial interests of shareholders.

General questions about this Viewpoint can be directed to Ira Kay in our New York office at [redacted] *or by email at* [redacted] *or Blaine Martin in our New York office at* [redacted] *or by email at* [redacted].

[3] While the example above shows that both CAP and realizable pay are aligned with TSR, this outcome may be coincidental. There are numerous possible scenarios where CAP shows misaligned pay while realizable pay is closely aligned.