National Investor Relations Institute

225 Reinekers Lane, Suite 560, Alexandria, VA 22314
(703) 562-7700 FAX (703) 562-7701
Website: www.niri.org

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

Submitted via e-mail: rule-comments@sec.gov

Re: Pay Versus Performance (Release No. 34-74835, File No. S7-07-15)

Dear Mr. Fields:

This letter is submitted on behalf of the members of the National Investor Relations Institute (NIRI). Founded in 1969, NIRI is the professional association of corporate officers and investor relations consultants responsible for communication among corporate management, shareholders, securities analysts, and other financial community constituents. NIRI is the largest professional investor relations association in the world with more than 3,300 members representing more than 1,600 publicly held companies and $9 trillion in stock market capitalization.

NIRI appreciates the opportunity to comment on the Securities and Exchange Commission's (SEC) proposed rule to implement Section 953(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act). NIRI members play a key role in ensuring that U.S. public companies understand and respond to investors' questions about corporate financial performance and executive compensation. NIRI members also work with their companies to ensure investors receive accurate and understandable disclosures on compensation so they can make better investing and proxy voting decisions.

While NIRI understands that the SEC proposed this rule to carry out a congressional mandate, NIRI believes that the draft rule, as written, is too prescriptive, given the wide variety of performance metrics that U.S. public companies use to determine executive compensation. The draft rule's mandate that companies prepare a new table with an annual total shareholder return (TSR) comparison will result in disclosures that may confuse many investors, especially retail shareholders who don't have sophisticated research tools at their disposal nor the time to fully explore the nuances of corporate compensation practices. As result of this mandate, many companies will conclude that they must provide additional disclosures beyond what is intended by the proposed rule -- for instance, to explain why annual TSR is not the most appropriate way to compare the company's performance and executive pay with peers within their industry. Consequently, many companies will produce even longer corporate proxy statements, which would be contrary to the goals of the Commission's Disclosure Effectiveness initiative.

As other organizations have referenced in their comment letters, NIRI believes the Commission can provide companies more flexibility and discretion to provide disclosure on their pay-performance alignment, while still carrying out and meeting the general intent of Section 953(a).[1]

NIRI's Views on the Proposed Rule

<u>The SEC should propose a principles-based rule that would give companies greater flexibility to explain how their CEOs' compensation corresponds to companies' performance.</u>

As other commenters have noted, the draft rule goes well beyond the text of Section 953(a)[2] and imposes new disclosure obligations that would do little to help investors better understand executive pay.

A principles-based approach would be better suited for the wide variety of companies that would be covered by this rule. Depending on their industry, market capitalization, growth stage, and tenure of executives, companies and their directors employ significantly different metrics and performance periods when setting executive pay. Most companies use multi-year performance metrics to encourage executive decision-making that promotes long-term value creation.

When recruiting a new CEO, many companies will provide significant, one-time equity incentives to entice the executive to leave his or her former employer. In such a scenario, executive compensation would be relatively high in the first several years of the new CEO's tenure, while it might take several years for the executive to turn the company around and produce a positive TSR relative to the company's peers. While the company's decision to hire a new CEO may produce tremendous value to investors over the long term, that reality won't be reflected in the short-term TSR disclosures mandated by the rule.[3]

It appears from the rulemaking release that the Commission opted for a prescriptive approach because it wanted to make it easier for investors to make comparisons among different companies. However, as various commenters, including several from the investment community,

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[1] See, e.g., the comment letters by Davis Polk & Wardwell LLP, the U.S. Chamber of Commerce, the Center On Executive Compensation, BlackRock, CFA Institute, the Business Roundtable, and the Aspen Institute's Business & Society Program.

[2] While Section 953(a) directs the SEC to require issuers to provide information "that shows the relationship between executive compensation actually paid, and the financial performance of the issuer," the statute makes no mention of TSR, annual share performance, or the performance of peer groups.

[3] See Equilar, Executive Compensation Blog, June 18, 2015 (discussion of one-time initial awards).

have pointed out, such an objective is not a realistic goal, given the vastly different market and industry circumstances that shape executive pay decisions at U.S. public companies. By imposing detailed requirements that would force companies to report their "pay versus performance" relationship in the same way, regardless of a company's industry or specific value drivers, the draft rule likely will obscure, rather than illuminate, many executive pay decisions.

In its comment letter, the Aspen Institute's Business & Society Program concluded that a principles-based approach, rather than greater comparability, would result in better information for average investors:

> *We believe a principles-based rule to implement Section 953(a) of Dodd-Frank would provide more meaningful disclosure as it would allow companies the flexibility to explain the actual rationale and decisions underlying their pay structures. A principles-based disclosure regime should focus on drivers of long-term value for the company, be tied closely to the company's mission and strategy, focus on benchmarks that are within the control of the NEO, and be linked to metrics that are difficult to manipulate. This may sacrifice comparability, but we believe this could facilitate greater transparency around information critical to average investors.*[4]

Likewise, CFA Institute expressed concern about the prescriptive nature of the rule:

> *We do not believe such a prescriptive disclosure regime is necessary or beneficial in this instance. We believe that by just providing basic requirements for disclosure concerning pay for performance, the SEC should allow issuers the freedom to tell their stories in the ways that they see fit.*
>
> *Some investors may wish for a more prescriptive disclosure that makes their analysis easier, but we feel it is important to allow issuers flexibility in presentation. Over time best practices will emerge, and investors will encourage companies to follow those best practices. In particular, large institutional shareowners that drive voting decisions on pay generally have employees that are well trained in reading and understanding compensation disclosures. Investors also receive information concerning compensation from proxy advisers and other consultants. We therefore think that these mechanisms, together with say-on-pay votes, will encourage companies to develop produce and apply such best practices.*[5]

NIRI agrees that the Commission should propose a principles-based rule, and give issuers and their investors time to work together to determine which information on performance would be most

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[4] See Comment Letter of Judy Samuelson, et al., Aspen Institute's Business & Society Program, July 6, 2015, p. 5.
[5] See Comment Letter of James Allen, CFA, Head, Capital Markets Policy, and Matt Orsagh, CFA, Director, Capital Markets Policy, CFA Institute, July 6, 2015, p. 3.

helpful.[6] If best practices do not emerge in area, the SEC certainly could revisit this area in the future.

<u>The rule should not mandate that companies use annual TSR to assess their pay relative to their peers, given that many issuers use multi-year performance incentives (based on operational metrics) to motivate executives.</u>

As many commenters have pointed out, annual TSR is an imprecise measure of a chief executive's impact on a company's performance. As the IRRC Institute noted in its comment letter, TSR can be impacted by factors "such as fund flows, central bank policies, macroeconomics, geo-political risks and regulatory changes [that] are all beyond the control of executive management."[7]

As Commissioner Daniel M. Gallagher has observed, a simple TSR comparison likely will produce "false positives" that suggest that a particular company's executive compensation is not aligned with performance, which then would force the company to prepare supplemental disclosures to explain its pay practices.[8] Of course, these additional disclosures would require more management time, including the attention of IR professionals, and prompt investors to have to devote more time to reading this information during proxy season.

The draft rule's annual TSR mandate inevitably will encourage short-term thinking by management, because TSR, as defined by the SEC in this draft rule, is focused heavily on share price; some companies will be tempted to delay capital expenditures or engage in additional share buybacks that would boost their share price on a short-term basis. This mandate also will distract attention from other performance metrics, such as return on invested capital, that may do a better job of promoting long-term value creation at many companies.

In recent years, several well-known institutional investors and corporate advisors, such as those who founded the "Focusing Capital on the Long-Term" initiative, have encouraged public companies to stop providing quarterly earnings guidance and instead emphasize their strategy for creating long-term shareholder value. In addition, Larry Fink, CEO of BlackRock, has urged companies to work with investors and policymakers to help change regulations, such as the U.S. tax code, that incentivize short-term behavior.[9] The short-term-oriented TSR disclosures

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[6] In a recent speech to the Society of Corporate Secretaries & Governance Professionals, Chair Mary Jo White recognized the limits of SEC rulemaking and encouraged issuers and investors to work together to reach common ground on the disclosure of interim vote results and other proxy issues. See Chair Mary Jo White, "Building Meaningful Communication and Engagement with Shareholders," June 25, 2015. Likewise, companies and investors should be able to reach a consensus on best practices for providing "pay versus performance" information.

[7] See Comment Letter by Jon Lukomnik, Executive Director, IRRC Institute, May 6, 2015.

[8] See Commissioner Daniel M. Gallagher, Statement at Open Meeting on Pay Versus Performance, April 29, 2015.

[9] See Laurence D. Fink, BlackRock, Letter to CEOs at S&P 500 Companies, March 31, 2015. ("We believe that government leaders around the world -- with a concerted push from both investors and companies -- must act to address public policy that fosters long-term behavior.")

mandated by this draft rule would undermine this movement, to which many investors, executives, and board members have been receptive.

In revising the rule, it is our belief that the Commission should:

- Allow companies the flexibility to use alternative performance measures in addition to TSR in the new "pay versus performance" graph.
- Allow companies the flexibility to report their TSR on either an annual or on a multi-year basis, and to select the number of years that would be measured.
- Not require any companies[10] to disclose the collective TSR of their peer groups, which can be impacted by macroeconomic trends and unique factors that concern specific peer firms, neither of which are directly relevant to the reporting company's compensation practices.

<u>This draft rule will generate disclosures that are not relevant or helpful to most investors.</u>

Before adopting any rule, the SEC is required by the Administrative Procedure Act to carefully consider the costs and benefits of the rule. In this case, the limited benefits of the draft rule are clearly outweighed by the new burdens *on both issuers and investors.*

As the Commission has recognized during its Disclosure Effectiveness project, additional mandated disclosure is not necessarily better, particularly if many companies already are providing similar disclosure elsewhere in their proxy materials. For almost a decade, most companies have produced detailed Compensation and Discussion Analysis (CD&A) sections in their proxy statements. Since the arrival of "Say on Pay" votes at most companies in 2011, many issuers have provided clearer CD&A disclosures that explain how their executive pay is linked to financial performance. Unfortunately, some investors have overlooked these explanations because proxy statements have become longer and more cumbersome. In response, a growing number of companies now voluntarily produce "executive summaries" (or letters to shareholders) that highlight their pay-for-performance alignment.[11] Such summaries are much more likely to be read and understood by investors than the new table and other disclosures mandated by the draft rule.

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[10] The draft rule exempts smaller reporting companies from the TSR peer group requirement, in part because of concern over the compliance burden. While this rule won't be as onerous as other Dodd-Frank mandates, such as the draft CEO pay ratio disclosure rule, the Commission still has a legal obligation to look for ways to reduce the compliance burden on all companies. The Commission should consider delaying the peer group mandate of the rule for five years to assess whether such a requirement is truly necessary.

[11] For more information on disclosure improvements, see CFA Institute's *Compensation Discussion and Analysis Template: Second Edition* (2015), available at: http://www.cfapubs.org/doi/abs/10.2469/ccb.v2015.n4.1 CFA Institute formed a working group of investors and corporate representatives, including NIRI, to develop a model CD&A template in 2011 to help small and mid-cap issuers more effectively communicate their compensation practices to investors. An updated edition was published in April 2015. Likewise, the SEC should encourage issuers and investors to reach a similar consensus on "pay versus performance" information.

The SEC should consider the information that companies already are providing voluntarily, as well as the proxy voting workload of investors, before mandating a new set of prescriptive disclosures that won't be read or understood by most shareholders.

The Commission should pay particular attention to the concern expressed by BlackRock, which analyzes the proxy materials of thousands of companies each year. As BlackRock observed in its comment letter:

> *We are concerned that a prescriptive reporting requirement (as in the Proposal) could result in disclosures that are not relevant to particular issuers. This could result in issuers expending additional resources to explain the information, and investors also expending additional resources to understand the disclosures. We believe this additional engagement activity may draw attention away from other high priority engagement topics on corporate governance issues linked to long-term performance, including but not limited to board composition and effectiveness, executive succession planning and risk management.*[12]

This burden on investors likely will be even more acute for smaller institutions, which typically don't have in-house staff to analyze proxy disclosures. Retail investors likely will ignore or misunderstand these additional disclosures on "pay versus performance."

<u>Smaller reporting companies, which have fewer resources to produce additional proxy disclosures, should be exempted from this rule.</u>

A disproportionate amount of investor concern and activism on the subject of executive pay has focused on widely held, S&P 500 companies where the limited market for top CEO talent has resulted in significant compensation packages for many chief executives. Chief executives at small-cap and microcap companies typically receive more modest pay packages, and their investors typically are more focused on a company's revenue and growth prospects, rather than on the design of executive compensation packages.[13]

The SEC and Congress have long recognized the importance of reducing the compliance burdens of smaller issuers. Smaller companies already are exempt from other disclosure requirements,

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[12] See Comment Letter by Zachary M. Oleksiuk, Director, Head of Corporate Governance and Responsible Investment, Americas, BlackRock, July 2, 2015.

[13] According to Equilar, the average annual compensation for new CEOs, who were promoted from within a company, was $1.9 million at S&P 600 small-cap issuers in 2013, while new (internally promoted) CEOs at S&P 500 large-cap companies received an average of $5.96 million. Externally hired chief executives at large-cap firms did even better, receiving $9.1 million in average annual compensation. See Equilar, "In With the New – Compensation of Newly Hired Chief Executive Officers," Feb. 7, 2015. Given this reality, there is less of a need to require smaller companies to provide new "pay versus performance" disclosure.

such as Section 404(b) of the Sarbanes-Oxley Act, receive more time to make their Form 10-K filings, and have fewer reporting obligations under Regulation S-K. While the draft rule would require smaller reporting companies to provide disclosure for the past three years (instead of five) after a transition period, this incremental relief would not significantly lessen the burden on small and micro-cap companies. Instead, the Commission should consider completely exempting smaller reporting issuers for five years after the effective date of this rule so the SEC staff can first assess how larger companies are complying with the rule.[14]

At the same time, smaller companies are required to hold "Say on Pay" votes, so their investors already have a powerful mechanism to express concern if those companies fail to provide sufficient disclosures on performance metrics. Instead of imposing a new disclosure mandate on small issuers, the Commission should allow the investors of these companies a chance to determine how they wish to receive "pay versus performance" information after seeing how larger companies comply with this rule and reviewing the voluntary disclosures by smaller companies.

<u>The required disclosure should be limited to the compensation of principle executive officers.</u>

The draft rule includes a mandate to include an average of the compensation of all named executive officers in the new "pay for performance" table. Including other named executive officers in this new table will make the rule more costly for companies while producing information that is not material to most investors. There is no evidence that most investors pay close attention to the compensation of the general counsel, the chief financial officer, or other named executive officers when casting their "Say on Pay" votes unless the compensation for these executives is an extreme outlier or is swelled by exorbitant one-time circumstances. Not surprisingly, investors primarily focus on the incentives for the CEO because the design of the pay package for the chief executive typically sets the tone for how the other named executive officers are compensated.

<u>This SEC should proceed cautiously before adopting a new XBRL mandate.</u>

The draft rule includes a requirement to data-tag the new "pay versus performance" table in the XBRL format. This table would be the first proxy disclosure to be XBRL tagged, and a SEC commissioner has expressed hope that this XBRL mandate would be extended to other proxy disclosures.[15] However, there is little evidence that investors are actually using XBRL-tagged

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[14] NIRI also believes that all public companies should be provided more time to determine how they will comply with this rule. NIRI supports the Business Roundtable's request for a one-year transition period, so that compliance would not be required until a company's first fiscal year that starts after the one-year anniversary of the effective date of this rule. See Comment Letter by John Hayes, Chairman, President and Chief Executive Officer, Ball Corporation and Chair, Corporate Governance Committee, Business Roundtable, pp. 5-6.
[15] See Commissioner Kara M. Stein, Statement on Proposed Rule on Pay Versus Performance, April 29, 2015.

financial disclosures now, and it appears that the costs for companies far outweigh any benefits for shareholders. In May, the House Financial Services Committee overwhelmingly approved a bill that would exempt public companies with less than $250 million in annual revenue from XBRL filing for five years. As Commissioner Michael S. Piwowar has noted, the Commission should not impose new XBRL mandates on a piece-meal basis, but should take its time to carefully consider the costs and benefits of data-tagging proxy disclosures generally.[16]

Conclusion

NIRI appreciates this opportunity to comment about "pay versus performance" disclosure. NIRI remains hopeful that the Commission will prepare a principles-based rule that fulfills the intent of Section 953(a) without burdening companies and investors with new disclosure that would be confusing and not relevant to how most issuers and their boards make executive compensation decisions.

Sincerely,

James M. Cudahy, CAE
President & CEO

[16] See Commissioner Michael S. Piwowar, Statement at Open Meeting on Clawbacks of Erroneously Awarded Compensation, July 1, 2015.