Center On Executive Compensation

November 1, 2016

VIA Electronic Delivery

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

RE: Request for Comment on Subpart 400 of Regulation S-K; 17 CFR Part 229; Release Nos. 33-10198; 34-78687; File No. S7-18-16

Dear Mr. Fields:

The Center On Executive Compensation ("Center") is pleased to submit comments to the Securities and Exchange Commission ("Commission") providing its perspective on the Commission's review of Regulation S-K. This letter provides the Center's feedback regarding the executive compensation disclosure requirements outlined in Regulation S-K Item 402, including the Compensation Discussion and Analysis and the required compensation tables.

There is general dissatisfaction with the current state of executive compensation proxy disclosures which have become exceedingly lengthy and dense to the point where investors have indicated that material information is no longer easy to identify.[1] According to a Stanford University and RR Donnelly Survey on investor preferences in proxy disclosures, "55 percent of investors believe the typical proxy statement is too long."[2] Further, "48 percent [of investors] believe that a typical proxy statement is difficult to read and understand" and thus "investors claim to read only 32 percent of a typical proxy, on average."[3]

The Center believes the SEC can make executive compensation disclosures more effective and efficient by making specific adjustments to the Summary Compensation Table and other required tabular disclosures. However, extensive additions to executive compensation disclosures have occurred since 2007, and especially since the 2010 Dodd-Frank Act which introduced mandatory say on pay and required the forthcoming pay ratio disclosure as well as the eventual inclusion of the pay for performance, hedging, and clawback disclosures in the proxy statement. For this reason, the Center also urges the SEC to undertake a comprehensive re-

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[1] 2015 Investor Survey – Deconstructing Proxy Statements – What Matters to Investors, available at https://www.gsb.stanford.edu/sites/gsb/files/publication-pdf/cgri-survyey-2015-deconstructing-proxy-statements_0.pdf (last visited 10/31/2016). Furthermore, in remarks given on October 15, 2013 SEC Chair Mary Jo White warned of the risk of "disclosure overload" in expressing concern that "ever-increasing amounts of disclosure would make it difficult for an investor to [identify material information]." See Chair Mary Jo White's speech "The Path Forward on Disclosure" available at https://www.sec.gov/News/Speech/Detail/Speech/1370539878806#.Ul_7RHBwqtg (last visited 10/31/2016).
[2] *Id.*
[3] *Id.*

examination of the current content, structure, and format of the executive compensation disclosure regime as soon as is feasible.

The Center is a research and advocacy organization that seeks to provide a principles-based approach to executive compensation policy from the perspective of the senior human resource officers of leading companies. The Center is a division of HR Policy Association, which represents the chief human resource officers of over 360 large companies, and the Center's more than 125 subscribing companies are HR Policy members that represent a broad cross-section of industries.

I. The Center Supports the Principles-Based, Materiality-Focused Structure of the Compensation Discussion and Analysis.

Pursuant to Regulation S-K Item 402, public companies are required to disclose extensive information annually in the proxy statement concerning the compensation paid to the company's named executive officers. The current requirements were implemented in 2007 and consist of two primary components: a principles-based narrative, known as the Compensation Discussion and Analysis (the "CD&A"), and a more structured set of required Compensation Tables (the "Tables"). The 2007 Release featured a combination of the prior two executive compensation disclosure approaches. From 1983 until 1992, the SEC required a mostly narrative disclosure approach before switching to a mostly tabular approach in 1993. In 2007 the Commission approved a blended approach that consisted of tabular disclosure and a principles-based narrative out of its belief that the "complexity of and variations in compensation programs" were not adequately accommodated in the tables.[4] As a result, per the release, the Commission was concerned that investors could "lack material information"[5] about the company's compensation programs. Thus, the CD&A was included to supplement the Tables with "a discussion and analysis of the material factors underlying compensation policies and decisions reflected in the data presented in the tables."[6]

The current CD&A requirements outlined in Regulation S-K Item 402 provide seven mandatory topics of discussion with an additional list of fifteen examples of types of information which could be material to investors. The 2007 release did not intend to create a list of 22 mandatory requirements for the CD&A, but rather, the "principles-based disclosure concept allows each company to assess its *own facts and circumstances* and determine what elements of the company's compensation policies and decisions are *material* and warrant discussion (*emphasis added*)."[7] Unfortunately, for many companies, the push to "comply" with the

[4] Executive Compensation and Related Person Disclosure, 71 Fed. Reg. at 53221 (codified at 17 CFR Parts 228, 229, 232, 239, 240, 245, 249 and 274).
[5] *Id* at 53160.
[6] *Id* at 53221. It is also worth noting that the 2007 release, in effort to make sure the amendments "result in disclosure that is clear, concise, and understandable to investors" expanded the Plain English requirements to the proxy statement.
[7] "Staff Observations in the Review of Executive Compensation Disclosure," available at http://www.sec.gov/divisions/corpfin/guidance/execcompdisclosure.htm. The 2007 Release states quite clearly that in making the recommended 15 CD&A discussion topics that there was no intention of creating set of mandatory or exclusive requirements. Instead, the release states "We also note that in some cases an example may not be material

disclosure framework, combined with the *de facto* standards set by proxy advisory firms, has created a defense-driven disclosure strategy which in many, if not most, cases has transformed all 22 topics of discussion into quasi-requirements regardless of whether information is actually material.

The Center strongly supports the concepts behind the principles-based, materiality-focused structure of the current requirements. In theory, the current requirements provide companies with the necessary flexibility to craft disclosures which accommodate the individualized nature of each company's executive compensation program structure as well as the unique composition of that company's shareholders. Conceptually, by shaping the scope of the disclosure based on the concept of only providing "material" information, the current CD&A requirements should allow executive compensation disclosures to be appropriately targeted and tailored despite intense public scrutiny.

The concept of a company providing only "material" disclosures is well established in the federal securities laws and is based on whether a "reasonable investor" would find the information important in making an investment decision.[8] Key to the rationale is that it rejects the idea that information is material if an investor "might" find it important. Instead, there must be a "substantial likelihood that the reasonable shareholder would consider [the information] important in deciding how to vote."[9] The Center believes the SEC should continue to use "materiality" as the standard for determining whether executive compensation information should be disclosed.

The concept of "materiality" is by definition limited and cannot include any and all information available. For example, organizations like the UN Principles for Responsible Investment have suggested that investors demand disclosure on environmental, social or governance (ESG) matters from issuers in which they invest, and encouraged standardized reporting on ESG issues within proxy disclosures (https://www.unpri.org/about/the-six-principles). While there may be cases where this information is indeed material, the core definition of materiality would dictate that there would not be a universal requirement mandating the disclosure of this type of information.

Unfortunately, the intended flexibility provided in the CD&A requirements has not worked as intended and has yielded the extremely lengthy and complicated disclosure seen in many of today's proxy statements. Combined with growing influence of proxy advisory firms, the result has been that, rather than merely using the CD&A as a medium to explain their executive compensation policies and highlight the link between pay and performance, many companies instead seek to make sure they cover all the 22 CD&A topics. Subsequently, when confronted with a decision of whether a certain piece of information is considered material, the company

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to a particular company, and therefore no disclosure would be required." Further, the release states that the "Compensation Discussion and Analysis should reflect the individual circumstances of a company and should avoid boilerplate disclosure." Executive Compensation and Related Person Disclosure, 71 Fed. Reg. at 53165 (codified at 17 CFR Parts 228, 229, 232, 239, 240, 245, 249 and 274)

[8] *TSC Industries, Inc. v. Northway*, 426 U.S. 438, 448-449 (1976).

[9] *Id* at 449.

will choose to include it if there is even a remote possibility that the absence of the information would be noticed by one or more stakeholders. The resulting disclosure overload is only set to further expand with impending rules implementing a pay ratio disclosure as well as the Dodd-Frank pay for performance requirement. These controversial rules will significantly expand the length and density of company proxy statements, further impeding the ability to find actual material information.[10]

Furthermore, since the 2008 financial collapse, and particularly since the introduction of mandatory say on pay, companies have worked to provide even clearer disclosure of their executive compensation programs with an emphasis on how pay correlates and connects with company performance. The desire to provide company performance information within the executive compensation section of the proxy to demonstrate the connection of pay and performance is a product of company engagement with investors as well as a desire to meet the evolving standards of proxy advisory firms.

The consequence, however, of this development is that companies are including extensive information about company performance within the executive compensation disclosure. Prior to this development, this type of financial information was only reported in a company's annual report, but now it often makes up a substantial portion of company compensation disclosures. This is particularly the case for certain aspects of performance, such as company Total Shareholder Return in both a relative and absolute context, which are increasingly used in incentives and favored by proxy advisory firms that analyze company executive compensation programs and provide voting recommendations to investors. Furthermore, while performance information is important and material, it is also frequently pertinent to more than one aspect of a company's compensation plan and therefore, companies often end up repeating the same performance information multiple times in the proxy statement. For example, companies provide a performance breakdown in a discussion of the short-term incentive plan as well as the long-term incentive plan, in addition to the discussion provided in the executive summary.

II. Changes to Summary Compensation Table Will Make Executive Compensation Disclosures in the Proxy Statement More Effective.

In preparation for this comment letter the Center engaged, solicited and received a number comments from its Subscribers which are reporting companies subject to the executive compensation disclosure requirements in the Item 402. Of the feedback we received, one theme was almost universal: There is a general dissatisfaction with the figures in the Summary Compensation Table and a consensus that the values in the table are not necessarily representative of the actual compensation paid or what the company intended to pay under its compensation programs as designed. Thus, companies often feel it necessary to provide extensive CD&A disclosures in an effort to provide a more accurate depiction of their compensation programs and amounts and a more complete representation than what is allowed to be included in the table.

[10] According to Center data, among S&P 500 companies the average CD&A length has grown from 15.3 pages in 2011 to 17.5 pages in 2016. This growth correlates to the growth in the overall executive compensation section of the proxy, which includes the CD&A as well as the compensation tables which now averages 32 pages among S&P 500 companies, up 29.8 pages in 2011.

For companies, the consequences of the potential disconnect between how the Summary Compensation Table represents their pay programs and how executive compensation is awarded and paid are significant, considering the research showing heavy investor reliance on the Summary Compensation Table for analyzing pay programs as well as the use of Summary Compensation Table values by proxy advisory firms in analyzing management say on pay proposals.[11] The Summary Compensation Table combines elements of earned and contingent pay and is unlikely to represent how much an executive earns in a given year. The salary and bonus are values which are earned in a year. Equity awards, however, are valued based on the per-share grant date value, and because equity awards are contingent on future performance, the actual future payouts of the awards are apt to change significantly based on company performance. Similarly, options are valued using an estimate such as the Black-Scholes model; the actual value an executive realizes is likely to differ from the Summary Compensation Table value significantly. Additionally, because both options and equity awards typically vest over several years, the pay for performance accuracy of the Summary Compensation Table total value is significantly diminished. Although the Summary Compensation Table provides an accounting perspective on executive compensation, the CD&A requires companies to discuss how their compensation programs link to performance, for which the Summary Compensation Table is not well suited. This results creates a need for more disclosure.

The concern over the disconnect represented in the Summary Compensation Table has given rise to a plethora of supplemental disclosures, such as realized and realizable pay, which attempt to provide a different lens on compensation levels. However, a lack of standardization among alternative pay disclosures has discouraged many companies and investors from adopting their use.[12] Fortunately, the SEC has an opportunity to make some minor changes to the Summary Compensation Table which would lessen the need for companies to develop supplemental disclosure.

a. **The Pension Value and Non-Qualified Deferred Compensation Earnings Column in the Summary Compensation Table Should Be Removed.**

Under the current framework, the Summary Compensation Table contains a column which requires companies to disclose the “Change in Pension Value and Nonqualified Deferred Compensation Earnings.” Unfortunately, the values which are reported in this column are not representative of the compensation an executive will earn in a year or in the future. Instead, the values reported in this column are the result of fluctuations in long-term discount rates as well as changes in the mortality table and are completely outside the company’s control. Despite this, positive values are required to be reported in the Summary Compensation Table, often giving the

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[11] 2015 Investor Survey – Deconstructing Proxy Statements – What Matters to Investors, available at https://www.gsb.stanford.edu/sites/gsb/files/publication-pdf/cgri-survyey-2015-deconstructing-proxy-statements_0.pdf (last visited 10/31/2016). According to the survey, the Summary Compensation Table is the most referenced mandatory section of a company proxy statement by investors.

[12] See Supplemental Pay Disclosure: Overview of Issues, Proposed Definitions, and a Conceptual Framework, The Center On Executive Compensation and The Conference Board, available at http://www.execcomp.org/Docs/Conference_Board_Supplemental_Pay_Disclosures_9-29.pdf (last visited 10/31/2016).

impression of significant increases in executive compensation that distort the total compensation figure.

For example, during 2015 the media widely reported an increase in executive compensation while noting that the increase was driven mostly by an increase in pension values in 2014, which was caused by the discount rate and changes in the mortality table.[13] The *Wall Street Journal* reported that median compensation climbed by 13.5% from 2013 to 2014. However, another *Wall Street Journal* article highlighted the impact of executive pensions on pay, which in 2013 had made up only 3% of compensation, but in 2014 made up an average of 8%.[14] The increase in executive pay was reported even though the pension value in no way represented any compensation the CEO earned during the year. Subsequently in 2016, the media reported on a year-over-year decline in CEO pay from 2014 to 2015, noting that it was attributable to the "slower growth in CEO pension values, a year after pension increases for many top executives swelled because of changes to the actuarial assumptions underlying them."[15] This led the *Wall Street Journal* to report a decrease in median CEO pay among S&P 500 companies of 4.6%.[16] Despite these reports indicating that CEO pay went down, the reality is that if the pension value was removed from both 2014 and 2015 numbers, CEO pay increased slightly from 2014 to 2015.

The Center recommends the SEC remove the pension column completely from the Summary Compensation Table. This will enhance the quality of the Summary Compensation Table disclosure and make the total value more representative of a company's compensation program. Further, concerns that the value is needed by investors are alleviated by the presence of the required Pension Benefits and Nonqualified Deferred Compensation tables.

b. **The Current Approach to Equity and Options Reporting in the Summary Compensation and Grant of Plan-Based Awards Tables Creates a Need for More CD&A Disclosure.**

Under the current rules in Item 402, equity and option awards must be reported in the Summary Compensation and the Grant of Plan-Based Awards Tables for the year in which they are granted. Long-term incentive (equity) awards are typically granted in two ways – prospectively and retrospectively. "Prospective" awards are granted based on many factors, including overall company performance and current market conditions, with actual payouts

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[13] See "How Much the Best-Performing and Worst-Performing CEOs Got Paid", The Wall Street Journal, available at http://www.wsj.com/articles/how-much-the-best-and-worst-ceos-got-paid-1435104565 (last visited 10/31/2016); See also "Executive Pensions are Swelling at Top Companies", The Wall Street Journal, available at http://www.wsj.com/articles/executive-pensions-are-swelling-at-top-companies-1427241963 (last visited 10/31/2016); See also "Total CEO Pay in US Increased 12.1% in 2014, Towers Watson Analysis Finds", Willis Towers Watson, available at https://www.towerswatson.com/en-US/Press/2015/04/total-ceo-pay-increased-12-1-percent-in-2014 (last visited 10/31/2016).
[14] See "Executive Pensions are Swelling at Top Companies", The Wall Street Journal, available at http://www.wsj.com/articles/executive-pensions-are-swelling-at-top-companies-1427241963 (last visited 10/31/2016);
[15] See "CEO Pay Shrinks 4.6% but Offers Weak Reflection of Performance", The Wall Street Journal, available at http://www.wsj.com/articles/ceo-pay-shrinks-4-6-but-offers-weak-reflection-of-performance-1464880505 (last visited 10/31/2016) "CEO Pay Shrank Most Since Financial Crisis", The Wall Street Journal, available at http://www.wsj.com/articles/ceo-pay-shrank-most-since-financial-crisis-1460074559 (last visited 10/31/2016)
[16] *Id*.

determining future company performance. "Retrospective" awards are typically granted during the first quarter of the year, but instead of being focused primarily on future performance, they are explicitly based on company performance during the previous year. Whether or not the award pays at target is subsequently determined by future performance and the payouts of awards at the end of the performance period are disclosed elsewhere in the table footnotes. However, because the current disclosure rules require the disclosure of such awards in the year in which they are actually granted, the target LTI grant is put in the Summary Compensation Table for a year which does not relate to the year's performance on which it was based. Instead it is disclosed one year later. At the same time, annual incentive awards, which are typically paid in cash in the first quarter of the year after they are earned, are disclosed in the table not in the year they are actually paid, but for the same performance year for which they were earned. This framework creates a disconnect between bonus awards and LTI awards based on the same performance year. The SEC has recognized that this disconnect exists and has even provided it as an example of a potential change the SEC could undertake of the executive compensation disclosure requirements.[17]

This disconnect frustrates companies and among Center Subscribers there was considerable commentary and a desire to be able to place equity awards in the Summary Compensation Table in their performance year to allow these awards to line up with bonus awards based on the same performance year. Companies also reported that the disconnect under the current requirements creates additional pressure to provide supplemental CD&A disclosures to demonstrate how their pay for performance plans work and often to provide an extended discussion of how the LTI plan works to counter the information provided in the Summary Compensation Table.[18]

The Center believes the SEC should allow companies to place equity awards in both the Summary Compensation Table and the Grant of Plan-Based Awards Tables for the performance year even if the award is granted in the during the first two-and-a-half months of the following year. This would eliminate the need for companies to provide clarifying disclosures and footnotes.

c. **Footnotes Should Not Be Required Where the Information Would Be Duplicated in the CD&A.**

One of the most notable pieces of feedback the Center heard from our Subscribers in preparation for this comment letter was that there was frustration with having to repeat information disclosed in the CD&A which is also required to be disclosed in the footnotes to the Summary Compensation Table. Often, the CD&A disclosure contains extensive detail and includes helpful graphics or charts. In circumstances where a company has already addressed in the CD&A the information which would otherwise appear in a footnote, we urge the SEC to allow the company to include a hyperlink in the footnote to the discussion in lieu of being required to author a repetitive footnote. This has the potential to reduce unneeded duplication.

[17] See remarks by Keith Higgins, SEC Director of Corporation Finance, available at https://www.sec.gov/news/speech/executive-compensation-beyond-dodd-frank.html (last visited 10/31/2016).
[18] For an example of this, see the Johnson and Johnson Proxy Statement - https://www.sec.gov/Archives/edgar/data/200406/000119312516505952/d110075ddef14a.htm.

III. Greater Emphasis on Hyperlinking, Tagging, and XBRL Will Make Proxy Disclosures More Efficient and Effective.

The largest area for potential improvement within the federal disclosure regime, including the executive compensation tables and CD&A disclosures as currently written, is to make use of technology to make information easier to access and parse through. Proxy statements have exploded in length from about 30 pages to between 60 and 80 pages.[19] The length combined with the density of information makes the proxy statement particularly difficult to navigate. Furthermore, there is considerable overlap in information. To effectively read a proxy statement one often must flip back and forth between areas; for example, between the summary compensation table and the CD&A description of a company's long-term incentive plan. Hyperlinking allows this to some extent, but the current HTML or PDF-based framework provided by EDGAR is still relatively clumsy and difficult to fluidly navigate.

The Center believes the SEC could rework proxy statements to utilize a combination of hyperlinking, tagging, expanded in-margin menus, and XBRL to make proxy statements and executive compensation information more searchable and more navigable between interlinked parts. We believe this would significantly reduce repetition within proxy statements. During the Center's conversations with companies in advance of this comment letter, several companies reported that they placed information multiple times within the CD&A as well as in table footnotes because they felt the information was needed to help interpret multiple sections but were concerned that the navigational shortcomings of the HTML or PDF presentation of the proxy statement would impede the ability of the reader to view the information in its original location. Rather than risk the reader not understanding the section, these companies choose to include the information multiple times.

Providing enhanced digital access to proxy statement materials and other governance policies would significantly enhance the experience for investors. Most institutional investors already read proxies electronically, rather than in paper form, and thus they would directly benefit from the enhancements. Retail investors in general also possess internet access and would benefit from the ability to navigate and view proxy statement information in an enhanced digital format.

Furthermore, the SEC has the opportunity to use digital hyperlinking to make the proxy statement much more efficient and reduce boilerplate disclosures. For example, although material and important, unless they have changed from the previous year, the company's stock ownership guidelines and the state of their named executive officers' compliance with those guidelines could be referenced in a proxy statement using a hyperlink which would take the viewer to a permanent web location where the company information is located. This would remove the disclosure from the proxy but still allow readers to find the information easily. If the company were to update the policy, the SEC could require a registrant to include it in full in the proxy statement. There are other, more permanent executive compensation policies which are frequently included in the proxy statement which would be appropriate for similar online hyperlink representation in the proxy statement. These examples include how companies consider tax treatment in setting executive compensation and what role executive officers play in

[19] See remarks by Keith Higgins, SEC Director of Corporation Finance, available at https://www.sec.gov/news/speech/executive-compensation-beyond-dodd-frank.html (last visited 10/31/2016).

the compensation-setting process. Allowing companies to provide a hyperlink reference to a permanent web location for these policies would make proxies more effective by eliminating cluttering disclosures for policies which do not change often while still allowing investors to find and access them if desired.

IV. A Holistic Review of the Executive Compensation Disclosure Requirements is Warranted.

Executive compensation disclosures have evolved significantly over the past 10 years since the SEC last engaged in a wholesale revision of the proxy statement disclosure requirements in 2007. At the current time, there is widespread dissatisfaction with the state of executive compensation disclosures. Several factors have dramatically impacted the content and quality of executive compensation disclosures and have contributed to this dissatisfaction. These factors include:

- The 2009 SEC Disclosure Rules on Risks and Incentives;
- Mandatory Say on Pay and Say on Golden Parachutes;
- Compensation Consultant Independence;
- Mandatory Say on Pay and Say on Golden Parachutes; and
- Proxy Advisory Firm Policies and “Requirements”.

The development of the above factors, combined with the intense public scrutiny of executive compensation, has morphed the open-ended, materiality-based framework of the CD&A into a “regulatory check-the-box” document resulting in overly long and dense disclosures. The length of disclosure is only set to expand as several new regulations will go into effect in the next several years creating additional, lengthy disclosure requirements. These include:

- Pay Ratio Disclosure (2018);
- Pay for Performance Disclosure;
- Dodd-Frank Clawbacks Disclosure;
- Hedging Disclosure; and
- Financial Services Industry Incentive Compensation Rules.

None of these requirements existed and few were contemplated when the SEC last engaged in a comprehensive review of executive compensation and proxy statement disclosures. Furthermore, since 2007 there have been significant advances in technology which the Center believes the SEC could implement with the effect of significantly streamlining the presentation of executive compensation information.

The Center strongly supports and applauds the SEC’s current efforts to review the disclosure regime, including executive compensation disclosures, to make disclosure more effective. However, given the significant policy, legislative, regulatory and practice changes which have occurred in executive compensation since 2007, not to mention the impending implementation of the Dodd-Frank pay ratio and pay for performance disclosures, the Center believes the current regime is once again ripe for the SEC to engage in a comprehensive review for the purposes of re-writing the executive compensation disclosure requirements.[20]

V. Conclusion

For the reasons stated above, the Center believes the SEC could reduce the tendency of companies to provide unneeded disclosures by making changes to the Summary Compensation Table and the CD&A requirements.

The Center appreciates this opportunity to provide feedback on the Commission's ongoing effort to streamline corporate disclosures and make them more effective. If you have any questions about the Center's comments, please do not hesitate to contact me at [redacted].

Sincerely,

Sincerely,

Henry Eickelberg
Chief Operating Officer

cc: Securities and Exchange Commission:
Hon. Mary Jo White, Chair
Hon. Kara M. Stein, Commissioner
Hon. Michael S. Piwowar, Commissioner

[20] The Center notes SEC typically engages in a comprehensive review of executive compensation disclosures about once every 10 years, the last time taking place in 2007 and the previous comprehensive re-write taking place in 1992.