



BETTER MARKETS

March 4, 2022

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

Re: Reopening of Comment Period for Pay Versus Performance Compensation (File No. S7-07-15, RIN 3235-AL00)

Dear Ms. Countryman:

Better Markets¹ appreciates the opportunity to comment on the above-captioned Proposed Rule (“2015 Proposal”), which was published by the Securities and Exchange Commission (“SEC” or “Commission”) in the Federal Register on May 7, 2015, and reopened for comment on February 2, 2022 (“Proposal” or “Release”).²

The Proposal would implement Section 953(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“Dodd-Frank Act”).³ Under that provision, the Commission must adopt rules requiring issuers to disclose in any proxy or consent solicitation material for an annual meeting of shareholders a clear description of any compensation required to be disclosed under 17 C.F.R. 229.402 (“Item 402 of Regulation S-K”), including information that shows the relationship between executive compensation actually paid and the financial performance of the issuer, taking into account any change in the value of the shares of stock and dividends of the issuer and any distributions, including the option to include a graphic representation of the information required to be disclosed. The proposed rule would amend the current executive

¹ Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system that protects and promotes Americans’ jobs, savings, retirements, and more.

² Pay Versus Performance, 80 Fed. Reg. 88, 26330 (May 7, 2015) (to be codified at 17 C.F.R. Pts. 229 and 240); Reopening of Comment Period for Pay Versus Performance, 87 Fed. Reg. 22, 5751 (Feb. 2, 2022).

³ Section 953(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, *codified at* Section 14(i) of the Securities Exchange Act of 1934; 15 U.S.C. § 78n (2010).

compensation disclosure rules to require a description of how executive compensation actually paid by a registrant is related to the financial performance of that company.

Generally speaking, the Commission has developed a strong proposal that largely adheres to both the letter and the spirit of Section 953(a) of the Dodd-Frank Act. Nevertheless, the Commission can and should improve the Proposal in several respects to ensure that it fully realizes the Congressional objectives underlying Section 953(a) and maximizes meaningful shareholder participation in corporate governance. In this comment letter, we endorse the enhancements described in the Release that the Commission is considering, and we provide suggestions for ways in which the SEC can improve the Proposal, in response to certain specific questions asked in the Release. Above all, however, the Commission's top priority should be to resist the inevitable calls from industry opponents to weaken or dilute this generally well-crafted Proposal and to avoid conducting a misplaced, flawed, and unnecessary quantitative cost-benefit analysis.

INTRODUCTION

Major contributors to the financial crisis were misaligned incentives generally, and executive compensation policies in particular, at many financial institutions that motivated corporate leaders to engage in high-risk activities for short-term profit and lucrative bonuses. Citigroup CEO Chuck Prince's infamous quote captures much of what went so wrong in the suites of the too-big-to-fail banks on Wall Street:

“When the music stops, in terms of liquidity, things will be complicated. But as long as the music is playing, you've got to get up and dance. We're still dancing,”

These short-sighted policies, fueled by misguided competitiveness and greed rather than principles of sound corporate governance, came at the expense of the long-term viability of those institutions, the entire financial system, and, ultimately, the U.S. economy. As a result, the financial crisis of 2008 will ultimately cost over \$20 trillion in lost GDP, in addition to the long-lasting suffering experienced by millions of Americans who lost their jobs, savings, and homes.⁴

A specific problem in the realm of corporate governance was the tendency of some corporate executives to engage in accounting fraud or manipulation and high-risk business strategies to bulk up revenues and attempt to justify inflated compensation awards. As one Congressional study of the crisis concluded:

“Even before the current crises, many criticized such incentive plans for encouraging excessive focus on the short term at the expense of consideration of the risks involved. This short-term focus led to unsustainable stock buyback programs, accounting manipulations, risky trading and investment strategies, or

⁴ See generally Better Markets, “The Cost of the Crisis” (July 2015).

other unsustainable business practices that merely yield short-term positive financial reports.”⁵

The Financial Crisis Inquiry Commission agreed:

“Compensation systems—designed in an environment of cheap money, intense competition, and light regulation—too often rewarded the quick deal, the short-term gain—without proper consideration of long-term consequences. Often, those systems encouraged the big bet—where the payoff on the upside could be huge and the downside limited. This was the case up and down the line—from the corporate boardroom to the mortgage broker on the street.”⁶

To address these abuses, Congress enacted a collection of corporate governance and executive compensation reforms in Subtitle E of Title IX of the Dodd-Frank Act, including the following:

- Section 951, requiring shareholder advisory votes on executive compensation and golden parachutes;
- Section 952, requiring new listing standards that impose enhanced independence requirements for members of issuers’ compensation committees;
- Section 953(b), requiring disclosure of the ratio between the CEO’s total compensation and the median total compensation for all other company employees;
- Section 954, requiring a rule that directs the securities exchanges to establish issuer listing standards providing for the clawback of any erroneously awarded compensation over the prior three years if an issuer is required to prepare an accounting restatement because of the issuer’s material noncompliance with financial reporting requirements, without regard to fault.
- Section 956, mandating the disclosure to regulators of all incentive-based compensation arrangements, and prohibiting incentive-based compensation arrangements that encourage inappropriate risks by providing executives or others with excessive compensation.

Section 953(a), a part of this collection, is specifically designed to require disclosure of executive compensation in relation to company performance. Once implemented, it will provide several benefits. Through heightened transparency, it will inhibit bloated executive compensation packages that drain capital, reduce productivity, and ultimately hurt shareholders and employees. In particular, it will enable shareholders to see what factors are driving compensation for the

⁵ Congressional Oversight Panel Special Report on Regulatory Reform, “Modernizing the American Financial Regulatory System: Recommendations for Improving Oversight, Protecting Consumers, and Ensuring Stability.” (2009).

⁶ *The Financial Crisis Inquiry Report*, Financial Crisis Inquiry Commission, at xix (Jan. 2011).

executives of the companies they own and ensure that compensation bears a reasonable relationship to company performance. The rule will also provide information that will better inform shareholders who wish to vote on executive compensation pursuant to the related say-on-pay reform mandated under the Dodd-Frank Act and implemented by the SEC. And it will help curb high-risk activities by shedding light on companies that are rewarding executives for engaging in such activities.⁷

COMMENTS

I. TOTAL SHAREHOLDER RETURN IS A FLAWED MEASURE OF FINANCIAL PERFORMANCE AND IT SHOULD BE SUPPLEMENTED WITH THE OTHER METRICS DESCRIBED IN THE RELEASE.

The 2015 Proposal would require registrants to include in relevant disclosures tabular information, for the previous five most recent fiscal years, listing actual compensation paid to the Principle Executive Officer (“PEO”); an average of actual compensation paid to the remaining Named Executive Officers (“NEOs”); the total shareholder return (“TSR”);⁸ the issuer’s peer group TSR; the relationship between executive compensation actually paid to the issuer’s NEOs and the cumulative TSR of the issuer; and the relationship between the issuer’s TSR and the TSR of the issuer’s peer group.⁹

Such a table would allow investors to compare PEO and NEO compensation to an issuer’s TSR and, perhaps more importantly, to that issuer’s peer group TSR, thus allowing investors to make their own determination as to the reasonableness of the issuer’s executive compensation and whether that performance was company-specific or more likely attributable to the peer group’s experience as a whole.

The Commission’s original proposal to use TSR as the metric for a company’s financial performance has several justifications, as explained in the Release. First, it satisfies the Dodd-Frank requirement that “the financial performance of the issuer tak[e] into account any change in the value of the shares of stock and dividends of the issuer and any distributions.” Furthermore, TSR offers a number of advantages in that it is objectively calculable, readily comparable among issuers, familiar to investors, and already required to be disclosed.

However, TSR is problematic because it represents an incomplete and potentially even misleading indicator of a company’s financial performance. For example, TSR generally includes shareholder payments arising from share buybacks or repurchases. But such repurchases boost distributions to shareholders and cause temporary spikes in the share price that can mask or distort the true financial performance of a company. In addition, relying on TSR alone can be expected

⁷ See S. Rep. No. 111-176 (2010).

⁸ TSR is defined in 17 C.F.R. 229.201(e); *i.e.*, Item 402(v) of Regulation S-K.

⁹ Release at 5753. Issuers would be required to provide a clear description of the relationship among the measures provided in the tabular form. The issuer would be allowed to choose the format used to present the relationship, such as a graph or narrative description. *Id.*

to incentivize buybacks. Yet a growing body of research and analysis indicates that stock buybacks often do little more than manipulate stock prices upward without reflecting fundamental value. They also allow senior executives to cash out rather than maintain their investments, thus weakening their incentives to promote the long-term success of the company. And they prevent profits from being retained and invested to enhance productivity or improve the pay and working conditions of employees.¹⁰ In short, buybacks can inflate the apparent financial performance of a company as measured by TSR, raise inferences about executive performance that are not necessarily justified, and even undermine the long-term success of the company.

Accordingly, we strongly endorse the Commission’s proposal to add pre-tax net income, net income, and “a measure specific to a particular registrant, chosen by said registrant (the “Company Selected Measure”)” to the mandated disclosures.¹¹ The first two, at least, will reflect corporate financial performance without the distortive effects of buybacks. They will therefore enhance the value of the pay v. performance disclosures as investors seek to evaluate the appropriateness of executive compensation. Moreover, pre-tax net income and net income are already calculated by issuers, thus minimizing any compliance challenges.

Finally, we join with other commenters on these important issues who have argued against exempting smaller reporting companies (“SRCs”) from any of the requirements contemplated in the Proposal, including the addition of the net income-related disclosures and the disclosures relating to the five performance measures discussed below. Multiple factors support this position. Section 953(a) itself contains no evidence that Congress intended or authorized the SEC to create carve-outs for SRCs or any other exemptions. The fundamental rationale for the rule, namely creating meaningful transparency surrounding executive compensation at companies for the benefit of shareholders, applies equally to the owners of companies of all sizes. In terms of sheer importance, the rule is clearly a central component of a collection of reforms aimed at addressing key issues in our system of corporate governance. Finally, to the extent cost of compliance is relevant at all in this rulemaking process, the reality is that such costs are comparatively low with respect to the disclosures contemplated in the Proposal, as issuers must already develop essentially the same data points pursuant to other regulatory requirements.

¹⁰ See Lenore Palladino & William Lazonick, *Regulating Stock Buybacks: The \$6.3 Trillion Question*, ROOSEVELT INSTITUTE (May 2021), https://rooseveltinstitute.org/wp-content/uploads/2021/04/RI_Stock-Buybacks_Working-Paper_202105.pdf; Robert J. Jackson, *Stock Buybacks and Corporate Cashouts* (June 11, 2018), <https://www.sec.gov/news/speech/speech-jackson-061118>.

¹¹ Release at 5753. Issuers would be required to provide a clear description of the relationship among the measures provided in the tabular form. The issuer would be allowed to choose the format used to present the relationship, such as a graph or narrative description. *Id.*

II. THE RULE MUST REQUIRE DISCLOSURE OF AT LEAST FIVE PERFORMANCE MEASURES TO PROVIDE MORE MEANINGFUL INSIGHT INTO EXECUTIVE COMPENSATION AND A COMPANY'S APPROACH TO PRESSING ECONOMIC AND SOCIETAL CHALLENGES.

The Release explains that the Commission is considering whether to separately require registrants to provide a list of at least their “five most important performance measures used by the registrant to link compensation actually paid during the fiscal year to company performance, over the time horizon of the disclosure, in order of importance.”¹² The Commission must follow through with implementation of this provision, notwithstanding any industry pressure to reduce the reporting requirements.

A. The five factors will increase transparency as to compensation practices and priorities.

Currently, the Compensation Discussion and Analysis (“CD&A”) requirements in Item 402 of Regulation S-K include requiring a registrant to explain all material elements of the compensation paid to its NEOs including (i) what specific items of corporate performance are taken into account in setting compensation policies and making compensation decisions; (ii) how specific forms of compensation are structured and implemented to reflect these items of corporate performance; and (iii) how specific forms of compensation are structured and implemented to reflect the NEOs’ individual performance and/or individual contribution to these items of the company’s performance.¹³

However, as the Release notes, “there is no existing rule that specifically mandates disclosure of the performance measures that actually determined the level of recent NEO compensation actually paid.”¹⁴ We believe that this disclosure would enable investors to more easily assess which performance metrics have the most impact on compensation actually paid and make their own judgments as to whether compensation appropriately incentivizes management. It would also provide investors with context that could be useful in interpreting the remainder of the pay versus performance disclosure. Armed with this disclosure, investors would also be better able to make determinations as to how they wish to vote on say-on-pay shareholder resolutions.

Thus, with respect to Question Number 11, we do not believe that a registrant should be permitted to disclose less than five performance measures.¹⁵ Issuers already currently calculate countless financial metrics as part of U.S. Generally Accepted Accounting Principles (“GAAP”), many of which will be appropriate measurements of NEO performance. Any issuer that limits its evaluation of NEO performance for purposes of compensation to less than at least five metrics is

¹² Release at 5754.

¹³ *Id.*

¹⁴ *Id.*

¹⁵ Release at 5757.

likely focusing NEO performance on too small a group of metrics and thus failing to comprehensively reflect the metrics that are actually determining executive compensation.

B. The five factors will also provide invaluable information about an issuer’s approach to emerging financial and societal challenges and opportunities.

Requiring disclosure of the five most important measures used to link compensation to performance will provide shareholders with key insights into how management is prioritizing critically important and evolving challenges, particularly those at the center of the ESG movement. Twenty-five years ago, few companies would have tied executive compensation to a company’s response to climate change or the need to promote racial economic justice. Today these issues are thankfully climbing to the top of many companies’ priority list, partly as a matter of emerging regulatory requirements and partly as a matter of prudent business strategy.¹⁶ And because the most pressing business challenges in today’s world are rapidly evolving, any rule should recognize that a registrant’s five most important company performance measures can change. Any final rule should therefore require issuers to provide additional narrative disclosure explaining the nature of any such changes and the reasons for making them.

There can be no doubt that the ESG factors and their role in compensation decisions are relevant in the context of the Section 953(a) requirements. Section 953(a) requires issuers to disclose information that shows the relationship between executive compensation actually paid and the “financial performance” of the issuer.¹⁷ As the Release notes, Section 953(a) does not specify how to measure an issuer’s “financial performance” other than it must take into account “any change in the value of the shares of stock and dividends of the issuer and any distributions.”¹⁸ It is thus an expansive and open-ended mandate.

The Commission’s proposal to add tabular disclosure of the registrant’s five most important company performance measures for determining NEO compensation reflects a reasonable interpretation of Section 953(a), one that will provide an opportunity for expanded disclosure by socially responsible issuers regarding their efforts in the areas of environmental stewardship and corporate diversity and how those companies tie those efforts to executive compensation. There have been significant recent developments regarding executive compensation packages, particularly in terms of environmental, social, and governance-related metrics.¹⁹ And the fact is that investor concerns with ESG factors are rational even from purely

¹⁶ Friso Van Der Oord, *Tying CEO Pay to Carbon Emissions Works. More Companies Should Try It*, CNN Perspectives (Aug. 12, 2021), <https://www.cnn.com/2021/08/12/perspectives/climate-carbon-emissions-ceo-pay/index.html>.

¹⁷ Section 953(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, *codified at* Section 14(i) of the Securities Exchange Act of 1934; 15 U.S.C. § 78n (2010).

¹⁸ Release at 5753.

¹⁹ Release at 5758-59.

economic and financial perspectives, as empirical research has shown that companies that do better on each of the aspects of ESG tend to outperform their peers:

- **Environmental:** The environmental factor focuses on how a company contributes to, or mitigates, degradation of the environment, with a particularly urgent focus on the threat of climate change. For example, research by Morgan Stanley demonstrated that, in 2020, sustainable funds “outperformed their traditional peer funds by a median total return of 4.3 percentage points.”²⁰ This is unsurprising. Given the unprecedented global challenge climate change alone poses, and the significant global effort that will be required to cope with the current impacts of climate change and to prevent the worst future impacts, no company can claim to be immune from the financial impact of climate change. Accordingly, those companies that focus on sustainability and seek to adapt to climate change, and fight against it, are likely to do better financially.
- **Social:** Among other things, the social factor focuses on the diversity of a company’s workforce, *i.e.*, does it reflect racial and gender diversity, and, importantly, is that diversity reflected up and down the corporate ladder? Again, research on this issue indicates that a company’s attention to diversity has a positive impact on a company’s bottom line. A recent report by McKinsey & Company, a consulting firm often seen as an avatar for the pursuit of maximal corporate efficiency,²¹ found that “companies in the top quartile [of ethnic and cultural diversity] outperformed those in the fourth [quartile] by 36 percent in terms of profitability in 2019.”²² Again, this is unsurprising, as “diverse teams have been shown to be more likely to radically innovate and anticipate shifts in consumer needs and consumption patterns—helping their companies gain a competitive edge.”²³
- **Governance:** The governance factor deals with how well a company is managed by its leadership and whether the company has sufficient controls in place to ensure management serves the interests of, and is accountable to, various company stakeholders. As a 2019

²⁰ Morgan Stanley Institute for Sustainable Investing, *Sustainable Funds Outperform Peers In 2020 During Coronavirus*, (Feb. 24, 2021), <https://www.morganstanley.com/ideas/esg-funds-outperform-peers-coronavirus>.

²¹ Ryan Cooper, *Opinion: What McKinsey Really Suggests About Pete Buttigieg*, *The Week* (Dec. 12, 2019), <https://theweek.com/articles/883584/what-mckinsey-really-suggests-about-pete-buttigieg>.

²² McKinsey & Company, *Diversity Wins: How Inclusion Matters* 4 (May 2020), <https://www.mckinsey.com/~media/mckinsey/featured%20insights/diversity%20and%20inclusion/diversity%20wins%20how%20inclusion%20matters/diversity-wins-how-inclusion-mattersvf.pdf>.

²³ McKinsey & Company, *Diversity Wins: How Inclusion Matters* 4 (May 2020), <https://www.mckinsey.com/~media/mckinsey/featured%20insights/diversity%20and%20inclusion/diversity%20wins%20how%20inclusion%20matters/diversity-wins-how-inclusion-mattersvf.pdf>.

report by S&P Global makes clear, “there is already substantial empirical evidence to suggest that the ‘G’ aspect of ESG ultimately yields better corporate returns.”²⁴

Thus, it is beyond reasonable dispute that the ESG factors are appropriate considerations in the evaluation of financial performance. The SEC’s Proposal, if enhanced with the five-factor requirement, will better allow investors to see which companies explicitly take ESG factors into account in assessing executive performance, and thus which companies are likely to have better financial performance specifically because of their focus on those factors. Ultimately, we believe that this disclosure would enable investors to more easily assess which performance metrics have the most impact on compensation actually paid and make their own judgments as to whether compensation appropriately incentivizes management on the matters that matter most to them. It will also provide investors with context that could be useful in interpreting the remainder of the pay versus performance disclosures. Armed with this disclosure, investors would also be better able to make determinations as to how they wish to vote on say-on-pay shareholder resolutions.

III. THE COMMISSION SHOULD REFRAIN FROM UNNECESSARY, BURDENSOME, BIASED, AND POTENTIALLY HARMFUL QUANTITATIVE COST-BENEFIT ANALYSIS.

Better Markets has for years fought against industry’s attempt to foist quantitative cost-benefit analysis requirements on the SEC, and it has done so in its comment letters, special reports, and amicus briefs.²⁵ This is because (1) a comprehensive quantitative cost-benefit analysis is not required of the SEC under the securities laws; (2) such analyses are notoriously imprecise, unreliable, and industry-biased; and (3) the process not only unduly burdens the agency but also lays the foundation for court challenges to the SEC’s meritorious rules that could serve the public interest well but for all too frequent judicial nullification.

²⁴ Kelly Tang, S&P Global, *Exploring the G in ESG: Governance in Greater Detail – Part I* (Mar. 22, 2019), <https://www.spglobal.com/en/research-insights/articles/exploring-the-g-in-esg-governance-in-greater-detail-part-i>.

²⁵ Better Markets, *SETTING THE RECORD STRAIGHT ON COST-BENEFIT ANALYSIS AND FINANCIAL REFORM AT THE SEC* (July 30, 2012) <https://bettermarkets.com/sites/default/files/Setting%20The%20Record%20Straight.pdf>; BETTER MARKETS, *COST-BENEFIT ANALYSIS IN CONSUMER AND INVESTOR PROTECTION REGULATION: AN OVERVIEW AND UPDATE* (Dec. 8, 2020), https://bettermarkets.org/sites/default/files/Better_Markets_WhitePaper_CBA_Consumer_Investor_Protection_Dec-2020.pdf; Brief Amicus Curiae of Better Markets, Inc. in Support of Respondent at 15-25, *N.Y.S.E v. SEC*, 2020 WL 3248902 (D.C. Cir. 2020) (No. 19-1042), <https://bettermarkets.com/resources/court-filing-sec-attempts-protect-investors-and-market-integrity-exposing-exchange-pricing>; Better Markets Comment Letter to the FSOC on Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies at 5-6, 14-19 (May 24, 2019), <https://bettermarkets.com/rulemaking/better-markets-comment-letter-fsoc-authority-require-supervision-and-regulation-certain>.

For example, Question Number 10 in the Release raises the specter of cost-benefit analysis by inviting commenters to submit data that would allow the Commission to calculate the “cost to registrants of any computations required to identify and rank the five most important performance measures.”²⁶ We therefore reiterate all of our concerns regarding the peril of undertaking and relying upon quantitative cost-benefit analysis as the Commission develops its final rule. We especially caution against placing undue weight on the industry’s complaints about the costs of the proposal, in its original form or as it may be strengthened in accordance with the Release.

The point is especially telling in this case, as the Release appropriately notes that TSR is a “measure for which disclosure is already required and with which shareholders are familiar, so its use was intended to mitigate the burdens both to registrants to provide the disclosure and to investors to analyze the new disclosure.”²⁷ Moreover, the Release correctly notes that pre-tax net income and net income are already required by GAAP and are familiar to investors and registrants.²⁸ Therefore, their tabular disclosure should not be burdensome. Above all, and whatever form of cost-benefit analysis it undertakes, the Commission must be sure to properly account for the enormous public benefits that a final rule would confer. These include improving transparency in corporate governance; curbing bloated compensation packages that undermine long-term company success and workforce well-being; reducing the incentives for buybacks; promoting more enlightened, ESG-focused governance that improves financial returns while addressing important societal challenges; and reducing some of the incentives that could contribute to another financial crisis and the vast harm such a calamity would inflict on investors, markets, and the economy as a whole.²⁹

CONCLUSION

We hope these comments are helpful as the Commission finalizes the Proposal.

Sincerely,



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²⁶ Release at 5757 (Question #10).

²⁷ Release at 5753

²⁸ *Id.*

²⁹ BETTER MARKETS, THE COST OF THE CRISIS: \$20 TRILLION AND COUNTING 66-69 (2015), <https://bettermarkets.com/sites/default/files/Better%20Markets%20-%20Cost%20of%20the%20Crisis.pdf>.

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