

MEMO# 34019

February 3, 2022

SEC Reopens Comment Period for Pay Versus Performance Proposal: Request for Comment on ESG-related Performance Metrics

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TO: ICI Members SUBJECTS: Compensation/Remuneration
Disclosure
ESG

Fund Accounting & Financial Reporting RE: SEC Reopens Comment Period for Pay Versus Performance Proposal: Request for Comment on ESG-related Performance Metrics

The SEC reopened for comment a proposal to amend its executive compensation disclosure rule to require certain registrants (including business development companies but not registered investment companies) to describe, in response to Item 402 of Regulation S-K, how their executive compensation relates to their financial performance.[\[1\]](#) Comments are due to the Commission on March 4.[\[2\]](#)

The Release asks if it should require registrants to provide a Company-Selected Measure, which would, in the registrant's assessment, represent "the most important performance measure (that is not already included in the table) used by the registrant to link compensation actually paid during the fiscal year to company performance, over the time horizon of the disclosure."[\[3\]](#) The Commission also asks how environmental, social and governance ("ESG")-related metrics have changed and/or developed since 2015 and how the Commission should consider such changes in developing any new disclosure requirements.[\[4\]](#)

The Release also asks whether the Commission should require each registrant to list the five most important performance measures used to link compensation actually paid during the fiscal year to company performance, over the time horizon of the disclosure, in order of importance. The Release explains that:

the [Compensation Discussion & Analysis] CDA tends to be prospective in nature and focused on the design of the registrant's compensation program. However, there is no existing rule that specifically mandates disclosure of the performance measures that

actually determined the level of recent [Named Executive Officer] NEO[5] compensation actually paid. Tabular disclosure of a list of the five most important performance measures that drove compensation actually paid may be useful to investors [enabling] investors to more easily assess which performance metrics actually have the most impact on compensation actually paid and make their own judgments as to whether compensation appropriately incentivizes management. The disclosure of the five most important performance measures that drove compensation actually paid may also provide investors with context that could be useful in interpreting the remainder of the pay versus performance disclosure.[6]

Each of the Commissioners issued statements. Commissioners Lee and Crenshaw supported the reopening of the comment period, and Commissioner Peirce opposed the Commission's approach.[7]

Commissioner Lee[8] stated that:

[t]he reopening release contemplates providing companies additional flexibility through disclosure of, in addition to the proposed performance metric of total shareholder return, other metrics of their choosing.

The modern compensation landscape now encompasses enhanced reliance on performance metrics related to, for example, climate, diversity, and other company-specific ESG goals.[9] It would be helpful to hear from commenters on how the increased flexibility contemplated in today's reopening release may facilitate investor analysis of the use of such metrics and targets in compensation plans, and how it may enable companies and investors to better evaluate the success of the many tailored and unique compensation plans companies employ.

Commissioner Crenshaw[10] stated that:

companies are increasingly linking executive pay to ... ESG measures, which is one tangible way that companies may be able to advance their stated ESG goals and improve performance.[11] As the Commission considers the best ways to calibrate pay and performance disclosures, I encourage commenters to provide insight into how ESG measures are utilized in executive pay packages. It is critical that investors and commenters let the Commission know whether there is sufficient insight into the methodologies behind the measures on which ESG compensation targets are based.[12] Separately, similar questions arise about the use of targets based on measures of performance with qualitative or discretionary inputs—for example, targets that are not based on quantitative measures with defined methodologies or items disclosed in financial statements. The reopening release seeks to grapple with these practices by proposing to give registrants flexibility in deciding what measures should be disclosed.[13]

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endnotes

[1] Reopening of Comment Period for Pay Versus Performance (January 27, 2022) (Release No. 34-94074) ("Release"), available at <https://www.sec.gov/rules/proposed/2022/34-94074.pdf>. The original proposal was published in 2015, Release No. 34-74835 (Apr. 29, 2015) [80 FR 26329 (May 7, 2015)]

available at <https://www.sec.gov/rules/proposed/2015/34-74835.pdf>. The Commission issued the proposal to implement Section 953(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act").

[2] Because the 2015 Proposal excluded registered investment companies from its scope, the Institute did not comment.

[3] See Release at pages 9-10 (where the Commission explained that this would permit registrants to select their own measure, rather than mandating a further specific measure, to elicit additional useful disclosure, while reducing the risk of misrepresenting or providing an incomplete picture of how pay relates to performance, given the differences across companies in performance measures that companies or investors care about).

[4] The Commission also asks whether it should require registrants to disclose pre-tax net income and net income, noting that GAAP already provides for these measures.

[5] Item 402(a)(3) of Regulation S-K defines NEOs as 1) all individuals serving as the registrant's principal executive officer ("PEO") or acting in a similar capacity during the last completed fiscal year, regardless of compensation level, 2) all individuals serving as the registrant's principal financial officer ("PFO") or acting in a similar capacity during the last completed fiscal year, regardless of compensation level, 3) the registrant's three most highly compensated executive officers other than the PEO and PFO who were serving as executive officers at the end of the last completed fiscal year, and 4) up to two additional individuals for whom Item 402 of Regulation S-K disclosure would have been provided but for the fact that the individual was not serving as an executive officer of the registrant at the end of the last completed fiscal year.

[6] Release at page 11-12.

[7] See Commissioner Hester Peirce, Dissenting Statement on Reopening of Comment Period on Pay Versus Performance, available at <https://www.sec.gov/news/statement/peirce-dissent-pvp-20220127> (stating that that "while I agree that we should move forward on this ... Dodd-Frank rulemaking mandate, I do not agree with the approach taken in this release. Instead of fixing critical shortcomings of the 2015 Proposing Release, the re-opening release doubles down on a flawed proposal and raises the prospect of additional disclosure requirements. These supplemental requirements would increase the burdens of public company reporting, but seem likely to be of dubious use to investors.")

[8] See Commissioner Allison Herren Lee, Measuring Pay Against Performance: Are Shareholders Getting Their Money's Worth?, available at https://www.sec.gov/news/statement/lee-statement-pvp-012722?utm_medium=email&utm_source=govdelivery

[9] See Hazel Bradford, [Executive pay increasingly tied to environmental, social performance metrics](#), Pensions & Investments (Nov. 12, 2021) ("Five years ago, of the 65 S&P 500 companies including E&S [environmental and social] metrics, less than 20% had more than one. By 2020, 100 S&P 500 companies included roughly 150 metrics."); Emily Glazer and Theo Francis, [CEO Pay Increasingly Tied to Diversity Goals](#), Wall Street Journal (June 2, 2021) ("By this spring, a third of S&P 500 companies had disclosed using a diversity measure in their compensation structures, or mentioned diversity in explaining executive pay."). We know that compensation can work to help achieve any number of metrics and

targets a company might set. Consider for instance academic research from 2019 demonstrating that airlines offering their executives bonuses for on-time flight arrivals did in fact achieve more on-time flight arrivals. See Rajesh K. Aggarwal and Carola Schenone, [Incentives and Competition in the Airline Industry](#), 8 Rev. of Corp. Fin. Studies 380 (2019). Even where, as in the airline example, the specific metrics may not be traditional financial metrics, they are still ultimately aimed at enhanced financial performance. With respect to ESG metrics and targets, there is increasing recognition of their relationship to long-term value. See, e.g., BlackRock Investment Stewardship, [Global Priorities](#) (Jan. 2022) ("Disclosure of material issues that affect the company's long-term strategy and value creation, including material ESG factors, is essential for shareholders to be able to appropriately understand and assess how risks are effectively identified, managed and mitigated."); Bank of America, [2020 Annual Report](#) ("As our Global Research team has found, companies that pay close attention to environmental, social and governance (ESG) priorities are much less likely to fail than companies that do not, giving investors a significant opportunity to build investment portfolios for the long-term. And — through research and our own lived experience — we know that ESG commitments can translate into a better brand, more client favorability and a better place for our teammates to work.").

[10] See Commissioner Caroline Crenshaw, Statement on the Reopening of Comment Period: Pay Versus Performance, available at <https://www.sec.gov/news/statement/crenshaw-statement-pvp-012722>

[11] See UN Principles for Responsible Investment, [ESG-Linked Pay: Recommendations for Investors](#) (June 17, 2021) ("In the last few months, a steady stream of companies have announced the introduction of ESG-linked executive pay to bolster sustainability credentials...The moves appear to be in line with a broader trend: a 2020 Willis Towers Watson survey found that four in five companies are contemplating similar measures over the next three years, elevating environmental and social factors in their incentive plans."); [Meridian Compensation Partners, 2020 Executive Compensation Trends and Developments Survey](#) (20% of 108 issuers surveyed included ESG performance metrics in 2020 incentive plans, with most adding ESG metrics to the short-term incentive plan).

[12] See Release Request for Comment #22 at 28. See also Caroline A. Crenshaw, Commissioner, Sec. & Exch. Comm'n, [Virtual Remarks at the Center for American Progress and Sierra Club: Down the Rabbit Hole of Climate Pledges](#) (Dec. 14, 2021) ("Accurate and reliable climate metrics are not only important for investors' evaluation of sustainability efforts or how companies are spending shareholder money on politics, it is also critical for assessing fundamental and traditional corporate governance matters, like executive compensation. Recent surveys indicate that more executive compensation is being linked to 'sustainability performance.' Linking executive pay to achieving ESG or sustainability-related goals can be a positive alignment of incentives. However, without reliable and consistent disclosures about those ESG targets, I wonder whether investors and Boards have the tools to accurately assess if such targets have been met and if that alignment between executive pay and ESG targets has been achieved.").

[13] See *Id.* at 9-11.

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