Leading Investor Group Petitions SEC to Require Clear Disclosure on CEO Pay Targets

Press Conference Call on Monday, April 29th at 2:30 PM ET

Washington, D.C., April 29, 2019 — As shareholders cast votes on executive compensation this proxy season, they look to the company’s proxy statement to evaluate whether the CEO hit performance targets the board set for incentive pay. But what if the pay-for-performance metrics in the proxy statement are misleading or incomplete? At many companies, that is exactly what is happening. Too many are tying executive pay to “adjusted” earnings (or other measures) that overstate performance as measured by U.S. generally accepted accounting principles (GAAP), without clear definition and explanation of the measures used.

Institutional investors say it’s time for the Securities and Exchange Commission (SEC) to ensure that public companies explain why and how they use non-GAAP metrics to determine CEO pay.

That is the goal of a petition filed today by the Council of Institutional Investors (CII) with the SEC. Specifically, the petition asks the SEC to require companies, in the Compensation Discussion & Analysis (CD&A) section of their proxy statements, to explain why they are using any non-GAAP metrics in setting executive compensation and provide a quantitative reconciliation of such metrics to their GAAP financials.

MIT Sloan School of Management Senior Lecturer Robert Pozen and CII Executive Director Ken Bertsch will speak on the April 29 press conference call. Pozen, who also is a Senior Fellow at the Brookings Institution, is former president of Fidelity Investments and former executive chairman of MFS Investment Management. Pozen has written on problems in disclosures on non-GAAP performance measures in CD&As, including in a recent Wall Street Journal op-ed, (co-authored with SEC Commissioner Robert Jackson Jr.) and in a 2017 Harvard Business Review article, (co-authored with MIT Sloan School of Management Professor S.P. Kothari).

Registration for the press conference is available here:
https://attendee.gotowebinar.com/register/1093420731701291789

“Adjusted earnings and other adjusted measures should not be used to engineer excessive payouts,” said Bertsch. “Given the complexity in executive pay plans, and confusion about the links between pay and performance, investors need greater transparency about the measures boards use to determine incentive pay.”

The problem, as Pozen and Jackson explain in their recent Wall Street Journal op-ed: “The SEC’s disclosure rules have not kept pace with changes in compensation practices, so investors cannot easily distinguish between high pay based on good performance and bloated pay justified by accounting gimmicks.”
The SEC currently requires companies to reconcile any “adjusted” financial measures they use to GAAP figures in the earnings releases and most reports that public companies must file with the regulator—but not in proxy statement disclosures on executive pay targets. Clarity on financial criteria for payouts is critical in the proxy statement because that is what shareholders review when deciding how to cast advisory votes on executive compensation, which occur annually at most companies.

To be clear, CII is not asking the SEC to ban companies from using non-GAAP financial measures to determine compensation. There can be valid reasons to use adjusted earnings or other measures to assess performance. But, as the petition states, “GAAP is the standard, and deviations need to be clear and put in context.”

Why context matters: Research by the Accounting Observer found that 386 companies in the S&P 500 index reported “adjusted” earnings in 2016, up from 264 in 2009. In both years, “adjusted earnings” were on average about one-third higher than reported GAAP earnings. Companies excluded from adjusted earnings expenses such as costs of equity grants, asset impairments, intangible amortization and restructurings.

In 2016, adjusted earnings of 28 companies in the S&P 500 showed substantial profits, even though their GAAP earnings were actually losses. Another 37 companies reported adjusted earnings that were more than 100% higher than their GAAP earnings. Of these 65 companies, 62 used adjusted earnings as compensation criteria in their CD&A’s, according to research by MIT’s Pozen.

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**About CII:** The Council of Institutional Investors (CII) is a nonprofit, nonpartisan association of pension funds, other employee benefit funds, endowments and foundations, with combined assets that exceed $4 trillion. CII’s non-voting members include asset management firms with more than $35 trillion under management. CII is a leading voice for effective corporate governance, strong shareholder rights and vibrant, transparent and fair capital markets. CII promotes policies that enhance long-term value for U.S. institutional asset owners and their beneficiaries.