THE NETWORK FOR
SUSTAINABLE FINANCIAL MARKETS

December 2, 2013

Re: File Number S7-07-13 - Dodd-Frank Act Pay Ratio Disclosure Mandate; Proposal for a Safe Harbor Disclosure Process

Via Email: rule-comments@sec.gov

Elizabeth M. Murphy, Secretary
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These comments were developed by the undersigned participants in the Network for Sustainable Financial Markets (SFM), an international, non-partisan, non-profit organization comprised of financial market professionals and academics. They are also endorsed by other market participants who have signed below or are submitting separate letters of support.

We support the CEO pay ratio proposed rule and suggest improving it by adding a safe harbor that would encourage implementation of pay ratio and management layering disclosures more consistent with the intent of other Dodd-Frank Act provisions on executive compensation, risk management and corporate governance. We note that this approach offers additional long-term company and investor advantages that would also improve the SEC pay ratio rule cost-benefit analysis.

While our comments are broadly applicable to the proposal, we believe they are particularly relevant to the following issues:

- Questions 6,7, 21, 22, 23, 24, 25, 26, 28, 33, 34, 35, 36, 37, 38, 39, 40, 41 - further guidance to registrants on determining which roles to include and how to calculate median compensation, pay ratios, how executive pay ratios align to different levels of CEO work, innovation and risk horizons, and additional narrative disclosures required for investors;
- Questions 32, 60 - alternative ways to meet the policy intent of the Dodd-Frank pay ratio;
- Questions 61, 62, 63, - additional benefits for board and investors that are not already discussed; and
- Questions 65, 66, 67, 69 - other impacts on boards, companies and capital market formation, efficiency, effectiveness and sustainability.[1]

Using Pay Ratio Disclosure to Support Dodd-Frank Act Governance, Enterprise Risk Management and Executive Compensation Reform Priorities

The pay ratio disclosure provision of the Dodd-Frank Act was not enacted in a vacuum. It was part of a collection of legislative enactments relating to:

[1] Data privacy concerns are also addressed in the Appendix to this comment letter.

- Corporate governance (e.g., proxy access for long-term investors, disclosure of the board's leadership structure, compensation committee independence, consideration of compensation consultant independence);
- Risk management (e.g., risk-related limits on financial institution incentive compensation, executive compensation clawback policies to deter wrongdoing, disclosure of the relationship between compensation policies and risk management); and
- Performance measurement and executive compensation (e.g., shareholder say on pay votes, pay for performance disclosures, company policy on employee hedging of equity incentive compensation).

Accordingly, we believe that the pay ratio disclosure rule has the potential to add value for registrants and investors and should be implemented with an eye toward achieving the Dodd-Frank Act's broader strategic corporate governance and risk management goals, as well as to provide additional compensation and organizational insights to stakeholders. If the pay ratio rule is effectively implemented, we think it could become a catalyst for encouraging company improvements in strategic governance analytics and processes and for enhancing risk management, innovation and sustainable performance and capital market efficiency.

Our comments focus on taking advantage of the extensive knowledge base that already exists around organizational design, internal pay equity and behavioral dynamics. We believe that input from these disciplines could benefit the policy debate surrounding CEO pay ratio disclosure. The SEC should recognize and utilize the decades of research that relates to management structure design, pay ratios and real world behavioral dynamics in structuring the SEC pay ratio rule so as to achieve the policy goals of the Dodd-Frank Act. This comment letter is based on the realization that, by encouraging boards and investors to focus on documented research findings and company-specific data rather than personal interests and bias, executive compensation disclosures could facilitate improving company organizational structure and management practices, with significant financial advantages.

Advancing Sustainable Value Creation with a Safe Harbor Structured Around Research Findings on Organizational Design and Pay Equity

We agree that a "one size fits all" approach to pay ratio disclosure is not appropriate, given the variations in complexity, size, structure and operations of the companies that will be covered by the rule. However, we believe that the rule could be implemented so as to encourage adoption of practices aimed at providing boards, management and investors with the information needed and insights required to apply the pay ratio disclosure process to improve strategic planning, innovation, risk management, corporate governance and efficient use of capital.

The Appendix attached to this comment letter contains a summary of organizational design and behavioral research from the United States, Canada and Britain.[2] It confirms the following principles that provide a foundation for making the rule's pay ratio disclosure process a more valuable mechanism for promoting sustainable value creation.

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[2] In addition to the Appendix, research findings on optimal management structure design, internal pay equity and "Felt Fair Pay" are available at these sites: http://globalro.org; http://stores.homestead.com/CasonHallPublishersStore; http://www.jstor.org/discover/10.2307/2391950?uid=3739448&uid=2129&uid=2&uid=70&uid=3737720&uid=4&sid=21102888420493; and http://www.law.harvard.edu/faculty/bebchuk/pdfs/CEOpayslice.Oct2009.pdf.

- Employees consistently say that a reasonable pay differential between adjacent (value-adding) management layers in their company's management structure would be a compensation increase multiple of two to 2.5 times from one management level to the next higher level;
- Each value-adding management layer ("Work Level") is worth about two to 2.5 times more in total compensation than the level directly below it;
- The current median pay ratio difference between the principal executive officer ("PEO") and the other Named Executive Officers ("NEOs") directly reporting to that role at the largest 2000 issuers in the Russell 3000 for which data is available is less than 2.5;
- The total number of Work Levels between front line employees and the PEO can vary between companies and between subsidiaries or business lines in the same company;
- Evaluation of pay differentials and the degree of delegated authority between Work Levels can provide insights into a company's organizational and operational efficiency and innovation capacity, as well as the effectiveness of its risk management and PEO succession planning processes;
- The longest accountable performance period for which the PEO and other management Work Levels are held accountable, when compared to the business and risk horizons applicable to each Work Level, is an indication of whether total compensation is linked to risk-adjusted performance;
- In many companies where management of enterprise risk exposures are central to sustainable success, the pay ratio and Work Level difference between the PEO and chief risk officer ("CRO") can be a signal of how robust the enterprise risk management function is at the company.

These findings have influenced the analyses used by credit rating, governance and investor service providers. For example, GMI Ratings, Moody's Investor Services and Glass Lewis all have incorporated red flag measures of internal pay differential ratio between the PEO and direct reports to the PEO into their analytical processes.[3] (See the Appendix for additional discussion.) Recent research from the University of Delaware also supports the need for internal consistency of compensation throughout a company, up to an including the PEO.[4]

Mainstream investors already see the SEC's proposed rule as a valuable tool that would help them better understand a company's pay practices.[5] We suggest that the SEC use the CEO pay ratio disclosure rule to expand the usefulness of internal pay equity transparency beyond mere compliance reporting of relative CEO compensation ratios to capture measures of organizational efficiency, innovation, risk management, corporate governance and allocation of capital to creation of sustainable value.

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[3] Moody's research suggests that high pay equity disparity can flag succession planning risk, increase cost of capital and affect credit ratings. Analyzing Credit and Governance Implications of Management Succession Planning; Moody's Investors Service; May 2008.

[4] "Review of an executive's compensation should be done within the context of the organization as a whole. The executive is, after all, an employee of the corporation. His pay should be considered as an extension of the infrastructure that governs the rest of the company's wage structure. Internal consistency, or pay equity, throughout the organization, up to and including the CEO, should be a natural and reasonable objective. The board should not consider executive pay separately from the structures that govern compensation of other employees, rather its design should be structured upon the same foundations and precepts." Elson, Charles M. and Ferrere, Craig K., Executive Superstars, Peer Groups and Overcompensation: Cause, Effect and Solution (August 7, 2012), pages 129 -130. Available at SSRN: http://ssrn.com/abstract=2125979 or http://dx.doi.org/10.2139/ssrn.2125979.

[5] In a recent informal poll of CFA Institute members on the proposed rule, 43 percent said it would be a useful tool for investors to understand pay. See http://blogs.cfainstitute.org/marketintegrity/2013/11/26/survey-says-mixed-response-to-proposed-sec-ceo-pay-ratio-rule/.

Benefits from a Safe Harbor that Encourages Accurate Measurement and Effective Management of Organizational Value and Enterprise Risks

In today's knowledge-based economy, less than 25% of the valuation of the S&P 500 is comprised of tangible assets such as property, plant, equipment inventory and cash reflected in financial statements. The other 75% of the valuation is associated with intangible assets of a company, little of which is evident in financial statements prepared under GAAP.[6] The intangible assets and market valuation of future company prospects are the real long-term value drivers for customers and shareholders. They include such intangibles as the optimal management structure design, work processes, information databases, patents, brand equity, enterprise risk management and the human capital that work within the structural capital and work systems of the enterprise.

A major advantage of identifying the median layer in the management structure and median compensation for the entire enterprise (in complying with the Dodd-Frank Act pay ratio disclosure mandate) could be development of valid and reliable information systems for reporting to the board and C-suite on structural and human capital investments, costs and risks. Development of this data would also allow more accurate reporting to the board and investors of actual and complete enterprise long-term value drivers.

The benefits of viewing pay ratio disclosure in this broader context could be enormous. Other comment letters submitted to the SEC on this rule demonstrate the value that could be added by addressing current widespread problems in determining equitable, fair, and defensible CEO compensation. The Human Resource Policy Association (which includes 350 of the largest companies in the United States) provided survey results to the SEC that show a surprising and concerning lack of available and reliable organizational data and related analytics. For example, the Association survey found that 84% of company respondents could not easily calculate worldwide enterprise cash compensation for all employees.[7]

MVC Associates International (a signatory to this letter) cites first-hand knowledge of registrants, which are large global banks that have discovered they do not have the following types of information for thousands of employee roles.[8]

- The location of the business unit where each role is included;
- What role is the accountable manager for each role (thus they are orphaned roles in the information system and on organization charts); and
- What the delegation of authority is from the manager to each reporting role, putting the enterprise at material risk.

In addition, these registrants lack reliable information on:

- How many total enterprise layers they have (PEO to front line);
- Cost of management by layer; and
- Median employee total compensation costs by layer.

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[6] For further discussion, see Hulten and Hao, "What is a Company Really Worth? Intangible Capital and the 'Market to Book Value' Puzzle," NBER Working Paper Series (2008) at ftp://db.stanford.edu/pub/gio/CS99I/nber_w14548.pdf.
[7] http://www.sec.gov/comments/df-title-ix/executive-compensation/executivecompensation-79.pdf http://www.hrpolicy.org, http://www.execcomp.org, and http://www.execcomp.org/Docs/Center_Statement_SEC%20Pay%20Ratio_Sept%202013.pdf.
[8] For many registrants across all sectors this is not an uncommon condition.

From the perspective of long-horizon investors (such as pension funds, sovereign wealth funds, endowments and foundations), these deficiencies are very likely to be seen as material "managerial control risks and weaknesses" that should be known to the company's chief risk officer and accurately reported to the board. Where these material control weaknesses exist, we believe they should also be disclosed to investors along with a plan to remedy, in the same way that material weaknesses in internal control over financial reporting are reported to audit committees and disclosed in periodic SEC filings. The Dodd-Frank pay ratio disclosure process could provide the vehicle for identifying and addressing these shortcomings.

We recognize that it might take a transitional period before most companies could develop robust information systems to solve for these material managerial control weaknesses.[9] However, once developed and implemented by registrants, their C-Suites and boards will be able to use the process and analytics to more effectively manage these key organizational assets and minimize associated risks.

In addition, the cost issues many have raised in reviewing the SEC's cost-benefit analysis for the Pay Ratio rule would be overwhelmed by benefits from improved insights on organizational and management structure, cost of management, clarity of accountabilities and delegated decision authorities, human capital re-deployment opportunities, PEO succession planning, risk management and corporate governance. The SEC should not blindly accept high cost estimates for Dodd Frank Pay Ratio compliance. MVC Associates International (a signatory to this letter) recently did two real world client proposals for top to bottom organizational structure and pay ratio analyses at global companies with 25,000 to 30,000 employees where the Dodd Frank Act CEO pay ratio compliance component was estimated at only $10,000 incremental cost to the overall structure analytics proposal. This minimal cost pales in comparison to the gains associated with development of robust structural capital and human capital information systems.

One of the major advantages of calculating the median role and median compensation for the entire global enterprise and the other more useful PEO pay ratios (see the Appendix for research) would be valid and reliable information systems for reporting on structural and human capital investments, costs and risks to the board and C-Suite, in addition to valid and more reliable disclosure to investors using actual and complete enterprise data, not sampling.[10] Comparability of pay ratios across companies would also be enhanced by greater transparency on management levels of work complexity, innovation and accountable time horizons. (See the Appendix for additional discussion.)

Experts who have advised registrants on these issues (some of whom are signatories to this letter) have seen the benefits of improved information systems on organizational and management structure, cost of management, clarity of accountabilities and delegated decision authorities, human capital re-deployment opportunities, PEO succession planning and strategic leadership assessment risks. For example, at one company with 25,000 employees, the resulting potential annual impact on improved management structure and compensation investment was in the hundreds of millions of dollars. Improved data, analytics and reporting would also create a more informed proxy voting and say on pay voting process. These benefits would flow through to improve sustainability of return on invested capital, free cash flows, enterprise valuation and total shareholder return for long-horizon investors.

[9] Up to a three-year transition period would appear to be reasonable.
[10] The need for reliable systems and data highlights the importance of this information being "filed" with the SEC as accurate and reliable, rather than merely being publicly furnished as useful but unverified.

Comments on Structuring the Safe Harbor

We would be happy to assist the SEC in revising the required disclosure reporting standards to achieve the goals identified above. The minimum data needed by boards and management would include the following:

- **Total Full Time Employees ("FTE")**
  - FTE by Enterprise, by Business Unit, by Geography (Country or Hemisphere), by Management Layer
  - This includes the FTE of leased or outsourced employees where there is a 1 year or greater contractual commitment for delivery of services to the employer
  - The FTE count as of year end
  - Together this would outline the TOTAL employment and workforce foot print of the enterprise worldwide and the sustainable employment value for societies the company generates

- **Total Number of Management Layers PEO to Front Line & Cost of Management**
  - Identify the total number of management layers segmented by business unit and corporate function
  - Within each management layer the TOTAL count of number of FTE employees and the TOTAL Cost of Management at each layer
    - Total Compensation cost for each global employee would include:
      - Base Salary
      - Annual Bonus
      - Any applicable Longer Term Incentive compensation
      - Estimated Pension and Benefits (e.g., as a plug number, 8% of base salary)
      - Currency adjustment to USD at year end
  - Median Role(s) (employees) up the management structure

- **The Total Number of Managers** (versus front line or individual contributors)

- **The PEO's Longest Accountable Performance Period** for which the PEO role is held accountable for, measured on and compensated

- **Total Enterprise Compensation Cost** (broken out from selling, general and administrative expenses)

- **Pay Ratios and Internal Pay Equity**
  - The median total compensation for EACH management layer up the management structure (layer to layer), including the median layer to PEO pay ratio required by the Dodd-Frank Act
  - **The PEO Total Compensation divided by the median Total Compensation of all roles in layer 2 of the management structure**
  - **The PEO Total Compensation divided by median of all roles in layer 3 of the management structure**
  - If a financial or other risk-intensive institution, the PEO pay ratio (which is the PEO Total Compensation) divided by the total compensation of Chief Risk Officer role

Table 2 in the Appendix provides a sample analytics and reporting format for aggregating this information. Such organizational capital analytics would provide the C-Suite and the Board with organizational insights about structural and human capital investments and how they are currently deployed, as well as workforce and management structure design and options for possible redeployment that would increase economic profit and productivity.

Correspondingly, disclosures needed by investors to effectively evaluate management of organizational capital, corporate governance and risk management would include:

- **Total Full Time Employees (FTE), including leased employees**
- **Total Number of Management Layers PEO to Front Line & calculation of Median Role(s)**
- **Total Number of Managers** (versus front line or individual contributors)
- **The PEO's Longest Accountable Performance Period** for which the PEO role is held accountable for, measured on and compensated
- **Total Enterprise Compensation Cost** (broken out from selling, general and administrative expenses)
- **The Pay Ratios and Internal Pay Equity**
  - **The median total compensation for EACH management layer up the management structure (layer to layer), including the median layer to PEO pay ratio required by the Dodd-Frank Act**
  - **The PEO Total Compensation divided by the median Total Compensation of all roles in layer 2 of the management structure**
  - **The PEO Total Compensation divided by median of all roles in layer 3 of the management structure**
  - If a financial or other risk-intensive institution, the PEO pay ratio (which is the PEO Total Compensation) divided by the total compensation of Chief Risk Officer role

These disclosures should ideally be provided in a table format that allows for easy XBRL tagging (see http://en.wikipedia.org/wiki/XBRL_International) and thus for inclusion in financial and other databases, to facilitate analysis by investors, credit ratings agencies, proxy advisors and other investment service providers. Five-year trend lines are needed to capture time frame data that materially impact company performance and valuation and are central to any company's capacity to create sustainable value. Table 1 in the Appendix is a sample reporting format for investors.

In evaluating the information required by investors, it is important to stress that the PEO pay ratios to the median of both management layers 2 and 3 are needed. Because the number of senior executives in layer 2 is often minimal, it could be relatively easy for some companies to increase total compensation of that level to present an artificial view of the management structure, compensation and enterprise internal pay equity. Inclusion of layer 3 (direct report roles once removed from the PEO) will provide a more accurate picture, capture more of the most likely sources for senior management succession and mitigate opportunities to manipulate the data.

Attention to Development of Coordinated Disclosure Process

If the SEC is not now able to implement a disclosure regimen that applies the suggested broader management structure design and related research on organizational and strategic leadership risk, we believe the issues raised in this comment letter deserve continued attention. In that event, we recommend that the SEC seek out advice from experts in management structure and accountability, including related internal pay equity design, and start an initiative with participation of its Investor Advisory Committee and Issuer Advisory Committee to explore development of an approach to corporate disclosures that will encourage improved management of organizational design, enterprise risk management, corporate governance and efficient use of structural, human, natural and financial capital.

We believe that improved reporting to the C-Suite and boards, combined with transparent disclosures to investors along the lines described above, will contribute to a number of benefits:

- Dramatically improved information systems for Organizational Capital analytics (structural and human) and reporting to the C-Suite and Board
- More insightful analytics related to organizational performance and risks disclosure for investors
- Materially better performance of investee companies
- More insightful proxy and "Say on Pay" voting processes
- More sustainable returns for investors
- More efficient capital markets overall.

These are significant cost-benefit advantages that should not be overlooked.

If any of us can be of assistance in finalizing how the pay ratio rule is implemented or providing more information, feel free to contact us.

Respectfully submitted,
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Hon Mary Jo White, Chairman
Hon Kara Stein, Commissioner
Hon Luis Aguilar, Commissioner
Hon Daniel Gallagher, Commissioner
Hon Michael Piwowar, Commissioner

United States Senate Banking Committee
The Honorable Tim Johnson, Chairman
The Honorable Mike Crapo, Ranking Minority Member

United States House of Representatives Committee on Financial Services
The Honorable Jeb Hensarling, Chairman
The Honorable Maxine Waters, Ranking Minority Member

Appendix

Table 1

Proposed Table Layout for Organizational Capital & Pay Ratio Disclosures For Investors

	Yr 0	Yr 1	Yr 2	Yr3	Yr 4	4 yr Absolute Growth (Change)	4 yr % Growth (Change)
Total Full Time Equivalents (FTEs)							
Total # Managers							
Total # Layers (PEO to Front Line)							
Longest Accountable Performance Period for Principal Executive Officer							
Total Enterprise Compensation							
PEO Total Pay Ratio to Median Total Pay 2nd Management Layer							
PEO Total Pay Ratio to Median Total Pay 3rd Management Layer							
PEO Total Pay Ratio to Median of Enterprise (Dodd Frank)							

Research Background on Management Structure and PEO Pay Ratio(s) Reporting and Governance / Risk Insights for Boards and Disclosures for Long Horizon Investors

Pay Ratio and Optimal Management Structure Design Research

Starting with work that Elliott Jaques and the Brunel Institute for Organization and Social Studies (BIOSS) initiated, more than a dozen research studies investigated the relationship between differential pay, position in the management structure and corporate hierarchy, the time-span of decision discretion of a particular role and the nature of role complexity.

These studies involved over 1,000 participants – from PEO to manager levels in the U.S., Canada and the U.K. – concluding that the "Felt Fair Pay" ratio and differential compensation between the real work in organizations consistently differed by a multiple of two. Also see the follow up research studies in the USA undertaken by Roy Richardson and Edna Homa.

The research identified that each value-adding management layer - called a "Work Level" - should be worth two times more in **Total Compensation** than the level directly below it (Manager to Direct Report role relationship in the management structure) *if the manager role is designed properly and truly performing differential and value adding wor*k. When analyzing the entire management structure the **median** Pay differential at each management layer is the proper analysis method and not the **average,** which would be distorted by outlier pay data and outlier pay ratios in the management structure.

The Felt Fair Pay research findings were based on Total Compensation and not Total Cash Compensation.

Recently, MVC Management Corporation undertook an extension of this management structure and "Felt Fair Pay" research at the request of Board clients and analyzed the PEO to Median NEO pay ratios for the USA. They analyzed the 2035 largest USA issuers in the Russell 3000 for which 3 yr Named Executive Officer (NEO) Pay data was available (2003 – 2005).

Removing the outlier data, the results of the updated research identified that PEO Pay Ratio some 25 years since the last major study had been conducted confirmed the Fair Pay ratio for America's top managers at 2.45 (CEO to other NEO's). Over the last 60 years the Manager to Direct Report pay ratio has been consistently identified as seen as equitable and fair in the 2 to 2.5 times broad range as a guiding organizational principle and corporate governance check.

http://www.prnewswire.com/news-releases/internal-pay-equity-key-to-fixing-a-broken-PEO-pay-system-new-research-shows-excessive-PEO-pay-may-link-to-performance-failure-and-business-risk-58367222.html

http://www.mvcinternational.com/documents/MVC_Pay_PEM_2007F.pdf

http://www.sec.gov/comments/df-title-ix/executive-compensation/executivecompensation-303.pdf

When the PEO total pay ratio in relationship to Layer 2 (direct reports) and Layer 3 (direct reports once removed from the PEO role) becomes too large the research has identified the following material risks for investors:

- Named executive officers and or Layer 3 roles may lack appropriate delegated decision authority creating organizational risks due to an overly dominant PEO

- Layer 2 and Layer 3 may not have appropriate accountability and or authority for creating the Future Value and innovation of the Enterprise when as of March 2013 the Future Value was approximately 50 % of the Valuation of the S&P 500

- PEO succession planning risks as evidence that **too large a PEO pay ratio identifies** (> 3X to layer 2 and > 6 X to layer 3) both structural and talent gap material risks for PEO continuity

- Materials weaknesses in Board processes, Director Independence and execution of Fiduciary Accountability and possible credit risk for bondholders.

Defining What to Measure and How for the Median Employee Compensation

The research on Internal Pay Equity, "Felt Fair Pay" and Internal Pay ratios identifies that the "Felt Fair" compensation identified by the managers and direct reports as equitable pay differentials was based on Total Compensation and NOT base salary only.

For consistent global application across countries and in meeting the intended application for good Corporate Governance, insightful pay ratios and Dodd Frank compliance, Total Compensation for each employee and the median employee compensation by layer should be calculated and include the following pay elements:

- Base Salary
- Annual Bonus
- Any applicable Longer Term Incentive Compensation
- Estimated Pension and Benefits (use an estimated 8 % of base salary)
- Currency adjustment to USD at year end

The estimated 8 % of base salary as a pension & benefit cost is based on a review of the Mercer global pension and benefit global database and calculation of the Median pension and benefit cost for the world.

Identifying the median role (employee) and median compensation in the management structure is easily done by:

1. Doing a database query to count the number of management layers from the PEO to the Front Line employees (deepest depth structure in the management reporting structure)
2. Counting the median layer (mid-point between Layer 2 and the deepest front line employee) and not including the Principal Executive Officer (PEO) in that count
3. Running a query on the median pay for each layer in the management structure
4. Calculating the Median Enterprise compensation by taking the Median TOTAL compensation of each role managerial layer
5. See Table 2 for an example USA registrant

PEO Pay Ratio, Management Structure, PEO Succession Risk & Corporate Governance

Subsequent to the recent 2007 research by MVC Management and the previous research, Moody's (the bond rating service) confirmed the validity of material capital markets risk and they outlined their policy in assessing the PEO pay differential at > 3X to the other Named Executive Officers as a Red Flag for PEO succession and corporate governance risk and for input into corporate credit rating risk down grade. Moody's outlines this further in a number of their credit rating special comment white papers (2005, 2006, 2007 and 2008).

GMI Ratings and its predecessor companies (Governance Metrics International and The Corporate Library), as the leading Governance Risk Rating firm in the world adopted the same policy and now reports and RED FLAGS all PEO to Median NEO pay ratios greater than 3 times.

Applying the research and "Felt Fair Pay" principles, if the PEO to median of total pay differential to all 2nd layer role relationships is greater than 3X then this "Red Flags" a material risk related to corporate governance, delegation of authority, PEO succession and long-term enterprise continuity - all clearly material risks for investors.[12] This PEO pay differential indicator correlates highly with an overly dominant PEO, possibility of failure to delegate authority, lack of PEO succession candidates in the 2nd layer, and weak corporate governance by the Board of Directors.

It is easy to overpay the 2nd layer of management and have a large PEO pay differential with the 3rd layer of management (the PEO role being the 1st layer of management down from the Board). It is the 3rd layer where the work, accountability and decision authority may be more operationally focused depending on the complexity of the enterprise and how many layers of management the firm has.

A further and more insightful check of PEO pay ratios is required for investors (equity and debt). If the PEO to median total pay differential to all 3rd layer role relationships is greater than 6.00 X then this further validates structural problems and PEO succession and future value risks. This wide Pay Differential gap indicates a failure to provide effective delegation of authority in the management structure.

As well, it is the 3rd layer of Management from which many next generation of PEO succession candidates usually are selected depending on the ages of the second layer incumbent talent pool.

The Board should be provided with an enterprise analysis of management structure and Pay ratios once a year that is similar to Table 2. This includes identifying any Red Flags for corporate governance reporting and investor disclosure.

This is why reporting and disclosing the total number of layers, total number of managers, total FTE in the enterprise is also important for Boards and Long Horizon Investors in understanding the shape of the management structure and workforce productivity for shareholders. These context-setting organizational insights also assist effective comparison between PEO Pay Ratios within the same company and across companies.

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[12] Key findings on optimal management structure design, internal pay equity and "Felt Fair Pay" are archived at these sites: http://globalro.org; http://stores.homestead.com/CasonHallPublishersStore; http://www.jstor.org/discover/10.2307/2391950?uid=3739448&uid=2129&uid=2&uid=70&uid=3737720&uid=4&sid=21102888420493.

[See Table 3 with examples of PEO Pay ratios and how they vary due to changing management structure and organizational complexity.]

If the issuer is a financial institution, disclosure of the PEO to Chief Risk Officer (CRO) total pay ratio can provide great insight and has been confirmed to us by a number of former Bank PEOs. Their view is, if the Pay differential between the PEO to CRO roles is greater than 3X, then this indicates the structure and authority of corporate risk function and caliber of executive leading such a critical function for shareholders is inadequate. To further improve this disclosure, the PEO pay differential to the median of all role relationships in the second layer of the corporate risk function would also benefit investors.

Banks today disclose all their Enterprise Compensation through compensation and benefits line item in their financial statement, along with a total-stock based compensation disclosure line item. Added together, these create the bank's total investment in structural and human capital, which we call Organizational Capital. With this disclosure an investor can then determine the banks' Return on Organizational Capital (ROOC), calculated as NOPAT / Total Bank Compensation.

This represents the shareholders' performance and return on what has been invested in the structural and human capital of the enterprise. It can then be compared across peer banks to see the relative performance of structural and human capital productivity. A bank that overpays its PEO and top 200 – 300 + officers will have a lower Return on Organizational Capital compared to a bank that pays closer the median of the rest of banking industry. This disclosure is available for all banks today in the United States.

All listed companies, like banks, should be required to provide breakout disclosures on Total Enterprise Compensation costs as separate from SG&A costs and have this disclosed in either their financial statements or the proxy statement. This would allow for more insightful investor analysis of organizational capital productivity and / or under-investment. It could also have a secondary effect of moderating any rise in total enterprise compensation costs for shareholders.

Table 2:

Sample Organizational Capital, Management Structure & Pay Ratio Reporting For Boards

Mgmt Structure & Layering	Median Total Rewards by Layer	Lyr to Lyr Pay Ratio	CEO to Median Lyr2 Pay Ratio (Red Flag 3X)	CEO to Median Lyr3 Pay Ratio (Red Flag 6X)	CEO to Median Enterprise (Dodd-Frank)
CEO-1 (Sum Comp Table Pay)	**$9,801,101**				
Lyr 2	$2,451,257	4.00	**4.00**		
Lyr 3	$771,203	3.18		**12.71**	
Lyr 4	$422,199	1.83			
Lyr 5	$209,336	2.02			
Lyr 6	**$144,997**	**1.44**			
Lyr 7	**$133,553**	**1.09**			
Lyr 8	$83,429	1.60			
FL Mgr & Indv Contr = Lyr 9	$64,666	1.29			
FL Mgr & Indv Contr = Lyr10	$54,448	1.19			
Front Line Employee = Lyr11	$27,013	2.02			
Enterprise Median = CEO to Lyr11	**$144,997**				
Median 2 = Median Lyr 2 to Lyr11	**$139,275**				
CEO Pay Ratio to Median Balance of Mgmt structure per SEC filing rule (Dodd-Frank)	**$9.8M divided $ 139,275**				**70.37**
CEO Pay Ratio to Median Front Line Employee					**362.83**
Global SBU's	**10**				
Total FTE	**29,000**				
North America		**15000**			
Europe		**6000**			
South America		**2000**			
Asia Pacific		**6000**			
Total Mgmt Layers (CEO to Front line)	**11**				
PEO Longest Accountable Performance Period	**5 yrs**				
Total Enterprise Compensation Costs - Yr End	**$1,350,583,338**				
Total 5 Named Officer Compensation Cost - Yr End - SCT	**$27,353,875**				

Table 3:
How Median PEO Pay Ratios change by different Organization Structures and Management Layering

	5 Work Levels		7 Work Levels	
Using 2.5 X Felt Fair Pay ratio by Work Level				
			Layer	**Median TDC by Layer**
		Median TDC by Layer	PEO 1	$9,277,344
	Layer		2	$3,710,938
	PEO 1	$1,484,375	3	$1,484,375
	2	$593,750	**4**	$593,750
Median Mgmt Structure	**3**	$237,500	**5**	$237,500
	4	$95,000	6	$95,000
	5	$38,000	7	$38,000
	PEO	$1,484,375.00		
	Median	**$166,250.00**		
	PEO / Enterprise Median	**8.93**		
			PEO	$9,277,343.75
			Median	**$415,625.00**
			PEO / Enterprise Median	**22.32**
	PEO / Front Line Pay Ratio	39.06		244.14

Evidence of Excessive PEO Pay Ratio, Poor Performance and Enterprise Risk for Shareholders

In the recently released research commissioned by the New York Times related to Pay and Performance, and PEO Pay ratios the research further validated the performance risk for investors and efficient capital markets.

http://www.nytimes.com/2013/10/13/business/when-the-stock-price-hides-trouble.html?src=me&_r=0

http://knowledge.ckgsb.edu.cn/2013/10/09/policy-and-law/the-rich-and-the-rest-executive-pay-corporate-growth

http://www.organizationalcapitalpartners.com/SiteAssets/latest-news/MVC_P4P_NYTimes.pdf

Eighteen Fortune 300 companies delivered a 5 yr combined economic loss of $134 billion over 5 years. All 18 companies had an ROIC less than WACC over 5 years and destroyed intrinsic shareholder value. The 90 named officers of these 18 companies were granted $ 3.1 billion in 5 yr realizable compensation.

The hidden headline is the PEO to Median Other Named Executive Officer pay ratio for the 18 companies was on average 3.2 X, greater than the Moody's and GMI Red Flag of 3 X, and a number of these Value Destroying companies had significant PEO to median NEO pay ratio in the 3.5 to 4.9 range further validating the investor risk when there is an excessive PEO pay differential.

Dodd-Frank PEO Pay Ratio to Median Role / Employee of Enterprise – Improving Comparison of Disclosures

The National Investor Relations Institute recent comment letter to the SEC makes a point that there is a risk that pay ratio disclosures will be inappropriately used to make comparisons between companies across various industries and with different levels of organizational complexity. However, there is always potential for misuse of any disclosure. We support the proposed SEC rule. By requiring companies to focus on internal pay equity, rather than allowing boards to chase pay levels at companies with different organizational structures, competitive environments and human resources issues without adequate contextual data, the proposed rule is a major step in the right direction. Nevertheless, we believe that added disclosures encouraged by the safe harbor would reduce potential for ill-informed cross-company comparisons by making information available that enhances the ability to do more nuanced compensation comparisons.

For example, if a company has 5 Layers of Management, a median compensation for layer 5 at $ 38,000 and uses a "Felt Fair Pay" and internal pay equity differential of 2.5 X per layer, then the PEO Pay Ratio under Dodd-Frank disclosure rule for this company is 8.93. (See Table 3.)

A company that is much more complex and global might have 7 or more layers. Following the same management structure and pay ratio principles and calculations would result in a PEO Pay Ratio of 22.32 times. This would also result in a Median CEO pay level of applying "Felt Fair Pay" ratios of $ 9.2 million.

This aligns very closely to the median S&P 500 CEO total pay as identified by Professor Steven Kaplan for 2011.[13] Thus the shape of the management structure, complexity of the company, number of business units, number of layers, and number of FTE, and location of the FTE around the world will all impact the validity, reliability and interpretation of the PEO to Median Enterprise disclosure and its application for strategic corporate governance and proxy voting by investors.

Including organizational shape and complexity-related disclosures as part of the narrative in describing the PEO / Median of Enterprise disclosure would reduce the potential for misinterpretation when comparing pay ratios between peers. The most critical additional disclosures to provide effective interpretive and comparative insights of the PEO to Median Pay employee ratio (under Dodd-Frank), include:

- **Total Enterprise FTE (globally), including leased employees**
- **Total Number of Management Layers (deepest structure PEO to Front Line Employee)**
- **Total Number of Managers**
- **Longest Accountable Performance Period for the PEO**
- **Total Enterprise Compensation Costs**
- **The PEO pay ratio to the median total compensation of roles in layer 2 of the management structure**
- **The PEO pay ratio to the median total compensation of roles in layer 3 of the management structure**

Dodd Frank PEO Pay Ratios, Levels of Innovation, CEO Role Complexity, LTIP Design Alignment and PEO Pay Ratio Interpretation

The additional disclosures outlined above (i.e. # FTE, # Layers, Enterprise Total Compensation, PEO to Layer 3, etc) would provide boards and investors with valuable insights for creating higher performing companies and ensuring consistency between management structure and compensation, both for the CEO and enterprise wide. Table 4 outlines, based on pro-forma assumptions using Felt Fair Pay principles and procedures from Table 3, what three different CEO pay ratio disclosures might look like and how these benchmarks could be applied by a Board and Investors.

As an example, if a company has CEO to Enterprise Median Pay Ratio of 21 X, then information on the following factors would be needed to determine whether differential CEO work complexity and skill requirements are sufficient to justify the corresponding pay differentials and 21 X versus 7 X pay ratios shown in Table 4:

- Level of CEO role complexity
- Level of innovation
- Strategic risk horizon
- Key Performance Indicators (KPI's)
- LTIP design

[13] http://faculty.chicagobooth.edu/steven.kaplan/research/kgovppt.pdf

If a company's level of Innovation, strategic risk horizon and Level of Value creation align to a Level CEO 3 role when the Dodd-Frank PEO to Enterprise Median pay ratio is approximately 20 to 25 X, then the CEO role would appear to be materially over-compensated by a factor of 3 times (7x vs. 21 X) in terms of Fair and Equitable PEO compensation relative to the level of CEO role complexity. Boards and Investors could use these proxy benchmarks as key inputs into analyzing the Level of Complexity of CEO work alignment with the level of defensible total "Felt Fair" compensation and its requisite PEO Pay Ratio. This analysis could influence executive compensation, management structure and accountability design, capital allocation, strategic governance and structural and human capital strategy decisions.

Table 4

Dodd Frank PEO to Median Enterprise Pay Ratio Benchmarks and Alignment to Levels of Innovation, Risk Horizons and KPI's

CEO Level of Work Complexity	Level of Innovation	Strategic Risk Horizon	Value Creation for Whom	Key Performance Indicators & or Contribution To	OVA and Equitable Dodd Frank CEO Pay Ratio Approx. Benchmarks
5 (Work Level 7)	Global Business / Societal Innovation	20 yrs +	Humanity/ Future Generations, Long Horizon Shareholders	Nation Building, Economic and Political System Innovation, Innovation for Energy-Food-Water Security for Humanity, Climate Change, Enterprise Sustainability, Global Peace & Security	**21X**
4 (Work Level 6)	Global Industry Structure Innovation	10 -20 yrs	Individual Societies / Triple Bottom Line	Future Value for Societies, Asset & Business Portfolio Stewardship / Citizenship, Triple Bottom Line, Corporate Responsibility to Societies	**14X**
3 (Work Level 3)	New Business Model Innovation	5 - 10 yrs	Customers, Employees & Shareholders	Future Value for Stakeholders, ROIC > WACC, Economic Profit, Business Model Viability, Customer Loyalty, Employee Engagement	**7X**

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Data Privacy and Pay Ratios

Data privacy rules will have to be observed. For example, the European Union has a Safe Harbor agreement with the US, so data transfer can be done legally and should retain the same rights as is held in Europe.

The second way to access the data is under contracts that use sets of model clauses drafted by the European Commission. Please see:

http://export.gov/safeharbor/

http://ec.europa.eu/justice/data-protection/document/international-transfers/transfer/index_en.htm

Removing any personal identifiers (name, phone number, badge number, email address, company personnel number) from any databases to be accessed or data exports could also address many of these privacy concerns.

The focus is on the management structure, roles, compensation, pay ratios and NOT the people.

Glossary of Terms

The following is a list of terms related to effectively defining Accountability, Authority, Felt Fair Compensation and Pay Ratios in management structures that are employment hierarchies.

Accountability	A relationship where one role (manager) is held to account to another role for its actions and decisions in the managerial structure or other body authorized to approve and or which has a fiduciary duty to others
Authority	Legitimate decision right or action vested by delegation with power vested to invest resources and capital (structural, human, intellectual, financial) to create value for customers and shareholders
Level of Complexity	Level of complexity is determined by the number of factors, their inter-relationships and rate of change in those factors to be taken into account in making a decision
Decision	The making of a choice with a commitment to a future goal and the investment of capital (structural, human, intellectual, financial)
Delegation	The act of assigning an accountability for a performance outcome and the related resources to direct reports and other roles to exercise judgment and discretion for investing those resources to create value
Felt Fair Pay	A level of total compensation payment that is seen by the role holder, manager and manager once removed (MoR) as equitable payment based on the differential work of the role (accountability and authority)
Front Line Role	A role that is accountable for direct outcome work assigned by the manager and is at the front line of delivery of value to customers
Full Time Equivalent	**Full-time equivalent** (**FTE**) is a unit that indicates the workload of an employed role in a way that makes workloads comparable across various contexts. FTE is often used to measure a roles involvement in a project, or to track cost reductions in an organization. An FTE of 1.0 means that the role is equivalent to a full-time worker, while an FTE of 0.5 signals that the worker is only half time. In The U.S. federal government, FTE is defined by the Government Accountability Office (GAO) as the number of total hours worked divided by the maximum number of compensable hours in a full-time schedule as defined by law. For example, if the normal schedule for a quarter is defined as 411.25 hours ([35 hours per week * (52 weeks per year – 5 weeks regulatory vacation)] / 4), then someone working 100 hours during that quarter represents 100/411.25 = 0.24 FTE. Two employees working in total 400 hours during that same quarterly period represent 0.97 FTE.
Layer	A reporting role relationship (manager to direct report) in an accountable management structure

Longest Accountable Performance Period	The targeted completion time for the longest accountable activity or strategic program / initiative into the future for which the role is held to account for performance, has delegated authority and decision discretion to invest resources, create value and a return on the invested capital
Manager	A role held to account for the direct output of that role and the delegated accountability and outcome of direct report roles and direct report roles once removed, including the minimum managerial decision authorities of hire, removal from role, assignment of type work, goal setting, appraisal of performance, and rewards
Principal Executive Officer (PEO)	The first full time accountable role in a managerial hierarchy of a corporation which is being held to account for specific strategic and operations goals established by the board of directors and has been delegated authority by the board to exercise good business judgment in the investment of capital
PEO Pay Ratio	The pay ratio between the PEO total compensation and total compensation of other roles in the management structure
Return on Invested Capital (ROIC)	The Return on Invested Capital is calculated as Net Operating Profit after Tax divided by Total Invested Capital (including intangible capital adjustments)
Role	A role is a position in a management structure where the manager has set clearly defined metrics, targets, by when including its level of expected innovation, longest expected accountable performance period, and delegated resources (operating or investment capital) and delegated decision authority to exercise judgment to meet established goals set by the manager
Strategic Risk Horizon	Furthest into the future that a role is required to conceptualize the future(s), innovate, set milestones and invest risk capital for investors to reach a future state and a Return on Invested Capital (ROIC)
Total Compensation	The total amount of compensation adding together the elements of compensation including base salary, bonus, long term incentive, benefits and pension
Work	The exercise of judgment and discretion in making decisions in carrying out goal directed activities (what, by when, with what quality standards and what resources) as assigned by the manager
Work Level	A unique and clearly differentiated level of work complexity, level of innovation and targeted completion time for value creation that is differentiated in the management structure; there may be 2 or more layers in a single Work Level