

March 21, 2017

Acting Chairman Michael S. Piowar
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Comments on Acting Chairman Piowar's February 6, 2017, Statement on Reconsideration of Pay Ratio Rule Implementation

Dear Acting Chairman Piowar:

Willis Towers Watson appreciates this opportunity to provide our comments to the Securities and Exchange Commission on its final regulations under Item 402 of Regulation S-K that will require disclosure of the ratio of the annual total compensation of the registrant's chief executive officer to the median of the annual total compensation of all employees of a registrant (excluding the chief executive officer), as added by Section 953(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Our comments are based on information gathered in our discussions and consulting engagements with several registrants who are seeking to apply the requirements of the final regulations, as supplemented by the questions and answers provided by the Corporate Finance Staff's Compliance & Disclosure Interpretations (CD&Is) issued on October 18, 2016. Our comments will focus on how the Commission can move quickly to provide more clarity and simplification with amended and additional CD&Is that, if adopted, could greatly reduce the burdens and costs associated with compliance for the pending disclosure.

Here are our observations and suggested language for the CD&Is:

1. Limit the scope of the definition of the terms "employee" or "employee of the registrant."

Item 402(u)(3) provides: "The definition of employee or employee of the registrant does not include those workers who are employed, and whose compensation is determined, by an unaffiliated third party but who provide services to the registrant or its consolidated subsidiaries as independent contractors or "leased" workers."

CD&I Question 128C.05: *Under what circumstances is a worker employed and his or her compensation determined by an unaffiliated third party such that the worker is considered an independent contractor or leased worker under the rule? When is a registrant considered to be determining the compensation of a worker?*

Answer: *In the release, the Commission noted its belief that the primary benefit of the pay ratio disclosure is to provide shareholders with a company-specific metric that they can use to evaluate the compensation paid to the CEO within the context of the company's unique situation. Therefore, in determining when a worker is an "employee" of the registrant under the rule, the registrant must consider the composition of its workforce and its overall employment and compensation practices. In furtherance of this, a registrant should include those workers whose compensation it or one of its consolidated subsidiaries determines regardless of whether these workers would be considered*

“employees” for tax or employment law purposes or under other definitions of that term. Frequently, a registrant will obtain the services of workers by contracting with an unaffiliated third party that employs the workers. When a registrant obtains services in this way, we do not believe it is determining the workers’ compensation for purposes of the rule if, for example, the registrant only specifies that those workers receive a minimum level of compensation. Further, an individual who is an independent contractor may be the “unaffiliated third party” who determines his or her own compensation.

For many registrants, interpreting the meaning behind this section’s definition of employee has proven frustrating. In many instances, registrants that believed they had a handle on performing their pay ratio calculations have been sent back to the drawing board to try and determine which, if any, of those workers not treated as employees under local law would need to be included in determining the median employee.

- a. This issue is particularly vexing for global registrants, but even domestic registrants have had their challenges, especially where they have many locations, each of which permits the local manager to hire contractors on an “as needed” basis. Often, the home office human resources professionals and the legal department are not aware of the scope of contractors being hired, so that an entire process needs to be established to gather data on contractors, to set parameters for making a determination and to document the results of the analysis. This often forces registrants to spend significant time chasing this information — in many cases, far more time than they spend in gathering pay data for their employee workforce and often for a relatively small number of individuals whose work represents a very small proportion of their overall number of hours worked by the registrant’s workforce.
- b. In contrast, other registrants are so concerned that their analyses of the employee/independent contractor issue will affect the application of home-country law that they have decided to apply this rule based solely on the legal definition of employee in those jurisdictions. In short, these registrants fear that they will face far greater scrutiny from local authorities if the portion of the workforce they treat as independent contractors under local law are treated in the registrant’s proxy disclosure as employees for purposes of the CEO pay ratio calculation.
- c. Finally, we would argue that the Commission’s current interpretation of the rule is overly broad and does not serve an actual policy goal. We understand that the Commission would have concerns that a more strictly interpreted rule could, in some circumstances, cause registrants to convert lower-paid workers from employee status to an outsourced environment where they are employed by third-party contractors, solely for purposes of crafting a more favorable pay ratio. We believe the risk of this is minimal and have seen no evidence that it’s being contemplated or has taken place.

Recommendation: We recommend that the Commission adopt an interpretation of these rules that permits registrants to determine their employee workforce based on whether a worker is treated as an employee in his or her home country by replacing the existing language in CD&I Question 128C.05 with the following:

CD&I Question 128C.05: *Under what circumstances is a worker considered to be an employee of the registrant when employed by an unaffiliated third party but who provides services to the registrant or its consolidated subsidiaries as independent contractors or “leased” workers?*

Answer: *In the release, the Commission noted its belief that the primary benefit of the pay ratio disclosure is to provide shareholders with a company-specific metric that they can use to evaluate the compensation paid to the CEO within the context of the company’s unique situation. The decision that a registrant makes to include or exclude a worker as an employee in a particular jurisdiction is*

the best indication of whether that worker should be included or excluded in the determination of the median employee, and this determination shall be presumed to be correct for purposes of calculating the CEO pay ratio, except where there exists compelling evidence that workers are being misclassified solely for the purpose of avoiding their inclusion in this calculation.

2. Clarify that prior year data can be used to identify the median employee.

Item 402(u)(3) provides that for purposes of paragraph (u), “employee or employee of the registrant means an individual employed by the registrant or any of its consolidated subsidiaries, whether as a full-time, part-time, seasonal, or temporary worker, as of a date chosen by the registrant within the last three months of the registrant’s last completed fiscal year.”

CD&I Question 128C.03: *When a registrant uses a CACM [consistently applied compensation measure] to identify the median employee, what time period may it use? Must the period include the date on which the employee population is determined? Must it always be for an annual period? May it use the prior fiscal year?*

Answer: *To calculate the required pay ratio, a registrant must first select a date, which must be within three months of the end of its fiscal year, to determine the population of its employees from which to identify the median. Once the employee population is determined, the registrant must then identify the median employee from that population using either annual total compensation or another CACM. In applying the CACM to identify the median employee, a registrant is not required to use a period that includes the date on which the employee population is determined nor is it required to use a full annual period. A CACM may also consist of annual total compensation from the registrant’s prior fiscal year so long as there has not been a change in the registrant’s employee population or employee compensation arrangements that would result in a significant change of its pay distribution to its workforce. [October 18, 2016]*

- a. For most registrants we’ve worked with, using calendar year-end pay data to determine the median employee is the most straightforward information to gather. The above CD&I does not appear to permit use of prior year data - it appears to be unnecessarily restrictive and there’s some uncertainty as to its meaning. This is because the rules provide that registrants can use only “annual total compensation” when using prior fiscal year data to determine the median employee and does not permit the use of other CACMs when using prior fiscal year data.
- b. Item 402(u)(2)(ii) provides that “annual total compensation” means total compensation for the registrant’s last completed fiscal year. Item 402(u)(2)(i) provides that, for purposes of paragraph (u), “total compensation” for the median of annual total compensation of all employees of the registrant and the PEO of the registrant shall be determined in accordance with paragraph (c)(2)(x) of this Item 402, regarding calculating Summary Compensation Table total compensation.” When read together, this suggests that the CD&I would only permit use of prior fiscal year data under circumstances where the registrant calculated Summary Compensation Table (SCT) total compensation for all employees employed on the current year’s determination date, or a subset of those employees where a registrant uses reasonable assumptions or statistical sampling.

Recommendation: We recommend that the Commission amend its answer in CD&I 128C.03 to clarify that registrants can use prior fiscal year data no matter which CACM they select, by deleting the following sentence:

“A registrant may select any CACM based on annual total compensation from the registrant’s prior fiscal year so long as there has not been a change in the registrant’s employee population or employee compensation arrangements that would result in a significant change of its pay distribution to its workforce.”

and substituting the following sentence:

“A registrant may also select a CACM from the registrant’s prior fiscal year so long as there has not been a change in the registrant’s employee population or employee compensation arrangements that would result in a significant change of its pay distribution to its workforce.”

3. Clarify that registrants can use base pay as a CACM.

Question 128C.01: *If a registrant does not use annual total compensation calculated using Item 402(c)(2)(x) of Regulation S-K (“annual total compensation”) to identify the median employee, how should a registrant select another consistently applied compensation measure (“CACM”) to identify the median employee?*

Answer: *Item 402(u) requires registrants to identify the median employee using annual total compensation or another CACM, such as information derived from the registrant’s tax and/or payroll records. Because of concerns about the expected compliance costs if registrants had been required to calculate annual total compensation for all employees, the Commission permitted registrants to use a CACM other than annual total compensation as a reasonable alternative to identifying the median employee. Any measure that reasonably reflects the annual compensation of employees could serve as a CACM. The appropriateness of any measure will depend on the registrant’s particular facts and circumstances. For example, total cash compensation could be a CACM unless the registrant also distributed annual equity awards widely among its employees. Social Security taxes withheld would likely not be a CACM unless all employees earned less than the Social Security wage base. The registrant must also briefly disclose the compensation measure used. Although the CACM must reasonably reflect annual compensation, it is not expected that the CACM would necessarily identify the same median employee as if the registrant were to use annual total compensation. [October 18, 2016]*

- a. Many global registrants and some domestic registrants we work with do not have direct access to actual payroll data for their entire workforce, which makes use of a CACM like taxable wages or W-2 compensation difficult to accomplish. The inability to track this pay information creates an interpretational problem for registrants with a workforce profile that includes both hourly and salaried employees, with the former eligible for overtime or pay differentials and the latter eligible for an annual bonus. Because these registrants cannot easily assemble taxable wages, which would include all these elements of compensation, they are left to decide whether the regulations permit them to use base pay, which is perhaps the only pay definition they can readily obtain for all employee types, as a CACM.
- b. Read on their own, the first several sentences of the question in CD&I 128C.01 seem to permit registrants to use base pay as a compensation measure that “reasonably reflects the annual compensation of employee.” However, the later sentences call this interpretation into question, with the example of a registrant that grants equity awards widely among its employees. For example, if the vast majority of a registrant’s workforce consists of hourly employees eligible for overtime or shift differentials, with a small management cadre that receive an annual bonus, a registrant would be concerned that it would be required to use a CACM that included the

overtime wages, despite the fact that this information is exceedingly difficult and expensive to collect. Importantly, our analysis of registrant pay demographics has shown that gathering this additional information is likely to provide very limited incremental value and have little or no impact on the individual who is ultimately selected as the median employee.

- c. The very nature of a compensation structure in which a large number of employees can receive overtime is far different than the example provided where equity is widely granted. Most registrants we work with manage equity grants from a central location, so adding the equity values back into the CACM is a relatively straightforward exercise. This is quite different for overtime or shift differentials, where this information is often kept by location and may not be readily accessible to global registrants, so there is a clear distinction from the example provided in the CD&I.

Recommendation: We recommend that the Commission amend its answer in CD&I 128C.03 to clarify that registrants can use base pay as a CACM in most circumstances by deleting the following sentence:

“For example, total cash compensation could be a CACM unless the registrant also distributed annual equity awards widely among its employees.”

and substituting the following sentence:

“For example, base pay would be an appropriate CACM where a registrant has a workforce that receives different elements of pay, such as those that have both hourly and salaried employees.”

4. Make clear that the disclosure can be a “reasonable estimate.”

Instructions 4 to Item 402(u) describes the “Methodology and use of estimates” to be used in compiling the pay ratio, providing:

1. *Registrants may use reasonable estimates both in the methodology used to identify the median employee and in calculating the annual total compensation or any elements of total compensation for employees other than the CEO.*
 5. *The registrant shall briefly describe the methodology it used to identify the median employee. It shall also briefly describe any material assumptions, adjustments (including any cost-of-living adjustments), or estimates it used to identify the median employee or to determine total compensation or any elements of total compensation, which shall be consistently applied. The registrant shall clearly identify any estimates used. The required descriptions should be a brief overview; it is not necessary for the registrant to provide technical analyses or formulas. If a registrant changes its methodology or its material assumptions, adjustments, or estimates from those used in its pay ratio disclosure for the prior fiscal year, and if the effects of any such change are significant, the registrant shall briefly describe the change and the reasons for the change.*
- a. We believe the above instruction gives registrants the flexibility to describe the methodology used to determine the median employee, but does not explicitly permit them to describe the essence of their pay ratio disclosure: that the disclosure itself is an estimate. This notion is inherent in the flexibility registrants are granted under the regulations to use estimates in their calculation, per Instruction 4 to Item 402(u):

- Subsection 1 permits registrants to “use reasonable estimates both in the methodology used to identify the median employee and in calculating the annual total compensation or any elements of total compensation for employees other than the CEO.”
 - Subsection 2 permits a registrant to “use its employee population or statistical sampling and/or other reasonable methods” in determining the employees from which the median employee is identified.
 - Subsection 3 affords great flexibility to use “annual total compensation or any other compensation measure that is consistently applied to all employees included in the calculation” to identify the median employee.
- b. Taken together, these instructions make it very clear that when determining the median employee, registrants are permitted to take an approach that is highly likely to yield a different pay ratio than they would obtain if they were required to calculate the SCT total compensation number for every employee before selecting the median employee. The issue on which we seek clarification is whether the SEC believes it would be permissible for registrants to disclose their pay ratios while stating that the calculation is an estimate.
- c. We read the preamble to the Adopting Release as endorsing a disclosure of the calculation being an estimate, as it discusses the reasoning behind permitting use of a CACM in the proposed regulations:
- *“Instead, we believed that registrants would be in the best position to select a compensation measure that was appropriate to their own facts and circumstances and that a consistently applied compensation measure would result in a reasonable estimate of a median employee [emphasis added] at a substantially reduced cost.”*
- d. Consistent with this notion of the calculation being an estimate is additional language in the preamble to the Adopting Release acknowledging that the permitted flexibility limits comparability:
- *“One result of allowing for this flexibility, however, is that the comparability of the pay ratio from registrant to registrant may be further diminished. We recognize this consequence but believe it is justified in light of the cost savings that such flexibility will provide and because we do not regard precise comparability as the primary objective of the final rule.”*

Recommendation: To help registrants properly present their calculations in their proxies (which is a “filed” disclosure subject to the added scrutiny such disclosures warrant), we respectfully suggest that the SEC should endorse a disclosure that includes the notion that the disclosure is an estimate. We would recommend that the Commission add a new CD&I 128C.06 to clarify that registrants can disclose that their pay ratio is an estimate:

Question: *If a registrant does not use annual total compensation calculated using Item 402(c)(2)(x) of Regulation S-K (“annual total compensation”) to determine the median employee, would the registrant be permitted to describe that it has not undertaken an exact calculation to identify the median employee and that the disclosed ratio should be viewed as a best estimate?*

Answer: *Yes. When a registrant uses a CACM other than annual total compensation, this will result in a reasonable estimate of a median employee rather than being an exact calculation of the median employee using annual total compensation calculated under Item 402(c)(2)(x) of Regulation S-K. For*

this reason, a registrant can disclose that, based on the methodology it selected, its disclosure of the CEO pay ratio is a reasonable estimate calculated in a manner consistent with the regulations.

5. Allow registrants to use readily accessible records to determine employee classifications (e.g., temporary or full-time employee).

Item 402(u)(3) provides that for purposes of paragraph (u), “employee or employee of the registrant means an individual employed by the registrant or any of its consolidated subsidiaries, whether as a full-time, part-time, seasonal, or temporary worker, as of a date chosen by the registrant within the last three months of the registrant’s last completed fiscal year.”

- a. Many global registrants find it impossible to independently verify the information provided by home-country representatives from foreign jurisdictions identifying the differences between full-time, part-time, seasonal or temporary workers and are forced to rely on the information provided in performing their median pay determinations.
- b. Being able to use these identifiers is extremely important for registrants that want to annualize compensation for employees who commence work during the determination year. Without being able to isolate their employees by these identifiers, registrants would be forced to treat all employees as if they were not able to have compensation annualized, which would result in them finding a lower-paid median employee than should be the proper result.
- c. The regulations permit registrants to use reasonable estimates both in identifying the median employee and in calculating any elements of total compensation. The regulations also provide that “In determining the employees from which the median employee is identified, a registrant may use its employee population or statistical sampling and/or other reasonable methods.”
- d. The regulations do not explicitly acknowledge, however, that registrants can use reasonable estimates in assembling demographic data, such as employee classifications. It would be extremely helpful for registrants to understand that they could rely upon the data they have pulled from existing employee records even in the absence of any ability to independently verify this data or its consistency across jurisdictions.

Recommendation: To assist registrants with internationally diverse sources of worker information, we recommend that the Commission adopt a new CD&I 128C.07 to clarify that the use of existing demographic data is permissible:

Question: *May a registrant rely upon records from its payroll or HRIS systems as it differentiates between employee classifications such as full-time, part-time, seasonal, or temporary workers?*

Answer: *Yes. Registrants can rely on the demographic information provided to them from various payroll and/or HRIS systems to the extent they reasonably believe that the data provided is accurate. The use of information from these systems for other internal or external reporting purposes is sufficient evidence that the registrant considers the data to be sufficiently accurate to rely on for this purpose.*

6. Clarify how “reasonable assumptions” can be used as part of statistical sampling for registrants with global workforces.

Instructions 4 to Item 402(u) describes the “Methodology and use of estimates” to be used in compiling the pay ratio:

1. *Registrants may use reasonable estimates both in the methodology used to identify the median employee and in calculating the annual total compensation or any elements of total compensation for employees other than the CEO.*

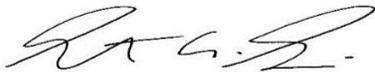
 5. *The registrant shall briefly describe the methodology it used to identify the median employee. It shall also briefly describe any material assumptions, adjustments (including any cost-of-living adjustments), or estimates it used to identify the median employee or to determine total compensation or any elements of total compensation, which shall be consistently applied. The registrant shall clearly identify any estimates used. The required descriptions should be a brief overview; it is not necessary for the registrant to provide technical analyses or formulas. If a registrant changes its methodology or its material assumptions, adjustments, or estimates from those used in its pay ratio disclosure for the prior fiscal year, and if the effects of any such change are significant, the registrant shall briefly describe the change and the reasons for the change.*
- a. Willis Towers Watson has assisted a number of registrants with global workforces manage their data collection efforts through the use of statistical sampling. Typically, this approach requires two distinct steps:
 - **Step 1:** Gather demographic information from each overseas location or business unit to quantify the number of workers that are within distinct pay ranges. Assume, for example, the registrant had a single business unit with employees in 30 overseas locations. Even though the registrant is not required to assemble precise pay data for each employee in those 30 locations, the registrant must provide sufficient detail on pay ranges, the number of employees within each range, the additional elements of compensation available at those ranges, and the part-time, full-time, temporary or seasonal status of those workers. For many registrants, this is a burdensome, time-consuming and expensive data-gathering effort.
 - **Step 2:** Once this information is assembled, it's possible to isolate the pay levels at which the median employee is likely to be found. Registrants will then determine how many workers to gather actual pay data on in order to have a statistically valid sample and produce a reliable estimate of pay for the median employee. They then will gather as much pay data as necessary for this group, with most registrants gathering all or nearly all elements of compensation that would be included in total annual compensation.
 - b. While this process is far less time-consuming than it would be if a CACM needed to be gathered for an entire global workforce, the efforts required are still significant.
 - c. We believe there's an alternative approach that would be far less time-consuming, while yielding a substantially similar estimate of the CEO pay ratio. However, we're unsure if this approach is permissible under the final regulations. While we feel confident that we understand what the regulations permit with respect to statistical sampling, there's little guidance as to the Commission's expectations when registrants use "reasonable assumptions."
 - d. We further believe this ambiguity can be clarified via an additional CD&I that would provide an example of how registrants can approach a global data-gathering effort using reasonable assumptions deemed permissible by the Commission.
 - e. Rather than use the two-step process described above, the Commission could clarify that the following approach is permissible where registrants have global workforces in multiple jurisdictions:

- **Step 1:** Clarify that where an organization has employees in multiple jurisdictions within the same business unit, it can use a sample of the employees from a single jurisdiction to represent the employees from other jurisdictions in that business unit **provided** that the registrant uses a statistically valid adjustment method, such as differences in average compensation (either actual or after a COLA) to adjust for any differences in compensation between employees in the varying jurisdictions.
 - For a registrant with a single business unit in 30 countries, this would enable it to gather demographic data only for a single or small subset of locations and then make adjustments to that information for the remaining jurisdictions. For example, if the registrant had a business in 10 countries in Western Europe, it might collect data in one or two countries and then use that information to estimate the pay for employees in the remaining jurisdictions.
- **Step 2:** This step would be the same as described above.

This approach would require only a relatively modest data-gathering effort for a limited number of jurisdictions, but it would still require the registrant to have headcount information for the remaining jurisdictions and a basic understanding of whether the pay structures in those countries are the same as where the demographic data were gathered. The result would be to substantially reduce the data-collection efforts while yielding a similar estimate for the CEO pay ratio disclosure.

We appreciate the opportunity to offer these comments and would be pleased to provide any additional information that might be helpful to the Commission in preparing additional guidance on the final regulations.

Please contact Steve Seelig at [REDACTED] if you have any questions or need further information regarding our comments.



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