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Michael S. Piwowar,
Acting Chairman
Securities and Exchange Commission
100 F Street, NE
Washington, CC 20549-1090

Dear Acting Chairman Piwowar,

This comment is in response to your request for comments on further delay in implementing Section 953(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act). This Section requires public companies to disclose the ratio of median annual total compensation of all employees to the total annual compensation of the chief executive officer (the "CEO-employee pay ratio"). This request is based on unspecified, "unanticipated compliance difficulties" some issuers have reported to the Securities and Exchange Commission (SEC).

In my opinion, the implementation of this Section should not be delayed because of past considerable delays in implementing this Section, the wide flexibility the SEC has given corporations in computing the ratio, and the considerable capabilities of public companies with today's technology to collect and analyze data and the time they have been given to do so. This information is not already disclosed to investors, it is material to investors, and important to long-term shareholder value creation.

A. Long delays in implementation.

In terms of delays in implementation, almost seven years have passed since Section 953(b) was enacted as federal law on July 21, 2010. The SEC took three years to propose its rule for Section 953(b)'s implementation and an additional two years to adopt its final rule.[1] There was plenty of time for companies to comply with the rule who are now claiming they have "begun to encounter" difficulties. The SEC's final rule was not applicable until January 1, 2017, a year and five months after it was issued on August 5, 2015. Moreover, the SEC rule does not apply to proxy statements until January 1, 2018, which is two years and five months after the SEC's issuance of its final rule and well over seven years since Section 953(b)'s enactment.

B. Wide flexibility in implementation.

Moreover, the SEC has given companies considerable flexibility in computing their ratio by allowing them to use any reasonable statistical sampling method to identify their median employee, any compensation measure consistently applied, and requires them to identify the median employee only once ever three years. The SEC stated its implementation philosophy with respect to Section 953(b) as follows, "we believe [companies] must make their own determinations on what is appropriate based on their own facts and circumstance."[2] I believe that the SEC has been too flexible in this regard and in doing so has hindered the comparability of ratios across companies. This is reminiscent of the SEC's modification of the net capital rules for brokers in 2004 that essentially deferred to company expertise and resulted in large increases in leverage at these companies, contributing to the financial crisis of 2008-2009.[3]

In view of the flexibility granted to companies by the SEC and the extensive delays in implementing Section 953(b) further delay appears unwarranted.

C. Unavailability of CEO-employee pay ratio information.

Information concerning the CEO-employee pay ratio is not readily available to investors. This is because it is difficult to find useful data on lower-level employee compensation. The U.S. Department of Labor (DOL), Bureau of Labor Statistics data provides only industry-specific employee compensation information, not company-specific data. Company-specific data is available on a limited basis from private sources and is based on data voluntarily disclosed by companies. This creates a self-selection bias problem. This kind of bias is demonstrated in a study that found companies that did not voluntarily disclose the number of workers they employed by geographical segment were companies that were offshoring jobs and therefore anticipated worker and public backlash if they disclosed that information.[4] Similarly, those companies that do not voluntarily disclose lower-level employee compensation information to private sources may not do so because they have high pay disparities.

The databases are problematic. As previously noted, the DOL provides only industry-specific information. A number of fairly current pay disparity studies use old data from private sources from the 1981-1985 period when CEO pay ratios were much lower than they are today, from roughly 30-to-1 to 59-to-1.[5] Other studies use reported data of bank holding companies that are now required to disclose this information. However, these companies appear to have much lower ratios than those of other U.S. public companies, with at the higher end pay ratios of 32-to-1. The CEO-employee ratio of major U.S. companies was estimated at 276 to 1 in 2016.[6] Of course, pay ratio calculations vary depending on what is included in compensation and in the private databases.

D. CEO-employee pay ratios are meaningful and useful.

The main argument made against disclosure of the CEO-employee pay ratios is that these ratios are meaningless because they vary among companies in different industries and that follow different business models.[7] However, all numbers the federal disclosure regulations require public companies to disclose, including profits, vary among companies in different industries and that follow different business models. If different industries, structures and strategies of companies, and their different business philosophies, justified non-disclosure of information, there would be nothing for public companies to disclose to investors in their filings with the SEC.

Information made available in SEC filings is often more meaningful to investors when analyzed by security analysts who control for various differences among companies. In the context of CEO-employee pay ratio studies, researchers control for such factors as industry sector, firm size, job mix, location and other factors such as corporate performance and leverage to arrive at excess pay ratios, called the residual, that provide a basis for analysis. Unfortunately, the SEC has not sought to facilitate comparisons by investors of "CEO pay ratios from one registrant to another"[8] and thus granted companies very wide flexibility in devising their ratios, because it has been persuaded by industry that such comparisons are meaningless.

Nevertheless, CEO-employee pay ratios are also meaningful from an intra-corporate perspective as discussed below. Note that employee compensation is an accounting number and is clearly material to companies in their calculation of profits. Disclosing this information is no different from disclosing R & D, inventories or other financial numbers.[9]

E. CEO-employee pay ratios are material to investors.

Shareholders care about CEO-employee pay ratios. They provide boards of directors an internal benchmark in setting CEO pay and information relevant to shareholders in evaluating CEO pay. Their disclosure may encourage corporate boards to defer less to CEOs on compensation matters and focus on pay disparities within their companies. They may be the only effective means for limiting enormous CEO pay packages that lead to CEO overconfidence resulting in inappropriate risk assessments and unfortunate internal corporate dynamics. CEO-employee pay ratios foster unethical cultures within corporations and problematic work cultures that impact corporate performance. Finally, they contribute to income inequality that will have negative long-term consequences for companies and the economy in general.

Internal Benchmark for boards of directors in setting CEO compensation. The CEO-employee pay ratio provides an internal benchmark that assists boards of directors in determining executive compensation. This is particularly important when external benchmarks have a ratcheting up effect as individual boards tend to set their CEO's compensation above the average CEO pay to signal confidence in their CEO. A number of studies have found that CEO compensation is excessive (rent seeking). Shareholders consider CEO-employee pay ratios relevant in evaluating executive compensation, as demonstrated in a recent study.[10] This study found a positive association between shareholders' dissent on "say on pay" proposals and higher levels of CEO-employee pay ratios.

Evaluation of boards of directors. Shareholders may assess the degree of influence CEOs have over their boards of directors with information on their companies' CEO-employee pay ratios. Some scholars view boards as unduly influenced by CEOs in deciding CEO compensation. The public disclosure of CEO-employee pay ratios has the potential of constraining boards from deferring to CEOs on compensation matters and encouraging them to limit excessive CEO compensation. It also propels boards to develop compensation policies that give more attention to internal pay disparities.

Ethical cultures. In my research I have found that large pay disparities contribute to an unethical culture within corporations.[11] This is a topic material to shareholders. Large pay disparities constitute a message by corporate leaders to employees about the values of the company they work for. Scholars have stressed the importance of corporate leaders in setting the moral tone for their corporation.[12] Moreover, they have classified corporate cultures as self-interested (instrumental-egotistical), benevolent or principled, finding that selfish cultures contribute to unethical behavior within corporations.[13] Corporate leaders send a message to others working within their corporations when they pay themselves enormous pay packages and do not share the wealth with their employees. They make individual self-interest particularly salient. Large disparities in compensation, as indicated by CEO-employee pay ratios, contribute to employees' perception of this message from their leaders that the corporation's main function is to serve individual self-interests.

Moreover, a compensation system that employees perceive to be fair contributes to an ethical culture within corporations.[14] One scholar notes, "[t]he importance placed on fairness is related less to the possibility that pay inequities will result in lower effort among disgruntled employees than to a larger concern with creating a set of corporate values that will be perceived as legitimate and moral by the work force."[15] Large pay disparities send a negative message concerning the legitimacy and morality of corporate authority and corporate purpose.

Self-interested cultures serve the self-interest of individual employees but do not necessarily serve the long-term interest of their corporations and shareholders. Ethical corporate cultures have become increasingly important and have a dramatic impact on both investors and the economy generally, as exhibited by the contributions of unethical corporate cultures to the financial scandals of the early 2000s and the financial crisis of 2008-2009.[16] Additional evidence of the negative impact of high pay disparities on ethics within corporations is found in an unpublished study that found a negative relation between higher CEO-employee pay ratio and financial reporting quality.[17] My analysis of what happened at Enron also provides support for the relevance of pay disparities to ethical cultures.[18] Moreover, the CEO's sense of self-importance enhanced by large pay disparities may increase the CEO's perception that rules and norms do not apply to them.[19] Thus, attention to pay disparities is important to the ethical cultures of corporations and material to investors.

CEO overconfidence and less accountability. Large disparities in compensation increase the likelihood of overconfidence on the part of CEOs due to the positive feedback these ratios reflect. Excessive overconfidence results in inappropriate assessments of risk. One study explored the impact of CEO hubris on the size of acquisition premiums.[20] One measure of CEO hubris used was the ratio of the CEO's pay relative to that of the second-highest paid executive in the company; this measure was viewed to be a "telling indicator of the CEO's own sense of potency and self-esteem."[21] The study found a positive relationship between pay ratios and the size of acquisition premiums. It also found hubris to be negatively related to company performance. This study provides evidence of the significance of CEO-employee ratios to assessing hubris and the effect of hubris on corporate decision-making.

Large pay disparities in compensation within the corporation can lead to less accountability for CEOs when large disparities in compensation lead underlings to curry favor with them in hopes of being promoted or increasing their compensation.[22] CEOs receive less critical feedback from employees and therefore become less accountable in this politicized environment, which in turn feeds the CEOs' overconfidence.[23]

Impact on treatment of employees. High pay disparities as well as high compensation activate CEOs' economic self-concept, making economics much more salient to them.[24] This increases the likelihood that they will view employees as merely short-term means to an end. For instance, one study found that downsizing of a corporation's workforce was more frequent when a significant portion of the CEOs' compensation consisted of stock options.[25] Large pay disparities also symbolize CEOs' status and power, creating greater psychological distance between CEOs and lower-level employees.[26] One study found a relationship between high CEO compensation and the callous treatment of lower-level employees.[27] The definition of callous treatment in this study included significant workforce reductions, poor union relations, substantial penalties or controversies regarding employee health and safety standards, underfunded or inadequate retirement plans, and other employee relation controversies.[28] While this treatment is important to employees, it is important to shareholders as well.

Lower-level employee behavioral implications. The relevance of pay disparities to employee motivation and behavior has been the subject of research for many years. The study of CEO-employee pay disparities in public companies has been hindered by the difficulty in acquiring company-specific information on lower-level employee compensation, as previously discussed. There have been recent studies on pay disparities within the top management team of public companies and within bank holding companies because of recent compensation disclosure requirements. However, this research is not specifically applicable to the CEO-employee pay ratio of major U.S. corporations other than bank holding companies. However, I find one study of relevance that addressed the issue of whether some employees lower in the hierarchy care about CEO pay. This study considered pay disparities between the CEO and the top five levels of managerial employees.[29] It found that the managerial employees were more likely to leave the firm when they were underpaid relative to the CEO and more importantly, that this effect was more pronounce for the two lowest levels of managers. The researchers gave the following explanation for this finding: "Perhaps overpayment of the CEO is particularly salient to those at lower levels in the organization because of the fact that their financial situation contrasts most sharply with that of the CEO. In this instance, inequity relative to the CEO may create more intense feeling of injustice."[30]

There are a couple of studies on the CEO-employee pay ratio that I am aware of that I have not already discussed. There is a careful article on the CEO-employee pay ratio that found that the ratio "depends on the balance of power between the CEO (relative to the board) and ordinary employees (relative to management)."[31] However, it did not find a negative relationship between relative pay and employee productivity. A limitation of this study, discussed by its authors, is that its database was subject to the self-selection bias. The sample used was also comprised of firms with lower ratios than usually attributed to public companies. Another study was submitted to the SEC in a comment on the SEC's proposed CEO pay ratio rule.[32] This study found a negative relationship between an increase in CEO-employee pay ratios and excess total shareholder return for nine of ten major industry segments of the S& P 500 Index for the years 2007 to 2012. This study used DOL lower-level employment data that is in my opinion less subject to the self-selection bias than other databases that rely on voluntary company disclosures. The DOL only provides researchers with industry-specific information. Also, the bias would normally lead to a finding that would contradict the finding of this study.

Inequality. Pay disparities contribute to inequality in the United States. One study of the causes of inequality found that among other explanations the "more likely explanation for the strong income growth at the top of the income distribution over the past decade is the rapid acceleration of chief executive compensation."[33] Increasing inequality is a concern for corporations and investors. It impacts consumer demand for products.[34] While declining wages have been offset to some degree by consumer debt and workers (and their family members) working longer hours, there are limits to these strategies for creating consumer demand. Rising inequality also raises the specter of political instability. This increases business risk. The polarization, anger and dissatisfaction of workers, as exhibited in the popularity of Bernie Sanders and Donald Trump in the most recent national election, are signs of significant political dissatisfaction. Recent research also suggests that inequality has a negative effect on a nation's economic growth.

In conclusion there are many reasons why the CEO-employee pay ratio is material to investors. It provides an internal benchmark for boards of directors in setting executive compensation and information relevant to shareholders in evaluating CEO pay. Its disclosure will encourage corporate boards of directors to defer less to CEOs on compensation matters and focus on pay disparities within their corporations. It leads to CEO overconfidence that results in inappropriate risk assessments and unfortunate internal corporate dynamics. It fosters unethical and problematic work cultures. It contributes to income inequality that will have negative long-term consequences for corporations and investors.

I therefore urge the SEC to not further delay the implementation of Section 953(b). It has been the law on the books since July 21, 2010.

Sincerely yours,

Lynne L. Dallas
Professor of Law

[1] SEC Release No. 33-9877, No. 34-75610, Pay Ratio Disclosure, Final Rule, Aug. 5, 2015, https://www.sec.gov/rules/final/2015/33-9877.pdf (hereinafter "SEC Release Final Rule"); SEC Release No. 33-9452, 34-70443, Pay Ratio Disclosure, Proposed Rule, Sept. 18, 2013, https://www.sec.gov/rules/proposed/2013/33-9452.pdf (hereinafter "SEC Release Proposed Rule").

[2] SEC Release Final Rule, *supra* note 1, at 118, 227-28n.628.

[3] Alternative Net Capital Requirements for Broker-Dealers That Are Part of Consolidated Supervised Entities, Exchange Act Release No. 34-49830, 69 Fed. Reg. 34428 (June 21, 2005); Lynne L. Dallas, *Short-Termism, the Financial Crisis, and Corporate Governance*, 37 J. Corp. L. 265, 294 (2012)(hereinafter "*Short-Termism*").

[4] Anne Beatty & Scott Liao, *What Do Multinationals' Disclosure of the Number of U.S. Versus Foreign Employees Tell Us?* Mar. 19, 2012, http://www8.gsb.columbia.edu/rtfiles/accounting/ANNE.BEATTY.pdf.

[5] Lawrence Mishel and Jessica Schieder, *CEO Makes 276 Times More Than Typical Workers*, Economic Policy Institute, Aug 3, 2016, http://www.epi.org/publication/ceos-make-276-times-more-than-typical-workers/ (noting the CEO-employee pay ratio of U.S. major companies was estimated at 30-to-1 in 1978 and 59-to-1 by 1989).

[6] *Id.*

[7] SEC Release Proposed Rule, *supra* note 1, at 47n.93. As the SEC stated in its Final Rule Release: "As we noted in the Proposing Release, we do not believe that precise conformity or comparability of the pay ratio across companies is necessarily achievable given the variety of factors that could cause the ratio to differ. Consequently, we believe the primary benefit of the pay ratio disclosure is to provide shareholders with a company-specific metric that they can use to evaluate the PEO's compensation within the context of their company." SEC Release Final Rule, *supra* note 1, at 12.

[8] *Id.*

[9] Many companies already report employment compensation data to the DOL. If companies were required to provide this information to the DOL and this information were disclosed on a company-specific basis, investors could obtain information on average employee compensation that would enable them to calculate a version of the CEO-employee pay ratio, provided they had information on higher paying managerial compensation to exclude from the calculation. Company-specific employment compensation information for other than the five highest paid company employees, however, has not been provided to investors for U.S. public companies other than bank holding companies.

[10] Steven S. Crawford, Karen K. Nelson & Brian R. Rountree, *Mind the Gap: CEO - Employee Pay Ratios and the Shareholder Say on Pay Votes*, January 2016, https://www8.gsb.columbia.edu/facultyresearch/sites/facultyresearch/files/CNR%20Jan2016%20(002).pdf (using banking holding company lower-level employment compensation data).

[11] Lynne L. Dallas, *A Preliminary Inquiry into the Responsibility of Corporate Officers and Directors for Corporate Climate: The Psychology of Enron's Demise*, 35 Rutgers L. J. 1 (2003) (hereinafter "*The Psychology of Enron's Demise*").

[12] *Id.* at 40-42; Mary Zey-Ferrell & Larry G. Gresham, *A Contingency Framework for Understanding Ethical Decision-Making in Marketing*, 49 J. MARKETING 87, 91 (1985); W. Michael Hoffman et al., *Integrating Ethics into Organizational Cultures*, in BUSINESS ETHICS 39, 43-44 (Chris Moon & Clive Bonny eds., 2001); Chris Moon & Clive Bonny, *Attitude and Approaches*, in BUS. ETHICS 22, 28-30, 34 (Chris Moon & Clive Bonny eds, 2001); Randall S. Upchurch & Sheila K. Ruhland, *The Organizational Bases of Ethical Work Climates in Lodging Operations as Perceived by General Managers*, 15 J. BUS. ETHICS 1083 (1996); James C. Wimbush & Jon M. Shepard, *Toward an Understanding of Ethical Climate: Its Relationship to Ethical Behavior and Supervisory Influence*, 13 J. BUS. ETHICS 637, 642 (1994).

[13] Dallas, *Psychology of Enron's Demise*, *supra* note 11, at 25-32; Bart Victor & John B. Cullens, *The Organizational Bases of Ethical Work Climates*, 33 ADMIN. SCI. Q. 101, 104-113(1988)(developing the ethical classification system for corporate cultures); Wimbush et al., *Empirical Examination of the Multi-Dimensionality of Ethical Climate in Organizations*, 16 J. BUSINESS ETHICS 67, 74-75 (1997) (finding support for this classification system); Wimbush & Shepard, *supra* note 12, at 641 (finding that the self-interested cultures foster unethical behavior).

[14] Dallas, *The Psychology of Enron's Demise*, *supra* note 11, at 37-38; Peter B. Doeringer, *The Socio-Economics of Labor Productivity*, in MORALITY, RATIONALITY, AND EFFICIENCY 108 (Richard M. Coughlin ed, 1991); Moon & Bonny, *supra* note 12, at 29 (discussing a 1999 employee survey demonstrating that fairness was one of the most important factors in a successful ethics program); Harvey S. James, Jr., *Reinforcing Ethical Decision-Making*

Through Organizational Structures, 28 J. BUS. ETHICS 43, 54 (2000).

[15] Doeringer, *supra* note 14, at 108-109

[16] Dallas, *The Psychology of Enron's Demise, supra* note 11, at 45-55; Dallas, *Short-termism, supra* note 3, at 316-23, 355-61.

[17] Xiaoyan Cheng, David Smith & Paul Tayi, *CEO Pay Ratios and Financial Reporting Quality*, May 13, 2014 (on file with author).

[18] Dallas, *The Psychology of Enron's Demise, supra* note 11, at 34-40, 45-55

[19] Sreedhari D. Desai et al., *When Executives Rake in Millions: the Callous Treatment of Lower Level Employees: Meanness in Organizations* (2011), at 7, *available at* http://www.cps-news.com/wp-content/misc_pdfs/When_Executives_Rake_in_Millions.pdf

[20] Mathew L.A. Hayward & Donald C. Hambrick, *Explaining the Premiums Paid for Large Acquisitions: Evidence of CEO Hubris*, 42 ADMIN. SCI .Q. 103 (1997).

[21] *Id.* at 121.

[22] Dallas, *The Psychology of Enron's Demise, supra* note 11, at 36-37.

[23] *Id.*

[24] Desai, *supra* note 19, at 6-7.

[25] Jiwook Jung, *Shareholder Value and Workforce Downsizing, 1981–2006*, 93 SOC. FORCES 1335 (2015)

[26] Desai et al., *supra* note 19, at 7-9.

[27] *Id.* at 3-4.

[28] *Id*. at 11-12.

[29] James B. Wade, Charles A. Reilly III & Timothy G. Pollock, *Overpaid CEOs and Underpaid Mangers: Fairness and Executive Compensation*, 17 ORG. SCI. 527 (2006).

[30] *Id.* at 540.

[31] Olubunmi Faleye, Ebru, and Anand Venkateswaran, *The Determinants and Effects of CEO-Employee Pay Ratios*, 37 J. Banking & Fin. 3258, 3258 (2013).

[32] Dieter Waizenegger, Executive Director, CtW Investment Group, SEC Comment Letter, Pay Ratio Disclosure File No. S7-07-2013, http://ctwinvestmentgroup.com/wp-content/uploads/2014/02/CtW-Investment-Group-comment-letter-20131125.pdf (defining excess return as the total shareholder return minus the sector benchmark return for the same period).

[33] E.g., Jonathan L. Willis & Julie Wroblewski, *What Happened to the Gain from Strong Productivity Growth*, FED. RESERVE ECON. REV. 1, 20 (2007).

[34] Ralph Gomory & Richard Sylla, *The American Corporation*, 142 DAEDALUS 102, 247 (2013), https://www.amacad.org/publications/daedalus/spring2013/13_spring_daedalus_GomorySylla.pdf .