Center On Executive Compensation

March 23, 2017

VIA Electronic Delivery

Mr. Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

RE: Request for Comment on the Reconsideration of the Dodd-Frank Pay Ratio Rule

Dear Mr. Fields:

The Center On Executive Compensation ("Center") is pleased to submit comments to the Securities and Exchange Commission ("Commission") providing its perspective on the Commission's reconsideration of the Dodd-Frank pay ratio disclosure.[1] Despite the Commission's attempt at providing flexibility in the final pay ratio rule, ongoing compliance efforts by registrants reveal significant and costly difficulties, particularly in determining the median compensated employee. Furthermore, several of the most important points of flexibility provided to registrants in the final pay ratio rule do not actually yield the intended compliance benefits envisioned by the Commission. The Center's letter provides the Commission with detailed feedback based on conversations with our Subscribing registrants on compliance difficulties and explains why the provisions in the final rule aimed at providing flexibility and reducing compliance burdens fail to do so.

The Center is a research and advocacy organization that seeks to provide a principles-based approach to executive compensation policy from the perspective of the senior human resource officers of leading companies. The Center is a division of HR Policy Association, which represents the chief human resource officers of over 360 large companies, and the Center's more than 125 subscribing companies are HR Policy members that represent a broad cross-section of industries.

I. Executive Summary.

In the final pay ratio rule, the Commission sought to provide registrants with compliance flexibility in hopes of reducing the excessive burdens stemming from identifying the median employee and developing the pay ratio disclosure. The flexibility was widely recognized as necessary due to the realization of the incredible compliance burdens imposed by the pay ratio along with an acknowledgement of the disclosure's highly questionable value.[2] Unfortunately,

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[1] See *Reconsideration of the Pay Ratio Rule*, Securities and Exchange Commission, (Feb. 6, 2017) available at https://www.sec.gov/news/statement/reconsideration-of-pay-ratio-rule-implementation.html (Last visited March 23, 2017).

[2] See Final Pay Ratio Rules at 80 Fed. Reg. at 50,107; See also "We also think it is important to observe that, despite our inability to quantify the benefits [of the pay ratio disclosure], Congress has directed us to promulgate this disclosure rule." 80 Fed. Reg. at 50,153.

as the Center will detail below, the benefits envisioned by the Commission stemming from the attempted flexibility in the final rule have either failed to fully materialize or the provisions providing such flexibility are outright unusable.

The combination of the burdens imposed by the pay ratio and the inability of many registrants to use the flexibility provided in the final rule carries significant implications. Registrants have no legitimate business purpose for aggregating the data required to comply with the pay ratio. Thus, the pay ratio rule imposes an otherwise purposeless exercise at a great expense of human and monetary capital.

Given that many, if not most, registrants are unable to effectively use much of the flexibility provided in the final rule, the Commission should revisit and simplify the core requirements in the pay ratio rule. The Commission can adopt the changes knowing there is not a single modification it could make to the rule which would impact its value as an investor tool or the end use of the pay ratio disclosure by those advocating for it. We would therefore urge the Commission to adopt the following changes to the pay ratio rule:

- Require only Full-Time, U.S. Employees in the Pay Ratio Disclosure: The majority of compliance issues facing registrants stem from the requirement to include all global employees, including part-time, temporary, and seasonal employees. Making this change would go a long way to resolving the most burdensome issues discussed below.
- In the Alternative, At a Minimum, Remove the Requirement Under the *De Minimis* Rule That Registrants Exclude All Employees in A Country: Registrants frequently reported being able to access segments of employee data in a foreign locality while being unable to access smaller segments of data in the same country. Accessing this data results in the incursion of significantly higher marginal costs than the rest of the data within the locality and is not likely to materially impact the overall ratio calculation. If the Commission determines not to limit the pay ratio calculation to only U.S. full-time employees, the Commission should permit registrants to exclude groups of foreign employees within a foreign locality without requiring the exclusion of everyone within the country. This change, at a minimum, would significantly reduce compliance costs for many registrants without any correlating reduction in the "value" provided by the pay ratio.
- Allow the "Calculation Date" to Be Any Day During the Registrant's Previous Fiscal Year: Registrants, particularly those with high employee turnover, have reported compliance difficulties with the calculation date. No matter the date chosen as the calculation date, registrants with high turnover always have an exceedingly difficult job identifying their employee populations. To provide flexibility, the final pay ratio rule allowed companies to use any date in the 90 days prior to fiscal year end to identify their employee population used for determining the pay ratio. Further, the final rule allowed companies to use prior year-end tax documents to determine the median employee. However, employee turnover in the period between the issuance of year-end tax documentation (*e.g.*, W-2 forms) and the calculation date in effect prevents the use of year-end tax documents to identify the median employee because often there is a wide range of employees who will not have year-end tax documents due to being hired after

tax documents were issued. The Commission can alleviate this issue, while also providing more compliance time, by allowing registrants to select any day in the registrant's fiscal year as the calculation date.

- Require Only Taxable Employees to Be Included in the Pay Ratio: Substantial confusion exists regarding whether temporary employees and independent contractors are required to be included in the pay ratio. The Commission should alleviate this issue by requiring only employees receiving a W-2 from the registrant to be included in the pay ratio.

The Center's comments provide greater explanation of the rationale for its suggestions and examples of why these changes are needed.

II. The Pay Ratio Disclosure Serves No Legitimate Business Purpose and Contradicts the Principles of the Federal Disclosure Regime.

No legitimate business purpose exists for collecting and maintaining the data required for compiling and calculating the Dodd-Frank pay ratio disclosure.[3] In fact, optimal operational efficiency for registrants, particularly for those operating globally, often dictates keeping payroll and human resources-related systems separate. This allows these systems to be tailored to the highly localized nature of human resources, taxation, and compensation practices.[4]

Compliance with the pay ratio disclosure, therefore, forces the creation of an otherwise wholly unnecessary process to gather data from purposefully separate systems. The resulting creation, implementation, and ongoing systems maintenance associated with annual pay ratio compliance imposes tremendous costs and resource burdens on registrants. Shareholders and employees bear the brunt of these costs, which, in the absence of the pay ratio mandate, would otherwise be used to enhance stakeholder value.

Today, there exists a broad consensus that, as a disclosure and a metric, the pay ratio cannot provide material value. Only a small cadre of labor unions, certain pension funds, special interest groups, and micro-minority shareholders unsurprisingly continue to argue that the pay ratio provides useful information to investors. In reality, and despite claims to the contrary, the pay ratio's only value rests in its ability to be used as a shaming and inflammatory talking point to admonish registrants by those with certain agendas.

The facts undercut the three general lines of argument attempting to cast the pay ratio as a valuable and material investor tool, none of which justify the resources spent by most public registrants to include the pay ratio in their annual proxy statement:

[3] According to a 2013 Center Survey, out of the 128 survey respondents, not a single registrant stated that there otherwise exists a legitimate business purpose for collecting the information necessary for calculating the pay ratio.
[4] Compensation practices are highly localized in nature and vary dramatically worldwide. In the United States, compensation is fairly straightforward and is typically composed of annual or hourly pay rate with the potential for a bonus or commissions. Worldwide, however, localized compensation can include food coupons, car stipends, housing allowances, rice allowances, and uniform credits, to name only a few. To accommodate these localized customs, not to mention compliance with localized taxation requirements, registrants must keep payroll purposefully decentralized.

1. General Shareholder Support: Shareholder support, beyond the small group of micro-minority special interest groups, fails to exist. The extreme infrequency of pay ratio shareholder proposals and the absolute lack of shareholder support for the few proposals voted on make this abundantly clear. Since 2010, only 17 shareholder proposals addressing or requesting a pay ratio have gone to a vote at S&P 500 companies. These proposals averaged less than 7% shareholder support with no proposal receiving more than 9.5% support.[5] When compared against other governance initiatives, the lack of investor desire for pay ratio becomes even more stark. For example, in 2016 alone 48 S&P 500 companies received proxy access proposals. These proposals averaged 51% support and 23 of the 48 received majority support.[6] Comparatively, in 2016 only two S&P 500 companies received proposals addressing pay ratio and pay disparity. These two proposals received average support of only 6%. Proponents of the pay ratio appear to understand the lack of mainstream support for the pay ratio and thus refrain from using shareholder proposals – a prototypical activist tool – because the lack of support undercuts the claim that the pay ratio is needed and desired by the investor community at large.
2. Executive Pay Transparency: Executive compensation information already spans an average of 30 pages of large registrant proxy statements.[7] Arguments that the Dodd-Frank pay ratio is needed to address a lack of transparency regarding executive compensation cannot stand when confronted with this data point.
3. The Pay Ratio "Metric": The pay ratio cannot provide shareholders with a measure by which to legitimately evaluate a registrant. The pay ratio fails as both a tool by which to compare a registrant against itself over a set period and as a tool to compare a registrant against its peers. First, the pay ratio metric uses the Summary Compensation Table definition of pay for CEO and median employee, which may differ considerably among years for the CEO since it includes items such as pension fluctuations, hiring incentives and accounting-based valuations of equity grants. This will cause the pay ratio to differ considerably in different years because of accounting requirements or changes in the structure of CEO pay even though there are no material changes in how the median employee is paid. Thus, the ratio is not a good barometer of internal trends in compensation. Second, each registrant's pay ratio will differ based on that registrant's unique business structure – *e.g.* owning manufacturing capabilities versus outsourcing them – thus rendering a peer-to-peer comparison (or any other comparison) of the pay ratio incoherent and misleading.

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[5] See *Pay Ratio Shareholder Proposals 2010 – 2017*, The Center On Executive Compensation, (March 1, 2017) available at http://www.execcomp.org/Docs/c17-27_PayRatio_Proposals.pdf (last visited March 23, 2017).
[6] See *Pay Ratio Proposals Compared to Prominent Proposals*, The Center On Executive Compensation, (March 1, 2017) available at http://www.execcomp.org/Docs/c17-26_PayRatio_SHPComp.pdf (last visited March 23, 2017).
[7] The Center maintains a database of executive compensation and proxy statement information for S&P 500 companies. According to Center Data, in 2016, S&P 500 Companies averaged 17.41 pages of Compensation Discussion and Analysis disclosure with a total average of 31.85 pages of proxy statement disclosure entirely devoted to executive compensation.

As the Center has previously explained, to expand the securities law concept of materiality-based disclosure to include the pay ratio opens the disclosure regime to inclusion of any political whim or desire of any group regardless of the general value or quality provided by the disclosure. The scope of required securities disclosure is not limitless, both out of necessity as well as in recognition that providing excessive, irrelevant, or misleading information contradicts the goals of the disclosure system. However, the SEC's clear goal of providing investors with only relevant and useful information facilitates an unavoidable tendency for the public to automatically assume that any information which is required to be disclosed is important, relevant, and helpful. Thus, while we understand Congress directed the Commission to implement the Dodd-Frank Pay Ratio requirement, we strongly urge the Commission to utilize the significant flexibility within its purview to implement the mandate in a manner which reflects the complete lack of value provided by the pay ratio given the implementation difficulties facing public registrants.

III. Ongoing Registrant Compliance Efforts Reveal Substantial Implementation Difficulties, Shortcomings of Purported Flexibility Offered in Final Rule.

In preparation for this comment letter, the Center engaged extensively with its Subscribers regarding their ongoing pay ratio compliance efforts. With the first disclosure set for early 2018, the registrants we engaged with had all taken significant steps towards determining the median employee of their global workforce. Although the SEC attempted to provide registrants with flexibility in the final rule, our conversations with registrants revealed that compliance with the pay ratio disclosure remains enormously burdensome and often requires a manual data collection process which is unable to be efficiently repeated on a year-to-year basis.

The chief and most concerning piece of feedback we consistently heard in our discussions with Subscribers involves the continued inability to gather the data needed to identify the median employee. This problem even extends to registrants which have a Human Resources Information System (HRIS) which provides access to employee compensation data. Keeping in mind that no legitimate business purpose exists for creating a system that provides access to all the data needed to comply with pay ratio, there are two factors which are the primary causes of the substantial difficulties in gathering the pay ratio data:

1. Employee Scope: The required inclusion of all employees globally, including full-time, part-time, temporary, and seasonal employees results in the largest burdens on registrants, particularly those which are global in scope. As noted above, registrants do not have a legitimate business purpose for retaining the records needed to calculate the pay ratio disclosure. The resulting process and data collection efforts needed to identify and gather information on employee populations worldwide is enormously time consuming and expensive. Furthermore, the inclusion of part-time, temporary, and seasonal employees serves as a multiplier of compliance difficulties because many registrants lack access to key information needed for pay ratio compliance for these specific employee groups.

2. Employee Turnover: Although employee turnover is an unavoidable business reality, it can make it exceedingly difficult for registrants to identify their employee population for the purposes of identifying the median employee. Some industries,

> such as the retail industry, have annual turnover rates which approach or even exceed 100%. The turnover rate is not a reflection of how these industries treat their employees. Rather, the turnover rate reflects the nature of the employment and the employee. However, turnover dramatically impacts the ability to calculate the pay ratio and to provide an "accurate" assessment of the median employee.

Our engagement with Center Subscribers has made it clear that these two factors work together to create enormous compliance headaches, even for registrants which have a common HRIS system which, theoretically, provides access to certain employment data from all locations. Even at the proposed rule stage, we shared our grave concerns based on feedback from our Subscribers as to the feasibility of gathering the data required to comply with the disclosure requirement. The points discussed below outline the routine experiences of registrants in complying with the final pay ratio rule.

A. Compliance With the Pay Ratio Imposes Excessive Data Collection Burdens on Registrants

Many registrants do not have access to the data required to calculate the pay ratio, even with the flexibility afforded to registrants in the final rule. To comply with the rule registrants are going to have to create a pay ratio compliance process from scratch at enormous expense, both in terms of human capital and company resources, which serves no other business purpose.

A key distinction here is between the data included in the human resources information system, or "HRIS" for short, and a registrant's payroll records. Increasingly, registrants are implementing unified, company-wide HRIS systems. These systems provide access to an array of human resources and compensation related information. With respect to compensation-related information, HRIS systems are typically limited to pay rate (*e.g.* $15 per hour) and the employee's classification (*e.g.* full-time or part-time). However, many if not most global registrants still have locally-developed payroll information including the actual hours worked by an individual as well as information on the many localized compensation practices, like food allowances, which are utilized around the world. Many registrants must rely on the local payroll systems to aggregate the information necessary to develop the pay ratio. However, these localized payrolls are not "connected" to the HRIS system, and thus, a manual data collection effort is required.

For example, one of our Subscribers, with 75,000 employees globally, would see a 90% reduction in compliance costs if the pay ratio were limited to only U.S. employees. This registrant has invested in a sophisticated HRIS system which provides access to an array of human resources information and some compensation data. Despite the sophistication and the capital spent implementing the system, it was not designed to provide for pay ratio compliance. Therefore, the registrant still must reach out to 30 out of over 80 separate countries to manually acquire the necessary data for calculation of the pay ratio – even after applying the 5% exception to eliminate many of its foreign localities which do not have significant employee populations. This is a common compliance issue among global registrants who are forced to engage in manual processes to aggregate data attributable to their foreign employee populations. According to a recent Center survey, the average Center Subscriber has operations in 38 countries.

A different Center Subscriber will be required to invest over 3,000 compliance hours – triple its initial estimates – on a cumulative basis by a team of at least 20 people across the globe as part of its data collection and validation process developed to comply with the pay ratio. This registrant does not possess a comprehensive HRIS system, and its pay ratio compliance process will involve manual data collection and subsequent validation of decentralized employee information.[8] The process will involve the collection of data from disparate payroll systems and the evaluation of many distinct incentive plan codes and programs.

The complications at another registrant are similar. This Center Subscriber is a global registrant with a centralized HRIS data system. The registrant began to develop its pay ratio by pulling information from its HRIS data system, but quickly found out that the system, which was not designed with pay ratio compliance in mind, lacked the ability to provide all the necessary records to identify the median employee. Thus, the registrant had to alter its compliance strategy and use its payroll records to develop the pay ratio. The registrant has 60 disparate payroll systems and providers globally, only some of which are connected to the HRIS system. Thus, the registrant must undertake a manual process to connect the data. To put into context the complexity of this process, there are over 1,500 earnings codes – detailing categories and types of compensation earned by an individual – with 709 of the codes relating to U.S. compensation alone.

Further complicating the process for this registrant, there are varying and inconsistent levels of data aggregation provided by the various disparate payroll systems which require manual work to comb through and smooth the data to make it consistent and comparable. The registrant received over 200 payroll files of data, provided in various formats and languages, most with multiple tabs of data which had be manually pulled, translated, smoothed, and validated before final input into the registrant’s data analysis tool. With 93% of the data gathered, the preliminary review of the data suggests that additional review and scrubbing of the data will be needed before a median employee can be identified from the data using the reasonable estimates provided in the final rule.

The elimination of non-U.S. employees would also help registrants which are primarily domestic as well. For example, registrants with foreign populations which approach but do not exceed the 5% limitation face significant consequences upon additional foreign investments which increase foreign populations above that limit. For instance, one of our Subscribers is a primarily U.S.-based registrant with an international employee population approaching 5%. With the ability to exclude international employee populations, this registrant can avoid the compliance issues facing many of the registrants above. However, the registrant is considering avoiding using the 5% exclusion out of concern that any future foreign investments may result in having to begin to include international employees when calculating pay ratio, thus forcing the registrant to change its pay ratio methodology to accommodate the inclusion of international

[8] The decentralized nature of payroll systems is a business necessity which allows registrants to accommodate the highly-localized practice of employee compensation which varies widely among international countries and can include everything from housing allowances to uniform coupons. It also allows compliance with local tax rules and other laws, like data privacy.

populations. Several other Subscribers, all primarily U.S. registrants with smaller, but growing, international presences, echoed this concern.

Another example which presents a departure from the foreign versus domestic employee issues regards U.S. expatriates working overseas. The compensation of expatriates is complex and includes allowances and payments which allow individuals to "equalize" compensation and ensure an individual can, for example, afford housing in countries with high costs. These allowances and equalization payments are necessary to entice individuals who are U.S. citizens to accept international work assignments. Tracking compensation for these individuals through the various tax circumstances resulting from working overseas is extremely challenging. The data is simply not included in a single system and mandates significant manual work to identify and quantify for the sole purpose of complying with the pay ratio.

B. The "Include One, Include All" Requirement of the 5% *De Minimis* Exemption Dramatically Increases Compliance Burdens Associated with International Employees

In the final rule, the Commission provided registrants with the ability to exclude up to 5% of its employee population – the "*de minimis*" exemption – with the caveat that, if one employee was excluded in a country, all employees in that country must be excluded. While the *de minimis* exemption has been helpful to registrants, the Commission could significantly reduce the burdens of the pay ratio rule by removing the caveat to the exemption which requires a registrant to exclude all employees in a country if a single employee is excluded.

Our engagement with Subscribers about ongoing compliance struggles revealed that registrants often do not have access to all the data in a foreign country for the purposes of finding the median employee. Often, specific compliance issues arise in obtaining access to pockets of data within a country. These pockets of data are highly inaccessible due to, for example, being maintained by a third-party provider. For instance, one registrant with a global HRIS system can access significant segments of the employee population in each of its 30 international countries. However, due to the constraints of the 5% *de minimis* rule and the requirement that upon excluding one employee in a country, all must be excluded, the registrant must undertake an inefficient, cumbersome, and manual effort to gather the data for the remaining employees, most of which is maintained by different third-party vendors and not accessible by their HRIS system. No central mechanism exists for administering or engaging with international third-party vendors, including payroll and temporary employment agencies, which will be different in each country. This requires an extraordinary amount of time and work for the sole purpose of pay ratio compliance.

Another registrant maintains a global HRIS system which provides access to most of the compensation data needed to identify the median employee. There are, however, several countries which are too large to be excluded under the 5% exclusionary rule where the HRIS system only provides about 80% of the necessary compensation data. Like the other example provided above, the data collection exercise necessary to identify, develop, and collect the remaining 20% of the data is a manual and cumbersome process. If the Commission decides not to make the pay ratio based on US employees only, this company and similarly situated ones will need to engage in a costly and time consuming process to gather the rest of the data.

C. <u>The Inclusion of Part-Time, Temporary, and Seasonal Employees Substantially Increases Compliance Costs and Distorts the Pay Ratio Disclosure</u>

As detailed below, the incremental costs and burdens associated with including part-time, temporary, and seasonal employees in the pay ratio are substantial. At the same time, the incremental information obtained from requiring the ratio to be computed based on part-time, temporary and seasonal employees does not justify the effort required to gather the information. Moreover, the income that a part-time or seasonal employee receives from a single employer could give a significantly distorted picture of the employee's annual income, if the employee also works for other employers during the year, as part-time and seasonal workers often do.

Registrants often maintain records for part-time and seasonal workers in a different manner than full-time employees. Even for registrants with HRIS systems, the *actual* hours worked by part-time employees are kept locally, at the payroll level. For example, registrants, especially those in industries with a high proportion of part-time employees, typically have a baseline number of hours which an individual works as a part-timer – *e.g.*, 20 hours per week. However, the actual number of hours worked can fluctuate dramatically. The actual number of hours worked are kept locally by payroll and are not usually transmitted to the registrant's HRIS system or another system. Thus, for part-time populations, many registrants can access the pay rate of part-timers, but they are unable to easily access the number of hours worked by the part-time employees to determine what the actual annual total compensation is. Gathering the data on part-time hours worked becomes a difficult process. Furthermore, many registrants rely heavily on part-time workforces, for example by employing college students, retirees and other individuals seeking a part-time only work arrangement.

D. <u>The Lack of Clarity Regarding the Inclusion of Independent Contractors Results in Significantly Increased Compliance Burdens</u>

Based on our discussions with Center Subscribers, the determination of whether independent contractors and certain temporary employees are required to be included in the pay ratio calculation is one of the most consistent areas of confusion and subsequent burdens for registrants. Many registrants work with third-party temporary agencies for temporary workers. These registrants negotiate with the agency regarding the compensation rate the temporary employees are paid or the registrants states they want a worker, or number of workers, at a certain rate. In these situations, the registrant does not pay the worker – the registrant pays the staffing agency which then pays the worker and typically provides access to other benefits. The registrant does not track any compensation data for these individuals who may perform work for the registrant for as little as a single day. However, under the final pay ratio rule and the subsequent CD&I's issued by the Commission, registrants do not believe there is clarity regarding whether these individuals are "independent contractors". The same confusion applies when addressing individuals who are independent contractors and who negotiate their salary with a registrant. Registrants are unclear as to whether such negotiations over salary result in the registrant having determined that individual's compensation as well as the definition of "minimum level of compensation" as referenced in the SEC Staff interpretations issued by the Commission in October 2016.[9]

For example, one Center Subscriber, Registrant A, is a primarily domestic registrant with its employees mostly located in the United States, and can therefore utilize the 5% exclusionary rule to eliminate countries with small employee populations in which it does business. However, the registrant employs many independent contractors which, under the current definition in the final rule, Registrant A has determined must be included in the pay ratio calculation. Many of these independent contractors are not employed by a third-party and instead have individual agreements with the registrant. To compile the data for independent contractors, Registrant A must manually identify each independent contractor and look at the individual agreement for their compensation. This, per Registrant A, is a tremendous undertaking which has significantly complicated the compliance process by adding an entirely manual workload which otherwise has no existing infrastructure or business purpose.

A different Center Subscriber – Registrant B – also employs many independent contractors. However, unlike Registrant A, most of these independent contractors are employed through a third-party staffing firm and Registrant B has determined these individuals are not required to be included in the pay ratio calculation. Additionally, for the individuals who are not employed by a third party, Registrant B still feels comfortable they fall outside of the definition of employee. Registrant A, on the other hand, largely due to the vagueness of the definition of employee and independent contractor in the final rule, has not arrived at the same conclusion and thus is subject to significantly more compliance work.

Another Center Subscriber – Registrant C – also is experiencing substantial compliance difficulties regarding the treatment of independent contractors. Registrant C uses an array of staffing firms to fulfill needed roles that last from anywhere from a day, to a week, to longer periods. Tracking the compensation for these individuals is nearly impossible as they are compensated by the third-party staffing firm – not by Registrant C – which instead pays the staffing firm. However, under the definition of independent contractor in the final rule, Registrant C believes these individuals should be included in the ratio because there is some company involvement in the discussion of the pay rate of the individuals, as Registrant C does not feel comfortable determining that these individuals only receive a "minimum level of compensation."

E. <u>The "Calculation Date" Requirements Often Prevents the Use of Year-End Tax Documents to Identify the Median Employee</u>

The employee population of a registrant is fluid and constantly subject to employee turnover. As a result, the employee population at the calculation date will never match the employee population date defined by pre-existing records, like W-2 or other international tax records. The resulting employee-tax record "gap" is extremely problematic. The resulting gap forces registrants to abandon the use of year-end tax records, like W-2s, for more complicated measures which are not as readily available as year-end tax documents. Other registrants determined to

[9] *Section 128C Answer 128C.05 – Item 402(u) Pay Ratio Disclosure*, Securities and Exchange Commission, available at https://www.sec.gov/divisions/corpfin/guidance/regs-kinterp.htm (last visited March 23, 2017).

continue to use tax records must supplement those records due to employee turnover in the interim period. This requires an extremely complicated process of annualizing the compensation for partial-year employees to create a parallel compensation figure.

The process of annualizing compensation, particularly for those registrants without a HRIS system is often an entirely manual and labor intensive process. For example, one Center Subscriber experiences nearly 100% workforce turnover in a year – the registrant hires as many as 120,000-130,000 employees annually for a workforce of 150,000. For this registrant and others which experience similar turnover rates, the three-month calculation date window does little to assist the registrant with compiling the pay ratio. Another, registrant informed the Center that to annualize compensation for their employees, each of the 75,000 employee records would have to be individually and manually examined to identify those which would need to be annualized. The registrant estimated the task would take approximately two minutes per record which amounts to about 2,500 hours or well over a year's work time for an employee. Other Subscribers echoed the concerns with the amount of work which would be required to identify specific records which can be annualized, particularly those in industries which experience high turnover rates. For example, one Subscriber reported that they plan to hire 80,000 employees as it enters its busy season and a total approaching 200,000 in a year. Another registrant employs nearly 400,000 employees worldwide and experiences a turnover rate which approaches 100% in its largest employee category. Neither of these registrants, because of the calculation date requirements as currently constructed in the final rule, can use year-end tax documents, like a W-2, as a consistently applied compensation measure.

F. <u>Calculating the Summary Compensation Table Value Compensation for the Median Employee Presents a Tremendous Challenge, Particularly for International Employees</u>

Once the median employee has been identified, registrants are required to calculate the Summary Compensation Table compensation value for the median employee. Unfortunately, the unique nature of the Summary Compensation Table, which lacks any similar value outside of the U.S. securities laws, has become a major burden for registrants charged with communicating what is needed to calculate the Summary Compensation Table value of an international median employee to their international staff. For example, one Center Subscriber expressed grave concerns with calculating the Summary Compensation Table value for the median employee. With an international employee population, the registrant found it nearly impossible to do an "apples to apples" comparison of the compensation practices and forms for each country. Major complications which arose resulted from differing fiscal years, pension/retirement values, and a lack of W-2 equivalents for international employees.

G. <u>Although Well-Intended, the Three-Year Median Employee Is Not Feasible For Most Registrants</u>

The final rule provides registrants with the ability to use the same identified median employee for a period of up to three years so long as the registrant determines there have not been any material changes in its workforce. In our conversation with Subscribers, however, not a single registrant stated they felt secure in utilizing the flexibility provided. Registrants either would be forced to calculate the median employee on an annual basis to ensure there was not a material change or there was a fear that compensation critics would take issue with the determination that a new median employee did not need to be identified.

IV. The Commission Can Make Several Common-Sense Adjustments to the Pay Ratio Rule to Dramatically Reduce Compliance Burdens

As detailed above, there exists a broad consensus that the pay ratio fails to provide any value to investors as a metric or a disclosure. At the same time, the pay ratio imposes exorbitant compliance costs and burdens on registrants, particularly those with global workforces. Fortunately, the Commission has the opportunity and the ability to make meaningful, common-sense changes to the pay ratio disclosure rule which could dramatically decrease compliance burdens for registrants.[10] Additionally, none of these changes, if adopted, would have any material impact on the quality of the resulting pay ratio disclosure.[11]

A. Restructure the Pay Ratio to Require Only U.S. Full-Time Employees

The most impactful change the Commission should make to the pay ratio disclosure requirement is to limit the ratio to only U.S., full-time employees. Permitting registrants to include only U.S., full-time employees in the pay ratio would substantially reduce compliance costs and burdens. Furthermore, the change would also eliminate or significantly scale back the myriad of other issues stemming from pay ratio compliance the Center has highlighted in this comment letter.

Beyond the fact that the pay ratio disclosure would *not* be useful to investors, it is likely to harm investors by providing misleading information. Unlike other disclosures, the pay ratio is inherently misleading because it purports to represent information concerning a registrant's pay practices and culture when it is impossible for the pay ratio to do so. One of the most notable elements of the final pay ratio rule which contributes to the misleading nature of the pay ratio is the required inclusion of global employees as well as part-time, temporary, and seasonal employees.

For many registrants and particularly those in the retail sector, employee turnover can approach and even exceed 100%. Although these registrants maintain a small full-time employee population, the bulk of their workforce will consist of a continually changing part-time population. The resulting median employee for these registrants is likely to be a part-time individual who only worked part of the last fiscal year and the resulting median pay number and ratio would dramatically distort the registrant's pay practices.

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[10] Under Section 36 of the Exchange Act, the Commission is authorized to "exempt, either conditionally or unconditionally, any person, security, or transaction, or any class or classes of persons, securities or transactions, from any provision or provisions of the Exchange Act or any rule or regulation thereunder, to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors." See 15 U.S.C. § 78mm. Likewise, under Section 28 of the Securities Act, "[t]he Commission, by rule or regulation, may conditionally or unconditionally exempt any person, security, or transaction, or any class or classes of persons, securities, or transactions, from any provision or provisions of this title [15 USCS §§ 77a et seq.] or of any rule or regulation issued under this title [15 USCS §§ 77a et seq.], to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors." See 15 U.S.C. § 77z-3.

[11] Proponents of the pay ratio will use whatever number is disclosed by a registrant in the exact same manner regardless of calculation method or the costs of compliance.

Eliminating international employees, as well as part-time, seasonal, and temporary workers, would have the effect of removing the arduous manual data gathering associated with finding annual compensation for these individuals.

The Commission has the authority to reduce the burden on registrants by making this change. Furthermore, because of the lack of investor interest in, or benefit provided by the disclosure, limiting the scope of employees to all U.S., full-time employees would discharge the Commission's regulatory mandate while significantly reducing the cost and compliance burdens of the approach. The Commission expressly noted in the final pay ratio rule that its "exemptive authority under Section 36 of the Exchange Act and Section 28 of the Securities' Act would allow [the Commission] to exempt registrants from including non-U.S. employees in the median employee determination required by Section 953(b)."[12] Additionally, in the final rule, the Commission expressly acknowledged the burden the decision was placing on registrants by making requiring the inclusion of international employees.[13] The Commission now has the opportunity to reverse the decision with the knowledge that the change will neither impact the quality of the disclosure nor general investor desire for the information.

B. <u>In the Alternative, at a Minimum, Revise the *De Minimis* Rule to Allow the Exclusion of Pockets of Employees Within a Country</u>

Limiting the pay ratio disclosure to only U.S. full-time employees is by far the most effective way to significantly reduce compliance costs and burdens. However, if the Commission chooses not to limit the rule to U.S. employees, there are other avenues which can reduce compliance costs – though not nearly to the same degree – while limiting potential abuses.

In the final rule, the Commission provides the ability for registrants to exclude employees in international localities up to 5% of their total employee population with the caveat that, if the registrant excludes one employee in a country, all employees in that country must be excluded. However, as detailed above in Section III, registrants are often able to get access to parts of the data needed to comply with pay ratio but not all of it. For these registrants, obtaining this remote data has a dramatically higher marginal cost than gathering the data from the rest of the country. This is often due to the records being held by a third-party provider for which, particularly in non-U.S. localities, there often is no way for registrants to get access to the needed records.

C. <u>Allow the "Calculation Date" to be Any Day During a Registrant's Fiscal Year</u>

In the final rule, the Commission permits registrants to choose any day during the three months prior to the last day of the registrant's fiscal year and use that day as the "Calculation Date." For the purposes of the pay ratio calculation, only employees who are employed as of the "calculation date" are part of the pool from which the registrant identifies the median employee. The Commission's decision to provide a 90-day "calculation date" window in the final rule is superior to proposed rule which required the use of the final day of the fiscal year as the "calculation date". However, the same pitfalls and shortcomings still exist under the final rule's construction of the calculation date and they continue to plague registrants trying to prepare for the first pay ratio compliance.

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[12] See 80 Fed. Reg. at 50,107.
[13] *Id.*

The Commission could reduce the problem by allowing registrants to select any day during the registrant's fiscal year as the calculation date. To be clear, the change would not eliminate the burdens for registrants, particularly for those with high employee turnover. Yet, the change would allow registrants to select a date on which they could maximize the number of employees which have pre-existing compensation records, like W-2s. Furthermore, allowing the calculation date to be selected from any date during the registrant's fiscal year allows pay ratio compliance to be included in the typical proxy statement preparation process, a process which starts long before the calculation date under the final rule.

D. The Final Rule's Treatment of Independent Contractors Needs More Clarity

The implications of having to include independent contractors in the pay ratio calculation is tremendous. For individuals who are employed by a third-party staffing agency, registrants will not have access to the needed payroll records and may never have an avenue to obtain access to them since they will be held by a different registrant altogether. For independent contractors that are individuals, the agreements are individual in nature thus imposing a huge data collection exercise if these contracts need to be aggregated for pay ratio. The Commission could eliminate these problems by altering the definition of employee in the pay ratio rules to require that an individual be a taxable employee of the registrant to be included in the pay ratio calculation.

E. Consider the Pay Ratio to be "Furnished" Information – Not "Filed"

The pay ratio final rule provides that the information will be considered "filed" information and thus subject to Sarbanes Oxley certification. The pay ratio disclosure is fundamentally different from other information, like financial information, subject to the "filed" standard. For other "filed" disclosures, there is a presumed standard of rigor, procedure, and process that goes into formulating the disclosures. The pay ratio in no way fits in the same category as these disclosures with regard to how it is calculated or with regard to the quality of information it communicates.

Our Subscribers have reported having issues with both their legal and audit teams regarding the pay ratio to the point that there are major concerns with making use of some of the flexibility provided by the SEC due to the ratio being considered a "filed" disclosure.

F. Allow a Cost-of-Living Adjustment to Be Performed After the Identification of the Median Employee

The final pay ratio rule provides for the ability of a registrant to perform a cost-of-living adjustment when calculating the pay ratio to help provide additional context for the median employee compensation level. Unfortunately, because the cost-of-living adjustment (COLA) is required to be conducted and applied alongside a normal pay ratio calculation in finding the median paid employee, the costs associated with the calculation are going to be prohibitive, particularly for global registrants. Instead, the Commission should permit registrants to identify the median paid employee, which will already involve using exchange rates to equalize currency, and then subsequently apply a COLA adjustment to the median employee.

G. Allow the Exclusion of Countries with Data Privacy Laws Based on a Good Faith Effort to Collect the Data

The final pay ratio rule provides an exception whereby registrants can exclude employees from the calculation if the data needed is protected by data privacy laws. Before reaching this conclusion, however, registrant must complete several steps including making a good faith effort to collect the data as well as securing a local legal opinion on the legality of accessing the data.

Unfortunately, there is a consensus, which was echoed in our conversations with our Subscribers, that the steps the Commission lays out as a prerequisite to claiming this exception are too onerous to actually make use of the exception. Furthermore, registrants which expressed a tentative interest in making use of the exception fear pursuing and making the exception and then encountering another registrant which claimed it could access the data and did not need the exception, thereby calling into question their use of the exception.

The Center recommends the Commission permit registrants to exclude employees based on a documented good faith effort that collection of the data was not feasible due to the interference of data privacy laws.

V. Conclusion

For the reasons stated above, the Center believes that compliance with the Dodd-Frank pay ratio should be indefinitely postponed to allow the Commission time to consider and address the problematic aspects of the final pay ratio rule discussed in detail above.

The Center appreciates this opportunity to provide feedback on the Commission's reconsideration of the final pay ratio rule. If you have any questions about the Center's comments, please do not hesitate to contact me at [redacted].

Sincerely,

Henry Eickelberg
Chief Operating Officer

cc: Securities and Exchange Commission:
Hon. Michael S. Piwowar, Acting Chairman
Hon. Kara M. Stein, Commissioner