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October 30, 2013

Elizabeth M. Murphy, Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Comment Letter on Pay Ratio Disclosure (File No. S7-07-13)

Dear Ms. Murphy:

The Institute for Policy Studies — a research and action center that has been closely monitoring executive pay developments for the past 20 years — strongly supports the proposed Securities and Exchange Commission rule for implementing Section 953(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.

We consider this reform both vitally important and long overdue, as we have expressed in our previous SEC comments on 953(b),[1] and we remain confident that the vast majority of American investors share our perspective.

But not all stakeholders in our contemporary corporate world, of course, agree. This law has sparked a heavy blast of overheated rhetoric and outright ridicule from various corporate and political leaders. This past June, for instance, the chairman of the House Financial Services Committee asked sarcastically what ratio disclosure mandate would be coming next, a requirement that companies calculate the ratio of healthy to unhealthy drinks in company soda machines?"[2]

None of this should surprise us. Elements in the corporate community have, after all, vigorously resisted every major attempt to bring transparency to executive compensation. In 1936, for instance, corporate critics of the initial SEC executive pay disclosure rules claimed that any public interest in executive salaries amounted to "criminal curiosity."[3]

In these comments, we address one of the most sophisticated attempts to trivialize the importance of pay ratio disclosure, a set of comments submitted by the National Investor Relations Institute.[4] The over 3,300 corporate officials this Institute represents hail from more than 1,600 publicly traded enterprises and sit upon $9 trillion in market capitalization. This Institute contends that the SEC's 953(b) proposal "would provide no material benefit to most investors while imposing significant costs on more than 3,800 U.S. issuers and inhibiting efficiency, competition, and capital formation."

To buttress this critique, the National Investor Relations Institute advances five specific claims, many of which are repeated by other opponents of CEO-worker pay ratio disclosure. Below, we address these five claims one by one.

Claim #1: "The proposed rule would result in misleading disclosures."

Pay ratio disclosure, the contention goes, would generate "a single 'headline' number that would grossly oversimplify corporate compensation practices." This claim has reality backwards. We already have an executive compensation "headline" number, the total CEO pay figure media outlets extract out of existing required corporate executive pay disclosures. Pay *ratio* disclosure would add a new number into the mix, not erase any numbers that already go before the investing public.

Under the proposed SEC rule, enterprises that feel this new 953(b) number in any way oversimplifies their compensation practices can release any supplementary explanations they choose. They can even present, as corporate pay analysts at Towers Watson recently noted, "additional ratios to supplement the required ratio, provided that any such additional ratios must be clearly identified and not misleading, and should not be presented with greater prominence than the required ratio."[5]

The National Investor Relations Institute also warns that corporations facing public "pressure to maintain a low pay ratio" might stop expanding operations to low-wage regions, a move that would have a harmful impact on "U.S. states and cities with lower labor costs."

Let's be clear here. The current harm to low-wage states and cities is coming from corporations that refuse to pay decent wages and benefits and force their exploited workers to rely on taxpayer-funded social programs.

In effect, the executives at corporations that situate their operations disproportionately in low-wage regions have created a business model that relies on taxpayer subsidies. Pay ratio disclosure would help the *investing* public — a cohort that mirrors the *taxpaying* public — better identify these corporations.

Claim #2: "The lack of defined standards will result in inconsistent disclosures and may cause investor confusion and increase compliance costs."

By allowing enterprises to use different methodologies to calculate their median employee pay, this charge asserts, the proposed SEC rule will result in garbage data, as some companies "take statistical shortcuts to save money."

This objection reminds us of the old quip about the kid who kills his parents and then asks the court for mercy — because he's an orphan.

In the three years immediately after the Dodd-Frank Act's 2010 passage, corporate groups furiously decried what they said would be the exorbitant cost of having to examine each and every employee's compensation to calculate a "median" pay level. The SEC listened to this loud lament and came up with a rule that lets companies use whatever reasonable statistical methodology they choose to calculate their medians.

Under this rule, individual companies can tally up all their paychecks, as distinct data points, and calculate a median. Or they can use whatever statistical sampling technique best matches the size and structure of their business to find their median employee compensation. Corporations routinely use such sampling techniques in other spheres of their activity.

But now corporate leaders, no longer required to tally up all their paychecks, are decrying their newly won flexibility.

Some corporations, to be sure, may seek to exploit the flexibility the SEC rule allows. These companies might try to employ statistically *dishonest* methodologies. But the proposed SEC rule requires public methodological disclosure as well. This disclosure will help keep enterprises statistically honest.

But it will be important for the SEC to verify, not just trust. Especially in the early days of 953(b) enforcement, the SEC should employ some statistical sampling of its own to examine how responsibly individual corporations are behaving with their median calculations.

Claim #3: "Proposed rule likely will lead to less informed proxy voting."

Lazy and small investors, opponents charge, will base their "say-on-pay" votes purely on the 953(b) pay ratio number. They will use the pay ratio to "subject companies to unfair comparisons with peer firms with different business structures and compensation programs."

Corporations that pay their top executives far above average and their employees far below are likely to declare *any* pay comparison with other companies "unfair."

Such top-heavy pay practices, these corporations understand, simply cannot be justified, either in the court of public opinion or in the narrower confines of America's business school community. No contemporary research on the factors that make for enterprise effectiveness has concluded that wide pay gaps between executives and workers are a prescription for sustained success.

In our modern economy, companies that are "built to last" value their employees and nurture their creativity and loyalty. This nurturing takes time to get right. Lazy corporate executives, by contrast, simply shortchange their workers to fatten their short-term corporate bottom line and maximize their own personal compensation.

The robust pay ratio disclosure the new SEC rule enables will allow both small investors and large proxy advisory firms to more easily identify level-headed, long-term-thinking executives.

Claim #4: "Pay ratio disclosure should be limited to full-time, U.S.-based employees."

Opponents of the proposed 953(b) rule contend that limiting the employee pay base to just U.S.-based full-timers will "provide more useful disclosure and reduce compliance costs."

This is simply not the intent of the law. Section 953(b) of Dodd-Frank explicitly references "all employees." And 953(b) makes this stipulation for good cause. If the rule excluded all but full-time, U.S.-based workers, investors would receive incomplete information about company pay and employment practices that are of material interest, especially in an era of rampant outsourcing to areas where routine violations of basic worker rights contribute to political and economic instability. The resulting pay ratios would whitewash the practices of corporations that are driving the trend towards fewer secure and decent employment opportunities. Corporations that turn good jobs into bad ones, we believe, *should* have to pay more in 953(b) compliance costs than companies that maintain a commitment to decent employment opportunity.

Claim #5: "Companies should be able to use existing BLS data to calculate their pay ratios."

The National Investor Relations Institute insists that requiring corporations to calculate their own individual pay ratio data "would shed little light on employee pay beyond that already illuminated by existing employee data." The Institute suggests instead that corporations be allowed to use industry-level data on U.S. wages from the Bureau of Labor Statistics.

As noted above, we disagree strongly with the idea that the CEO-worker pay ratio should be based only on U.S.-based workers. But that's not the only problem with this proposal. Letting corporations use existing industry-level worker pay data as a substitute for what individual corporations actually pay their workers would penalize corporations that follow effective enterprise "best practice" and reward corporations that pay their top executives much more than their corporate peers and their workers much less.

Let's suppose, as an example, that we have an industry where one major corporate player compensates its CEO at $20 million a year and its median worker at $20,000. Another corporate player in this industry pays its CEO $2 million annually and its median worker $35,000. The industry-wide worker median as determined by BLS statistical sampling: $25,000.

Let's do the math. If our disclosure rule allowed companies to substitute the BLS figure for actual corporate pay figures, the wide-gap company would show a CEO-worker pay differential of 800-to-1. The narrow-gap company would show a differential of 80-to-1.

If, on the other hand, our disclosure rule requires — as the SEC proposed rule does — actual median worker pay, the wide-gap company would show a 1,000-to-1 ratio, the narrow-gap firm a 57 times ratio.

If allowed to use industry-wide data, the wide-gap company would have a pay divide that runs 10 times wider than the pay divide in the narrow-gap company. Under the SEC proposed rule, the wide-gap company has a pay divide that runs over 17 times wider than the pay divide in the narrow-gap company.

How Industry-wide Worker Data Would Conceal Extreme Wage Gaps
(based on illustrative examples of one hypothetical company with a wide pay gap and one with a narrow gap)

	Wide-Gap Company	Narrow-Gap Company
Actual CEO pay	$20,000,000	$2,000,000
Actual median worker pay	$20,000	$35,000
Actual CEO-worker pay ratio	1,000-to-1	57-to-1
CEO-worker pay ratio based on industry-wide worker pay data (based on an industry median of $25,000)	800-to-1	80-to-1

But these numbers *understate* the actual pay ratio difference between these two corporations. Why? The low paychecks the wide-gap company offers its workers *lower* the overall industry median that the BLS computes. A major low-wage employer — like Wal-Mart, for instance — will by its very size reduce its industry median wage and, as a result, show off an artificially lower ratio if allowed to substitute the industry median for its own individual corporate median.

We need to make one other point here as well. Only by requiring corporations to calculate a CEO-worker pay ratio based on what they actually pay their workers can we enable investors to effectively compare an individual corporation's internal pay practices over time.

Consider a company that over the span of a decade freezes its median worker pay, a practice that would likely drive up employee turnover rates. At the same time, other players in this industry raise their own medians enough to substantially raise the industry-wide median. A pay ratio rule that lets the pay-freeze company use the industry-wide median will, in effect, be keeping investors in the dark about the company's actual pay practices.

Additional Delays Are Not in the Interest of Investors

The National Investor Relations Institute ends its 953(b) comments submission with a series of recommendations that follow from the five claims noted above. These recommendations ask for still more delay before CEO-worker pay ratio disclosure goes into effect.

More delay strikes us as exactly what investors don't need. Dodd-Frank became law in 2010. If the 953(b) rule does not go into effect until sometime in 2014, then no pay ratio figures will be calculated before the 2015 fiscal year and no ratio figures will go before shareholders until proxy statements appear for annual shareholder meetings in 2016.

Those calling for more delays are merely playing games with our regulatory process. The delays they seek have little to do with improving the information that 953(b) seeks to deliver. The delays they seek will simply give them more time to lobby for 953(b)'s repeal — before pay ratio disclosure begins to pay real and meaningful dividends for America's investors.

In a functioning democracy, translating an enacted law into practice should not take six years. We urge the Commission to finalize the proposed 953(b) rule as expeditiously as possible.

Sincerely,

John H. Cavanagh

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Director
Institute for Policy Studies
Email: [redacted]

[1] Submitted comments, John Cavanagh, Director, Institute for Policy Studies, Washington, DC, March 16, 2011. http://www.sec.gov/comments/df-title-ix/executive-compensation/executivecompensation-62.pdf

[2] Emily Chasan, Legislators Take Aim at Dodd-Frank Pay-Ratio Rule, *Wall Street Journal*, June 20, 2013. http://blogs.wsj.com/cfo/2013/06/20/legislators-take-aim-at-dodd-frank-pay-ratio-rule/

[3] Harwell Wells, “No Man Can Be Worth $1,000,000 a Year”: The Fight over Executive Compensation in 1930s America, *University of Richmond Law Review*, Vol. 44:689. http://lawreview.richmond.edu/wp/wp-content/uploads/2010/01/Wells-442-JB.pdf

[4] Submitted comments, Jeffrey D. Morgan, President & CEO, National Investor Relations Institute, Alexandria, Virginia, October 17, 2013. http://www.sec.gov/comments/s7-07-13/s70713-228.pdf

[5] Bill Kalten, Steve Seelig and Dave Suchsland, Q&As on the SEC’s Proposed CEO Pay Ratio Rules, Towers Watson, October 21, 2013. http://www.towerswatson.com/en/Insights/Newsletters/Global/executive-pay-matters/2013/Executive-Compensation-Bulletin-Q-As-onSEC-Proposed-CEO-Pay-Ratio-Rules?utm_source=SilverpopMailing&utm_medium=silverpop%20email&utm_campaign=EC-N-Executive%20Pay%20Matters%20October%2021%202013%20Feedburner%20%281%29&utm_content=