NATIONAL ASSOCIATION OF CORPORATE DIRECTORS

Dec. 1, 2013

Re:
File No. S7-07-13—Pay Ratio Disclosure

Ms. Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F St. NE
Washington DC 20549-1090

Dear Ms. Murphy:

The National Association of Corporate Directors (NACD) is the nation's oldest and largest organization for directors and boards—with more than 13,500 members. We convene, educate, and inform directors on a wide range of governance issues, including compensation. Indeed, the board's role in hiring, overseeing, and compensating executives has been central to our mission since NACD's founding. Over the years, NACD has issued many points of guidance for compensation committees, including Blue Ribbon Commission reports focused on executive compensation. Executive compensation is also a core component of NACD's two flagship director education programs for new and experienced directors, as well as a standing feature of our webinar programming.

We are grateful for the opportunity to comment on the proposed rule for pay ratio disclosure, issued on Sept. 18, 2013. Our views reflect recent surveys of our members, as well as the values implicit in the findings of NACD's thought leadership groups such as our Blue Ribbon Commissions and Fortune 500 committee chair advisory councils. This letter also incorporates perspectives from NACD chapter leader roundtables, director forums, director education programs, and other events focused on promoting effective governance practices.

The pay ratio provision appears to have two main goals—one related to information and one related to social change. Its original sponsor wrote it "so that investors and the general public know whether public companies' pay practices are fair to their employees, especially compared to their highly compensated CEOs."[1] In addition, some supporters clearly hope that the disclosure will have the ultimate effect of narrowing differentials in pay. We do not believe that the rule accomplishes the first goal, and question the appropriateness of the second.

Despite our concerns regarding the goals of the original provision, we understand that as a matter of U.S. law, the U.S. Securities and Exchange Commission (SEC) is mandated to pass a rule implementing it. In a previous comment letter on provisions of Dodd-Frank sent Nov. 18, 2010, NACD noted an "unfavorable cost-benefit ratio for the rule, with no perceivable benefits and significant costs," and urged the SEC to implement this provision with "extreme care."[2] We still believe this to be true, and share a number of suggestions below for how the final rule might address these concerns.

[1] http://www.menendez.senate.gov/imo/media/doc/Letter%20to%20SEC1-19-11.pdf.
[2] http://www.sec.gov/comments/s7-31-10/s73110-34.pdf.

2001 Pennsylvania Ave. NW, Suite 500 | Washington DC 20006 | tel. 202.775.0509 | Fax: 202.775.4857 | NACDonline.org

Recommendation: Permit Use of Statistical Sampling at Company's Discretion

The proposed pay ratio rule requires the company to use a median, rather than an average (or mean), to represent employee pay in the ratio calculation. Medians can be useful in pay analysis, but in groups that include high earners, the general effect of using a median, compared to using an average, will be to lower the result.[3] Furthermore, calculation of the median can be especially complex for large data sets.

Significantly, the U.S. Department of Labor (DOL) uses averages, not medians for most of its reports on employee pay. (The only exception is the inclusion of medians in analyses of occupations.) For the purpose of industry analysis, the DOL reports averages, not medians. When the DOL has used medians, it has cautioned readers on the complexity involved. Medians are

> calculated from the corresponding distributions by linear interpolation within the interval in which the median falls. Therefore, because of this interpolation, the median value depends not only on the distribution of income but also on the income intervals used in calculating the median.[4]

To its credit, the SEC has provided flexible alternatives for the calculation of the median for the pay ratio numerator. Under the proposed rule, a company need not necessarily calculate all pay awarded and calculate a median pay amount. Instead, a company can identify a median employee and report that employee's total pay, rather than having to analyze pay details of those above and below. Alternatively, under the proposed rule, the company, if large enough, can use ***statistical sampling.*** NACD commends the SEC for this flexibility, but believes that the SEC should leave it to the company to determine whether statistical sampling is appropriate when calculating a median.

Recommendation: Permit Use of Relevant Industry Pay Data

In addition, we believe that the SEC should allow companies to refer to ***relevant industry pay data*** gathered by the DOL, including the use of industry averages, as opposed to medians.[5] (Currently the DOL relies on averages, rather than medians, for capturing pay trends in industries.)[6] Recognizing that any given reporting company may pay on a different scale from this industry norm, the rule could require that the company disclose in a note any significant known company variances from this DOL-derived industry norm.

Recommendation: Exclude Use of Non-Comparable Data

Furthermore, NACD takes strong exception to the proposed inclusion of non-comparable data from part-time, seasonal, and non-U.S. workers, as well as temporary workers employed at year end. Inclusion of these pay amounts distorts the ratio, makes it even less meaningful, and adds considerably to the time and expense of calculation. Therefore, we recommend that these types of workers be excluded from the calculation.

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[3] As a simplified example, the median of 9, 2, and 1 is 2, but the average of these three numbers is 4.
[4] http://www.bls.gov/opub/mlr/1982/04/art5full.pdf.
[5] http://www.bls.gov/bls/wages.htm.
[6] U.S. Department of Labor (DOL), *Current Employment Statistics: National*, http://www.bls.gov/ces/tables.htm#analytical.

Recommendation: Permit Use of Notes to Counterbalance Distortions From Item 402

Regarding the pay that is disclosed for the CEO and for the median employee, NACD would like to respond to a pair of questions contained in the proposed rule, namely:

Are there other alternatives to calculating total compensation in accordance with Item [SK] 402(c)(2)(x) that would be consistent with Section 953(b)? and

Should the requirements provide instructions or should we provide additional guidance about how to apply the definition of total compensation under Item 402(c)(2)(x)…to employees that are not executive officers?

These two questions are interrelated. They both point to the fact that it is difficult to compare CEO pay to average worker pay under the Summary Compensation Table (for total pay) in Item 402. In a comment letter submitted prior to the proposed rule, the Retail Industry Leaders Association noted:

> By design, Item 402 captures all of the various compensation components received by a named executive officer, excluding certain limited items like benefits under non-discriminatory plans (e.g., healthcare) and perquisites and personal benefits that aggregate less than $10,000…. Applied to an average worker, however, these rules will work in the opposite direction. By excluding certain benefit plans and perquisites (e.g., employee discounts, transportation/parking benefits, education assistance) that do not exceed the $10,000 threshold, the rules understate the average employee's real total compensation. Relative to wages, benefits like healthcare and employee discounts both add significant economic value for an employee and are a prime motivator for the average employee when applying for and maintaining employment.[7]

To address this discrepancy, we recommend that companies be permitted, but not required, to publish two additional ratios in note form: the ratio of CEO W-2 take-home pay to median employee W-2 take-home pay; and the ratio of CEO total pay to median employee pay, adding back items excluded under Item 402 for both. These additional ratios would counterbalance any potential distortions.

Recommendation: Focus on Materiality

Materiality is an important value here. In Chairman Mary Jo White's Oct. 15, 2013, speech to directors gathered for NACD's annual board leadership conference, she highlighted the importance of materiality,

[7] 78 Fed. Reg. 60575 (Oct. 1, 2013) (internal footnote omitted), http://www.gpo.gov/fdsys/pkg/FR-2013-10-01/html/2013-23073.htm.

noting that that the SEC had held public hearings on corporate disclosures. In the course of those hearings, she said the SEC received suggestions in excess of 100 topics—a "bewildering array of special causes"—ranging from charitable contributions to "good things a company has done." Expressing the view that disclosure should generally be tethered to the concept of materiality, the SEC decided against requiring disclosure of the identified matters, noting that "as a practical matter, it is impossible to provide every item of information that might be of interest to some investor in making investment and voting decisions."[8]

In the spirit of this sage advice, we at NACD, hope that the SEC will keep in mind the important goal of materiality to investors. On behalf of the director community, we ask that the SEC increase the flexibility of this rule by *permitting use of industry averages*, by *limiting employees to full-time domestic employees*, and by *permitting* s*upplemental notes to correct any distortions caused by the use of "total pay" figures*.

We hope that these comments are helpful to you as you continue your efforts to ensure the materiality of disclosures pertaining to compensation practices in the nation's publicly traded companies.

Sincerely,

Ken Daly
President and CEO, NACD

Reatha Clark King
Chair, NACD

[8] http://www.sec.gov/News/Speech/Detail/Speech/1370539878806.