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Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street NE
Washington DC 20549-1090

Re: File No. S7-07-13
Proposed Rule on Pay Ratio Disclosure
(Release Nos. 33-9452; 34-70443)

December 2, 2013

Dear Secretary Murphy:

Mercer appreciates the opportunity to submit comments on the Proposed Rule on Pay Ratio Disclosure mandated by Section 953(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). Proposed Item 402(u) of Regulation S-K would implement the Dodd-Frank requirement that public companies disclose (i) the median annual total compensation of all employees except the CEO, (ii) the annual total compensation of the CEO, and (iii) the ratio of the two.

Mercer is a global consulting leader in talent, health, retirement, and investments. We help clients around the world advance the health, wealth, and performance of their most vital asset — their people. Mercer's more than 20,000 employees are based in 43 countries, and the firm operates in over 140 countries. Mercer is a wholly owned subsidiary of Marsh & McLennan Companies (NYSE: MMC), a global team of professional services companies offering clients advice and solutions in the areas of risk, strategy, and human capital.

Mercer's Talent business services include consulting and expertise on rewards, workforce analytics and planning, communication, and mobility, as well as a full range of best-in-class information and technology solutions. We have extensive experience designing and implementing executive and director compensation programs and assisting public companies with their executive compensation disclosures. We also have a strong understanding of how HRIS works and the type of data organizations maintain and collect on their employee populations. Mercer's Retirement business services include analyzing and managing defined benefit risks, delivering comprehensive plan management, advising on high-performing defined contribution plans and innovative plan design.

Overview

Mercer supports the SEC's mission to require public companies to disclose material information to aid investors in making investment and voting decisions. However, we believe that the pay ratio disclosure will be of limited use to investors and compliance will require significant resources, as discussed below.

We agree with the SEC's statement in the proposing release that "…the lack of a specific market failure identified as motivating the enactment of this provision poses significant challenges in quantifying potential economic benefits, if any, from the pay ratio disclosure."[1] Similarly, at a recent conference, representatives of institutional investors and proxy advisory firms questioned whether and how they would use the disclosure.[2] Furthermore, we believe the ratio is not material to a voting or investment decision and epitomizes the "information overload" noted by SEC Chair Mary Jo White in a recent speech[3] — particularly if companies feel compelled to include detailed and lengthy disclosure to put it in context.

Recognizing that the rule will take effect, however, we believe it is important for companies to present information that is accurate, reliable, consistent, and comparable from year to year. To meet these objectives, companies will incur potentially significant costs, first in identifying the median employee and then in analyzing the data and preparing a clear explanation of the resulting ratio.

We support the SEC's flexible approach to determining the median employee as a way to reduce compliance costs and we expect many of our clients will use statistical sampling, consistently applied compensation methods, and reasonable estimates. But even if a company uses a consistent method for determining the median employee and does not significantly change pay levels, there may be large year-to-year swings in the median employee's pay level due to factors such as geography, age, and years of service. Efforts to analyze the underlying data, determine the reason for any change, and prepare a clear explanation for variations will require additional time and costs not considered in the SEC's proposal.

Most of our comments are aimed at promoting the integrity and consistency of each company's calculation from year to year by offering additional flexibility. We also have suggestions about the timing of the initial and annual disclosures and limiting the potential for groundless litigation.

[1] SEC Release Nos. 33-9452, 34-70443, page 91.
[2] Conference of the National Association of Stock Plan Professionals, Sept. 23-26, 2013, Washington, DC.
[3] Remarks of SEC Chair Mary Jo White, "The Path Forward on Disclosure," Oct. 15, 2013.

Consistency

For global companies, year-to-year swings could be the result of currency fluctuations, cross-border differences in pay and benefit programs, and expatriate pay programs. Even for companies with domestic operations only, year-to-year pay ratio volatility could result from including defined benefit pensions in the total annual compensation figure. While the prevalence of defined benefit pension plans has been declining, 25% of Fortune 500 companies still have fully active plans, 17% have active plans closed to new participants, and 23% have frozen plans — all of which have to be taken into account in calculating total annual compensation.[4]
The potential impact of these factors is illustrated in the following examples.

Example 1 – currency fluctuation. At a multinational company, the same Japanese employee is at the median three years in a row. Even without any changes to this median employee's pay level, the volatility of the Japanese yen relative to the dollar could significantly impact year-over-year pay comparisons based on the following yen/dollar exchange rate over a recent four-year period:

Illustration of currency fluctuation's effect on pay ratio

	2012	2011	2010	2009
Exchange rate (¥ to $)	86.64	76.98	81.67	93.08
Employee annual total compensation (¥)	¥3,500,000	¥3,500,000	¥3,500,000	¥3,500,000
Employee annual total compensation ($)	$40,397	$45,466	$42,855	$37,602
CEO annual total compensation ($)	$5,000,000	$5,000,000	$5,000,000	$5,000,000
Ratio	**123.8**	**110.0**	**116.7**	**133.0**

[4] Mercer's 2013 Executive Benefits Research Tool (EBeRT) database.

Example 2 – expatriate compensation. A multinational company uses salary to identify the median employee. Two employees receive the median salary of $40,000. One is a US expatriate working in Singapore and the other is an employee in the US. The following table shows the breakdown of their annual total compensation and a pay ratio that differs significantly (30.2 vs. 110.6), depending on which median employee is used for the calculation.

Illustration of expatriate compensation's effect on pay ratio[5]

	US Expatriate	**US Employee**
Salary	$40,000	$40,000
Bonus	-	$4,000
Cost of living allowance	$10,000	
Housing allowance	$95,000	
Education allowance	$20,500	
401(k) contribution	-	$1,200
Annual total compensation	$165,500	$45,200
CEO annual total compensation	$5,000,000	$5,000,000
Ratio	**30.2**	**110.6**

Example 3 – pension benefits. A company uses payroll records to identify the median employee, who earns $50,000 in salary and participates in both the company's 401(k) plan, receiving a $1,500 match, and the defined benefit pension plan. The defined benefit plan provides 1.2% of highest consecutive five-year average salary times years of service starting at normal retirement age 65. The pay ratio disclosed in a given year could differ substantially depending on the median employee's age, service, or salary history, or movements in discount rates since the end of the prior fiscal year. This is illustrated in the table below, which shows the median employee's total annual compensation ($50,000 salary + $1,500 401(k) contribution + increase in present value of defined benefit pension) and the resulting pay ratio (which ranges from 59.5 to 97.1) relative to the CEO's total annual compensation of $5 million, for various possible age, service, and prior year discount rate combinations.

[5] Mercer's *Cost of Living Reports 2013 Edition.*

Illustration of defined benefit pension plan's effect on pay ratio							
		Total compensation if prior year's discount rate was			Pay ratio if prior year's discount rate was		
Age	**Yrs of Srv.**	**0.75% lower**	**The same**	**0.75% higher**	**0.75% lower**	**The same**	**0.75% higher**
60	30	53,500	69,500	84,000	93.5	71.9	59.5
	20	54,500	65,500	74,500	91.7	76.3	67.1
	10	55,500	61,000	65,500	90.1	82.0	76.3
	1	57,000	57,000	57,000	87.7	87.7	87.7
45	20	51,500	58,000	66,500	97.1	86.2	75.2
	10	51,500	56,000	60,000	97.1	89.3	83.3
	1	54,500	54,500	54,500	91.7	91.7	91.7
30	10	51,500	53,500	56,500	97.1	93.5	88.5
	1	53,000	53,000	53,000	94.3	94.3	94.3

The table above assumes smooth salary progression: 3.5% annual salary increases. But larger salary increases due to promotions, or smaller (or no) increases due to a temporary pay freeze, would inject even more volatility into the results. This table also illustrates the illogical results that can occur when the change in the present value of pension benefits is included in total compensation: When the prior year's discount rate was lower, the pension appears more valuable for a short-service employee than for a same-age long-service employee — even though the long-service employee is earning a larger additional pension benefit for the year of service — because the discount rate change reduces the present value of benefits accrued at prior year-end.

Example 4 – differences in pay and benefit programs. A multinational company uses salary and bonus to identify the median employee. For the last two years, the median employee received $50,000 in salary and bonus. In year 1, the employee is located in the UK where he or she participates in a defined benefit pension plan that offers benefits above the statutory minimum — a common feature in that country. In year 2, the median employee is located in India which does not offer a retirement plan beyond the statutory minimum —

typical practice in that country. Thus, while the two employees have the same salary and bonus, their total compensation is influenced by local benefit practices.[6]

Mercer recommendations: To bolster the year-over-year integrity of each company's ratio while still managing the costs of compliance, we suggest the SEC allow companies to do one or more of the following provided they explain their rationale and act consistently from year to year:

- *Choose to exclude non-US employees.* Most of the potential for the large and misleading year-to-year swings in the pay ratio described above, and costs to develop and use a methodology that minimizes those swings, stem from the inclusion of non-US employees. While we understand the Commission does not believe it has the authority under the Dodd-Frank Act to exclude categories of employees, we urge the SEC to reconsider this position. It will be particularly difficult and costly for multinational corporations with tens of thousands of employees in dozens of countries with multiple HRIS and payroll systems to determine the median employee.

- *Choose to exclude part-time, temporary, and seasonal employees.* We believe the inclusion of part-time and temporary employees distorts the relationship between the CEO's compensation and the median employee's if the median employee's pay is not annualized. While companies could provide additional disclosure to clarify this, investors may focus exclusively on the ratio itself, and the additional explanations in the proxy statement may be overlooked.

- *Choose to exclude employees of unconsolidated subsidiaries.* It would make sense to exclude employees of unconsolidated subsidiaries since unconsolidated subsidiaries are excluded for most financial reporting purposes.

- *Choose to provide a range or average of median employee pay.* One way to reduce year-to-year fluctuations from selecting a single median employee would be to allow companies to use a range or average of several median employees' compensation. For example, a company that selects the median employee by arraying its entire population (or a central segment of its population, after eliminating the highest and lowest paid employees) using salary, could locate a limited number of "middle" employees within a symmetrical range around the median (such as the middle 1% of employees). Instead of computing annual total compensation for a single median employee, the company could compute annual total compensation for all employees within the range and either (a) present a range of

[6] Mercer's global compensation and benefits surveys include a suite of annual *Benefits, Policy and Practice Reports* for the UK, India and 78 other countries.

annual total compensation for the middle employees and the associated ratios to the CEO's pay or (b) calculate the average annual total compensation for all employees within the range and present that as the median.

> *Example.* A company with 10,000 employees identifies the 5,001st employee as the median based on salary data. To help minimize the risk of year-to-year swings, the company might identify the 4,991st through 5,011th "middle" employees and compute annual total compensation for all 21 employees. The company could then either (a) present the range of annual total compensation and associated ratios for the highest and lowest paid of the 21 employees, or (b) calculate the average annual total compensation for the 21 employees and present it as the median, along with the associated ratio.

This approach could also apply if the company identifies multiple employees with the same median salary.

- *Choose to use multiple statistical samples.* Another way to use ranges or averages would be to permit companies that identify the median employee using statistical sampling to select a number of samples, identify the median employee in each sample, then compute annual total compensation for the median employee of each sample. The companies could then either present the range of resulting annual total compensation values and associated ratios, the average, or the median.

- *Choose to exclude change in defined benefit pension values.* As illustrated in Example 3 above, changes in defined benefit pension values are driven by age, service, and external factors such as interest rates, rather than decisions about pay levels. Pension plans are also likely to differ by country and among participants within countries. Allowing companies to exclude the change in defined benefit pension values under US qualified plans or broad-based foreign plans from total annual compensation for purposes of calculating the ratio would greatly reduce pay-ratio volatility and the accompanying need to investigate and explain the year-to-year changes. Also, this would not be unprecedented. Current disclosure rules exclude the change in pension values when companies determine their proxy-named executive officers.

- *Choose to use average change in defined benefit pension values.* We recommend allowing companies to use an estimated overall average change in pension value calculated with readily available data. Under US accounting rules, the accumulated benefit obligation (ABO) for defined benefit pension plans must be calculated and disclosed annually. The ABO represents the present value at fiscal year-end of all benefits earned

for service through fiscal year-end by all plan participants, but using accounting assumptions (including best-estimate turnover and retirement assumptions), instead of the simplified assumptions used in proxy disclosures. Companies should be allowed to reasonably estimate the change in the defined benefit pension value for a median employee who participates in a defined benefit plan using the following process:

1. Determine the average change in pension value as the excess, if any, of (i) the ABO for all active plan participants divided by the number of active plan participants at current fiscal year-end, over (ii) the ABO for all active plan participants divided by the number of active plan participants at prior fiscal year-end. If the plan benefit formula is not salary related, this result would be used as the change in pension value for the median employee.

2. If the plan benefit formula is salary related, determine the median employee's change in pension value as the result of step (1) multiplied by the ratio of (i) the median employee's pension earnings for the current year (as used in the ABO calculation at current year-end) to (ii) the average pension earnings of all plan participants for the current year.

Timing of disclosure

We have concerns about (1) the effective date for providing initial pay ratio disclosures for companies with fiscal year ends other than December 31 and (2) the timing of annual disclosures.

Initial disclosures

We support the Commission's decision to delay the effective date for a full year after adoption of the final rule to give companies time to gather pay data, determine the best approach for identifying the median employee, and calculate the ratio. However, we note that, under the proposal, companies with fiscal year ends other than December 31 might have considerably less time before initially complying. For example, if the rule becomes effective before April 1, 2014, calendar year companies would be required to include pay ratio disclosures for 2015 in their proxy statements filed in 2016. In contrast, companies with fiscal years beginning on or after April 1, 2014 would be required to include disclosures for fiscal years ending in 2015 in their proxy statements filed in 2015.

Mercer recommendation: We recommend the Commission make the final rule effective for all companies for their 2016 (or later[7]) annual meetings regardless of their fiscal year end.

Annual disclosures

Companies may not have sufficient time between the end of the calendar year and the filing of their proxy statement to complete all the work necessary to determine the median employee and calculate the ratio. Companies are already tasked with compliance requirements during the months immediately before and after fiscal year end. Making the pay ratio determination a year-end activity will only add to this burden — not just for large, complex companies, but also for smaller companies with decentralized HRIS systems and limited resources. The proposed rule would require them to compile and analyze data that is not otherwise normally available, is not required for any other year-end reporting purpose, and often can be obtained only by running manual reports.

The data collection burden cannot be spread over the year because some of the required data is not available until after the end of the year, and annual cash incentives at calendar year companies are often not paid until February or March. Data collection difficulties are magnified for companies with multiple HRIS or payroll systems, particularly for those that are multinational and must replicate the process in every country in which they operate. Decentralized HRIS and payroll systems managed by a diverse group of employees are not uncommon, especially for companies with recent merger and acquisition activity. For example, one of Mercer's clients has 32 separate payroll systems in the United States alone. Timing will be even more challenging for companies with global operations. Another Mercer client has operations in 60 locations on four continents operating in four business units with 42 separate payroll systems in multiple currencies.

Mercer recommendation: We recommend the SEC allow companies to delay the pay ratio disclosure until it is calculable and then file the disclosure in a Form 8-K (as is currently permitted where Summary Compensation Table salary or bonus cannot be calculated as of the most recent practicable date) or Form 10-Q. This would give companies more time to compile the necessary data during a time of year that is not complicated by year-end financial statement and proxy statement preparation. Alternatively, companies could be permitted to use the prior 12-month compensation period, provided the alternative date is used consistently from year to year. For example, a Dec. 31 year-end company's annual proxy statement for 2015, filed in 2016, could disclose the pay ratio based on compensation for 2014. Given the limited utility of the pay ratio disclosure to proxy voting matters, a lag in disclosure would not likely be significant to investors.

[7] For example, if the final rule becomes effective after 2014.

Potential litigation

Although we support the flexibility the SEC has provided in the proposed rule, it may result in costly and time-consuming shareholder legal challenges to companies' methodologies and assumptions for selecting the median employee. Therefore, we ask the SEC to treat the disclosure as "furnished" rather than "filed" and recommend the final rule provide safe harbors and/or examples of how statistical sampling and reasonable estimates might be used.

Furnished not filed

Given the recent surge in executive pay litigation, we believe that flexibility in identifying the median employee and the ability to use reasonable estimates — while needed to facilitate compliance —- may encourage groundless legal action. According to the proposing release, no commenters have requested that the disclosure be "filed"[8] and we believe the disclosure should be afforded the same "furnished" status as the proxy statement's Compensation Committee Report and the annual report's Performance Graph. As noted in this excerpt from a recent Securities News Watch article:[9]

> The SEC's reasoning in connection with the "not filed" status of the Compensation Committee Report was that "[i]f shareholders are not satisfied with the decisions reflected in the report, the proper response is the ballot, not resort to the courts to challenge the disclosure." This same reasoning should apply to pay ratio disclosures. Instead of treating the disclosure that most companies will base on subjective estimates and statistical sampling as "filed" and thus subject it to the liability provisions of the Exchange Act and Securities Act, this disclosure should be afforded the "furnished" status and shareholders should use voting as the venue for objecting to a specific ratio.

<u>Mercer recommendation:</u> We recommend that the pay ratio disclosure be treated as furnished rather than filed. We agree with the article's author that the use of the word "filing" in the Dodd-Frank Act should not be given too much weight and that the act prescribes only the type of documents in which the disclosure should appear and does not dictate whether such disclosure should be furnished or filed. As the article points out, the SEC currently refers to certain furnished disclosures as filings, such as current reports on Form 8-K pursuant to Item 2.02 (Results of Operations and Financial Condition) and Item 7.01 (Regulation FD Disclosure) disclosures.

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[8] SEC Release No. 33-9452, p. 75 and Note 138.
[9] Yelena Barychev, *Should Pay Ratio Disclosure Be "Furnished" or "Filed?"* Securities News Watch Blog (Nov. 11, 2013).

Safe harbor

To reduce the likelihood of legal challenges to a company's methodologies and assumptions for determining the median employee, we believe a safe harbor should be established for determining an acceptable sample size for companies that use statistical sampling.

Mercer recommendation: Based on standard statistical methodologies, we recommend a safe harbor of the lesser of 10% of the population or 400 employees. We would be happy to meet with you to discuss the analytics underlying this recommendation.

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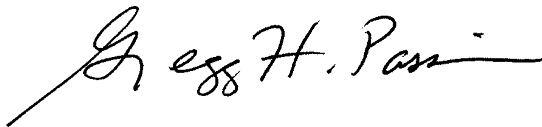
We thank the Commission for the opportunity to comment on the proposed rule and would be happy to answer any questions about our comments. We would welcome the opportunity to meet with you to discuss our suggestions. I can be reached at +1 (212) 345-1009.

Sincerely,



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