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December 2, 2013

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

Re: **Proposed Rules on Pay Ratio Disclosure, 17 CFR Parts 229 and 249; Release Nos. 33-9452; 34-70443; File No. S7-07-13; RIN 3235-AL47**

Dear Ms. Murphy:

The U.S. Chamber of Commerce's ("Chamber") Center for Capital Markets Competitiveness ("CCMC"), on behalf of its members, welcomes this opportunity to comment on the Securities and Exchange Commission's ("Commission" or "SEC") proposed rulemaking ("Pay Ratio Proposal" or "Pay Ratio Proposal Release") to implement Section 953(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("DFA").[1]

The CCMC has a number of concerns regarding the Pay Ratio Proposal including:

- **The Pay Ratio Proposal fails to promote investor protection because it provides no benefits for investors;**

- **The Pay Ratio Proposal actually harms investors by contributing to disclosure overload and increasing the complexity of the decision making process for investors;**

[1] The Chamber is the world's largest business federation, representing more than 3 million businesses and organizations of every size, sector, and region. The Chamber formed CCMC to promote a modern and effective regulatory structure for capital markets to function fully in our 21st century economy. CCMC supports strong corporate governance policies that are a fundamental cornerstone for business practices and capital formation.

- **It adversely impacts the ability of American companies, particularly those with a large overseas presence, to compete in a global economy;**

- **It makes it more difficult for businesses to engage in efficient capital formation;**

- **The Pay Ratio Proposal, in combination with other irrelevant disclosures, makes the public company structure a less attractive business model harming investors and the overall economy;**

- **As currently drafted the Pay Ratio Proposal may also place businesses in legal jeopardy because of conflicting international rules on privacy;**

- **The Pay Ratio Proposal has been subject to process flaws and we are disappointed that the SEC failed to take up our suggestions to prevent them; and**

- **The Pay Ratio Proposal is an economically significant rulemaking, as shown by information in the SEC's proposal. The CCMC requests that the SEC submit the Pay Ratio proposal to the Office of Information and Regulatory Affairs ("OIRA") for an enhanced regulatory review process.**

In order to address these flaws, the CCMC believes the Commission should consider the following process improvements and revisions:

- **Suspend its current DFA §953(b) rulemaking until roundtables have been convened, and the Commission has obtained useful input on each of the Pay Ratio Proposal's various facets;**

- **Defer completion of DFA §953(b) rulemaking until the Commission has completed its rulemaking under DFA §953(a);**

- **Defer formal rulemaking in favor of an organized pilot program;**

- **Adopt a measured phase-in of the various requirements embodies in the Pay Ratio Proposal;**

- **Make the pay ratio disclosures contemplated part of an addendum to formal filings, rather than an integral item in the actual disclosure document;**

- **Make pay ratio disclosures part of Management's Discussion and Analysis;**

- **The SEC should use its discretion to limit employees subject to reporting requirements to U.S. based, full time, employees;**

- **Determine the employees studied to determine the ratio;**

- **Provide a calculation of potential liability associated with the Pay Ratio rule and provide a safe harbor to insulate companies against such liability; and**

- **Maximize the flexibility of covered companies to determine the date for deciding which employees will be deemed employed as of the selected reporting date.**

The specific concerns and recommendations of the CCMC are discussed in greater detail below.

## I. Discussion

The CCMC recognizes that DFA §953(b) obligates the Commission to promulgate *some* rule or rules requiring public company disclosure of the ratio of their employees' median annual compensation to the annual total compensation of the Chief Executive Officer. While Congress' direction that the Commission require such disclosure is regrettable,[2] in doing so the SEC must balance this directive with its core obligations of protecting investors, facilitating capital formation and promoting the fairness and efficiency of the Nation's securities markets.[3] Given the Commission's *broad* discretion to achieve the proper balance between fulfilling this DFA requirement, and the Agency's duty to promote reasonable and cost-effective regulations that do not disserve its core responsibilities, the road to final rulemaking requires thoughtful and creative analysis.[4]

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[2] The disclosure DFA §953(b) requires is not material to reasonable investors. *See*, *e.g.*, Prof. J. R. Brown, Jr., *Dodd-Frank, Compensation Ratios, and the Expanding Role of Shareholders in the Governance Process*, 2 HARV. BUS. L. REV. ONLINE 91 (2011) ("Brown HBLR Pay Ratio Article"), http://www.hblr.org/2011/10/compensation/, D. Gallagher, Dissenting Statement Concerning the [Pay Ratio Proposal] (Sept. 18, 2013) ("Gallagher Dissenting Statement"), available at http://www.sec.gov/News/Speech/Detail/Speech/1370539815919#.Upi1tI2PY18. In a similar vein, Chair White recently noted that it is questionable "whether investors need and are optimally served by the detailed and lengthy disclosures about all of the topics that companies [are now obligated to report]." M.J. White, "The Path Forward on Disclosure (Oct. 15, 2013), available at http://www.sec.gov/News/Speech/Detail/Speech/1370539878806#.Updkl42PY18 ("Chair White Disclosure Speech").

[3] *See*, *e.g.*, *Bus. Roundtable and Chamber of Commerce* v. *SEC*, 647 F.3d 1144, 1148 (D.C. Cir. 2011) ("the Commission has a unique obligation to consider the effect of a new rule upon 'efficiency, competition, and capital formation . . . "); *See also Chamber of Commerce* v. *SEC*, 412 F.3d 133, 143 (D.C. Cir. 2005) ("[difficulty in determining the cost of a rule] does not excuse the Commission from its statutory obligation to determine as best it can the economic implications of the rule it has proposed.").

[4] *See*, *e.g.*, Brown HBLR Pay Ratio Article, *supra* n. 2, at §III ("The result [of the way DFA §953(b) is worded] was [to confer] *substantial discretion* on the part of the SEC in implementing the requirement") (emphasis supplied). DFA §953(b) placed this SEC rulemaking requirement in Section 14 of the Securities Exchange Act ("'34 Act"), 15 U.S.C. §78n, making any rulemaking under the provision—*as well as the Commission's authority in drafting those rules*—a part of the '34 Act. Thus, the Commission is able, among other provisions, to utilize '34 Act §23(a), 15 U.S.C. §78w(a) (emphasis supplied), to

> classify persons, securities, transactions, statements, applications, reports, and other matters within [its jurisdiction], and ***prescribe greater, lesser, or different requirements*** for different classes thereof.

Similarly, '34 Act §36(a)(1), 15 U.S.C. §78jj(a)(1) (emphasis supplied), provides that,

> notwithstanding any other provision of [the '34 Act], the Commission, by rule, regulation, or order, may conditionally or unconditionally ***exempt . . . any class or classes of persons, securities, or transactions, from . . . any rule or regulation*** [adopted by the SEC under the '34 Act], to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors.

It should also be noted that DFA §953(b) expressly adopts definitions and standards set forth in SEC Regulation S-K, 17 C.F.R. §229.10, *et seq.*, as it presently exists, *or as it may be amended.* The Commission therefore has the ability, as part of its DFA §953(b) rulemaking, to modify operative terms incorporated by reference from Regulation S-K. In its Pay Ratio Proposal Release, the Commission seemingly recognized this option, although it limited its utilization of this additional discretion to the application of *existing* Regulation S-K as a basis for limiting those companies that would be subject to the Pay Ratio Proposal, and those filings that must contain the information to be required. *See* SEC, Pay Ratio

In that vein, although the Commission's Pay Ratio Proposal Release reflects efforts by the Commission to exercise *some* discretion in crafting the Pay Ratio Proposal, the Commission does not appear to have considered, among other things, the breadth of its discretion provided by, among other provisions, '34 Act §§23(a) and 36(a)(1) (referenced in note 4, *supra*).[5] Instead, the Pay Ratio Proposal Release reflects the Commission's implicit view that it is immutably bound by DFA §953(b)'s directive to exercise only minimal discretion in crafting proposed rulemaking to comply with its obligation to promulgate *some* rule related to pay ratios.[6] The availability of greater discretion than the Commission seems to have recognized or embraced has significant implications for the comment process on which the SEC is embarked.

Without some indication by the Commission of its assessment of the amount of discretion it believes is available to it in formulating its Pay Ratio Proposal—or an explication of the limited discretion it chooses to apply (and the reasons for limiting that discretion)—it is difficult at best for commenters to offer views on the cost-benefit discussion in the Pay Ratio Proposal Release, or propose constructive alternative proposals to those set forth in the Pay Ratio Proposal.

The Commission did intersperse throughout its Pay Ratio Proposal Release requests for comments on possible alternatives,[7] but the lack of any statement in its Pay Ratio Proposal Release regarding the discretion it *could* exercise in crafting its Pay Ratio Proposal (as well as the reasons that it chooses to limit whatever amount of discretion it believes is available) of necessity prevents commenters from considering the full range of alternatives available to the Commission, a restriction that also affects

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Disclosure, Securities Act Rel. No. 33-9452 (Sept. 18, 2013), available at http://www.sec.gov/rules/proposed/2013/33-9452.pdf ("Pay Ratio Proposal Release"), at 14 (not requiring amendment of any forms that do not already require Item 402 information), 16 (interpreting §953(b) reference to "all issuers" to include only those that are required to provide summary compensation table disclosure pursuant to Item 402(c), excluding smaller reporting companies and foreign private issuers from the Pay Ratio requirement). *See also* Brown HBLR Pay Ratio Article, *supra* n. 2, quoted at the outset of this footnote.

[5] This conclusion follows from the fact that there is no discussion in the Pay Ratio Proposal Release of the Commission's discretion or authority under the '34 Act.

[6] *See* Pay Ratio Proposal Release, *supra* n. 4, at 38 (noting Congress specifically directed use of "median" employee in calculation), and 46-47 (discussing inability to allow the employment of Department of Labor statistics in calculating the ratio).

[7] *See* Pay Ratio Proposal Release, *supra* n. 4, at 27 (requesting comment on less burdensome alternatives to cover "all employees"), 38 (requesting alternatives to mitigate concern that adjustments to employee compensation diminish comparability), 50 (requesting alternatives for determining "median" employee), and 58 (requesting comment on alternative methods to calculate "total compensation").

the Commission's ability fairly to assess—or commenters to offer constructive comments on—the Agency's estimates of the costs and benefits of the Pay Ratio Proposal.

Of equal, if not greater, concern is the absence from the Pay Ratio Proposal Release of any statement of the precise objectives and benefits ***the Commission*** wishes its rulemaking to achieve. The Commission correctly notes the absence of any meaningful legislative history regarding DFA §953(b).[8] The Commission does summarize some potential benefits articulated by some commenters in response to the Commission's request for comments during the pre-proposal phase of its DFA §953(b) rulemaking.[9] But, the Pay Ratio Proposal Release lacks any statement of the objectives *the Commission* wishes its Pay Ratio Proposal to achieve.[10]

The absence of any Commission articulation of the discretion it has available (and the amount thereof it chooses to exercise, and why), as well as the precise objectives it seeks to serve with its Pay Ratio Proposal is a significant deficiency in the Pay Ratio Proposal Release. In essence, it appears from the Pay Ratio Proposal Release that the Commission assumes it *must* follow the literal directive set forth in DFA §953(b) *without* tailoring that directive to meet—*but not stray beyond*—the Commission's core mandates. But, the mandatory language of DFA §953(b) and the lack of any legislative history explicating Congress' intent in passing this provision, cannot, and does not, justify the absence of a clear Agency statement of the ways the SEC has reconciled DFA §953(b)'s directive with its core responsibilities, the amount

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[8] *See* Pay Ratio Proposal Release, *supra* n. 4, at 11, 85, 91.

[9] *Id.* at 11-12 (note 24) and 35 (acknowledging comments to the effect that the ratio could provide a measure of employee morale), 47 (noting some commenters suggested the usefulness of the ratio is for internal rather than external comparison). While it is useful to know what benefits some segments of the public believe a pay ratio rule might serve, that cannot substitute for the Commission's articulation of the benefits *it* intends its rulemaking efforts it serve.

[10] Indeed, the Commission's Release candidly acknowledges the "significant challenges in quantifying potential economic benefits, *if any*, from the pay ratio disclosure . . . ." *See* Pay Ratio Proposal Release, *supra* n. 4, at 91. The Commission does reference its desire to give investors information they *may* find useful, *id.* at 12 (noting attempt, in absence of objectives articulated by Congress, to confirm the rule to the purposes of existing mandates under Item 402), 35-37 (discussion whether allowing for annualization of some employees' compensation could reduce the comparability of companies' ratios) and 52 (use of "reasonable estimates" of employee compensation will not diminish the potential usefulness), but the absence of a clear articulation of the precise objectives the Commission wishes its Pay Ratio Proposal to serve, how it believes the actual proposal would serve those objectives, and the benefits its Pay Ratio Proposal in fact serves is not conducive to the preparation of meaningful comments, or to the Agency's receipt of thoughtful alternatives.

of discretion it has utilized to achieve that reconciliation, the reasons it has not exercised greater discretion, and the cost-benefit analysis that justifies the Agency's proposed reconciliation with available alternatives, as well as those alternatives it considered but rejected.

The absence of any discussion of these aspects of the required rationale supporting any Pay Ratio Proposal, the benefits it is expected to achieve, and the ways in which the Commission's proposal is tailored to create minimum burdens in achieving the SEC's core statutorily-mandated objectives, make it difficult to offer meaningful comments on, or alternatives to, the Pay Ratio Proposal.

Although we set forth in this letter some concerns and recommendations vis-à-vis the current Pay Ratio Proposal, we believe the Commission should consider the appropriate processes it could have employed in its rulemaking efforts and the critical issues it has not addressed in the Pay Ratio Proposal Release, address those issues, employ appropriate procedures to ventilate the contours of an appropriate rule, and revise its Pay Ratio Proposal in light of its appraisal of these subjects (or at least disclose its views on those procedures and issues, as well as the reasons it does not believe it should employ those procedures or revise its Proposal). Whatever conclusions and determinations follow from the exploration of these subjects, however, we strongly urge the Commission to publish those conclusions and resolicit comments before proceeding to adopt any Pay Ratio Proposal.[11] We stand ready to provide any assistance the Commission might find useful in proceeding along these lines.

## I. Summary of Concerns

The concept of pay ratio disclosure embodied in DFA §953(b), bears no meaningful relationship to the Commission's core mandates of investor protection, promoting fair and efficient securities markets and facilitating capital formation by American business enterprises. The provision was added to DFA for political reasons, not securities-law or investment reasons. This lack of any relationship

[11] Unlike some provisions of DFA, Congress did not mandate any specific time deadline for the adoption of rules pursuant to DFA §953(b). There is thus no plausible or compelling reason for the Commission to eschew further consideration of this topic and the re-circulation of information and revised proposals before adopting final rules. *See, e.g.,* Gallagher Dissenting Statement, *supra* n. 2.

between pay ratio disclosures and the Commissions core mandates is further demonstrated by the fact that, when given the chance to embrace pay ratio information, compelling numbers of investors express no interest in that data.

Notwithstanding the irrelevance of pay ratio data, the Commission is obligated by DFA §953(b) to promulgate *some* disclosure requirement. In doing so, the Commission has broad discretion by virtue of '34 Act §§23(a) and 36(a)(1) to cabin the extent of any such disclosures, limit the persons about whom such disclosure must be made, narrow the companies that must make such disclosure, restrict the frequency of any such disclosure, and otherwise limit the disclosures to be required. The Commission either did not realize the breadth of its discretion, or decided (without articulating the reasons therefor) not to utilize its discretion in responding to DFA §953(b)'s mandate.

As we discuss in some detail below, the rulemaking proceeding on which the Commission is embarked is premature, poorly structured, and otherwise fails to produce the best possible result under the worst conceivable circumstances. Among other process deficiencies, the Commission has not articulated what *its* objectives and goals are for any pay ratio disclosure it ultimately decides to require, and has not provided any basis for commenters to understand the choices the Commission made in preparing the Pay Ratio Proposal Release, or submit helpful commentary on those choices. Nor has the Commission performed meaningful cost-benefit analysis. Although the Commission references the estimated costs proffered by others, the Commission itself never offers its own analysis or quantification of the costs it presumes would flow from the adoption of the Pay Ratio Proposal. Under these circumstances, it is impossible for commenters to offer meaningful comments on the costs and benefits of the Proposal.

CCMC believes that the Pay Ratio Proposal fails to promote investor protection, contributes to disclosure overload increasing the complexity of the decision making process for investors, adversely impacts the ability of American companies, particularly those with a large overseas presence, to compete in a global economy, and makes it more difficult for businesses to engage in efficient capital formation.

The Pay Ratio Proposal, in combination with other irrelevant disclosures, makes the public company structure a less attractive business model, harming investors and the overall economy. As currently drafted, the Pay Ratio Proposal may also place businesses in legal jeopardy by requiring them to report on foreign-based employees, which may be contrary to foreign privacy laws. The Pay Ratio Proposal has been subjected to process flaws that need to be corrected to avoid the fate of other recent SEC rulemaking efforts. Finally, as even the information utilized by the Commission makes clear, the Pay Ratio Proposal is an economically significant rulemaking, and it should be submitted to the Office of Information and Regulatory Affairs for an enhanced regulatory review process.

The CCMC will discuss specific process enhancements and revisions to the Pay Ratio Proposal later in the letter.

## II. <u>Discussion of Itemized Concerns</u>

### a. Commission Objectives

As the Commission noted in its Pay Ratio Proposal Release, while certain executive compensation issues were raised in various Congressional hearings on the various legislative initiatives that ultimately coalesced into DFA, mandatory Pay Ratio disclosures were not the subject of any testimony or otherwise an issue ventilated during the relevant Congressional hearings;[12] effectively, DFA §953(b) sprang up out of whole cloth, without any vetting during the DFA legislative process.[13] Indeed, the Conference Report accompanying DFA makes no mention of the substance of DFA §953(b); similarly, the Report on the Senate Version of DFA does not mention the pay ratio requirement at all, but does append a short opposition statement by the minority.[14]

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[12] *See* Pay Ratio Proposal Release, *supra* n. 4, at 11.
[13] *See* Brown HBLR Pay Ratio Article, *supra* n. 2, at §III.
[14] *See* H.R. Rep. No. 11-517, 111th Cong. 2d Sess. (Jun. 29, 2010), at pp. 872-873, available at http://www.banking.senate.gov/public/_files/Rept111517DoddFrankWallStreetReformandConsumerProtectionAct.pdf. The provision itself is set forth at p. 538 of the Conference Report. *Id. See also* S.Rep. No. 11-176, 111th Cong. 2d Sess. (Apr. 30, 2010), at p. 245, available at http://www.banking.senate.gov/public/_files/Comittee_Report_S_Rept_111_176.pdf. The provision is attributed to Senator Menendez of New Jersey. Brown HBLR Pay Ratio Article, *supra* n. 2, at §III.

As a result, the Commission's Pay Ratio Proposal Release acknowledges that "neither [DFA §953(b)] nor the related legislative history directly states the objectives or intended benefits of the provision."[15] Notably, in the Pay Ratio Proposal Release's subsequent discussion of "Benefits and Costs Arising from the Mandated Disclosure Requirements," the Commission observes that

> [T]he lack of a specific market failure identified as motivating the enactment of [DFA §953(b)] poses significant challenges in quantifying potential economic benefits, *if any*, from the pay ratio disclosure.[16]

Despite this admirable candor, the Pay Ratio Proposal Release does not contain any affirmative acknowledgement or discussion of the significant *consequences* for SEC rulemaking flowing from the absence of any Congressional guidance on the objectives or benefits of the provision. Similarly, the Pay Ratio Proposal Release does not evidence the Agency's cognizance of, or the consequences attributable to, Congress' determination to make DFA §953(b) a part of the '34 Act, rather than a stand-alone provision.

These omissions from the Pay Ratio Proposal Release, among others, impermissibly impair the current rulemaking exercise for several important reasons, including the following:

- Although the SEC's *obligation* to adopt *some* pay ratio disclosure rule is mandatory, Congress's lack of *any* specification of the objectives such rules should promote *requires* the Commission to determine and articulate *its* objectives in promulgating the Pay Ratio Proposal, and demonstrate how its proposals meet those objectives, as well as the reasons that other alternatives, as well as alternatives considered by the Agency, were not pursued;

[15] *See* SEC Pay Ratio Proposal Release, *supra* n. 4, at 11. This sentiment is reiterated subsequently in the Pay Ratio Proposal Release in connection with the discussion of the costs and benefits of the Pay Ratio Proposal. *Id.* at 91.

[16] *Id.* at 91 (emphasis supplied). *See also* Gallagher Dissenting Statement, *supra* n. 2.

- The fact that some form of pay ratio rule is mandated does not permit the Commission simply to promulgate its Pay Ratio Proposal without first determining *and disclosing* its assessment of the breadth of the Agency's discretion, and the criteria—if any—it applied in determining whether and how to cabin its own discretion;

- Similarly, the Commission's duty to promulgate some form of pay ratio rule does not relieve the Agency of its obligation fairly to assess the costs and benefits of its rulemaking proposal, and facilitate informed public comment on them;[17]

- *Meaningful* public comment can only occur if the Pay Ratio Proposal Release explicates *the Commission's* rulemaking objectives, demonstrates how the rules proposed meet those objectives, delineates how the proposed rules further the Agency's core statutory mission, fairly assesses and discloses the anticipated costs and benefits of the proposed rulemaking, and justifies the proposal as the most effective, efficient and beneficial way (including the extent to which it has applied its discretion) to meet the Agency's core mission, obligations and objectives; and

- Congress' decision to incorporate the substance of DFA §953(b) into the '34 Act, rather than enact it as a stand-alone provision, means that the *substance* of any Commission DFA §953(b) rulemaking must be necessary or appropriate in furtherance of the Commission's core mandates under the '34 Act—protection of investors, facilitation of capital raising and promoting the fairness and efficiency of the Nation's securities markets; the Commission's Pay Ratio Proposal Release must disclose the Agency's

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[17] *See*, *e.g.*, *Am. Petroleum Inst., et al. v. SEC and Oxfam Am., Inc.*, No. 12-1668, 24 (D.D.C. Jul. 2, 2013) (quoting *Rodriguez v. US*, 480 U.S. 522, 525-26 (1987) ("no legislation pursues its purposes at all costs. Deciding what competing values will or will not be sacrificed to the achievement of a particular objective is the very essence of legislative choice—and it frustrates rather than effectuates legislative intent simplistically to assume that whatever furthers the statute's primary objective must be the law."); *see also Chamber of Commerce v. SEC*, 412 F.3d 133, 144 (D.C. Cir. 2005) (failure to consider a suggested alternative can itself violate the APA). *See also* J. McCabe, "*The Need for Improved Cost-Benefit Analysis of Dodd-Frank Rulemaking*, HARV. L. S. FORUM ON CORP. GOVERNANCE AND FIN. REG. (Apr. 17, 2012), http://blogs.law.harvard.edu/corpgov/2012/05/12/the-need-for-improved-cost-benefit-analysis-of-dodd-frank-rulemaking/.

rationale for believing that its Pay Ratio Proposal accomplishes that overarching obligation, and does so more effectively than alternatives that were available to the SEC.[18]

**b. Commission Priorities**

DFA has charged the Commission ninety-five rulemaking directives, of which seventy-seven, or over 80%, were subject to certain time deadlines.[19] As of November 1st, the Commission had apparently finalized only thirty-five of its directed rulemakings, or 45%.[20] While the Commission is entitled to a great deal of deference in its determination of priorities, the timing of the issuance of the Pay Ratio Proposal raises three issues of significant substance not discussed in the Pay Ratio Proposal Release.

First, DFA §953(b) rulemaking does not occur, and cannot be viewed, in a vacuum. The pay ratio provision in DFA §953(b) follows DFA §953(a), which is captioned "Disclosure of Pay Versus Performance." In that DFA provision, Congress directed the Commission to require issuers to disclose information evidencing the relationship between executive compensation actually paid and the financial performance of the company paying that compensation. Pay versus performance seeks to establish the connection—if any—between executive compensation and the financial performance of a company, as well as the shareholder returns generated by management's strategies and decision-making. To that extent, DFA §953(a) seeks the disclosure of information that may be of material interest to investors. The Chamber supports the concept of "pay for performance," and

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[18] The absence of any clear Congressional indication of the intended benefits of DFA §953(b) has led to significant bipartisan support for the provision's repeal. In the 112th and 113th Congresses, two bills have been introduced to repeal DFA §953(b), both of which were marked up by the House Financial Services Committee. H.R. 1062 was proposed by Rep. Nan Hayworth in the 112th Congress and was passed by the House Financial Services Committee on June 22, 2011, by a vote of 33-21. H.R. 1135 has been proposed by Rep. Bill Huizenga in the 113th Congress, and passed the House Financial Services Committee by a vote of 36-21 on June 19, 2013.

[19] *See* DavisPolk, Dodd-Frank Rulemaking Progress Report (Apr. 4, 2011), at 4, available at http://www.davispolk.com/files/uploads/FIG//040411_ProgressReport.pdf.

[20] *See* DavisPolk, Dodd-Frank Rulemaking Progress Report (Nov. 2013), at 5, available at http://www.davispolk.com/sites/default/files/Nov2013_Dodd.Frank_.Progress.Report_0.pdf.

appropriate Commission guidance vis-à-vis the nature and quality of disclosures to be made with respect to that concept.

Wholly apart from the fact that rulemaking under DFA §953(a) could, if carefully executed, provide real value to shareholders—unlike pay ratio disclosures—and would also be consistent with the Chamber's long-standing articulation of corporate governance principles,[21] understanding the relationship between a company's financial performance and the compensation its CEO receives is a necessary and indispensible precursor to the consideration of any disclosure of pay ratio information. If, for example, a company's CEO makes 379 times the average or median income of his or her company's employees,[22] shareholders could only understand that information in the context of information about the performance of their company's management team. In that respect, the principle of pay for performance embodies the fact that that there is no absolute truth regarding the right level of executive compensation. A CEO who turns around a company, or produces

[21] The Chamber first articulated its Principles on Corporate Governance, Investor Responsibility and Executive Compensation in 2009. *See* Chamber, Letter to Treasury Secretary Geithner (Feb. 6, 2009) ("Chamber Principles"), available at http://www.centerforcapitalmarkets.com/wp-content/uploads/2010/04/Exec-Comp-letter-2-6-09.pdf. The Chamber Principles have four fundamental premises:

- Corporate governance policies must promote long-term shareholder value, but should not constrain reasonable risk-taking or innovation;
- Long-term strategic planning should be the foundation for managerial decision-making;
- Executive compensation should be premised on the enhancement of shareholder value through the combination of individual accomplishment, corporate performance, adherence to board risk management guidelines and regulatory compliance; and
- Robust and transparent management-shareholder communications.

A copy of the Chamber's Letter was also submitted to the Commission, and the Chamber Principles have been referenced in numerous CCMC comment letters on corporate governance and executive compensation addressed to the Commission and other regulators.

[22] That is one figure that was estimated for average Fortune 50 CEO pay ratios. *See*, *e.g.*, "*Fortune 50 CEO Pay vs. Our Salaries*," CNN MONEY (2012), available at http://money.cnn.com/magazines/fortune/fortune500/2012/ceo-pay-ratios/.

extraordinary results, should be handsomely compensated, while those who preside over poor economic performance by their companies should not.[23]

By dealing with pay ratio disclosure *before* pay versus performance disclosure, however, the Commission has virtually ensured that any pay ratio disclosures that are ultimately required will be provided without appropriate context, and serve only to confuse, rather than inform, shareholders.[24] There is no justifiable basis for the Commission to adopt a disclosure rule under the '34 Act that would have that effect. But, even if there were some cogent reason for requiring the promulgation of pay ratio disclosure rules before pay for performance rules, the Pay Ratio Proposal Release does not articulate them, thus depriving commenters of the opportunity to consider the Commission's precise rationale—if any—for the order of its rulemaking.

Without that articulation, commenters are left to guess at the reason (or reasons)—if any—that the Commission is en route to requiring pay ratio disclosure ahead of disclosure that should be a necessary condition precedent for any attempt to craft pay ratio disclosures that are even minimally informative.[25] The failure to provide that information precludes commenters from assessing whether there are any purported benefits likely if the Commission's Pay Ratio Proposal were adopted, and whether any such benefits significantly outweigh the costs associated with such disclosure obligations, especially in the absence of any meaningful shareholder interest in such information.[26]

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[23] *See*, *e.g.*, Farient Advisors, "Communicating that You Are Doing the Right Things Just Got Easier," available at http://www.farient.com/what-we-do/proprietary-methodologies/ (defining pay for performance as total compensation, after performance has been factored in, that is both sensitive to company performance over time and reasonable relative to the market for executive talent and for the performance delivered).

[24] *See*, *e.g.*, National Investor Relations Institute, *Comment Letter on Pay Ratio Disclosure*, at 2-3, available at http://www.sec.gov/comments/s7-07-13/s70713-228.pdf ("NIRI Pay Ratio Letter") (explaining that "misleading and confusing disclosures . . . would result from [the Pay Ratio Proposal]"). *See also* D. Nicklaus, "Pay Ratio is a Big Deal Politically, But Meaningless to Investors," St. Louis Post-Dispatch (Sept. 24, 2013), available at http://www.stltoday.com/business/columns/david-nicklaus/pay-ratio-is-a-big-deal-politically-but-meaningless-to/article_eac7d26e-1169-5807-91b4-77cf430d16f1.html ("Hiring a lot of part-time workers, as McDonald's does, will make the CEO's pay look higher by comparison. Outsourcing your low-wage work to other companies, as Apple does, will make it lower. Comparisons among companies won't be very meaningful").

[25] *See*, *e.g.*, Gallagher Dissenting Statement, *supra* n. 2 ("Crossing one more required rule proposal off our long to-do list of unfinished Dodd-Frank mandates might be the closest thing to a benefit that an objective analysis can squeeze out of [the Pay Ratio Proposal]").

[26] *See*, *e.g.*, Center on Executive Compensation, "Press Release on SEC Commissioner's Proposal for Voluntary Pay Ratio Disclosure" (Feb. 21, 2013), available at http://execcomp.org/docs/c13-

Second, in 2010, the Commission published a concept release on a variety of issues relating to the mechanics of shareholder communications and voting under its proxy rules,[27] commonly referred to as the "Proxy Plumbing" concept release.[28] The stated rationale for the issuance of the Proxy Plumbing Concept Release, and the solicitation of comments on a broad variety of topics regarding the proxy process—including the need for better and more efficient company-shareholder communications—was that it had

> been many years since [the SEC] conducted a broad review of the system, and [the Commission was] aware of industry and investor interest in the Commission's consideration of an update to its rules to promote greater efficiency and transparency in the system and enhance the accuracy and integrity of the shareholder vote.[29]

But, since the issuance of the Proxy Plumbing Concept Release, the Commission has not pursued a holistic view of the proxy process (and its effects on corporate governance).[30] Such a holistic view would provide the Commission with necessary empirical data regarding the functioning of the current proxy system, and the context in which any pay ratio rulemaking proposal should be considered. In

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16_PR_Letter_to_Aguilar_Pay_Ratio_Feb_2013.pdf ("the Center has found that, unlike pay for performance, investors are generally not asking companies for pay ratio information, and where shareholder proposals have been offered on the pay ratio, support from shareholders has been very low"; and "the costs and burdens of calculating the ratio would be excessive relative to the information it would provide").

[27] *See* SEC, Concept Release on the U.S. Proxy System, '34 Act Rel. No. 34-62495 (Jul. 14, 2010) ("Proxy Plumbing Concept Release") available at http://www.sec.gov/rules/concept/2010/34-62495.pdf.

[28] *See*, *e.g.*, Cleary Gottlieb, "SEC Issues Concept Release on 'Proxy Plumbing'" (Jul. 15, 2010), at 1, available at http://www.cgsh.com/files/News/bfbc0ea6-c799-4e64-997d-fbd12e498989/Presentation/NewsAttachment/3bb5d1e9-148d-4dd0-9231-fc382a100f10/CGSH%20Alert%20Memo%20-%20SEC%20Issues%20Concept%20Release%20on%20Proxy%20Plumbing.pdf.

[29] Proxy Plumbing Concept Release, *supra* n. 28, at 1. The Commission's website indicates that it received a number of thoughtful comments, as well as thousands of form letters, with respect to the subjects raised in its Proxy Plumbing Concept Release.

[30] The Commission has, however, begun to address some specific subjects in its Proxy Plumbing Concept Release. Thus, for example, the Commission has convened a roundtable, to be held December 5, 2013, to discuss one subject in the Proxy Plumbing Concept Release—the role and performance of proxy advisory firms. *See* SEC, "SEC to Hold Roundtable on Proxy Advisory Services," Press Rel. No. 2013-236 (Nov. 5, 2013), available at http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370540266939#.UprmB42PY19; and SEC, "SEC Announces Agenda, Panelists for Roundtable on Proxy Advisory Services," Press Rel. No. 2013-253 (Nov. 27, 2013), available at http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370540419621#.UprmrY2PY19.

particular, it would put the Agency in a better position to consider the Pay Ratio Proposal in the light of disclosure overload,[31] enabling the Commission better to fit the Pay Ratio Proposal in the context of the Commission's core missions. Considering the Pay Ratio Proposal before assessing the issue of efficiency and transparency of the current proxy disclosure regime is tantamount to putting the proverbial cart before the horse, and precludes the Commission from tailoring its Pay Ratio Proposal to take account of its conclusions regarding the current extent of disclosure overload.[32]

Third, there is no doubt that the costs associated with any pay ratio disclosure rule will be considerable.[33] We recognize that, if Congress gives the Commission a valid rulemaking directive, the Commission must comply with it. But Congress has given the Commission multiple directives with respect to new rulemaking, not just in DFA, but also in the JOBS Act.[34] The Commission does not have the right or the ability to decline to engage in rulemaking Congress has directed it to pursue, of

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[31] *See*, *e.g.*, Chair White Disclosure Speech, *supra* n. 2.

[32] The Proxy Plumbing Concept Release was a prescient effort by the Commission. Nearly a year after the Commission announced its retrospective review of its existing proxy regulation, the President issued Executive Order Nos. 13563, "Improving Regulation and Regulatory Review" (Jan. 18, 2011), available at http://www.gpo.gov/fdsys/pkg/FR-2011-01-21/pdf/2011-1385.pdf, and 13579, "Regulation and Independent Regulatory Agencies," (Jul. 11, 2011), available at

http://www.whitehouse.gov/the-press-office/2011/07/11/executive-order-regulation-and-independent-regulatory-agencies, encouraging independent regulatory agencies, like the Commission, to take a retrospective review of its rules and regulations. On September 6, 2011, the Commission announced that it would comply with the retrospective regulatory look-back outlined by the President in Executive Orders No. 13563 and 13579. SEC, Retrospective Review of Existing Regulations, Securities Act Rel. No. 33-9257 (Sep. 6, 2011), available at http://www.sec.gov/rules/other/2011/33-9257.pdf. ("SEC Retrospective Review").

In response to the Commission's press release, CCMC sent a letter to the Commission suggesting ways in which the Commission should implement the President's directive. *See* Letter from D. Hirschmann (CCMC) to E. Murphy (SEC) re '34 Act Rel. No. 34-65262 (Oct. 6, 2011), available at http://www.sec.gov/comments/s7-36-11/s73611-62.pdf. But, the SEC has not taken any action to implement the President's directives to date, even though other agencies have successfully undertaken a retrospective review of their regulations. *See*, *e.g.*, , FCC, *In the Matter of Petition of USTelecom for Forbearance of Certain Legacy Telecommunications Regulations*, FCC 13-69 (May 17, 2013), available at http://transition.fcc.gov/Daily_Releases/Daily_Business/2013/db0517/FCC-13-69A1.pdf (FCC granting forbearance from 126 rules in furtherance of its "commitment to eliminate burdens on industry and promote innovation while ensuring our statutory objectives are met").

[33] *See*, *e.g.*, NIRI Pay Ratio Comment Letter, *supra* n. 25, at 1 (characterizing the costs of compliance as "exorbitant"); Center on Executive Compensation, "Press Release on Voluntary Pay Ratio Disclosure" (Feb. 21, 2013), available at http://execcomp.org/docs/c13-16_PR_Letter_to_Aguilar_Pay_Ratio_Feb_2013.pdf (reporting that one public company estimated the cost of producing pay ratio disclosures would be $7.6 million, and take twenty-six weeks to compile).

[34] *See* the Jumpstart Our Business Startups Act, Pub. L. No. 112-106, 126 Stat. 306 (Apr. 5, 2012).

course, even if the Commission does not agree with the substance of Congress' directive.[35]

But, where the Commission has been directed to implement disclosures for which it is unable to find a true benefit, and at the same time has numerous other rulemaking efforts the adoption of which are long overdue, and the benefits of such rules are not ambiguous or nonexistent, there is a need for the Agency to justify immediately imposing the costs associated with moving the Pay Ratio Proposal to the top of the Agency's rulemaking queue, especially when there is a bona fide reason for relegating the Pay Ratio Proposal to its proper order of priority, further down on the Commission's rulemaking agenda. This is a subject on which comments should have been, but were not, solicited.

In order to enable interested persons to provide meaningful comments, the Commission must provide transparency for the reasons underlying the advancement of this subject matter over other subjects for which there are time deadlines, and for which there are clear benefits. In our view, the lack of such disclosure in the Pay Ratio Proposal Release artificially precludes commenters from considering and addressing the additional cost consequences of the timing of the Commission's Pay Ratio Proposal.

**c. Commission Processes**

While we commend the Commission's effort to solicit general comments on DFA §953(b) in advance of formal rulemaking, as well as the Agency's public commitment to comply with the processes outlined in Executive Order Nos. 13563 and 13579 (*see* n. 31, *supra*), the Commission's processes—or the absence thereof—have stultified its ability to generate constructive suggestions, as well as empirical data, for developing a soundly based pay ratio regulation likely to withstand judicial scrutiny. Neither the Pay Ratio Proposal Release nor any other statement by the Commission provides any rationale for this aspect of the Commission's processes, and the decisions with respect thereto that the SEC has made.

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[35] It is noteworthy, however, that certain Congressional directives—complete with unambiguous time deadlines—that require the Commission to relax existing regulatory restraints on capital raising, such as "crowdfunding," required by the JOBS Act, are more than a year overdue.

Thus, the Chamber and other organizations representing hundreds of thousands of businesses and their professionals submitted recommendations for a number of process enhancements to expand the Commission's public outreach and to obtain a better understanding of potential alternatives available in implementing the requirements of DFA §953(b).[36] The Joint Business Representatives DFA §953(b) Letter recommended that the SEC:

- Hold a roundtable discussion of experts and stakeholders to better understand the potential issues and unintended consequences that could flow from the implementation of DFA §953(b);

- Consider engaging in negotiated rulemaking to ensure thorough and well-balanced input that minimizes unintended consequences;

- Follow the requirements outlined in Executive Order Nos. 13563 and 13579 to identify alternative approaches and choose the least burdensome means of implementing the rule, consistent with the Commission's public commitment; and

- Submit any Pay Ratio Proposal to the Executive Branch's Office of Information and Regulatory Affairs ("OIRA") for pre-adoption review, to obtain appropriate input on the cost-benefit implications of any Pay Ratio Proposal.[37]

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[36] *See* Letter from Twenty-three Business Organizations to the SEC re DFA §953(b) (Jan. 19, 2012), available at http://www.centerforcapitalmarkets.com/wp-content/uploads/2010/04/2012-1.18-Trades-Ltr-to-SEC-re-pay-ratio-rules1.pdf ("Joint Business Representatives DFA §953(b) Letter"). This letter was signed by American Benefits Council, American Insurance Association, American Petroleum Institute, Business Roundtable, Center On Executive Compensation, Competitive Enterprise Institute. The Financial Services Roundtable, HR Policy Association, National Association of Manufacturers, National Association of Real Estate Investment Trusts, National Association of Wholesaler-Distributors, National Investor Relations Institute, National Restaurant Association, National Retail Federation, Property Casualty Insurers Association of America, The ERISA Industry Committee, The Real Estate Roundtable, Retail Industry Leaders Association, Securities Industry and Financial Markets Association, Society of Corporate Secretaries & Governance Professionals, Society for Human Resource Management, U.S. Chamber of Commerce, and WorldatWork.

[37] OIRA is located within the Office of Management and Budget, and reviews federal regulations, reduces paperwork burdens and oversees policies relating to privacy, information quality, and statistical programs. *See* Office of Management and Budget, "Office of Information and Regulatory Affairs," available at http://www.whitehouse.gov/omb/inforeg_default.

The SEC has not implemented its public commitment to follow the guidance of Executive Order Nos. 13563 and 13579 in connection with its DFA §953(b) rulemaking. Nor is there any explanation for the Commission's failure to fulfill its public commitment in the Pay Ratio Proposal Release.

As a general proposition, the Commission has discretion to choose the process by which it will engage in rulemaking activities. But normal rulemaking processes are not necessarily appropriate here, where the Commission itself has

- Questioned the value of the rulemaking exercise in which it is now engaged;[38]

- Recognized the unusual cost associated with requiring pay ratio disclosures;[39]

- Committed to undertake a holistic view of the entire spectrum of its proxy regulations that could significantly influence the substance of any pay ratio rules it ultimately adopts;[40] and

- Publicly announced that it would subject its existing and future rules and regulatory activities to the methodology recommended by the President in Executive Order Nos. 13563 and 13579.[41]

The Pay Ratio Proposal Release offers no explanation for the Commission's apparent decision to reject alternative processes that might ultimately produce a more effective, less burdensome and significantly less costly regulation than the process on which the Commission is currently engaged, not to mention the Agency's decision to depart from its public commitments about its processes in connection with rulemaking like the current one. The lack of any explanation leaves commenters at sea with respect to the rationale for the decisions the Commission actually made, and

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[38] *See* Pay Ratio Proposing Release, *supra* n.4, at 91 ("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.").
[39] *Id.* at 7-8.
[40] *See generally* Proxy Plumbing Concept Release, *supra* n. 28.
[41] *See supra* n. 33.

at a loss to understand the reasons that prompted the Commission to eschew procedures here that would have materially enlightened and enhanced its rulemaking efforts.[42]

Additionally, nearly two months ago, and very shortly after the publication of the Commission's Pay Ratio Proposal Release, a group of fourteen interested business representatives requested that the Commission extend the comment period for the Pay Ratio Proposal beyond the sixty days originally provided.[43] As there noted, in the absence of some urgency—something assuredly not present here[44]—other SEC rulemakings traditionally provide the public at least ninety days within which to provide their comments, and often even more time than that. Given the lack of any urgency in the form of a statutory deadline for completion of the DFA §953 rulemaking, and the good faith reasons for requesting additional time, the Commission's apparent decisions to reject the request appears arbitrary.[45]

The unnecessarily short time frame for commentary deprives stakeholders of the ability to submit informed commentary to the Commission, and provide the Commission with empirical data that would better inform the Agency's current rulemaking adventure. CCMC, for one, is in the midst of collecting information from Chamber members to provide the Commission with an economic analysis of the costs, burdens and consequences of the Pay Ratio Proposal to the businesses that will have to comply with whatever rule the Commission adopts. It has proven impossible to complete that analysis within the sixty-day time frame the Pay Ratio Proposal

[42] Efficient capital markets cannot be subjected to the predilections of a narrow, self-interested, minority. While the Commission must adopt some pay ratio disclosure requirements, it statutorily is prohibited from crafting a rule that responds to the desires of a narrow self-interested minority, with costs borne by the market at large. *See*, *e.g.*, *Bus. Roundtable & U.S. Chamber of Commerce v. SEC*, n. 3, *supra*.

[43] *See* Letter to E. Murphy, SEC, re Request for Extension of [Pay Ratio Proposal] Comment Period (Oct. 9, 2013), available at http://www.sec.gov/comments/s7-07-13/s70713-163.pdf. The letter was signed by American Insurance Association, Center On Executive Compensation, Competitive Enterprise Institute, HR Policy Association, National Association of Real Estate Investment Trusts, National Association of Wholesaler-Distributors, National Investor Relations Institute, National Restaurant Association, National Retail Federation, Retail Industry Leaders Association, Society for Human Resource Management, The Real Estate Roundtable, U.S. Chamber of Commerce and WorldatWork.

[44] *See*, *e.g.*, Gallagher Dissenting Statement, *supra* n. 2.

[45] Exacerbating this situation is the fact that the Commission did not even respond to the request for additional time to comment in the two months since the request was filed.

Release allotted. While we intend to submit an economic analysis for the record, because of the condensed time frame we were not able to submit the analysis with this comment letter, and in fact may not be able to devote the appropriate time and resources such an analysis demands.

**d. Tailoring Pay Ratio Disclosures**

As noted above (*see* n. 27, *supra*), there is a paucity of investor interest in pay ratio disclosures. This is surely attributable, at least in part, to the fact that virtually all investors know that senior corporate executives are compensated considerably more generously than rank-and-file corporate employees. The fact that there is empirical evidence to demonstrate the lack of investor interest in pay ratio disclosure has significant implications for the Commission's Pay Ratio Proposal—it should affect both the scope of any disclosure required and the costs to be imposed on public companies compelled to make such disclosure.[46]

In October, the Center for Audit Quality ("CAQ") released its 7th annual Main Street Investor Survey ("CAQ Investor Survey").[47] The CAQ Investor Survey asked investors to assess the impact on their investment decision-making of thirteen different informational factors. The broad topic of CEO compensation ranked last on the list of factors used by investors in making investment decisions, with only 16% stating that it was essential to their investment decision-making process. Conversely, the vast majority—or seventy-six percent—stated that they either did not consider CEO compensation at all, or that their consideration of CEO compensation had no effect on their investment decision-making.[48]

Say-on-Pay is also informative about investors' views of the significance of executive compensation. Recent experiences with Say-on-Pay shareholder resolutions demonstrate that shareholders are generally highly supportive of pay levels with

[46] While it does not always follow that a lack of current investor interest in certain topics should cabin proposed rulemaking, this is always a factor the Agency must consider. And, where as here the Commission cannot discern any benefits for pay ratio disclosures, and none were articulated in DFA's legislative history, the absence of meaningful investor interest in pay ratio information militates strongly against any requirement that exceeds the barest minimum of information about the subject.

[47] *See* CAQ Investor Survey (Oct. 2003), available at http://www.thecaq.org/docs/press-release-attachments/2013mainstreetinvestorsurvey.pdf?sfvrsn=2. The CAQ survey interviewed 1,103 investors.

[48] *Id.*

respect to companies in which they own and vote shares. Among companies in the broad Russell 3000 Index in 2013,[49] average support for management compensation in connection with Say-on-Pay resolutions was 90.1%, and 97.6% of companies received majority shareholder support.[50] Moreover, shareholder support for management compensation, as expressed in Say-on-Pay resolutions, increased slightly as compared to 2012, when shareholder support for Say on Pay averaged 89.1% and 97.4% of companies received majority support.[51]

The empirical data available to the Commission as of this time, therefore, demonstrates an overwhelming lack of investor interest in CEO compensation as a factor in their decision-making process. Moreover, investors are overwhelmingly supportive of the CEO compensation paid in the businesses in which they are invested. This confirms that pay ratio information is not information for which investors are clamoring. Although the Commission noted the absence of any discernible investor benefit from the provision of pay ratio disclosure,[52] it apparently did not consider available empirical data on the magnitude of investor interest in such disclosure, and it did not employ the lack of any meaningful investor interest in this disclosure as a criterion to be applied in exercising its broad discretion to limit the extent to which the Agency will require public companies to make extensive disclosures about pay ratio information, or expend significant resources in doing so.

As a general rule, the Commission's disclosure requirements are designed to elicit the disclosure of information that facilitates the investment decisions confronted by existing and would-be investors relating to public companies and their operations. The disclosure of pay ratio information represents a dramatic departure from the

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[49] The Russell 3000 Index measures the performance of the largest 3000 U.S. companies, representing approximately 98% of the investable U.S. equity market. *See* Russell Investments, "The Russell 3000® Index," available at http://www.russell.com/indexes/data/fact_sheets/us/russell_3000_index.asp.

[50] *See* Conference Board, *July 2013 Proxy Voting Fact Sheet*, 8 (Jul. 2012) available at https://www.conference-board.org/publications/publicationdetail.cfm?publicationid=2547&topicid=30&subtopicid=210 (complimentary password required).

[51] *See* Conference Board, *July 2012 Proxy Voting Fact Sheet*, 8 (Jul. 2013) available at http://hcexchange.conference-board.org/publications/publicationdetail.cfm?publicationid=2275&topicid=10&subtopicid=90 (complimentary password required).

[52] *See* Pay Ratio Proposal Release, *supra* n. 4, at 11, 91.

standards employed vis-à-vis the protection of investors for nearly eighty years.[53] While the Commission may have no choice but to adopt *some* requirement of pay ratio disclosure,[54] the facts that this information

- Is not material,
- Does not serve any meaningful or broad-based investor interests, and
- Is merely an effort to achieve social objectives unrelated to investment decisions,

imposes an obligation on the Commission to tailor any pay ratio disclosures it may require to achieve the least amount of harm to investors and minimize the cost of compliance to public companies in which they invest. The Pay Ratio Proposal Release does not evidence the Commission's obligations in this regard, or what efforts, if any, the Commission expended to achieve those objectives. What does seem clear is that requiring the disclosure of such nonmaterial information will contribute to investors' disclosure overload, and will make it harder for them to understand and assess the material information they actually need to make informed investment decisions.

**e. Burdens and Costs**

The Pay Ratio Proposal would, if adopted as proposed, impose substantial costs and burdens on investors and the public companies in which they invest. CCMC will provide the SEC with an economic analysis to quantify these costs for a sampling of companies. As noted above, the initial truncated comment period, combined with the Commission's decision to extend the comment period as we, and

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[53] The other notable departure from the classic use of the securities laws to promote the disclosure of financially material information is DFA §1502, requiring disclosure and other conduct vis-à-vis so-called "conflict minerals." Unlike DFA §1502, however, DFA §953(b) contains no time limit within which rules implementing the Congressional directive must be adopted.

[54] As we discuss below (*see* pp. 26-30, *infra*), it is not clear that, at least at the outset of the Commission's considerations of pay ratio disclosures, the Commission is obligated to adopt *any* rule.

other business representative organizations, had requested, has prevented us from completing that analysis and submitting it along with this comment letter.

The burdens and costs of the Pay Ratio Proposal are not only excessive in their own right, they are also disproportionate in relation to any benefit such disclosure might provide. For smaller companies, or those that have their workforce located in a concentrated footprint, size and geographic concentration may lead to consolidated payroll systems and data flows that make the collection and analysis of information easier and less costly. However, for companies that have an extensive global presence with a large number of employees spread out in dozens of countries, such data collection and analysis will likely be unduly burdensome and costly.

By having to deal with different payroll systems, different legal definitions and forms of compensation and currency fluctuations, to name just a few issues, companies with large global and international operations will be challenged by burdens and costs even in the process of collecting the required information. These costs and burdens will accrue whether a company develops the full-prescribed ratio or engages in statistical sampling. It should also be noted that the extensive efforts required to produce the mandated pay ratio disclosures would divert manpower and resources from economically productive projects, to the detriment of shareholders.[55]

Further, the Commission's Pay Ratio Proposal is an "economically significant rulemaking," warranting review by OIRA. As noted in the Joint Business Representatives DFA §953(b) Letter,[56] one company has estimated that it would cost $7.6 million dollars to collect the proposed pay ratio data, and another has estimated

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[55] Those companies whose participation is necessary to attempt to achieve the Obama Administration's commitment to double U.S. exports before 2015, and thereby increase economic growth, will be placed at an economic disadvantage. *See, e.g.*, NY Times, *Obama Sets Ambitious Export Goal*, Jan. 28, 2010, available at http://www.nytimes.com/2010/01/29/business/29trade.html?_r=0.

[56] *See supra,* n.39. If there were any doubt about the invaluable role OIRA could have, in assessing the likely costs of the Pay Ratio Proposal, the Commission's final cost estimates for its conflict minerals regulation was 60 times larger than its initial cost estimates. *Compare* SEC, Conflict Minerals Final Rule Release, '34 Act Rel. No. 34-67716, available at http://www.sec.gov/rules/final/2012/34-67716.pdf, at 240 (estimating initial cost of compliance at "approximately $3 billion to $4 billion," and the annual cost of ongoing compliance between $207 billion and $609 billion), *with* SEC, Conflict Minerals Proposed Rule, '34 Act Rel. No. 34-63547, available at http://www.sec.gov/rules/proposed/2010/34-63547.pdf, at 72 (estimating the cost as requiring 153,864 hours of company personnel time and approximately $71,243,000 for the services of outside professionals).

that the costs to determine pension benefits, alone, would be over $2 million.[57] These partial estimates from two companies would put the costs of the Pay Ratio Proposal at almost $10 million. The Commission's Pay Ratio Proposal Release lists examples that place estimates of the compliance costs for several companies at well over $100 million,[58] OIRA's demarcation of economically significant rulemaking proposals. Even the scant information provided in the Pay Ratio Proposal Release demonstrates that the Pay Ratio Proposal will be an economically significant rulemaking. As such, CCMC requests again that the Commission submit its Pay Ratio Proposal to OIRA for enhanced regulatory review.

### f. Overseas Jeopardy

U.S. businesses operating overseas must abide by the laws and regulations of the countries in which they operate. The Commission's Pay Ratio Proposal Release reflects the Commission's working assumption that, in any pay ratio disclosures it adopts, it must require that compensation data be collected for all employees, including those that reside and work overseas.[59] This assumption is manifestly erroneous. As we have discussed above, however (*see* n. 4, *supra*), the '34 Act vests broad discretion in the Commission, including the right to exempt any person, transaction, company or security from any provision of the '34 Act, including the pay ratio disclosure provisions of DFA §953(b) that are now part of '34 Act §14.

Data and privacy laws in some countries may make it illegal for U.S. companies to gather and utilize this information.[60] As a result, some companies may be unable to comply with this provision. Although the Commission's Pay Ratio Proposal Release

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[57] Due to the truncated comment period, CCMC is unable to produce a more complete estimate of companies' expected costs of complying with the Pay Ratio Proposal. A more detailed discussion will follow in a separate submission.

[58] *See* Pay Ratio Proposal Release, *supra* n. 4, at 102.

[59] *Id.* at 23-27.

[60] *See*, *e.g.*, Pay Ratio Proposal Release, *supra* n. 4, at 26-27. While recognizing the possible applicability of foreign privacy laws, the Commission stated it determined to make no "additional accommodation to address this concern," because of its belief that "the flexibility afforded to all registrants under the proposed rules could permit registrants to *manage any potential costs* arising from applicable data privacy laws." Pay Ratio Proposal Release, supra n.4, at 27 (emphasis supplied). Of course, the issue is not simply one of costs. It is also a question of potentially unlawful corporate behavior by U.S. corporations under the laws of countries in which they do business. And, of course, the Commission never considered the application of '34 Act §§23(a)d and 36(a)(1).

rejected any "accommodation to address this concern" (*see* n. 62, *supra*), the Commission's rule implementing DFA §1504 was struck down because the disclosure of the required information would have been illegal in certain countries in which companies subject to that mandate have operations.[61] The same concerns apply in this context, as well, as businesses with international operations would either be forced to violate the Pay Ratio Proposal, comply with the Proposal and withdraw from doing business in those countries that prohibit the use of that information (causing the loss of revenues and profits), or comply with the Proposal but risk legal jeopardy overseas.

The Commission's pronouncement—that it would not make any "additional accommodation" to relieve U.S. companies of these acknowledged burdens—and offering no explanation of the reasons that its powers under the '34 Act should not be utilized to avoid this legal issue in its entirety, reflects either a cavalier concern for the interests of shareholders, or a belief that the Commission lacks any discretion whatsoever to implement DFA §953(b) in a manner that promotes, rather than undermines, the protection of investors, the facilitation of capital raising, or the promotion of fair and efficient capital markets. Either interpretation reflects a misperception by the Commission of its broad discretion, and the Agency's failure to explicate the reasons that it will not utilize its broad '34 Act powers to do so, make the Pay Ratio Proposal a prime candidate for a finding that its promulgation was arbitrary and capricious.

The Pay Ratio Proposal Release requested commenters to quantify, to the extent practicable, the impact of data and privacy laws outside the U.S. on registrants subject to DFA § 953(b), such as an estimate of the number of registrants affected or the average percentage of employees affected.[62] The Commission's implication that the Pay Ratio Proposal's flexible approach would allow U.S. companies to balance the requirement to provide pay ratio disclosure but nonetheless comply with the laws of other jurisdictions,[63] focused on the wrong issue—costs—and markedly did not provide the Commission's own analysis of these laws and the potential burdens and

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[61] *Am. Petroleum Inst., et al. v. SEC and Oxfam Am., Inc.*, No. 12-1668 (D.D.C. Jul. 2, 2013)

[62] *See* Pay Ratio Proposal Release, *supra* n. 4, at 25-30.

[63] *Id*. at 27.

problems that companies would confront in trying to comply both with the Pay Ratio Proposal and foreign privacy laws. Presumably, if the Commission had conducted its own research, and determined the Pay Ratio Proposal's impact on the ability of U.S. businesses to comply with foreign privacy laws, it would have disclosed that analysis. The failure to have done that analysis, or publish it, deprives the public of the ability to provide meaningful comments on the Pay Ratio Proposal.

**g. Furnished v. Filed**

The Pay Ratio Proposal Release solicits comments on whether the proposed pay ratio disclosure should be deemed "filed" material, or merely be treated as having been "furnished" to the Commission.[64] The Commission has a long history of deeming certain required disclosures to be "not filed" for purposes of the liability provisions of the '34 Act.[65] CCMC strongly believes any pay ratio information should be deemed "furnished," rather than "filed."

Despite the best intentions of legislators and regulators, efforts to promote certain disclosures without exposing those who make those disclosures to additional obligations or civil liability frequently fall victim to those with litigious instincts, seeking to obtain hedges against investments that did not perform as well as hoped. A case in point is DFA §951, the so-called "Say-on-Pay" provision. In order to preclude anyone from arguing that an advisory Say-on-Pay vote was binding or otherwise imposed enforceable obligations on corporate directors or officers, DFA §951(c) makes it unequivocal that any Say-on-Pay vote is purely advisory, has no binding effect on companies or boards, does not effect any change in the fiduciary duties of companies and boards, and does not create any new fiduciary obligations. Notwithstanding this unambiguous provision, Say-on-Pay advisory votes have given

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[64] *Id.* at 75-76. This question is at odds with other aspects of the Commission's interpretation of DFA §953(b), since the literal language of the statute contemplates that the disclosures required will be contained in filed documents. The Commission does not indicate exactly how it can disregard the "filing" language of DFA §953(b), but not do the same for foreign, part-time, seasonal or other employees, for example.

[65] *See*, *e.g.*, D. Martin and G. Robinson, "To Be or Not to Be 'Filed,'" 17 INSIGHTS No. 9 (Sept. 2003), available at http://www.cov.com/files/publication/c905d77e-ee22-4c67-b489-b279f4e974c2/presentation/publicationattachment/abf3095c-7e2d-41d4-a784-b83636dd3835/oid49560.pdf.

rise to lawsuits seeking to read back into DFA §951(a) what subsection (c) removed.[66] When challenged, these suits are generally not successful, and at least one of the Say-on-Pay lawsuits was dismissed with prejudice.[67] But, the issue is not whether these cases can eventually be defended successfully; rather, the issue is whether the time, resources and cost of these lawsuits can better be precluded or ameliorated.

The short answer is that, in the case of pay ratio disclosures, these types of lawsuits can be precluded or ameliorated by deeming the disclosures required not to be deemed "filed" material within the meaning of the '34 Act. The Commission should be relentless in endeavoring to avoid the imposition of liability over disclosures for which it is at a loss to declare any definable or observable shareholder benefit. Accordingly, we strongly recommend that any pay ratio disclosure that is ultimately required be deemed furnished rather than filed. We expect to make additional recommendations to address issues regarding potential liability in a separate submission to the SEC.

## III. Potential Changes

As the foregoing discussion reflects, CCMC believes the Pay Ratio Proposal is deficient and ill advised. We believe that investors and the companies in which they invest would be poorly served by the adoption of the current Pay Ratio Proposal. While many of our concerns relate to the substance of the Pay Ratio Proposal, we believe that the process by which it was crafted is materially deficient in a number of crucial respects. Our objective, however, is not merely to point out the deficiencies we have observed, but more importantly to engage in appropriate discussions with the Commission and its Staff, to assist in your efforts to craft an appropriate regulation that heeds Congress' directive while, at the same time, providing investors with information that is as useful as possible, without imposing undue burdens and costs on those obligated to comply with the ultimate product of the Commission's rulemaking effort.

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[66] *See*, *e.g.*, B. Romanchek and T. Meyer, "Say on Pay Lawsuits: History, Analysis and Future Direction" (Apr. 2013), available at https://www.boardmember.com/say-on-pay-lawsuits-history-analysis-and-future-direction.aspx http://www.meridiancp.com/images/uploads/TNU-2013-5_Say_on_Pay_Litigation.pdf.

[67] *See*, *e.g.*, Meridian, Client Update Vol. 4, Issue 5, "Delaware Federal Court Dismisses Say on Pay Case" (Mar. 26, 2013), available at http://www.meridiancp.com/images/uploads/TNU-2013-5_Say_on_Pay_Litigation.pdf.

In that spirit, we briefly set forth a list of some process and substantive changes that could be effected in the Pay Ratio Proposal to minimize the concerns discussed above, as well as those raised by a host of other commenters: This list is both a cursory review of some ways to modify the proposal and is by no means exhaustive. Given the peculiar circumstances of this subject matter, we again urge the Commission to convene roundtables on various aspects of the rule, and to pursue a negotiated rulemaking, as the best methodology for obtaining broad-based input and ultimately a better result.

- ***Suspend the current DFA §Rule 953(b) rulemaking until roundtables can be convened on various aspects of the contours of a pay ratio disclosure rule, and follow those roundtables with negotiated rulemaking procedures.*** A roundtable, and negotiated rulemaking offer the Commission the best methodology for obtaining broad-based input and ultimately a better result.[68]

- ***Defer DFA §953(b) rulemaking until the completion of Commission rulemaking pursuant to DFA §953(a).*** As noted, the development of appropriate disclosures under DFA §953(a) is a necessary precursor for deciding upon the nature of the pay ratio disclosures to be required, as well as the persons of whom those disclosures will be required.

- ***Abandon formal DFA §953(b) rulemaking in favor of a "pilot project" to test various aspects of the Pay Ratio Proposal.*** In 1972, the Commission was approached with a proposal to create organized exchange trading for options on equity securities. Rather than engage in formal rulemaking, the Commission institute a "pilot project," pursuant to which the Commission developed empirical data, and ultimately adopted the extensive options trading rules the Commission currently has in place.[69] The Commission utilized the same process when it first instituted its

68 *See* Joint Business Representatives Letter on DFA §953(b), *supra*, n. 37.

69 *See*, *e.g.*, SEC Historical Society, "The Institution of Experience: Self-Regulatory Organizations in the Securities Industry—Governing a New Market, Pilot Operation," http://www.sechistorical.org/museum/galleries/sro/sro05b.php.

EDGAR database.[70] The advantage of a pilot project is that it avoids the perpetual conundrum the Commission faces in performing a meaningful cost-benefit analysis. In a pilot project, the participants are volunteers,[71] and the Commission is free to develop empirical data to support its ultimate rulemaking efforts without diverting its attention to satisfying standards of judicial review.

- ***Phase-in the requirements of DFA §953(b), to minimize the disruptive impact and expense inherent in the Pay Ratio Proposal.*** There is nothing in the language of DFA §953(b) that precludes the Commission from adopting its Pay Ratio Proposal and then phasing in various requirements. This is an approach the Commission has used regularly, as recently as this past summer.[72]

- ***Make pay ratio disclosures an addendum to documents required under Regulation S-K, and have them deemed "not filed" for purposes of the '34 Act.*** At least at the outset of the Commission's experience with pay ratio disclosures, public companies should be relieved of the expenses that are inherent in any effort to make pay ratio disclosures in publicly filed materials. By treating these materials as furnished rather than filed, the Commission can minimize some of the expenses (including legal expenses) associated with creating publicly filed disclosures. Moreover, by keeping these disclosures removed from investor-relevant information, the Commission potentially could ease a burden created by these disclosures known as "information overload." By placing this data in an addendum, only those investors who really care about the information—if any—would search out the data and utilize it for whatever

[70] *See*, *e.g.*, TAP INFO Internet Distribution List, "NSF Announces Grant to Put EDGAR Online," http://w2.eff.org/Activism/edgar_grant.announce.

[71] While most public companies are probably not eager to subject themselves to pay ratio disclosure, a number of public companies have already undertaken, or would be willing, to make such disclosures voluntarily, as part of a true pilot program. There are many appropriate "benefits" the Commission can confer on volunteers, and the Commission should do so, attempting to attract a diverse body of initial participants to give its efforts as broad a base of experience as possible.

[72] *See*, *e.g.*, SEC, Order Temporarily Exempting Certain Broker-Dealers and Certain Transactions from the Recordkeeping and Reporting Requirements of Rule 13b-1, '34 Act Rel. No. 34-70150 (Aug. 8, 2013), available at http://www.sec.gov/rules/exorders/2013/34-70150.pdf.

purposes they wish, while leaving the vast majority of investors free to disregard that data if they choose.

- ***Alternatively, make pay ratio disclosures part of the MD&A section of filed materials.*** CCMC recommends that the Commission explore other potential options that may satisfy the legislative intent of DFA §953(b). One alternative may be that a discussion, rather than the disclosure, of a ratio be included in companies' Management Discussion and Analysis (MD&A) to avoid contributing to disclosure overload as well as increased liability. An MD&A discussion could include information of industry wide studies (as the SEC has provided in the release)[73] that may include a discussion of the compensation practices of a company. This would at least provide a level of comparability and potential relevance to investors.

- ***The Commission should limit the employees of Companies subject to DFA*** **§953(b)** ***to U.S. based, full-time, employees.*** Even if the Commission were to conclude that it ultimately would have no choice but to apply the literal language of DFA §953(b) to include the breadth of employees proposed to be covered in the Pay Ratio Proposal, there is no reason that the Pay Ratio Proposal cannot be subject to an appropriate phase-in period, to give the Commission the ability to monitor the experiences of companies under the regulation.

- Similarly, we do not agree with the Commission's reading of DFA §953(b)—to the effect that it precludes any amendment of Regulation S-K subsequent to the passage of DFA that would alter the definition of total compensation in Item 402 of Regulation S-K[74] in effect on the day before the date of enactment of the Dodd-Frank Act.[75]

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[73] *See* Pay Ratio Proposal Release, *supra* n. 4, at 88.

[74] 17 CFR §229.402(c)(2)(x).

[75] Pay Ratio Proposal Release, *supra* n. 4, at 50-51.

- Moreover, contrary to the Commission's implicit assumptions, Regulation S-K Item 402 does not contain a single reference to hourly or overtime compensation, which the SEC has elected to consider in calculating total compensation.[76] Accordingly, the SEC's decision to extend the rule to non-salaried employees that receive "wages plus overtime," rather than salary, is a use of discretion, which goes beyond a plain reading of Section 953(b), and increases the burdens and costs associated with the Pay Ratio proposal.

- ***We recommend that, consistent with a plain reading of Item 402, the use of the term "employee" be limited to salaried employees.***[77] Nevertheless, if the SEC continues to define "employee" as applying to non-salaried employees that receive "wages plus overtime," then, for the purposes of the required cost- benefit analysis, the SEC must treat this expansion to "wages plus overtime" as a cost associated with the exercise of its discretion.

- ***The Commission should quantify the potential liability for businesses when the Pay Ratio Proposal becomes effective.*** From an economic analysis perspective, this is a discernible estimate, and one that investors are entitled to know, since they ultimately bear the costs of any litigation that may arise as a result of the Pay Ratio Proposal through settlements and depressed returns. Increased liability and legal costs harm businesses and make capital markets less efficient. We believe the Commission is required to include such an analysis with its ultimate rulemaking.

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[76] *Id.* at 53.

[77] For the purposes of DFA 953(b) Congress explicitly stated that the total compensation of an employee of an issuer shall be determined in accordance with section 229.402(c)(2)(x) of title 17, Code of Federal Regulations, as in effect on the day before the date of enactment of this Act. Beyond precluding use of any amended version of Item 402, the regulations the SEC is directed to use reference only "salary and base salary" and not hourly or overtime compensation. Given this explicit Congressional command and the absence of legislative history to the contrary, it seems clear Congress only intended for the ratio to include salaried employees and that it did not give the SEC the discretion to extend it to non-salaried employees excluded from the definition of employees covered in Item 402.

- ***The Commission should create an explicit safe harbor to accompany the finalized Pay Ratio Proposal.*** Given the Commission's own doubts about the appropriateness of pay ratio disclosure, and the lack of any discernible benefit to investors flowing from such disclosure, it would seem pointless to subject companies to the possibility of litigation. Whatever the merits of shareholder litigation generally, there could be absolutely no benefit from litigation to vindicate a rule that the Commission is only adopting because it must. While the creation of a safe harbor cannot improve the utility of the rule, it will mitigate some of the ways in which the Pay Ratio Proposal could be used to harm investors.

- ***The Pay Ratio Proposal should permit companies flexibility in determining the date on which employees must be employed to be included in the required calculation.*** In the Pay Ratio Proposal, the Commission has chosen the last day of a registrant's last completed fiscal year as the calculation date to determine whether an employee will be included in the required computations.[78] We believe Companies should be allowed to select the date upon which to make the calculation. The final Fiscal Year date is used as a calculation for many different disclosures and reports. This also requires a great amount of staff time and resources. By allowing companies to pick a specific date of their own choosing, businesses will be able to choose a point in time when they are best able to devote the resources and staff time to determine the ratio.[79]

## IV. <u>Conclusion</u>

We are sympathetic to the difficult task the Commission is required to perform in satisfying its obligations under DFA §953(b), and we appreciate the opportunity to comment on the Pay Ratio Proposal. But, the difficulties inherent in complying with DFA §953(b)'s mandate have been compounded by the way the Commission has approached this rulemaking effort. We believe the initiation of formal rulemaking

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[78] *See* Pay Ratio Proposal Release, *supra* n. 4, at 30-33.

[79] We recognize that this suggestion reduces the comparability of the disclosures that would be required under the Pay Ratio Proposal. But, the Commission has already accepted that possibility by permitting companies to select different methodologies for the calculations the Proposal would require. Companies would, presumably, disclose what date they selected, and the reasons that the particular date was selected.

procedures was premature, and has resulted in a flawed process—problems that could, and should, have been avoided if the Commission had utilized the roundtable approach we selected months ago.

We are troubled by the Commission's lack of recognition for the broad discretion it possesses in formulating '34 Act rules to implement DFA §953(b). And, we are troubled by the Commission's failure to designate the objectives it chooses to pursue in its pay ratio disclosure rulemaking, as well as the Commission's failure to identify and quantify an appropriate cost-benefit analysis. The comments that will be elicited on this round of rulemaking cannot possibly provide the kind of insight to which the Commission is entitled, and that investors and public companies deserve.

And yet, each of the flaws we perceive in both the process and the substance of the Commission's efforts is capable of being cured. There is considerable doubt that, even under the best of circumstances, *any* pay ratio disclosure could provide investors with useful information, or avoid harming competition, efficiency and capital formation. While we understand the busy agenda Congress has imposed upon the Commission, the Pay Ratio Proposal has not been informed by Commission research into, and exploration of, a significant number of crucial issues. As matters now stand, the Pay Ratio Proposal exposes public companies to legal liability overseas, and expands the scope of those employees encompassed within the required pay ratio calculations beyond those whom Congress presumably intended to be covered.

Despite the Commission's attempt to build in flexibility through statistical sampling, this is not a real improvement, since tremendous data collection burdens and costs will continue to be borne by businesses and their investors, with little or no commensurate benefit. The lack of materiality or even relevance of pay ratio disclosures to investors notwithstanding, the improvements outlined in this letter would help achieve a far superior rule than the current Pay Ratio Proposal. We remain ready and willing to work with the Commission and its Staff to achieve that goal.

Sincerely,

David Hirschmann