Technical Compensation Advisors, Inc.

December 2, 2013

Via Internet Comment Form

Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20546-1090

Re: File Number S7-07-13

Dear Ms. Murphy:

I am writing this letter to provide comments on the Commission's proposed amendments to Item 402 of Regulation S-K to implement Section 953(b) of the Dodd-Frank Wall Street and Consumer Protection Act.

By way of background, Technical Compensation Advisors is a boutique compensation consulting firm that focuses on complex matters including regulatory issues, disclosure, accounting, valuation, tax as well as anything quantitative, financial or statistical. A number of the clients I assist would be included among the nearly 4,000 companies that would be expected to comply with the proposed rule. I am providing the following comments based in part on my discussions with these issuers.

The comments I provide below generally question the benefits of the proposed rule to investors and specifically address certain questions posed throughout the release, particularly requests 21 – 24, 25 – 28, 32, 59 – 60, 62 – 63. My comments are summarized as follows:

- The Commission should postpone the implementation of Section 953(b) indefinitely unless and until it can:
    - Demonstrate how any rule would be consistent with its mission
    - Fully quantify the costs and benefits associated with the adoption of any rule.
- If the Commission insists on the proceeding with the adoption of rules to implement Section 953(b) without a full understanding of the costs and benefits, then the final rule should focus on reducing the costs of compliance which would ultimately be borne by the shareholders the Commission is charged with protecting.
- To reduce the cost of compliance, the final rule should provide explicit alternatives that favor practicality over spurious precision which includes:
    - Allowing issuers to make safe harbor assumptions about the distribution of compensation at companies (e.g., explicitly permit an assumption that compensation is lognormally distributed within a company or segment)
    - Explicitly permitting expedient formulaic and/or numerical approaches to estimate median compensation as an alternative statistical sampling (e.g., simulation)

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    - Providing issuers with the ability to report a range of pay ratios based on a range of reasonable assumptions.
- Eliminate the most blatant distortions in the pay ratio by requiring companies to annualize the pay of all part-time and seasonal employees to reflect annual full-time equivalent pay or reflect an hourly rate for all employee pay.

The remainder of this letter provides more detail on the above comments.

Postpone implementation of Section 953(b)

Given that Section 953(b) has no specific deadline, the Commission should postpone adoption of any pay ratio rule until it can demonstrate that (1) the implementation is consistent with the Commission's mission and (2) the costs and benefits are fully quantified.

According to the Commission's website, "the mission of the U.S. Securities and Exchange Commission is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation." The website continues to state that ". . . all investors, whether large institutions or private individuals, should have access to certain basic facts about an investment prior to buying it, and so long as they hold it. To achieve this, the SEC requires public companies to disclose meaningful financial and other information to the public."

Nothing in the proposal makes it clear that the implementation of Section 953(b) is consistent with the Commission's mission. The proposed rule makes no mention of how it would protect investors, provides what can only be considered a hypothesis that the rule may improve the efficiency of U.S. capital markets and expresses some concerns that the rule could have a negative impact on capital formation. Accordingly, the Commission should provide more evidence that adopting this rule is consistent with its mission.

In addition, there clearly will be costs associated with compliance, but the Commission has provided little evidence that there would be any benefits (i.e., that the information would be meaningful). Compliance with additional rules and regulations represent additional agency costs that must be borne by all shareholders, yet not all shareholders would appear to benefit from the implementation of a pay ratio rule. Effectively, there is a transfer of wealth from all shareholders to those charged with preparing the disclosure (i.e., employees, lawyers and consultants) and the cost of this compliance is being subsidized by the shareholders that do not perceive any benefits for the sake of those shareholders that perceive some benefit.

Activist institutional shareholders were well represented in the comments received by the Commission while many other large institutional investors were notably absent from making comments. One might speculate that this inaction on the part of many large institutional shareholders suggests an indifference to the proposed rule and, if so, the Commission would be justified in serving the interests of those that provided comments without regard for those that were silent. Note, however, that the Commission's website states that, ". . . the SEC continually works with all major market participants, including especially the investors in our securities markets, to listen to their concerns and to learn from their experience." If the Commission truly wants to consider all of the investors it has been charged with protecting, then I urge the Commission to actively seek input from this very large and important constituency and share this input with the public.

Focus on reducing the cost of compliance

The proposed rule attempts to address issuers' concerns regarding the cost of compliance by allowing issuers to use estimates, statistical sampling or other reasonable methods and compensation measures other than annual total compensation to identify the median. While the Commission's decision to allow for flexibility in developing the disclosure should help in reducing compliance costs, the proposed rule places considerable emphasis on statistical sampling and does not provide any detail on the other reasonable methods that can be used. Accordingly, I am urging the Commission to provide more explicit guidance on what "other reasonable methods" are available. This could be accomplished by expanding proposed Instruction 2 to Item 402(u) to:

- Explicitly permit issuers to make specific safe harbor assumptions about the statistical - distribution of compensation within the company and its business units -
- Allow for formulaic, numerical and other computational approaches to estimate the median compensation (including simulation techniques), and
- Provide issuers with the ability to disclose a reasonable range of outcomes rather than spend considerable effort identifying the "right" outcome.

Note, however, that nothing in this letter is intended to suggest that the Commission should prohibit the use of statistical sampling. The suggestions are intended to provide tools in addition to statistical sampling that might be used by issuers.

My discussions with clients have led me to question how useful statistical sampling would be for many issuers. The Commission's proposal and many of the comments provided appear to imply that statistical sampling is some sort of trivial exercise that would alleviate all concerns about compliance costs. In helping clients think through the practical issues associated with sampling, it becomes apparent that there are considerable logistical issues with collecting all of the necessary data regardless of whether they would be used for sampling or to create an array. If the data were accessible, figuring out exactly how the sample data would be extracted from the population (e.g., with multiple payroll systems) would create costly challenges for companies. For example, how much staff time would be spent manually collecting these data or is it even possible to have a computer program written to draw data from multiple payroll systems? If the data for the entire employee population were accessible, then companies might question whether more effort would be spent determining the sampling approach, extracting the data and developing confidence intervals compared to simply arraying all of the employee data and determining the median compensation (e.g., data for all 2.2 million employees at Walmart can be placed in three columns of Excel).

However, for a number of companies, seriatim compensation data from multiple business segments are simply not available which makes statistical sampling impossible. These issuers are faced with a daunting task of integrating information from multiple payroll systems into a single group of data based on nothing more than limited summary statistics (e.g., quartiles, averages, etc.). If the Commission were to expand Instruction 2 to proposed Item 402(u) as I suggest above, then an issuer would be able to (1) assume that compensation data are lognormally distributed in each of the payroll systems, (2) estimate the standard deviations of log-adjusted compensation within each payroll system based on summary statistics (e.g., using the interquartile range) and (3) use the median and standard deviation of the log-adjusted data to simulate the log-adjusted pay for all of the employees in each payroll system. Once this is accomplished, the simulated data can be combined into one series and the median compensation can be estimated from this combined series. This approach has the benefit of being expedient – once summary statistics are obtained for each of the payroll systems, the calculations involved with estimating the median compensation would probably take no more than a couple of weeks which could be considerably less expensive than conducting a statistical sampling analysis.

Another approach that might be considered was briefly mentioned in the proposing release. The approach was described as statistical inference that involves a weighted sample median using stratified cluster sampling. If, as I suggest above, summary statistics are provided for each payroll system, a similar approach could be used to estimate the median compensation (no stratified cluster sampling would actually be used in this situation – actual medians from each segment would be used). This approach is even more expedient than the simulation approach suggested above.

Those that oppose such expedient approaches might raise concerns about the accuracy of the estimates. But that begs the question as to how precise this disclosure needs to be to provide any of the purported benefits and whether the trade-off between incremental precision is worth the incremental costs with attaining that precision. Would the alleged benefits to investors change if an issuer's disclosure states that the CEO was paid 250 times the median worker vs. 200 or 300? Each investor that perceives some benefit from this proposed disclosure would have an acceptable margin. It would be helpful if the Commission actively sought this information from those that support the disclosure.

Once the Commission determines an acceptable range that can be disclosed, then issuers can provide a reasonable range of pay ratios based on a range of reasonable assumptions. For example, any change in pension values could be calculated based on extreme age and service assumptions with $0 assigned to an assumed younger employee with little service to some maximum amount based on an employee that has just become eligible for early retirement. When I conduct valuations and other analyses, I often conclude that it is easier to calculate multiple estimates than it is to determine which is "correct." If the range of outcomes is acceptable, then any additional effort spent on being more precise would clearly be a waste of shareholders' money.

<u>Annualize part-time and seasonal compensation</u>

As proposed, the rule would typically require the comparison of a full-time CEO to employees that might have part-time schedules that reflect less than full-time equivalent schedules. While there are a number of other possible distortions created by the proposed rule, I suggest that the Commission at least address this particular distortion. The Commission should reconsider this requirement by permitting either an adjustment of all part-time, temporary and seasonal employees to reflect a full-time equivalent schedule or, if the data are available, permit an adjustment to all compensation data to reflect an hourly rate for each employee. The latter approach would provide the more valid comparison since many full-time employees work more than 40 hours per week, while the former approach would likely be more expedient since the number of hours each employee worked would not be needed to calculate the hourly rate (e.g., a 40-hour work-week would be assumed to be full-time for all employees). To be consistent, similar adjustments would need to be made to the CEO's pay if he/she were employed for a partial year.

Without adjustments like these, the data have little meaning and could have negative implications for companies that use part-time workers (even if these workers earn high hourly wages) as compared to companies that use mostly full-time workers (even if they earn minimum wage). By analogy, it would be meaningless to determine the fuel-efficiency of a car without knowing both the number of gallons of fuel used and the number of miles driven.

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I hope that the Commission finds these comments helpful. If anyone at the Commission would like any assistance or would like to discuss any of these comments with me, I would be delighted to do so.

Sincerely,

Andy Restaino
Managing Director