Center On Executive Compensation

December 2, 2013

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

RE: **Comments on Proposed Rule Implementing the Pay Ratio Disclosure**
File Number S7-17-13

Dear Ms. Murphy:

The Center On Executive Compensation ("Center") and HR Policy Association are pleased to submit comments to the U.S. Securities and Exchange Commission ("SEC" or "Commission") regarding the proposed rules implementing Section 953(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act.[1]

I. Introduction and Overview.

The Commission's Proposed Rule will impose significant and wholly unnecessary costs on U.S.-listed companies and U.S. investors. The pay ratio requirement itself is mistaken: it will provide no useful information to investors and to the extent the information is used by investors at all, it is likely to be misleading and thus will be harmful to them.

These useless and potentially harmful disclosures will, however, come at great cost: a majority of issuers would be required to gather data manually from dozens of countries globally with total compliance costs estimated to be at least $186.9 million, considerably greater than the estimate in the proposed rule. The Commission possesses the authority to significantly reduce these costs in the final rule. Limiting the mandatory ratio disclosure to U.S. employees only would reduce the rule's costs by nearly 50% for U.S.-based multinational registrants with no loss in the reliability or utility of the information being disclosed. Limiting disclosure to full-time, year-round employees—which also would make the data no less reliable—would reduce the costs by 20 percent. All of these changes can be made through the exercise of the Commission's existing statutory authorities. Indeed, because the Commission can significantly reduce the rule's deleterious effects on efficiency, competition, and capital formation without any adverse effects on investors, it is obligated to make these and other changes identified in our comments. That is the lesson taught by the recent "extractive industries" rulemaking, where the court determined that the Commission had imposed unwarranted costs on American businesses and investors due to a mistaken belief that Dodd-Frank left it no choice but to adopt a patently unreasonable rule.[2] In this rulemaking too, the Commission has alternatives available that would produce a significantly less onerous rule.

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[1] U.S. Sec. Exch. Comm'n, Proposed Rule: Pay Ratio Disclosure, Release Nos. 33-9452, 34-70443, 78 Fed. Reg. 60,559 (Oct. 1, 2013) (to be codified at 17 C.F.R. §§ 229.402(u)).
[2] 2013 WL 3307114, at *13 (D.C. Cir. July 2, 2013).

The Center On Executive Compensation is a research and advocacy organization that seeks to provide a principles-based approach to executive compensation policy from the perspective of the senior human resource officers of leading companies. The Center is a division of HR Policy Association, which represents the chief human resource officers of over 350 large companies, and the Center's more than 100 subscribing companies are HR Policy members that represent a broad cross-section of industries. Because this issue is extremely important to both Center Subscribers and HR Policy members, these comments are being submitted on behalf of both organizations.[3]

A. The Center's Survey Shows That the Compliance Burdens in the Proposed Rule Are Excessive Relative to the Benefits to Investors.

In response to the Commission's request for information about the burdens and cost of compliance of the proposed rule, the Center, along with HR Policy Association and the Society of Corporate Secretaries and Government Relations Professionals surveyed our members about the impact of the proposed pay ratio rule ("COEC Survey"). The results from this survey demonstrate that investors have not requested the proposed pay ratio disclosure and that its implementation would be burdensome and costly to companies. The results are referenced throughout these comments, and Section III below summarizes the results in detail.

B. 60-Day Comment Period Is Too Short to Fully Develop Sound Data for Assessing the Proposed Rule's Compliance Burden.

The Center believes that the 60-day comment period provided for the proposed pay ratio rule was too short for registrants to properly assess the impact of the proposed rule. The proposed rule was published in the Federal Register on October 1, 2013, providing for a 60-day comment period. On October 9, 2013 the Center along with 12 other organizations petitioned the Commission to extend the comment period. Our petition stated that because of the intricate nature of this rule and the diverse array of complex issues on which the SEC is specifically requesting comments, the 60 days would not provide interested parties with the opportunity to review the Proposed Rule, collect the data requested by the SEC, and provide commentary. Our experience in conducting the survey referenced above and preparation of these comments has confirmed that registrants have not had adequate time to review how the proposed pay ratio methodology and disclosure will impact them and that more time is needed to fully contemplate and analyze the implications of the proposed rule.

II. The Pay Ratio Disclosure Provides No Benefits for Investors and Will Be Misleading to Them.

[3] The Center and HR Policy have consistently opposed the pay ratio requirement in the Dodd-Frank Act because the ratio provides no benefits to investors while imposing excessive and unnecessary administrative burdens and costs on companies and thus have sought to lessen the costs of compliance or eliminate the requirement altogether. See *Hearing on Legislative Proposals to Relieve The Red Tape Burden on Investors and Job Creators Before the H. Comm. On Financial Services*, 113th Congress (2013) (statement of Charles G. Tharp, Chief Executive Officer, Center On Executive Compensation)(available at http://www.execcomp.org/Docs/c13-29 House Subc on Capital Markets Tharp Testimony 5-23-13.pdf); Center On Executive Compensation, *Center On Executive Compensation Comments on the Use of Statistical Sampling to Implement Section 953(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act*, (2011), http://www.sec.gov/comments/df-title-ix/executive-compensation/executivecompensation-79.pdf; Center On Executive Compensation, *Comments on Executive Compensation and Governance Provisions in Title IX, Subtitle E of the Dodd-Frank Wall Street Reform and Consumer Protection Act*, (2010), http://www.sec.gov/comments/df-title-ix/executive-compensation/executivecompensation-8.pdf.

The proposed rule will not provide any value to investors. At the same time, the proposed rule will be excessively burdensome for registrants. There is simply no empirical basis for asserting that the ratio of CEO pay to the pay of the median employee will meaningfully influence investor behavior in determining to purchase or sell securities or in voting for directors. Likewise, investors do not currently use pay ratios as contemplated by the proposed rule in making investment decisions. Investors do not use pay ratios to compare companies. Nor do investors look at pay ratios to evaluate internal pay equity and compensation practices. [4] Moreover, because of the differences in how companies are structured, the disclosure is likely to be misleading and therefore—to the extent it is used by investors at all—will be *harmful* to them.[5]

For these reasons, the Commission should seek to minimize the burdens on registrants in developing the disclosure, given that the information will be highly company- and context-specific. Section 953(b) of the Dodd-Frank Act, as well as the Commission's exemptive authority under the Securities Act and the Exchange Act, afford the Commission the flexibility to tailor the rule in this manner.[6]

A. The Pay Ratio Disclosure Is of No Value to Investors.

For over 75 years, the disclosure system has been the cornerstone of securities regulation in the United States and is charged with the goal of protecting investors by ensuring the availability of relevant and useful information regarding investment decisions. The scope of required disclosures, however, is not limitless. This is somewhat out of necessity, but also in recognition that providing excessive, irrelevant or misleading information actually contradicts the goals of the disclosure system. SEC Chair Mary Jo White echoed these concerns recently in a speech, cautioning that when disclosure "gets to be too much or strays from its core purposes" it can cause "information overload" and make it difficult for investors to focus on information that is

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[4] In any event, statements by a small cohort of special interest investors about the supposed importance of the pay ratio information do not constitute substantial evidence that the pay ratio disclosures are useful and cannot overcome the overwhelming consensus of informed and sophisticated investors who invest for the purpose of maximizing the value of their portfolios rather than to further certain social purposes. Overall, investor satisfaction with executive pay is overwhelming. In fact, according to Center data, in 2013 investors approved over 98 percent of S&P 500 companies' executive pay proposals with an average of nearly 91 percent shareholder support and a median exceeding 95 percent. *Cf. Business Roundtable v. SEC*, 647 F.3d 1144, 1152 (D.C. Cir. 2011) (Commission acted arbitrarily by failing to consider that "investors with a special interest, such as unions and state and local governments whose interests in jobs may well be greater than their interest in share value, can be expected to pursue self-interested objectives rather than the goal of maximizing shareholder value").

[5] In addition to the harm resulting from the misleading nature of the proposed pay ratio, the proposal also violates the First Amendment. The First Amendment protects "both the right to speak freely and the right to refrain from speaking at all." *Wooley v. Maynard*, 430 U.S. 705, 714 (1977). Section 953(b) and the proposed pay ratio rule compel speech in violation of the First Amendment. Neither the statute nor the proposed rule involves speech that "proposes a commercial transaction," and thus Section 953(b) and the pay ratio rule are not subject to intermediate scrutiny. *See Cent. Hudson Gas & Elec. Corp. v. Pub. Serv. Comm'n of N.Y.*, 447 U.S. 557, 562 (1980) (internal quotation marks omitted). Nor can the requirements at issue be characterized as a disclosure calculated to correct false or misleading speech. *See Zauderer v. Office of Disciplinary Counsel of the Supreme Ct. of Ohio*, 471 U.S. 626, 650-51 (1985). Likewise, Section 953(b) and the proposed pay ratio rule do not regulate "[s]peech relating to the purchase and sale of securities," *SEC v. Wall Street Pub'g, Inc.*, 851 F.2d 365, 373 (D.C. Cir. 1988), and do not represent an attempt by the Commission to "prevent investor misunderstanding," *id*. at 374 n.9. Accordingly, the requirements are not subject to whatever relaxed standard might be thought to apply to government regulation of securities. *Cf. id*. at 372-74. Instead, Section 953(b) and the pay ratio disclosure rule are subject to strict scrutiny and are constitutionally infirm because they are not narrowly tailored to achieve a compelling state interest.

[6] 15 U.S.C. §§ 77z-3, 78mm.

actually relevant and material.[7] As a result of the SEC's clear goal of providing investors with only relevant and useful information, there is a natural and unavoidable tendency for the public to automatically assume that any information which is required to be disclosed, simply by its nature of being disclosed, is important, relevant, and helpful.

By requiring companies to disclose the pay ratio, the Commission creates a preconceived bias that the pay ratio provides useful information about a company when in fact the pay ratio does not and cannot provide any utility to investors. The pay ratio fails as a tool to compare registrants because the pay ratios of individual companies will be a unique result of each company's business structure, employee population, and compensation practices. Nor does the proposed pay ratio provide a measure of internal pay dispersion within a registrant, and even if it did, the ratio would not provide insight into a company's pay practices over time due to ongoing internal changes within companies. For the same reason, the pay ratio fails as a tool by which to measure pay trends within a company.

Investors themselves have not expressed any desire for the pay ratio. According to Center data, since 2010 there have been only 14 separate shareholder proposals requesting a pay ratio or similar disclosure. These proposals averaged 93% shareholder *opposition*.[8] None of the proposals received over 10 percent support. Nor was there an increase in support for the proposals during that three-year period demonstrating a trend. Additionally, when asked about the costs of pay ratio implementation, not one of the 128 respondents to the COEC survey reported ever receiving an inquiry from one of their top 10 investors with regard to the pay ratio.[9]

Despite the lack of use of and interest in the pay ratio, requiring it to be disclosed will cause harm to both investors and registrants. The ratio is highly inflammatory and may lead investors to assume high ratios would be indicative of abusive and unfair pay practices. Any use of the pay ratio will create a distorted picture of a company, which harms investors as well as the company itself.

1. *There Is No Reliable Evidence That Disclosure of a Pay Ratio Will Influence CEO Pay Levels.*

Although proponents have claimed that disclosure of the pay ratio will have widespread influence on CEO pay levels, there is no evidence to support their statements, and anecdotal evidence from recent shareholder votes demonstrates that investors overall are very satisfied with CEO compensation levels.[10] In addition, if pay ratio data were relevant for investors generally,

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[7] The Honorable Mary Jo White, "The Importance of Independence," A.A. Sommer, Jr. Corporate Securities and Financial Law Lecture, Fordham Law School, SEC.gov, Oct. 3, 2013, http://www.sec.gov/News/Speech/Detail/Speech/1370539864016#.Upn_TsTrzbw, last visited Nov. 30, 2013.
[8] Center On Executive Compensation, *Pay Ratio Proposals Since 2010*, (2013), http://www.execcomp.org/Docs/c13-56 Pay_Ratio_Shareholder_Proposals_Since_2010.pdf
[9] Dr. Stuart Gurrea & Dr. Jonathan Neuberger, The Economic Impact of the SEC's Proposed Rule on Required Pay Ratio Disclosure, Appx. II 5 (2013).
[10] "Moreover, statements by a small cohort of special interest investors concerning the supposed importance of the pay ratio disclosure do not constitute substantial evidence that the disclosures are useful and cannot overcome the overwhelming consensus of informed and sophisticated investors who invest for the purpose of maximizing the value of their portfolios rather than to further certain social purposes. *Cf. Business Roundtable v. SEC*, 647 F.3d 1144, 1152 (D.C. Cir. 2011) (Commission acted arbitrarily by failing to consider that "investors with a special interest, such as unions and state and local governments whose interests in jobs may well be greater than their

as opposed to special interests, the investors would have been asking companies for it, and a material number of companies likely would have voluntarily disclosed it. CEO pay is set by an independent compensation committee which takes into consideration the performance of the company, the CEO's execution of the company's strategy and development of new leaders, and the market for similar CEO talent. Meanwhile, just as compensation committees seek to provide a competitive compensation package to retain talented and high performing CEOs, companies seek to compensate other workers consistent with the markets in which they are working. Companies are market takers, not market makers, and the pay ratio is the result of the markets for CEOs and the markets for other workers.

2. *There Is No Reliable Evidence That Disclosure of a Pay Ratio Will Influence Investors' Evaluation of Employee Morale, Productivity or Human Capital or the Value of Securities.*

There is no reliable economic research to suggest that disclosure of a pay ratio is "relevant to employee morale, productivity, investments in human capital and ultimately the value of securities."[11] A study conducted for this rulemaking by Dr. Stuart Gurrea and Dr. Jonathan Neuberger notes that the research cited by pay ratio proponents "does not always concern pay dispersion among all employees (or employees and CEOs) and, more generally, offers inconclusive empirical evidence."[12] For example, the authors note that the proponents of the proposed pay ratio disclosure have claimed that companies with higher pay ratios have less productive workers. In reality, the authors note that "the economic literature on this subject . . . is unrelated to these claims."[13] The authors note that the study frequently cited with respect to the impact of pay disparity on collaboration, "Pay Disparities Within Top Management Groups: Evidence of Harmful Effects on Performance of High-Technology Firms," by Phyllis Siegel and Donald C Hambrick, "concerns executive pay and pay disparities among top executives, not the difference between CEO pay and the compensation of the median employee, which is the object of the pay ratio."[14] Gurrea and Neuberger also note that the other economic literature on pay disparity and productivity "focuses on pay disparities *among* employees [with comparable jobs], not differences between the top executive and the typical employee."[15] The authors report that same is true with respect to research on the impact of pay differentials on training.

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interest in share value, can be expected to pursue self-interested objectives rather than the goal of maximizing shareholder value")."

[11] Dr. Stuart Gurrea & Dr. Jonathan Neuberger, The Economic Impact of the SEC's Proposed Rule on Required Pay Ratio Disclosure, 9 (2013). The report is attached to these comments.

[12] *Id*. Pay dispersion is defined as the range of a distribution of employee pay numbers and provides information on whether the pay is clustered together or widely scattered across the range of the distribution.

[13] *Id*. at 10.

[14] *Id*.

[15] *Id.* at 11.

3. There Is No Evidence in Practice That Shows the Disclosure of a Pay Ratio Will Be of Value to Investors.

Experience confirms that pay ratio information has no genuine value or utility. Investors historically have not requested such information from registrants. If pay ratio disclosures were believed to provide meaningful information to investors that was helpful in making investment decisions, we would expect to see repeated investor requests for this information. As demonstrated by the survey responses discussed above, investors are not asking companies to disclose this information.

The lack of value to investors is also reflected in the popular press. As stated by CFO.com editor David McCann, "while shareholders are very hot on pay for performance, they don't give a whit about pay ratio" because the "so-called 'pay ratio' does not tell investors anything useful about a company."[16] News coverage of the proposed rule is equally critical of the pay ratio. An October *Los Angeles Times* opinion piece criticized the pay ratio, noting that "unlike most SEC regulations" the ratio is not "designed to provide information for investors" and that "the rule doesn't tell investors anything useful."[17] Asking rhetorically if the burdens of preparing the ratio are justified by the benefits, the article bluntly concludes that they are not, and notes that the ratio, which is designed simply to shame companies, does not provide information not already available from the current disclosure scheme.

4. A Majority of SEC Commissioners Have Expressed Concern With the Use of the SEC Disclosure Regime as a Vehicle to Exert Social Pressure on Companies.

Even a majority of SEC Commissioners has expressed concerns about the use of disclosure, including the pay ratio, to further social objectives, rather than provide information to investors. For example, SEC Chair Mary Jo White, in a recent speech, contrasted disclosures "aimed at making our financial system and the protections with investors stronger" with other mandates that "seem more directed at exerting societal pressure on companies to change behavior, rather than to disclose financial information that primarily informs investment decisions."[18] She went on to say "as the Chair of the SEC, I must question, as a policy matter, using the federal securities laws and the SEC's powers of mandatory disclosure to accomplish these goals."[19] Although Chair White did not speak directly about the pay ratio provision, it fits squarely within the proposals she described.

Likewise, Commissioner Gallagher, in his remarks at the open meeting to consider the proposed rule, stated bluntly that the "only conceivable purpose [of the proposed rule] is to name and, presumably in the view of its proponents, shame U.S. issuers and their executives. This political wish-list mandate represents another page of the Dodd-Frank playbook for special interest groups who seem intent on turning the notion of materiality-based disclosure on its

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[16] David McCann, *Dodd-Frank Pay Provision Is a Net Zero*, CFO.com, (Feb. 25, 2013), http://ww2.cfo.com/compensation/2013/02/dodd-frank-pay-provision-is-a-net-zero/.

[17] Michael Doriff, *Congress' Wrong-Way Approach to CEO Pay*, The Los Angeles Times, (Oct. 17, 2013), http://articles.latimes.com/2013/oct/17/opinion/la-oe-dorff-executive-pay-20131017..

[18] The Honorable Mary Jo White, "The Importance of Independence," A.A. Sommer, Jr. Corporate Securities and Financial Law Lecture, Fordham Law School, SEC.gov, Oct. 3, 2013, http://www.sec.gov/News/Speech/Detail/Speech/1370539864016#.Upn_TsTrzbw, last visited Nov. 30, 2013.

[19] *Id*.

head."[20] Commissioner Piwowar echoed a similar theme, stating that "proponents have acknowledged that the sole objective of the pay ratio disclosure rule is to shame CEOs."[21]

The lack of any articulated benefit to investors, something that the Commission itself acknowledged in the proposed rule,[22] means that in developing the final rule, the Commission must deploy its discretion in a manner that minimizes the burdens on covered companies.[23] Instead, the Commission's proposed approach threatens to impose tremendous costs on covered companies in a manner that is inconsistent with its obligations under the Exchange Act.[24]

B. The Pay Ratio Disclosure Will Be Misleading to Investors.

Beyond the fact that the proposed pay ratio disclosure would not be of value to investors, it is likely to actually harm investors by providing misleading information. Generally, investors use company disclosures, and executive compensation disclosures particularly, to compare a subject issuer to other issuers the investor considers the company's peers. Investors also use disclosures to compare information for the subject issuer over several years to determine the impact of changes in a company's business strategy and leadership. Unlike these disclosures, the pay ratio is inherently misleading because it purports to represent information concerning a company's pay practices and culture when in reality it is impossible for the pay ratio to do so. Even so, by requiring the information to be disclosed, the Commission creates an external perception that the pay ratio provides value to investors.

1. Comparing Pay Ratios Among Companies in Different Industries Will Be Misleading Due to the Substantial Differences in Pay Arrangements.

The most obvious areas in which the proposed pay ratio rule would be misleading are those in which an investor attempts to compare pay ratios among companies in different industries. Companies in different industries have significantly different workforces, such as the difference between the highly skilled workforce required for a global biotechnology company and the lesser-skilled – and lesser-compensated – workforce required for a large retailer or hospitality company. Other differences include the share of employees that are full-time versus part-time, the mix of jobs within a company and competitive and geographic impacts on market compensation levels. As a result, when looking at companies across industries, their ratios would look markedly different merely because of the differences among industry workforces.

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[20] Commissioner Daniel M. Gallagher, *Dissenting Statement of Commissioner Daniel M. Gallagher Concerning the Proposal of Rules to Implement the Section 953(b) Pay Ratio Disclosure Provision of the Dodd-Frank Act*, sec.gov, Sept. 18, 2013, http://www.sec.gov/News/Speech/Detail/Speech/1370539815919#.UpyO_dJDvWc.
[21] Commissioner Michael S. Piwowar, *Statement at Open Meeting Regarding Municipal Advisors and Pay Ratio Disclosure*, sec.gov, Sept. 18, 2013, http://www.sec.gov/News/Speech/Detail/Speech/1370539811778#.UpyPRNJDvWc
[22] 78 Fed. Reg. at 60,562
[23] 15 U.S.C. §§ 77z-3, 78mm.
[24] *See* 15 U.S.C. §§ 78c(f), 78w(a)(2).

2. Comparing Pay Ratios of Among Companies in the Same Industry Will Likewise Be Misleading.

Differences among companies in the same industry may also serve to undermine the use of the proposed pay ratio in determining whether investing in one company is better than investing in a competitor. Here again, differences in the companies' sizes and global reach, competitive and geographic labor market forces in the markets in which the companies operate, and the mix of jobs within each company based on decisions about workforce structure would reduce the comparability of such disclosures across companies, making comparison virtually meaningless.

3. Year-to-Year Changes in Company Structure, Employment and Other Practices Will Make Comparing the Pay Ratio Within Companies May Be Misleading.

As noted above, a company's pay ratio will be the sum of the company's unique business structure, employment and pay practices. As a result, changes in business structure, employment arrangements or pay practices will likely result in a fluctuation of the pay ratio. Companies make these changes, (*e.g.* mergers, divestitures, outsourcing) because they believe the changes are in the best interest of the company and its shareholders. However, because of the inflammatory nature of the pay ratio and what it purports to convey, it will shift attention away from the merit of the business decision to an effort to gauge the meaningless and potentially misleading implications of the change in the pay ratio. The disclosure harms investors and the company alike.

Even without a significant business decision or disclosure change, investors are likely to try to infer some meaning from year-to-year changes in the pay ratio. This detracts from actually relevant and useful information which investors could otherwise be using to evaluate a company.

III. The Commission's Cost-Benefit Analysis Severely Underestimates the Cost of Compliance.

The Commission has a statutory obligation to "do what it can to apprise itself—and hence the public and the Congress—of the economic consequences of a proposed regulation."[25] Specifically, under Section 2(b) of the Securities Act[26] and Section 3(f) of the Exchange Act[27] the Commission is directed "to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition and capital formation." In addition, under Section 23(a)(2) of the Exchange Act[28] the Commission must "consider the impact that any new rule would have on competition" and refrain from "adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act." The Commission acknowledged these duties in the Proposed Rule and specifically requested comment on the rule's effects on efficiency, competition, and capital formation.[29]

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[25] *Chamber of Commerce v. SEC*, 412 F.3d 133, 144 (D.C. Cir. 2005); *see also Credit Suisse Sec. (USA) LLC v. Billing*, 551 U.S. 264, 283 (2007) (observing that the Commission must "take account of competitive considerations when it creates securities-related policy and embodies it in rules and regulations.").

[26] 15 U.S.C. § 77b(b).

[27] 15 U.S.C. § 78c(f).

[28] 15 U.S.C. § 78w(a)(2).

[29] *See* 78 Fed. Reg. at 60,582 & n.150. Because the pay ratio rule is being promulgated under the Securities Act and the Exchange Act, the Commission is obligated to comply with all of its duties under those statutes in defining

Courts have construed these provisions to require the Commission to "weigh[] the costs and benefits," including the rule's "net benefit," and "cost[s] at the margin".[30] An economic analysis that does not determine whether the means chosen will produce the ends desired, or consider whether lower-cost options would be comparably effective, is arbitrary and capricious.[31] Likewise, to impose massive costs without any discernible benefit would violate the Administrative Procedure Act.[32] Yet that is precisely what the Proposed Rule threatens to do.

The Commission concedes as much, repeatedly acknowledging that the costs of compliance could be "substantial" and "significant," while observing that the rule does not achieve any apparent benefit.[33] Given the gulf between the costs and benefits of the pay ratio disclosure, and the Commission's express obligations to protect investors, minimize burdens on efficiency, completion, and capital formation, and refrain from adopting regulations that "would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act," the Commission must exercise its discretion to minimize costs to covered registrants.[34]

A. *The Center's Proposed Pay Ratio Rule Compliance Survey Predominantly Focused on Large Companies With More Than 10,000 Employees.*

In order to obtain a better sense of the impact of the proposed rule on Center On Executive Compensation Subscribers, other HR Policy Association Members, and members of the Society of Corporate Secretaries and Governance Professionals, the Center led a company survey in October and November of 2013. The results in this comment letter reflect the responses to the survey.

One hundred twenty-eight large companies responded to the survey out of a population of 1,270 companies. Fifty-nine percent of respondents had $10 billion or more in revenue, with nearly 95 percent having more than $1 billion in revenue. Nearly 80 percent of respondents had more than 10,000 employees, including part-time, seasonal and direct hire temporary employees, with over 34 percent having more than 50,000 employees. Over 50 percent of respondents had employees in more than 25 countries with the average respondent having employees in 34 countries. The average company among all respondents had 15 payroll or information systems. Reflecting a broader global scope among larger companies, the median HR Policy Association member had 20 payroll systems, with nearly 30 percent having more than 50 payroll systems. Notably, out of the 128 survey respondents, not a single registrant stated that there otherwise exists a legitimate business purpose for collecting the information necessary for calculating the pay ratio.

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the contours of the pay ratio rule. *Cf. Pub. Citizen v. Fed. Motor Carrier Safety Admin*., 374 F.3d 1209, 1216 (D.C. Cir. 2004) (rule was arbitrary and capricious because agency failed to consider a factor required by statute).

[30] *Bus. Roundtable v. SEC*, 647 F.3d 1144, 1151-1153 (D.C. Cir. 2011)

[31] *See id.* at 1151 ("[T]his type of reasoning, which fails to view a cost at the margin, is illogical and, in an economic analysis, unacceptable.").

[32] *Pub. Citizen*, 374 F.3d at 1218.

[33] *See* 78 Fed. Reg. at 60,561, 60,562, 60,563, 60,587, 60,588, 60,590.

[34] 15 U.S.C. §§ 77b(b), 78c(f), 78w(a)(2).

B. The Lack of Centralized Data And Privacy Restrictions Add to the Time Required to Identify the Median Employee and Calculate Total Compensation.

According to the COEC Survey results, a majority of issuers surveyed do not have centralized data that would permit the company to identify the median employee. Out of these companies, nearly three-quarters (72%) will either collect data in the form of a consistently applied compensation measure from all locations or will narrow their employee populations and then collect the data for the smaller subset of employees or countries. Companies choosing this option made comments such as the "most direct and complete" way to calculate the ratio was simply to explain to HR teams in various countries and regions what kinds of data collection were required and send them off to collect the relevant data. A few respondents noted that adopting this approach would "provide the most accurate information in calculating the median employee and ratio so that our CEO and CFO can comfortably certify the results." One issuer without a centralized payroll system noted that to obtain centralized data, "the company would need to commit $10 million for a system that is not currently needed for any other reason." Rather than commit such substantial resources to implement a single-use system, the company concluded it would need to take the more burdensome but less costly route of collecting the data manually from each system in order to gather data on each employee globally.

As discussed below, data privacy restrictions in certain countries will add to the time and expense required to identify the median employee. Many companies noted that compliance with the data protection laws of each European Union member country will be a significant obstacle to the collection of necessary information. In addition to the 27 jurisdictions which have implemented the EU Directive, our survey respondents noted that there are several other countries which have restrictive data privacy laws including China, Japan and Mexico.

Overall, 58% of companies indicated that it would require 60 days or more to calculate the pay ratio. As discussed further below, this is a short period, recognizing that the proposed rule requires the calculation to be made based on individuals employed as of the end of the fiscal year, and in many cases, total compensation information is not available until up to eight weeks after the end of the fiscal year.

C. Statistical Sampling Is a Useful Alternative, But Not Seen as a Practical or Cost-Effective Approach to Determining the Median Employee for Most Registrants.

In the proposed rule, the Commission allowed registrants to use several alternatives to identifying the median employee and developing the total compensation for that individual. Among those alternatives, the Commission spends a significant amount of time discussing how statistical sampling could be used to reduce the cost of compliance with the rule, especially in situations where data privacy restrictions in other countries may make it difficult to obtain individually identifiable information. Although the Center believes that sampling should be an alternative available to registrants to determine the median employee, it is not likely to be a widely used method, at least initially. The COEC Survey showed that a total of 16.8 percent of companies would use statistical sampling, with 9.6% engaging in sampling of all employees globally and 7.2% sampling a targeted subset of employees. Several respondents noted that they do not currently track pay information at the level of detail required by the rule, making comments such as "We cannot run statistical sampling without first getting an understanding of our global population, which we currently have no need to know." Others noted that the scope of their businesses made developing a sample challenging. For example, one respondent stated: "Determining an appropriate random sample of employees would be challenging. A statistically valid random sample of the workforce would need to consider various factors, including the distribution of compensation data across the organization, employees (full-time, part-time, seasonal and temporary), geographies, lines of business, etc." Others who selected sampling indicated that they were not yet certain whether they would actually use it. In sum, sampling will be useful to some companies, but in crafting the final rule, the Commission should recognize that only a minority of companies believe it is their preferred approach to compliance.

D. The Center's External Economic Analysis Demonstrates Substantially Higher Costs of Calculating the Pay Ratio Under the Proposed Rule.

The Center engaged Dr. Stuart Gurrea and Dr. Jonathan Neuberger of Economists Inc. to review the estimates and assumptions in the Commission's cost-benefit analysis and to conduct its own cost estimate based upon the responses from the Center's survey. In sum, the review concluded that the SEC significantly underestimated costs, with costs expected to be $186.9 million compared to the $72.8 million estimated by the Commission.

1. The SEC's Decision to Use Compliance Costs for the 2006 Disclosure Changes to Estimate Costs of the Pay Ratio Proposal Is Without Sound Basis.

The SEC's cost estimates for calculating the pay ratio are erroneously based on the Commission's unsubstantiated speculation that the compliance time for the proposed pay ratio rule will be will be two times the compliance hours estimate it estimated for the 2006 compensation disclosure changes.[35] As Gurrea and Neuberger discuss, the Commission neither explains why the burden should be two times as great, nor does it explain the differences between developing the tables and narrative disclosure for the named executive officers and total compensation for the median employee globally. The two are very different requirements and necessitate fundamentally different approaches. As Gurrea and Neuberger note: "Since this multiple has a direct effect on the magnitude of the SEC's cost estimates, the use of this assumption undermines the reliability of the cost estimates."

The calculation of total compensation for named executive officers involves tracking no more than 15 executives (although for many companies it is much less), usually only from one or a couple of countries. By contrast, the median employer in our survey had 31,500 employees in 25 countries. The development of the named executive officer disclosure is largely manual, involving a relatively small team, typically at company headquarters as opposed to locations in countries across the globe. As discussed further in the Gurrea and Neuberger study, "identifying the median employee and calculating total compensation will require education of team members in these countries, developing a process for collection of the information, ensuring that the information is reliable, and identifying the median employee among all employees." After that, total compensation can be manually calculated for the individual and the disclosure can be developed.

[35] 78 Fed. Reg. at 60,601.

2. Issuers Will Incur Greater Costs In Subsequent Years Because of Ongoing Changes in Business Structures and Operations.

Gurrea and Neuberger also criticize the SEC's cost estimate for estimating that compliance costs will drop by 50 percent in each of years two and three as companies become more adept at calculating the proposed pay ratio. Although that assumption may be correct when calculating total compensation of named executive officer total pay because pay programs and thus calculation methodologies do not change considerably, that is not the case when identifying the median employee. Gurrea and Neuberger explain that "the survey reveals that on average 72 percent of the estimated costs of initial compliance are expected to be incurred in subsequent years." This leads to an increase in estimated three-year costs of 279 hours as opposed to 190 hours, nearly a 50 percent increase.

3. Revising The SEC's Cost Estimates for Outside Professionals to a Market Rate Would Increase Compliance Cost Estimates by 75%.

In its cost-benefit analysis, the Commission explained that it used $400 per hour as an estimate for outside professionals, which is the rate it "typical estimate[s] for outside legal services used in connection with public company reporting."[36] This assumption is severely underestimated according to the Center Survey responses. More than half of survey respondents reported external counsel costs of $700 or more, with 30 percent selecting $800 or more. Gurrea and Neuberger estimate that changing this assumption, without making any other changes to cost estimates, would increase the Commission's estimated compliance costs by 75 percent.

E. The Costs of the Proposed Rule Would Negatively Impact Global U.S. Public Companies and Put Them at a Competitive Disadvantage.

As discussed above, the costs and burdens of the proposed rule would impose significant additional costs on U.S. public companies and put them at a disadvantage. First, by requiring registrants to calculate the ratio based on all global employees instead of all U.S. employees, the proposed rule will put global companies at a disadvantage compared with registrants with only U.S. employees due to the complexities, burdens, and costs discussed throughout this comment involved in calculating the ratio across many countries and pay systems. The Commission can lessen this impact by limiting the scope of the rule to U.S. employees only. Second, the rule puts U.S. public companies at a disadvantage relative to companies listed on other exchanges. To our knowledge, no other country requires public companies to calculate a ratio based on all employees globally. Finally, the rule makes it less attractive for companies to access the capital markets, especially those for whom a global pay ratio calculation would be cost prohibitive or for those companies where the disclosure of the ratio could impact the public's perception of the company's brand. Given these significant adverse competitive effects and the pay ratio disclosure's lack of value to investors, the Commission should exercise its discretion to minimize costs to the covered registrants.

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[36] 78 Fed Reg. 60,600.

F. Alternative Approaches to Compliance Would Significantly Reduce Costs.

As discussed in more detail below, the Center strongly urges the Commission to act in the interests of competition, efficiency and capital formation and limit the final rule to full-time U.S. employees, as required under the Securities and Exchange Act. The COEC Survey results demonstrate that by adopting this interpretation, the Commission would significantly reduce compliance costs, and there would be no measurable impact on the benefits to investors. Indeed, Gurrea and Neuberger report that the burden imposed on issuers for requiring compliance based on global, full-time, part-time and seasonal employees "does not appear to be offset by any benefits to managers or investors."[37] They also explain that the estimated savings do not account for savings in indirect costs that will be generated by the pay ratio requirement.

Limit the Disclosure to All U.S. Employees Only. Roughly nine out of 10 issuers surveyed have employees in countries outside the U.S., and on average, each company employs workers in 34 different countries. With this in mind 79 percent of respondents indicated that costs would decrease relative to the proposed rule if the pay ratio calculation were limited to U.S. employees only. The average reduction in costs of taking a U.S. only approach for respondents with non-U.S. employees was nearly half -- 47 percent. As discussed below, the Commission has the authority to limit the application of the final rule to U.S. employees, and there would be a significant cost impact to companies with minimal impact to investors. By taking this approach, the Commission would reduce the impact on competition between public companies with U.S. employees only compared with registrants with a global footprint.

Limit the Disclosure to Full-Time Employees Only. Nearly all firms, 122 of 128, have part-time and/or seasonal employees. With this in mind, two-thirds of survey respondents to the survey indicated that limiting the application of the proposed pay ratio rules to full-time employees only would reduce their costs. The average savings for these respondents would be approximately 20 percent.

Maintain Broad Compliance Approaches. In addition to limiting compliance to full-time, U.S. employees, the Commission should maintain the compliance flexibility in the proposed rule to account for the wide variations in the way issuers are organized and information is maintained, even on a U.S. basis. When asked in our survey what the cost implications would be if the Commission were to require companies to calculate the Summary Compensation Table pay for all employees for the purpose of identifying the median, respondents projected an average increase in costs of 4,592 percent.

The Commission Should Not Require the Disclosure of Separate Pay Ratios. The Commission should only require registrants to include U.S. employees in its pay ratio calculation. However, if the Commission chooses not to follow our recommendation, under no circumstances should the Commission require the disclosure of two pay ratios, one for U.S. employees and one for non-U.S. employees, or some permutation thereof. Requiring registrants to include two separate ratios – whether that is a U.S. ratio accompanied by a non-U.S. ratio or a U.S. ratio in addition to an all employee ratio – would substantially increase the administrative burdens and costs associated with complying with the pay ratio rule. Specifically the requirement to report two ratios would require companies to develop two sets of calculations using two different populations, to identify two median employees, and to calculate total

[37] Dr. Stuart Gurrea & Dr. Jonathan Neuberger, The Economic Impact of the SEC's Proposed Rule on Required Pay Ratio Disclosure. (2013)

compensation for each one. Such a requirement also has the potential to magnify the distortive effects of the disclosure of a single pay ratio. If registrants believe that disclosing an additional ratio would helpful in explaining their particular business operations, they should be allowed to do so, but the Commission must not require the disclosure of two separate pay ratios covering U.S. employees and global employees.

IV. The Commission Can Use Its Exemptive Authority to Minimize the Costs and Burdens of Covered Companies.

When an agency finds itself imposing enormous costs with no clear benefit, it should use all available means to reduce the burden on affected parties. Indeed, Congress has vested the Commission with special authority in that regard. Under Section 36 of the Exchange Act, the Commission is authorized to "exempt, either conditionally or unconditionally, any person, security, or transaction, or any class or classes of persons, securities or transactions, from any provision or provisions of the Exchange Act or any rule or regulation thereunder, to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors."[38] Likewise, under Section 28 of the Securities Act, "[t]he Commission, by rule or regulation, may conditionally or unconditionally exempt any person, security, or transaction, or any class or classes of persons, securities, or transactions, from any provision or provisions of this title [15 USCS §§ 77a *et seq*.] or of any rule or regulation issued under this title [15 USCS §§ 77a *et seq*.], to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors."[39] Congress is presumed to have been aware of the Commission's exemptive authority when it enacted Section 953(b) of the Dodd-Frank Act.[40]

The Commission's use of exemptive authority in implementing the requirements of Congressionally-mandated rules is well established. In the implementation of Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings mandated by the JOBS Act §201(a), the Commission went beyond the limits of the statutory mandate by including a proposal designed, which - if implemented - could limit the mandate of JOBS Act §201(a).[41] In the case of the pay ratio mandate, the case for the Commission's exercise of exemptive authority is particularly compelling in light of the total absence of any investor benefit of the ratio and the excessive compliance costs and burdens imposed on companies.[42]

V. The Definition of All Employees Should Be Narrowed to "All U.S. Employees".

The Commission has the authority to reduce the burden on registrants of calculating and disclosing the pay ratio requirement by interpreting "All Employees" as "all U.S. employees." Because there is no evidence that investors are interested in or benefitted by the pay ratio

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[38] 15 U.S.C. § 78mm.
[39] 15 U.S.C. § 77z-3. Both provisions are relevant here because the pay ratio rule is being promulgated pursuant to Sections 7, 10, and 19(a) of the Securities Act, and Sections 3(b), 12, 13, 14, 15(d) and 23(a) of the Exchange Act. *See* 77 Fed. Reg. at 60,604.
[40] *See FDA v. Brown & Williamson Tobacco Corp*., 529 U.S. 120, 133 (2000) (courts must "interpret [a] statute as a symmetrical and coherent regulatory scheme and fit, if possible, all parts into an harmonious whole") (internal quotation marks and citation omitted).
[41] Re-opening of Comment Period for Amendments to Regulation D, Form D and Rule 156, Release No. 33-9458; Release No. 34-70538, File No. S7-06-13. (July 10, 2013).
[42] *See supra note 35.*

disclosure, limiting the scope of the disclosure to all U.S. employees would discharge the Commission's regulatory mandate while removing some of the anomalies created by a broad definition of "all employees." The inclusion of global employees in companies' pay ratio calculations not only renders the information less useful but is tremendously costly, while offering no benefit. Indeed, in the Proposed Rule, the Commission expressly observes that including foreign employees in companies' compensation calculations could "distort the comparability of employee compensation" and cause adverse competitive effects.[43] The only rationale the Commission has offered for declining an exemption is that "the inclusion of non-U.S. employees in the calculation of the median is consistent with the statute."[44] In fact, the statute is silent on whether "all employees" refers to all employees in the U.S. or worldwide. In accordance with the well-established presumption against the extraterritoriality of U.S. laws, the phrase should be understood to refer to employees in the U.S. only. In any event, the fact that something is "consistent with the statute" does not answer whether its benefits outweigh its costs or whether it is in the public interest, as the Commission is required to consider under Section 36 of the Exchange Act and Section 28 of the Securities Act.

If for some reason the Commission concludes that the statutory phrase "all employees" includes non-U.S. employees, it nonetheless could—and in view of this Rule's costs and negligible benefits, should—use its exemptive authority to limit ratio reporting to U.S. employees only. As the district court observed in *American Petroleum Institute v. SEC*, an agency may not decline an exemption because it is purportedly inconsistent with the statute, since doing so "ignores the meaning of 'exemption,' which, by definition, is an exclusion or relief from an obligation, and hence will be inconsistent with the statutory requirement on which it operates."[45] Here, the Commission has acknowledged that including non-U.S. employees in issuers' disclosures will "raise[] compliance costs for multinational companies" and "introduce[] cross-border compliance issues."[46] The Commission has also recognized that the pay ratio requirement achieves no clear benefit.[47] In light of these observations, there is simply no reasonable basis for the Commission to decline to exempt issuers from including non-U.S. employees in their pay ratio disclosures.[48]

A. *Including Global Pay Data in Identifying the Median Employee Will Produce Especially Flawed And Misleading Pay Ratio Information, Because of Significant Differences in Pay Structures Among Countries.*

Considerable variations in pay arrangements, tax structures and cost of living among different regions of the world will render a global pay ratio calculation especially meaningless and harmful. Bureau of Labor Statistics data on worldwide hourly direct pay in the manufacturing industry in 2010, converted to U.S. dollars, showed an hourly wage of $1.13 in China (2009 data) and $.82 in India vs. $6.81 in Brazil and $16.03 in Israel pay rates. Compare

[43] *See* 78 Fed. Reg. 60,566.
[44] *Id*.
[45] 2013 WL 3307114, at *13 (D.C. Cir. July 2, 2013).
[46] 78 Fed. Reg. at 60,566.
[47] *Id.* at 60,562.
[48] Insistence that "*all* employees" requires the inclusion of non-U.S. employees would be inconsistent with the Commission's interpretation of "*all* issuers" in Section 953(b), which the Commission has interpreted to *exclude* smaller reporting companies and foreign private issuers. 78 Fed. Reg. at 60,564.

these to $26.26 in the U.S.[49] It is worth noting that the BLS itself explicitly states that it is unable to directly compare wages in China and India to wages in other countries, due to "various data gaps and methodological issues," and goes so far as to present these wages completely separately from its other international data.[50] While the issues inherent in the gathering of statistical data may not directly correlate to the gathering of corporate wage data, we highlight this discrepancy as an example of how significantly data can differ from country to country and how meaningless a statistic which simply combines them is.

Variations in the way pay is awarded and understood in different countries often make direct comparisons particularly confusing. For example, "in kind" contributions make up a substantial part of compensation in certain parts of the world due to tax considerations, custom and culture and are considered a substitute for cash. Likewise, in some countries, benefits such as health care and retirement are deducted from the employee's compensation and provided by the government, rather than the employer. In countries such as the UK, "salary sacrifice" is a common arrangement where employees accept a reduction in cash compensation in return for benefits in kind such as pension contributions or childcare vouchers. In many Asian countries, guaranteed reimbursements of certain employee expenses, such as housing, are considered part of fixed pay rather than separate allowances. These differences are not just between the U.S. and other countries, but among different countries in different regions. For these reasons, the Commission should limit the pay ratio disclosure to U.S. employees only.

B. The Burdens and Costs of Identifying the Median Employee Among All Global Employees Are Excessive And Are Not Justified By Any Discernible Benefit.

As discussed above, the cost of identifying the median employee globally and calculating total compensation for that individual is extremely burdensome, particularly given that it results in a disclosure that investors will not use. As we have explained elsewhere in this comment, issuers will need to take the following steps to identify the median employee globally:

1. Determine the Approach for Identifying the Median Employee.

Based on the COEC Survey results, there is no one-size-fits-all approach that global registrants will use to identify the median employee. In looking at Center Subscriber and HR Policy member respondents, which tended to be larger and more global companies, nearly 60 percent do not have centralized data from which to identify the median employee. The proposed rule will require that these companies either manually gather the data from all countries in which they do business or engage in statistical sampling to obtain an informed estimate of the median.

- 56 percent of Center and HR Policy survey respondents had employees in 25 or more countries, with the average doing business in 38 countries. One company reported having employees in 150 countries.
- A common approach to gathering the data was to choose a consistently applied compensation measure, such as base salary or total cash compensation, across all or most countries and find the median out of the aggregate data, an approach reported by nearly 43 percent of respondents. To gather this information, issuers will need to either communicate with HR and finance staff in each country in which the company does

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[49] *International Comparisons of Hourly Compensation Costs in Manufacturing, 2012*. bls.gov, http://www.bls.gov/fls/ichcc.htm (last visited Dec. 2, 2013).
[50] *Id.*

business, or collect the information directly from each employee data system. According to our survey, the number of such systems varied widely among companies. The average was 52 employee data systems and the median was 20.

2. Differences in Definitions of Salary Demonstrate the Complexity of Using a "Consistently Applied Compensation Measure" to Determine the Median Employee.

Compensation for employees in foreign markets can vary dramatically from compensation of typical U.S. employees. For example, in many circumstances the "base" or "fixed" salary component of an overseas employee's pay comprises several different types of pay as opposed to simply the base or hourly rate, as is common in the U.S. In some countries these components include types of pay which in the U.S. would be considered perquisites, such as food allowances, car allowances, housing allowances, etc. For example, in India, "base pay" often includes housing, mobile phone and conveyance allowances. In certain Middle Eastern countries such as Saudi Arabia and others, these allowances may be supplemented by social or national allowances that only apply to local nationals, so that two employees doing the exact same job may receive different base pay depending on their nationality. In Belgium, base pay may include two separate vacation allowances (14 months' pay).

Given the wide disparity among countries, there is no effective way to standardize a request even for as simple a component of compensation as "base pay." If "base pay only" is specified, countries may provide a figure which is not truly representative of the employee's compensation. On the other hand, if all allowances are to be included, this may further complicate the collection of compensation data as staff will need to manually combine various components of pay in order to arrive at an artificial definition of "base pay" which may not reflect the way pay is expressed in local payroll systems. The wide variations, and the expense involved in making the information consistent, demonstrate why the pay ratio calculation should apply to U.S. employees only.[51]

3. Determine the Median Employee.

To identify the median employee, registrants will need to determine all employees at all locations as of the end of the fiscal year. Obtaining a global employee headcount is time consuming and complex. The timing of determining the median employee leaves the company very little time for both identifying the median employee and calculating that individual's total compensation so that a ratio can be calculated in time for it to be disclosed. For a more detailed discussion of the impact of the timing mechanics of the proposed pay ratio rule, please see our discussion in Section VI.

[51] As discussed below, if the Commission decides not to exempt non-U.S. employees from the final rule, it should, at a minimum, clarify that a "consistently applied compensation measure" does not mean an "identical measure."

4. Exchange Rate Differences Will Impact Pay Ratio Calculation.

All data collected from foreign countries will need to be converted to U.S. dollars by the corporate HR team responsible for aggregating the data. This will require collecting an exchange rate based on the date of record for pay data provided by each country. Where different countries have chosen different dates of record, the exchange rates will not be consistent. Further, currency exchange may fluctuate significantly from year to year, so that the ratio of median employee pay to CEO pay may change simply based on the impact of foreign exchange, a discrepancy which each company would need to address via further disclosure. Finally, pay data in countries around the globe is often recorded and described in the local language(s) of each country, and may need to be translated before or after submission to corporate headquarters for aggregation and audit.

5. Determine the Impact of Data Privacy Laws and Foreign Exchange Calculations.

As noted above, many jurisdictions –including the European Union, China, Japan, Canada, Mexico, and Peru – have data privacy laws that will limit companies' ability to collect and use compensation data. For this reason, exempting non-U.S. employees is even more pressing. Compliance with foreign data privacy laws will require companies to retain local counsel in each jurisdiction in which non-U.S. employees reside, thereby substantially increasing the costs of an already burdensome rule, with no countervailing benefit.[52]

For example, the European Union ("EU") restricts the transfer of personal data outside of the EU. The EU's data protection regime is articulated in EU Directive 95/46/EC of the European Parliament and the Council (the "EU Directive"). All EU member states are required to implement this regime at the national level.[53] Accordingly, U.S. multinational companies operating in the EU will be subject to the EU's data protection laws when transferring personal compensation data, which will require retention of local counsel in each country that has implemented the EU Directive. Moreover, one of the requirements under the EU Directive is that personal data be transferred only to those countries that ensure "an adequate level of protection."[54] Under the EU's standards, the U.S. offers inadequate protection, and therefore the transfer of compensation data to the U.S. will be restricted unless companies either enter into intra-group arrangements that have been approved by a national data protection authority, or they agree to adhere to the Safe Harbor Principles approved by the European Commission and the U.S. Government and file a self-certification with the U.S. Department of Commerce.[55]

If the Commission declines to exempt disclosures regarding all non-U.S. employees from the pay ratio rule, it should at minimum exempt employees in jurisdictions with data privacy laws that prohibit the information-sharing required to comply with the rule.[56] The Commission has

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[52] *See* 78 Fed. Reg. at 60,566.
[53] Twenty-seven jurisdictions have implemented the EU Directive, including the United Kingdom, Sweden, Spain, Slovenia, Slovakia, Romania, Portugal, Poland, the Netherlands, Malta, Luxembourg, Lithuania, Latvia, Italy, Ireland, Hungary, Greece, Germany, France, Finland, Estonia, Denmark, Czech Republic, Cyprus, Bulgaria, Belgium, and Austria.
[54] *See* EU Directive at 57 ("the transfer of personal data to a third country which does not ensure an adequate level of protection must be prohibited").
[55] Countries like Japan and Singapore have developed or are in the process of developing domestic data privacy regimes that are similar to the EU regime. Consequently, issues identified in this comment are likely to exist in jurisdictions other than EU member states.
[56] *Cf. Murray v. Schooner Charming Betsy*, 6 U.S. (2 Cranch) 64, 118 (1804) ("an Act of Congress ought never to be construed to violate the law of nations if any other possible construction remains").

repeatedly used its exemptive authority to avoid conflicts with foreign law. One year after the Exchange Act was enacted, for example, the Commission promulgated Rule AN18 (now codified as Rule 3a12-3), which exempts foreign private issuers from certain disclosure requirements.[57] Similarly, the Commission has exempted certain foreign broker-dealers from disclosures that would violate local law.[58] The Commission should use its authority under Section 36 of the Exchange Act and Section 28 of the Securities Act to exempt employees in countries with data privacy laws that prohibit the pay ratio disclosures.

There Is No Value to Investors in Defining "All Employees" as "All Global Employees" That Would Justify the Added Costs. The burdens and costs to companies of requiring that registrants calculate the pay ratio disclosure based on all employees globally are not justified by any marginal benefit to investors. On the contrary, including employees worldwide would make data that already served no useful purpose even less meaningful or reliable. The Commission has acknowledged that the burdens to companies from having to compute the pay ratio are substantial and therefore has proposed to allow companies to use reasonable estimates to identify the median employee. Based upon COEC Survey data, it appears that most global companies will use a consistently applied compensation measure to identify the median employee, and that the majority of companies will need to develop that measure. However, the Commission has acknowledged that allowing each company to determine its own approach to the calculation will result in variations and thus less consistency and comparability among companies. By contrast, if the Commission bases the ratio on U.S. data alone, it can reduce the data inconsistencies that would be inherent in a global number. In addition, according to the COEC Survey, the average responding company has employees in 34 countries globally, and yet reports that 62 percent of its employees are located in the U.S. These numbers weigh in favor of allowing the median employee to be calculated based on U.S. employees alone.

Given that the pay ratio information will not be useful to investors generally, requiring that the calculation be based on non-U.S. employees will impose an additional cost with no incremental benefit. Thus, it follows that limiting the calculation to all U.S. employees rather than global employees would not be detrimental to investors.

According to the COEC Survey, requiring the disclosure to be based on U.S. employees would have a substantial impact on compliance costs. Over half of all respondents indicated that applying the pay ratio calculation to U.S. employees only would reduce the cost by more than 50 percent. Another 28 percent indicated that a U.S.-only approach would reduce costs by up to 50 percent. In sum, the Commission should apply the pay ratio requirement to U.S. employees only.

C. The Commission Should Define "All Employees" as All Full-Time Employees.

In addition to defining "All Employees" as all U.S. employees, the Commission should limit the scope of the ratio calculation and disclosure to full-time employees. According to the Center's survey, 86 percent of the average employer's employees are full-time, with the median employer having 95 percent of its workforce as full-time employees. The incremental information obtained from requiring the ratio to be computed on the basis of part-time and seasonal employees does not justify the effort required to gather the information. Moreover, the income that a part-time or seasonal employee receives from a single employer could give a

[57] *See* 17 C.F.R. § 240.3a12-3.
[58] 17 C.F.R. § 240.15a-6.

significantly distorted picture of the employee's annual income, if the employee also works for other employers in the course of the year, as part-time and seasonal workers often do. If not limited to full-time U.S. employees the Commission should permit, but not require, employers with a substantial number of part-time workers to annualize the compensation of those individuals for purposes of calculating the pay ratio. Annualization would allow a more consistent approach to reporting the ratio, and would mitigate the comparison of a full-time CEO to a part-time worker that would likely occur in sectors with a large part-time workforce, such as the retail, restaurant and hospitality industries. Several of our Subscribers are concerned that without annualization, users of the disclosure, particularly the media and other stakeholders such as labor unions, may draw inappropriate conclusions about the registrant's pay and human resource practices, especially where the registrant is paying consistent with market rates for similarly skilled and experienced individuals.

VI. The Commission Should Allow Companies to Establish a Date for Both Determining the Median Employee and Calculating Total Compensation Within the 12-Month Period Before the End of the Most Recent Fiscal Year (Look-back Period).

The proposed rule requires registrants to identify the scope of employees subject to the pay ratio using a "calculation date" of the last day of their fiscal year. Once the median employee is identified, a registrant is required to calculate the total compensation for that employee for the last completed fiscal year akin to the calculation for NEOs for the Summary Compensation Table. In an effort to provide flexibility, the proposed rule allows registrants to use a consistently applied compensation measure. The proposed rule further allows companies to utilize pre-existing payroll and/or tax records to establish a consistently applied compensation measure even if the records cover a time period which does not coordinate with the registrant's fiscal year. This may occur, for example, where a calendar-year registrant's operations in another country operate on a localized tax year which ends on June 30. However, by requiring registrants to use the last day of their fiscal year as the calculation date, most registrants will be precluded from taking advantage of any purported flexibility provided by the use of pre-existing payroll and tax records because such records will not account for any interim changes in the registrant's employee population which occur between the date of the pre-existing compensation records and the end of the registrant's fiscal year. In the most basic terms, the employee population at the calculation date will not match the employee population date defined by the pre-existing records. Any benefits garnered from the use of the pre-existing data records are negated by the data collection efforts which would be required to make use of the data records in these situations.

In addition, it will be extremely difficult for many global companies to compute the median employee between the end of their fiscal year and the time they are required to file their proxy or 10-K. Although companies are able to make this calculation for the named executive officers, compiling the data in the short window between the time total compensation information is available for all employees and the time the proxy must be sent for printing will create significant burdens for registrants and in many cases may be virtually impossible to accomplish in such a protracted time period. The problem is further exacerbated by the proposed rule's use of the last day of the registrant's fiscal year as the calculation date. Employee populations are not static. Employee turnover is a natural part of a registrant's business with registrants in some industries averaging over 100% employee turnover during a single fiscal year. Because employee populations change on a daily basis, registrants are effectively prevented from beginning the pay ratio calculation process until the last day of their fiscal year – and the beginning of the 120 day compliance window.

For example, one respondent noted that it would likely use tax reporting data, and stated "Since [the data is] not available in the U.S. until the end of January, and it would then take us three to four months to conduct the calculations and have them certified, it would be nearly impossible to provide the information in a timely manner."

With these issues in mind, the Center recommends that the Commission establish a 12-month "look-back" period to determine the median employee and their total compensation similar to the process currently used under section 409A of the Internal Revenue Code to determine key employees.

A. The Proposed Rule's Purported Flexibility in Identifying the Median Employee and Calculating the Pay Ratio Is Undermined By the Requirement That the Ratio Be Determined Based on Individuals Employed "On the Last Day of the Fiscal Year."

We agree with the Commission's decision in the proposed rule to allow registrants to use the time period used for payroll or tax recordkeeping when identifying the median employee based on consistently applied compensation measures, regardless of whether the time periods correspond with the registrant's last completed fiscal year. Aside from the fact that various companies in the U.S. use different fiscal years (some calendar-based, some not), both fiscal and tax years differ across countries outside the U.S. as well. For example, tax year in the UK ends on April 5 while in Australia it ends on June 30. This affects the time period for which payroll data is collected and recorded. The Commission's proposed approach has the potential to mitigate some of the excessive burdens of collecting this data for companies which have access to these records.

However, by requiring registrants to use the last day of their fiscal year as the calculation date, the proposed rule effectively prevents registrants from realizing the benefits of using other fiscal year-end time periods in pre-existing payroll or tax records for the purposes of identifying the median employee. Specifically, the use of pre-existing records from an earlier period, by definition, will not account for interim changes in the employee population occurring between the earlier fiscal year end and the registrant's fiscal year-end (referred to in the proposed rule as the calculation date). As a result, if a registrant were to use payroll or tax records from a time period disconnected with the end of its own fiscal year, the employee population represented by the pre-existing data would not parallel its calculation date employee population. The registrant would then be required to go back and identify the employees not covered by the data and then estimate comparable annual compensation information for those employees. This extra data collection step undermines the financial and administrative benefits of being able to use pre-existing information.

B. The Requirement That the Pay Ratio Disclosure Be Calculated and Included in a Proxy Statement or 10-K Within 120 Days of the End of the Fiscal Year Is Unduly Burdensome.

1. Most large global registrants are not able to identify at the touch of a button individuals employed by the registrant and its subsidiaries as of fiscal year end.

Under the proposed rule, the last day of a registrant's fiscal year serves two distinct purposes: (1) the calculation date on which a registrant establishes the employee population for the purposes of the pay ratio; and (2) the start of the 120-day window within which a registrant is required to disclose the pay ratio.[59] Unfortunately, the dual purposes work against each other to hinder the ability of registrants to provide a pay ratio within the 120-day window in a cost-effective manner.

First, many registrants do not have the ability to easily obtain a list of their employees as of the last day of the registrant's fiscal year at the touch of a button, much less their compensation information. For companies without an integrated HRIS system, headcount information is often kept at the country, division or even regional basis, and thus it is as difficult to obtain the detailed headcount information necessary to use a consistently applied compensation measure to identify the median as it is obtaining the pay data itself. Compounding the problem, because employee populations are constantly changing, there is very little preparatory work a registrant can do to effectively limit the burdens of having to physically collect the data as of year's end. By making the last day of a registrant's fiscal year the calculation date, the proposed rule functionally prohibits registrants from starting on the most difficult aspects of pay ratio calculation until the beginning of the 120-day time window. If the information is not centralized, which according to our survey is true for a majority of large employers, the company must follow steps such as these:

- First, registrants will need to collect a list of current employees as of the last day of the registrant's fiscal year. For registrants without a centralized data system, this is a potentially overwhelming task which will require reaching out to HR and Finance departments in a significant number of U.S. regions or foreign countries, each of whom may have more than one payroll or other recordkeeping system. According to the COEC Survey data, registrants on average maintain 46 different HRIS systems in 34 different countries. For companies with a foreign presence, these communications will be further complicated by language barriers.
- In addition to compiling a list of current employees, registrants are likely to simultaneously gather compensation information for the employees, compounding the time required. This step will require companies to have previously determined what compensation data will be gathered for each employee and to explain it to the local HR and finance staff responsible for collecting the data, a process which is highly complicated by the fact that various countries define components of pay such as salary or cash incentive completely differently. Depending on the consistent definition of compensation chosen by the registrant, the collection of this data may be a manual process where data has to be collected from multiple systems just for one employee. For example, if both base salary and sales incentive must be collected, these two components of pay may be housed in separate systems. Local HR staff would need to manually compile the exact combination of compensation required for each employee as of the fiscal year-end date.
- Because the systems from which the employee and compensation data will be pulled are neither automated nor standardized, registrants will have to engage in an extensive data analysis in order to make the information useful. This will require the homogenization of multiple data formats including the application of exchange rates to normalize foreign compensation data to the U.S. dollar and the translation of pay records from dozens of

[59] The end of the fiscal year is also the period for identifying the named executive officers that will be disclosed in the proxy statement.

different languages into English. Even more important will be the data auditing which registrants will be required to perform, which for large companies could be for hundreds of thousands of records, to ensure that established processes for determining compensation have been followed and numbers are accurate. Only after this step is completed would the information gathered by the registrant be useful for identifying the median employee.

- Any of the above steps have the potential to be complicated by various regional data privacy laws which may limit or even prohibit a registrant's ability to gain access to employee information needed to calculate the pay ratio disclosure. A discussion of the complications resulting from regional data privacy laws is included in Section V.

The compliance timeframe resulting from the use of the last day of a registrant's fiscal year as the calculation date is further limited and complicated by the typical internal processes whereby a registrant prepares and reviews its proxy statement and 10-K report. For many registrants, the existing complexities in creating these disclosures mandate the process begin months in advance, and disclosures are approved shortly after the end of the fiscal year. Even if the median employee could be identified quickly, the calculation of total compensation under Section 402 of Regulation S-K is dependent upon the calculation of annual bonuses, which can take as long as eight weeks past the fiscal year-end, thus further delaying the calculation of total compensation and the disclosure that accompanies the ratio.

For example, one large company surveyed indicated its fiscal year-end is in the fall and its annual meeting is held in February. Although the proxy statement is required to be filed not less than 10 days before the annual meeting, in practice, the company must ensure it receives a quorum for the meeting by allowing sufficient time prior to the meeting for mailing the proxy, solicitation by the proxy solicitor, return of shareholder votes and tabulation of the votes. In addition, sections of the proxy statement are incorporated by reference into the annual report on Form 10-K, which must be filed no later than 60 days after fiscal year-end. This necessitates a proxy mailing date of mid-December. Given this deadline, the company has in fact fewer than 75 days after fiscal year-end to compile all the information necessary to compute the pay ratio, audit the ratio and prepare the disclosure for approval by the Board of Directors. In essence, the typical disclosure review processes necessary for a registrant to obtain certification and provide its disclosures in a thoughtful manner prohibit companies from making use of the entire 120-day time frame provided to disclose the pay ratio.

2. *Most Large Global Registrants Are not Able to Collect the Data Using a "Consistently Applied Compensation Measure" for all Employees Globally in an Expedited Manner.*

The use of the end of the most recent fiscal year as the calculation date further complicates the ability of most large global registrants to comply within the 120 day due to the complexity in collecting the data from global locations necessary to use a "consistently applied compensation measure" to identify the median employee. As noted above, the information collection cannot begin until after the fiscal year is ended. Most respondents to the Center Survey indicated that they were likely to use base salary as their consistently applied compensation measure because it was the easiest to obtain while also providing a reasonable basis for identifying the median employee. Assuming the Commission recognizes that "consistently applied" does not mean "identical" compensation measure[60] the mere collection of the data from dozens of locations is likely to take several weeks. If the Commission requires the definition of the measure, especially base salary to be equivalent across jurisdictions, the recalculation required to define the compensation measure consistently across jurisdictions will take considerably more time and make it considerably more expensive.

C. The Commission Should Permit Registrants to use a 12-Month "Look-back" Period for Determining the Median Employee.

We recommend the Commission allow registrants the flexibility to select a calculation date best suited to their own facts and circumstances up to one year prior to the end of the registrant's most recent fiscal year. Permitting a registrant to select a calculation date up to one year prior to the end of the registrant's most recent fiscal year effectively provides for adequate time for preparation of the pay ratio disclosure and ensures the disclosure can be included in the typical review process for major company filings. The resulting "Look-back" period fleshes out the flexibility intended by the proposed rule. The flexibility is also consistent with the language of 953(b).[61]

If put in practice, a registrant with a fiscal year end on 12/31/2013 would be provided the flexibility to choose a calculation date between 12/31/2013 and 12/31/2012. The registrant, however, would still be required to disclose its pay ratio within 120 days of 12/31/2013. The flexibility would ensure registrants can comply with the pay ratio mandate in as cost-effective manner as possible and would do nothing to lower the quality of the pay ratio disclosure. In fact, the additional time for compliance will likely allow registrants to provide a more thoroughly evaluated disclosure. The proposed rule already allows registrants to refer to pre-existing payroll and tax recordkeeping despite the fact that the time periods covered by those documents do not match with the registrant's fiscal year. However, by requiring the calculation date to be the last day of a registrant's fiscal year, the Commission inherently limits the effectiveness of the use of pre-existing payroll and tax records by ensuring the records cannot represent the current the employee population. The use of a "Look-back" period effectively rectifies this inconsistency.

For example, Company ABC is a calendar year retail company with only U.S employees which experiences approximately 35% employee turnover of its 5,500 employee population. ABC would like to use W-2 information for the previous year in order to establish a consistently applied compensation measure. Assuming ABC experiences the normal 35% turnover rate, if ABC is required to consider all employees as of 12/31/13, then ABC would only be able to use existing W-2 information for 65% of its employee population. Furthermore, there would be an

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[60] As noted above, in many circumstances the "base" or "fixed" salary component of an overseas employee's pay comprises several different types of pay as opposed to simply the base or hourly rate, as is common in the U.S. For example, in India, "base pay" often includes housing, mobile phone and conveyance allowances. In certain Middle Eastern countries such as Saudi Arabia and others, these allowances may be supplemented by social or national allowances that only apply to local nationals, so that two employees doing the exact same job may receive different base pay depending on their nationality. In Belgium, base pay may include two separate vacation allowances (14 months' pay).

[61] *See* Treas. Reg. § 1.409A-1 (2010). The look-back concept is used successfully under Section 409A of the tax code in identifying the top 100 "key employees" that are subject to a more rigid payout requirements for nonqualified deferred compensation. The IRS put the concept in place after receiving considerable comments about the shifting nature of the workforce and the fact that performing the calculations to identify the employees was both time-consuming and complex. Because there are no clear benefits of the pay ratio disclosure to investors, allowing employers to determine a consistent 12-month period for determining the median employee and calculating total compensation would not be a substantial burden.

additional data collection step where by ABC would have to see which employees were not covered by existing tax records, match them, then calculate compensation information for the excluded employees on a year to date basis, a number which would then need to be annualized. However, if the Commission were to permit ABC to select a calculation date of 12/31/12, then once 2012 year-end W-2 data was available, ABC would effectively be able to gather accurate compensation data for 100% of employees employed as of the end of the same time period covered by the 2012 tax records. As demonstrated, the changes actually enhance the flexibility the Commission seeks to provide in the proposed rule.

After the median employee is identified using the "look-back" period, we recommend the Commission permit registrants to calculate the total compensation of the median employee using information from the same fiscal year as the compensation information used to identify the median employee. This will ensure that registrants have the information available to calculate total compensation within the 120-day compliance window. In addition, the Commission could choose to require registrants to include a brief disclosure explaining why the particular calculation date was chosen.

D. The Commission Should Allow Companies to Determine the Median Employee Once Every Three Years Where Substantial Changes in the Workforce Have Not Occurred.

We also believe the Commission should allow registrants to identify the median employee once every three years rather than annually. Under this approach, the registrant would identify its median employee for year one and then would be permitted to use that employee or one who is similarly situated as its median employee in the following two years. For example, if the median employee identified in year one is in a particular pay band or holds a particular position (such as an hourly worker at a particular manufacturing plant), the registrant would be permitted to identify its median employee in each of the following two years from among employees in that pay band or holding that position. The Commission could require registrants to determine the median employee more frequently than once every three years if there are material changes in its workforce that would result in a material change in the pay ratio disclosure.

With regard to the calculation of total compensation for the median employee under this scenario, we believe the Commission could continue to require registrants to calculate total compensation for the identified median employee on an annual basis as is now required. It is instructive that our survey indicated that 53% of registrants did not anticipate needing to revise their methodologies on an annual basis due to changes in business organization or structure.

This approach satisfies the statutory language of Section 953(b) because it would still result in a company providing a pay ratio disclosure on an annual basis in whatever filings are required by the Commission. However, it minimizes the excessive burdens and costs required to determine the median employee annually when there have not been any interim changes which would result in a material year-over-year change in the pay level targeted as the median employee.

VII. The Commission Should Limit the Required Narrative Disclosure to the "Brief" Disclosure Outlined in the Proposed Rule.

The proposed rule provides that registrants are only required to disclose a "brief" description of the methodologies used to determine the median employee as well an explanation of any reasonable estimates used in calculating total compensation for the median employee. The proposed rule expressly states that registrants are not required to include mathematical or statistical measures, etc. with regard to the methodologies and reasonable estimates. The proposed rule further asks in several additional Questions whether or not registrants should be required to disclose additional information. Due to the highly inflammatory nature of the pay ratio we believe registrants are likely to provide more than a "brief" disclosure detailing how they arrived at their pay ratio calculation. According to our survey data, two thirds of companies anticipate providing more than a single paragraph of narrative disclosure accompanying the pay ratio. Further, over 66% of respondents anticipate feeling compelled to provide more than the proposed "brief" disclosure to explain how they arrived at their pay ratio. As a result, we do not believe that it is advisable for the Commission to require any more disclosure, particularly a more technical disclosure including statistical formulas, confidence levels or steps used in the analysis as it is likely to be provided voluntarily. The more technical data, particularly if it is statistical or mathematical in nature, is not likely to be highly informative to investors and will only serve to unnecessarily lengthen disclosures with more immaterial and potentially misleading information, leading to the disclosure overload that Chair White has cautioned against. Additionally, due to the unique nature of companies and the process by which they will develop their own pay ratio disclosures, we believe it is unlikely that a "boilerplate" disclosure will evolve.

VIII. Definition of Registrant Should Be Limited to Consolidated Subsidiaries Only.

The proposed rules apply the pay ratio disclosure standard according to rule 12b-2. We recommend the SEC only require registrants to include the employees of consolidated subsidiaries as defined under the accounting standards.[62] In order to comply with the pay ratio provision, registrants will be forced to engage in an extensive information gathering process which will require registrants to access human resources related information from all parts of its business. In the majority of cases, a registrant's access to the information necessary to calculate the pay ratio will only extend to wholly-owned subsidiaries that consolidate their financial statements with those of the registrant. Furthermore, it is highly unlikely registrants will have access to the payroll and human resources information needed for the pay ratio from subsidiaries or other entities with a more tenuous connection, such as joint ventures. Requiring collection of data from such entities would result in a significant increase in compliance costs for issuers. Respondents to our survey reported that they anticipated an average 91% *increase* in compliance costs with the proposed pay ratio if they were required to include minority-owned subsidiaries and joint ventures.

We also recommend the Commission not require entities to include the employees of a subsidiary in cases where the subsidiary is currently part of a pending transaction or divestiture whereby the employees may no longer be employed by the entity as of the registrant's calculation date.

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[62] FASB Accounting Standards Codification paragraph 810-10-15-8.

IX. The Pay Ratio Calculation Should Be Furnished Rather Than Filed.

Because pay ratio has no demonstrated value to investors and the development of the ratio will require substantial estimates and data gathering that is significantly different from that required for the other information covered under section 402, we urge that the Commission make the pay ratio disclosure furnished information rather than filed. The Commission expressed the belief in the proposed rule that:

> [T]he flexibility afforded to registrants in connection with identifying the median could reduce some of the difficulties of compiling the required information, because registrants would be able to tailor the methodology to reflect their own facts and circumstances. The ability to use reasonable estimates in connection with the calculation of annual total compensation for employees other than the PEO could also alleviate some of these concerns.[63]

Unfortunately, however, based on comments from our Subscribers, the higher standard of rigor required by the audit and compliance functions for Sarbanes-Oxley certification required for "filed" materials at many registrants threatens to undermine the ability of those registrants to utilize the purported flexibility provided in the proposed rule."

As part of our survey, we asked for feedback about the impact of the disclosure being "filed" rather than furnished. The following items are a sample of the feedback we received:

- "If subject to SOX controls, our external auditor will have an opinion on what we should use thereby eliminating 'flexibility.'"
- "We believe our decentralized systems and data complexities will limit our auditor's willingness to accept assumptions or simplified findings."
- "We will want to use the most representative data, and that is likely to require more than just looking at base salary alone. We will need to implement controls around the process and test it annually and it will be subject to internal audit review. This is likely to be a big task."
- "Absent a Safe Harbor provision or other limitation of liability, it's likely that we will be less inclined to use methods for data verification that are not strictly validated and confirmed."

Thus, having to obtain Sarbanes-Oxley certification for the pay ratio is likely to undermine the flexibility on which the Commission relies in its attempt to lessen the burdens of being a filed document and result in significant additional administrative burdens and compliance costs.

Section 953(b) of the Dodd-Frank Act provides that pay ratio disclosures must be disclosed "in any filing of [an] issuer described in section 229.10(a) of title 17, Code of Federal Regulations." The filings referred to in section 229.10(a) include registration statements under the Securities Act and "registration statements under section 12, annual or other reports under sections 13 and 15(d), going-private transaction statements under section 13, tender offer statements under sections 13 and 14, annual reports to security holders and proxy and information statements under section 14, and any other documents required to be filed under the Exchange Act, to the extent provided in the forms and rules under that Act."[64]

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[63] 78 Fed. Reg. at 60,580.
[64] 17 C.F.R. 229.10(a) (internal cross-references omitted).

In the Proposed Rule, the Commission has taken the position that Congress's reference to "filings" compels the conclusion that the pay ratio information must be "filed" rather than "furnished."[65] But this statutory construction is not compelled by the text. First, not all information that appears in the "filings" mentioned in section 229.10(a) is filed. For example, a Current Report on Form 8-K is referred to as a "filing" in Item 10(a) of Regulation S-K (17 C.F.R. § 229.10(a)), while information included in a Form 8-K pursuant to Item 2.02 (Results of Operations and Financial Condition) and Item 7.01 (Regulation FD Disclosure) is not "'filed' for purposes of Section 18 of the Exchange Act or otherwise subject to the liabilities of that section, unless the registrant specifically states that the information is to be considered 'filed' under the Exchange Act or incorporates it by reference into a filing under the Securities Act or the Exchange Act."[66] Accordingly, Section 953(b)'s reference to "filings . . .described in section 229.10(a)" cannot reasonably be interpreted to require that pay ratio information be "filed" and subject to certification by CEOs and CFOs pursuant to Section 302 of the Sarbanes-Oxley Act.

Second, until 2006, executive compensation information that was disclosed in the "filings" described in Section 229.10(a) was "furnished" to the Commission due to registrants' concerns about the potential for litigation, and the Commission's recognition that the disclosures would require companies to make subjective decisions regarding the proper calculation and application of data.[67] The same concerns apply to the pay ratio disclosure (*see* 78 Fed. Reg. at 60,580), and the Commission is obligated under the Administrative Procedure Act to provide a reasoned explanation if it is to ignore these concerns in favor of a formalistic interpretation of Section 953(b).[68]

Ultimately, Section 953(b) is properly interpreted to mandate the *type* of document in which the pay ratio disclosure must appear, rather than the legal status of the pay ratio information for purposes of liability under the Exchange Act and the certification requirements in Sarbanes-Oxley.

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[65] 78 Fed. Reg. at 60,580.

[66] *See* Form 8-K, General Information B.2; *see also* 17 C.F.R. § 230.491 (referring to information furnished in a filed registration statement); 17 C.F.R. § 229.101(d)(4) (same).

[67] *See* Executive Compensation Disclosure, 57 Fed. Reg. 48126 (Oct. 16, 1992); Executive Compensation and Related Person Disclosure, 71 Fed. Reg. 53158 (Sept. 8, 2006).

[68] *See Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983); *see also Cnty. of L.A. v. Shalala*, 192 F.3d 1005, 1021 (D.C. Cir. 1999) ("Where the agency has failed to provide a reasoned explanation, or where the record belies the agency's conclusion, [the court] must undo its action.") (internal quotation marks omitted).

X. The Commission Should Provide For a Staggered Compliance Transition By Requiring Companies to Include Only U.S. Employees in the First Pay Ratio Disclosure.

As explained above, the Commission should require pay-ratio reporting with regard to U.S. employees only. If, however, the final rule requires reporting for all employees worldwide, it should at minimum allow a transition period in which—for the first year of compliance—reporting is required as to U.S. employees only. The inclusion of global employees would be required in the ongoing annual disclosures in the second year and beyond. Such a staged implementation would allow companies to design methodologies for pay ratio compliance during the first year and test them on an employee population where data collection is more manageable. The extra year to prepare to gather data, whether current or in the form of pre-existing payroll and tax records, will impart a necessary benefit to registrants, particularly those who will, for the first time, have to reach out to dozens of countries and dozens of HRIS systems in order to collect the data necessary for compliance.

With regard to the time frame for compliance, the proposed rule provides that companies will be required to provide a pay ratio disclosure covering the compensation information for the fiscal year on or immediately following the introduction of the final rule. The proposed rule further details that if a final rule is issued in 2014, that calendar year fiscal year registrants would first be required to disclose a pay ratio in 2016 based on fiscal year 2015 compensation information. Under this scenario, however, registrants with fiscal year dates which are close to the date final rules are introduced are at a disadvantage due to having less time for compliance. For example, if a proposed rule is released on May 15, 2014, a registrant with a fiscal year ending on June 30 would have to start data collection for pay ratio compliance almost immediately after publication of a final rule. In the same scenario, a calendar year registrant would have six more months to analyze the final rule and prepare than the June 30 registrant. Similarly, if the pay ratio were released in late 2014, calendar year companies may find themselves disadvantaged compared to mid-year fiscal year companies which would have an additional time period in which to evaluate a final rule and prepare for compliance.

We understand that no matter how the Commission structures implementation, the differences in fiscal years are likely to result in some registrants having more time than others before initial compliance. However, we recommend the Commission take steps to ensure that the time period is sufficient for all registrants. This is of particular importance due to the complexities of the data collection which will be required in order to comply with the pay ratio requirement. In addition to the staged implementation approach detailed above, we would recommend that the Commission state that registrants must comply with the pay ratio mandate beginning in the first fiscal year starting on or after six months after the introduction of the final rule. This will ensure that all registrants have adequate time to analyze the implications and nuances of a final rule to allow compliance to occur in as cost-effective manner as possible.

We believe it would be problematic for the Commission to create differing implementation periods for registrants based on any particular characteristic of the registrant due to the wide variety of corporate structures and business strategies employed by registrants. This is particularly the case for the pay ratio rule where business structure will play a fundamental role in the pay ratio compliance efforts.

In the case of a transaction, acquisition or merger we believe the disclosing registrant should be able to exclude the employees acquired in such a transaction until the employees have been employees of exclusively the registrant for an entire fiscal year. For example, Registrant AB, a calendar year company, purchases Registrant XY in March of 2014. Registrant AB should not be required to include the employees acquired in the purchase of XY until the 2016 pay ratio disclosure using the compensation data for 2015. In this scenario, fiscal year 2015 would represent the first whole fiscal year the employees acquired in the transaction would be employed by AB.

XI. The Commission Should Include a Three-Year Sunset Provision In the Publication of the Final Rule Implementing Section 953(b).

We believe the Commission should include a three-year sunset provision accompanying any final rule implementing the pay ratio. There is Commission precedent for the use of sunset provisions in Dodd-Frank implementation. In July 2013 the Commission adopted the Retail Foreign Exchange Transaction Rule which implemented Dodd-Frank Section 742 and included a three-year sunset provision. According to the rule release, the Commission's decision to include the sunset provision was based on concerns with whether the rule would result in disruptions and unintended consequences to broker-dealers and their customers.[69] The Commission also noted in the release that it could choose to allow the sunset provision to lapse without renewing or adopting any final rule.

We believe there is an even stronger case for adopting a three-year sunset provision for any final rule implementing the pay ratio mandate. As the Commission identified in the proposed rule and as we have made clear in our comments and in the attached economic analysis, the pay ratio cannot and will not provide a benefit to investors. In fact, as we have demonstrated in our comments and as the Commission itself noted in the proposed rule, the pay ratio is likely to mislead investors. Secondly, as discussed extensively in our comments, compliance with the pay ratio will result in unnecessary and excessive administrative burdens and compliance costs. Together these factors easily exceed the level of concern which prompted the Commission to include a three-year sunset provision in the Retail Foreign Exchange Transaction Rule.

A three-year sunset provision would afford the Commission time to evaluate the compliance costs and evaluate whether investors actually make any legitimate use of the pay ratio disclosure. At the expiration of the period, the Commission could reevaluate whether or not such a mandate is necessary in light of the excessive compliance burdens.

[69] Retail Foreign Exchange Transactions, Exchange Act Release No. 34-69964; File No. S7-30-11, July 16, 2013.

Conclusion

The Center appreciates this opportunity to provide additional comments on the implementation and rulemaking related to Section 953(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act. If you have any questions about the Center's comments, please do not hesitate to contact me at [redacted].

Sincerely,

Timothy J. Bartl
President

cc: Securities and Exchange Commission:
Hon. Mary Jo White, Chairman
Hon. Luis A. Aguilar, Commissioner
Hon. Daniel Gallagher, Commissioner
Hon. Kara M. Stein, Commissioner
Hon. Michael S. Piwowar, Commissioner

Appendix I

The Economic Impact of the SEC's Proposed Rule on Required Pay Ratio Disclosure

By

Dr. Stuart Gurrea and Dr. Jonathan Neuberger

Economists INCORPORATED

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I. INTRODUCTION

On September 18, 2013, the U.S. Securities and Exchange Commission (SEC) proposed amendments to the existing rules on disclosure of information regarding executive compensation ("Proposed Rule").[1] These proposed amendments are aimed at implementing mandatory disclosures under section 953(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").[2] In particular, the amendments to the existing rules under Item 402 of Regulation S-K require from most listed companies:

> "[…] disclosure of the median of the annual total compensation of all employees of an issuer (excluding the chief executive officer), the annual total compensation of that issuer's chief executive officer and the ratio of the median of the annual total compensation of all employees to the annual total compensation of the chief executive officer."[3]

In response to the Proposed Rule, the Center On Executive Compensation engaged the authors of this study to conduct an economic assessment of the proposed compensation disclosure requirements (collectively "pay ratio disclosure").[4] To this end, we assessed from an economics perspective the purported costs and benefits attributable to the disclosure of the relationship between CEO compensation to that of the median employee ("pay ratio").

To complete our assignment, we consider the pay ratio disclosure requirements, their purported benefits, and whether these are supported by fundamental principles of finance, economics, and statistics. As importantly, our conclusions also are informed by the results of a survey designed to assess the economic impact of the implementation of the pay ratio disclosure requirements on corporations that are subject to the Proposed Rule. These survey results offer key insights into likely implementation costs associated with the Proposed Rule.

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[1] Pay Ratio Disclosure, Proposed Rule, SEC, September 18, 2013, http://www.sec.gov/rules/proposed/2013/33-9452.pdf.

[2] Public Law No. 111-203, 124 Stat. 1376 (2010), as amended by Public Law No. 112-106,126 Stat. 306 (2012).

[3] 78 Fed. Reg. 60,560.

[4] http://www.execcomp.org/.

The body of our report is organized as follows. First, we summarize our conclusions in Section II. Second, we consider the definition of the pay ratio and the significance of its reliance on median employee compensation. Then, in Sections IV through VI, we analyze the merits of potential benefits that may be attributed to the pay ratio disclosure: first, its economic significance to investors; second, its potential impact on the purported growth of CEO pay; and third, its reliability as a measure of CEO compensation relative to employee compensation. The second part of our analysis concerns compliance costs as revealed by survey evidence. Section VII describes the survey we relied on to assess the expected costs of implementing the pay ratio disclosure. Section VIII discusses the adverse effects of the Proposed Rule on competitiveness and how certain costs can be avoided. Finally, Section IX assesses the reliability of the compliance cost estimates reported in the Proposed Rule.

II. SUMMARY OF CONCLUSIONS

Our analysis of the pay ratio disclosure requirements leads to several conclusions:

1. The pay ratio does not provide useful information for investors because there is no theoretical or empirical economic support for the use of the pay ratio as the basis for valuing a corporation or for selecting securities for investment portfolios. This conclusion is corroborated by survey data indicating that investors do not request pay ratio information from companies.

2. Median employee total compensation does not measure the dispersion of pay within a firm. Such pay dispersion is a function of the company's industry, its size and global reach, competitive and geographic labor market forces, the industry in which it operates, and the mix of jobs it employs. While there is a body of economic and finance research on the effects of pay dispersion on corporate value and performance, and proponents of the pay ratio disclosure refer to this research to support their position, this literature does not focus on the impact of the median employee on firm value. In addition, more direct measures of firm performance than the pay ratio are available and already widely used.

3. There is no economic basis, theoretical or empirical, to support the claim that the disclosure of the Proposed Rule, and in particular the disclosure of median employee compensation, will influence the purported growth of CEO compensation.

4. The pay ratio is unsuitable for conducting cross-sectional comparisons of pay disparity, and its use for this purpose is misleading because: (i) differences in characteristics unrelated to pay disparity, such as type of employees (part time vs. full time) or international presence (percentage of non-U.S. employees), may account for observed differences in pay ratios across firms; (ii) the large information requirements to conduct meaningful comparisons may render them impracticable; and, (iii) the pay ratio is not a reliable measure for conducting comparisons across corporations because it is a flawed measure of pay dispersion by definition. Moreover, even if it were a valid measure of pay dispersion, the economic literature does not offer an unequivocal prediction about the relationship between pay disparity and performance.

5. The pay ratio is equally unsuitable for conducting inter-temporal comparisons of pay disparity within an individual corporation, and reliance on the pay ratio for this purpose is misleading because: (i) changes in an organization unrelated to the pay structure of existing employees may account for changes in the pay ratio of a corporation over time; and, (ii) the pay ratio by definition is not a reliable measure for conducting intertemporal comparisons because it is a flawed measure of pay dispersion. In fact, even a reasonable measure of dispersion would not be sufficient because, as noted above, the economic literature does not offer an unequivocal prediction about the relation between pay disparity and performance.

6. Survey evidence reveals that compliance with the Proposed Rule will put registrants at a competitive disadvantage because it imposes significant direct and indirect costs. A significant percentage of direct compliance costs, however, can be avoided by limiting the scope of the pay ratio disclosure to U.S. employees, full-time employees, and by excluding employees at partially-owned subsidiaries and joint ventures.

7. The cost estimates of compliance presented in the Proposed Rule are unsupported and understated. Small adjustments to these computations based on actual survey

data show that compliance is likely to require at least 255,000 additional company hours and an additional $114 million in costs for outside professional services above the 546,000 company hours and $73 million in costs estimated by the SEC.

III. THE PAY RATIO

To evaluate the purported benefits of the pay ratio disclosure requirement, it is important to understand the information that is used to construct the pay ratio itself. Failing to understand the definition, construction, and limitations of the proposed pay ratio may result in misleading economic interpretations of the ratio.[5] The pay ratio defined in the Proposed Rule concerns total compensation of the CEO and the median compensation of all employees, excluding the CEO. The Proposed Rule does offer some flexibility in the method for identifying the median, but registrants are still required to report CEO compensation relative to median employee compensation (excluding CEO compensation).[6]

The median employee compensation is the level of compensation that has an equal number of employees (excluding the CEO) receiving higher and lower amounts. By definition, the median compensation represents a level of compensation that occupies a *central* location in the distribution of employee compensation. The median does not, however, convey any information about whether this level of compensation is representative, that is, whether there are many other employees with the same or similar compensation. The median also is uninformative about the range or *dispersion* of employee compensation.[7] For example, half of the employees in a company may receive very low pay and the other half may receive very high pay (a bi-modal distribution). The pay ratio for such a company would be very high if the median compensation happened to fall in the low-pay group. Conversely, the pay ratio would be very low if the median compensation happened to fall in the high-pay group. The pay ratio itself, however, reveals little about the distribution of compensation between these two groups.

[5] 78 Fed. Reg. 60,560.

[6] 78 Fed. Reg. 60,563.

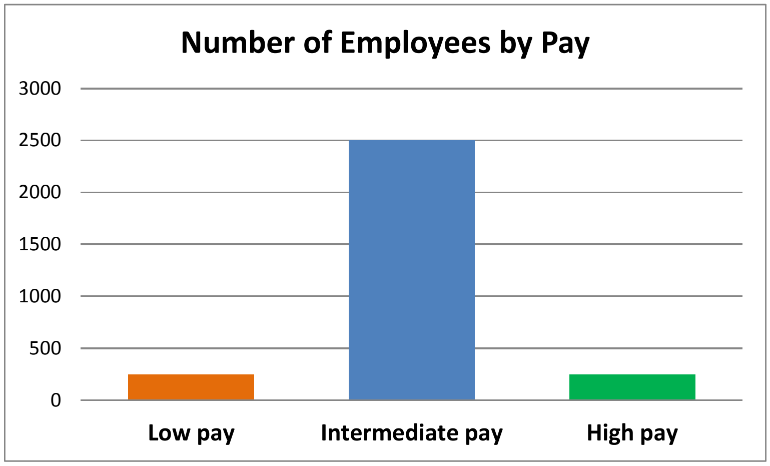
[7] Pay dispersion measures how close individual compensation is to the average compensation.

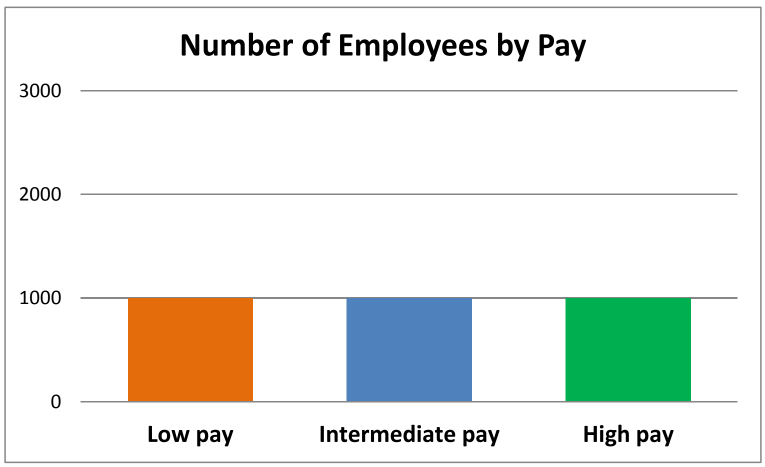
More generally, in statistical terms, if there is not a strong central tendency (low dispersion) in the distribution of employee compensation, the median will not provide a representative value of employee compensation. Hence, it is a mistake to conceive or interpret the pay ratio as a generally reliable measure of differences in compensation between the CEO and other employees because the median, by definition, does not tell us if the median compensation is a good or representative measure of compensation. The median is simply not a measure of wage dispersion – while the median identifies the "middle" observation of a distribution of employee compensation, it tells us little about the shape of that distribution.

For example, the two panels below depict very different compensation distributions for two companies, each of which employs 3,000 people. The first panel illustrates the case of a corporation with relatively small dispersion in compensation among employees – most employees are clustered at the "intermediate pay" level and the median will fall within this intermediate group. In the first panel, it is apparent that the median provides a representative value of employee compensation – many employees are paid at or near this level. This would be more likely at a corporation with a relatively homogenous workforce without a global presence, or if only U.S.-based employees are considered.

In contrast, the second panel represents a corporation with relatively high pay dispersion, where compensation is evenly spread among three broad groups of employees. The median compensation for this company also falls in the "intermediate pay" group, despite the fact that a relatively small number of employees actually receives this level of compensation. Importantly, these two companies each exhibit the same median pay, regardless of the obvious differences in their distributions of employee compensation. Recognizing that the median fails to capture differences in dispersion is of practical importance because the empirical evidence indicates that the level of pay dispersion varies significantly with industry characteristics.[8] These characteristics include skill level, global footprint, number of products, and degree of automation, among others.

[8] See Carl B. Barsky and Martin E. Personick, "Measuring wage dispersion: Pay ranges reflect industry traits," *Monthly Labor Review*, April 1981, pp. 35-41, and Krista Sunday and Jordan Pfuntner, "How widely do wages vary within jobs in the same establishment?" *Monthly Labor Review*, February 2008, pp. 17-50.





By definition, it follows that the pay ratio only represents a meaningful measure of the relationship between CEO compensation and other employee compensation in very specific cases: where the distribution of compensation is concentrated and the median compensation is representative of employee compensation. Therefore, it is erroneous and misleading to interpret pay ratios assuming that such a restrictive distributional assumption is universally met.

IV. THE PAY RATIO IS NOT MATERIAL TO INVESTORS

As a general proposition, SEC disclosure requirements are intended to provide *investors* with information about a firm's activities, practices and procedures that may be relevant to an assessment of the firm's publicly-issued securities.[9] Information that is likely to have a meaningful impact on the value of a security when disclosed to investors is considered *material*. Certain accounting practices, for example, may affect the way a firm reports income or records expenses on its financial statements. Such information, in turn, can influence the risk and return characteristics of the company's debt and equity securities. The SEC thus requires disclosure of such practices to disseminate relevant and material information to financial markets and to provide transparency to investors.

In the current case, the SEC has proposed disclosure rules associated with the pay ratio. This may be interpreted as an effort to provide investors with information about relative CEO pay that purportedly is relevant to corporate valuation and investment decisions. There is a long history in the U.S. of legislative and regulatory intervention regarding executive pay practices, ranging from disclosures of CEO pay, to changes in the tax treatment of various components of executive pay, to actual limits on the amounts publicly owned companies can pay their CEOs.[10] Since the 1930s, companies have been required by the SEC to provide disclosures of compensation paid to senior executives; current rules require detailed disclosures for the top five corporate executives in proxy statements and regulatory filings.[11] The Proposed Rule calls for additional disclosures regarding the pay ratio over and above those already required for executive compensation.

From an investor's perspective, the disclosure of pay ratios is material if it is likely to have an impact on an investor's assessment of a company or the value the investor assigns to the

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[9] The Securities Act of 1933 has two basic objectives: "require that investors receive financial and other significant information concerning securities being offered for public sale; and prohibit deceit, misrepresentations, and other fraud in the sale of securities. […] A primary means of accomplishing these goals is the disclosure of important financial information through the registration of securities. This information enables investors, not the government, to make informed judgments about whether to purchase a company's securities." http://www.sec.gov/about/laws.shtml.

[10] See Kevin J. Murphy, "Executive Compensation: Where we are, and how we got there," Chapter 4 in George Constantinides, Milton Harris, and René Stulz (eds.), Handbook of the Economics of Finance, Elsevier Science North, pp. 211-356.

[11] Regulation S-K Item 402.

company's securities over and above existing disclosures. Conversely, additional disclosures that do not reveal new information are unlikely to have a measureable impact on the investor's assessment or the value of securities, are unlikely to impact the investor's decisions, and thus do not rise to the level of materiality.

The economic rationale that purportedly underlies the claim that the pay ratio disclosure is material to investors is that pay disparities can reduce employee morale, productivity, investments in human capital, and ultimately firm value.[12] Since pay dispersion may be pertinent to these issues, according to this line of reasoning, investors will benefit from disclosure of information about that dispersion when evaluating companies and constructing portfolios of financial assets, including securities of reporting companies. This line of reasoning suffers from numerous basic flaws.

First and most fundamentally, as explained in the preceding section, the pay ratio is not a measure of pay dispersion and therefore is not suitable to draw conclusions about the impacts of that dispersion on employee morale, productivity, investments in human capital, and more generally, the value of corporate securities. Indeed, the median employee compensation is not necessarily the compensation of the representative employee and should not be taken as an accurate reflection of employee compensation for purposes of assessing pay disparities. For example, high variability in compensation may be driven by the inclusion of compensation for employees outside of the U.S. Median employee compensation in these cases is unlikely to be representative or informative. Analyzing pay differentials among employees and, e.g., productivity, requires a measure of pay disparity such as the Gini coefficient or the Herfindahl-Hirschman Index, which are often used in the empirical economic literature to address this question, rather than a measure of central tendency like the median.[13]

Second, even if the pay ratio were a reliable measure of pay disparities, there is no basis to claim that information on pay disparities is necessarily relevant to employee morale,

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[12] 78 Fed. Reg. 60,585.

[13] In this context, the Gini coefficient would measure the difference between the actual distribution of compensation and one where every employee receives the same compensation. The Herfindahl-Hirschman Index offers a measure of the share of each individual employee's compensation relative to the company's cumulative total.

productivity, investments in human capital, and ultimately the value of securities. According to the Proposed Rule, commenters "have suggested that a comparison of PEO [principal executive officer] compensation to employee compensation *could* be used by investors to approximate employee morale and productivity, or analyzed as a measure of a particular company's investment in human capital."[14] (Emphasis added). This rationale assumes that companies with larger pay ratios necessarily exhibit lower employee morale, lower productivity, lower investment in human capital, and worse economic performance. In contrast, companies with smaller pay ratios should, according to this logic, exhibit better employee morale, higher productivity, higher investment in human capital, and better performance. Supporters of the Proposed Rule may link this claim to a body of economic literature that studies the effects of wage dispersion among employees. This literature, however, does not always concern pay dispersion among all employees (or between all employees and CEOs) and, more fundamentally, offers inconclusive empirical evidence.[15] Therefore, to make assertions as to the broad materiality of the pay ratio information based on evidence suggesting that pay disparity may be relevant in particular sectors or circumstances is unfounded and represents a misreading of the research.

For example, according to the proposed rule, some commenters have suggested that a comparison between the principal executive officer's compensation and employee compensation could be used by investors to approximate employee productivity.[16] In particular, these commenters claim that employee performance is particularly sensitive to pay disparity in industries based on technology, creativity and innovation. In these sectors, pay differentials among employees purportedly undermine employee collaboration, sharing of

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[14] *Id* at 60,585.

[15] For example, many studies have focused on executive and managerial pay, not pay for all employees. (See, among others, Lucian Bebchuk, Martijn Cremers, and Urs Peyer (2010), "The CEO Pay Slice," forthcoming in the *Journal of Financial Economics*; James Wade, Charles O'Reilly III, and Timothy Pollock (2006), "Overpaid CEOs and Underpaid Managers: Fairness and Executive Compensation," *Organization Science*, vol. 17(5), pp. 527-544; and, Matt Bloom and John Michel (2002), "The Relationships Among Organizational Context, Pay Dispersion, and Managerial Turnover," *Academy of Management Journal,* vol. 45(1), pp. 33-42). Other studies have focused on peer comparisons among university faculty, top management in high-tech, academic administrators, and baseball players. (See discussion of these studies in Jeffrey Pfeffer (2007), "Human Resources from an Organizational Behavior Perspective: Some Paradoxes Explained," *Journal of Economic Perspectives,* Vol. 21(4), pp. 115-134).

[16] *Id.*

ideas, and effective functioning of teams.[17] The economic literature on this subject, however, is unrelated to these claims. Indeed, a published study often cited on the relationship between pay disparities and collaboration "examines the interactive effect of technological intensiveness and *top management group (TMG)* pay disparity on firm performance."[18] (Emphasis added). In particular, the cited article tests the hypothesis that "technological intensiveness imposes a considerable requirement for multiway information processing and collaboration among senior executives of a firm and (b) collaboration is diminished when large pay disparities exist." As is apparent, the study concerns executive pay and pay disparities among top executives, not the difference between CEO pay and the compensation of the median employee, which is the subject of the pay ratio.

More generally, the economic literature does not offer a consistent conclusion about the relationship between pay disparity and productivity: some studies indicate that productivity increases with pay disparity and others reach the opposite conclusion.[19] It is therefore incorrect to assume that a measure of pay differentials is a reliable metric of productivity. Moreover, much of this literature focuses on pay disparities that do not concern the top executive relative to the typical employee. Again, existing economic research does not provide support for disclosure of the proposed pay ratio as a meaningful measure of company productivity for analysts and investors.

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[17] *Id.*

[18] See Phyllis Siegel and Donald C. Hambrick (2005), "Pay Disparities Within Top Management Groups: Evidence of Harmful Effects on Performance of High-Technology Firms," *Organization Science*, vol. 16 (3), pp. 259-274.

[19] The theoretical literature on the effects of wage disparity on productivity is divided. Akerlof and Yellen (1991), Lazear (1989) and Levine (1991) suggest that wage disparity may reduce productivity; Lazear and Rosen (1981) and Ramaswamy and Rowthorn (1991) predict that some dispersion results in higher productivity. See, Akerlof, G. A. and Yellen, J. L. (1991), "The fair wage-effort hypothesis and unemployment," *The Quarterly Journal of Economics,* vol. 105(2), pp. 255-283; Lazear E. P. (1989), "Pay equality and industrial politics," *The Journal of Political Economy,* vol. 97(3), pp. 561-580; Levine, D. I., (1991) "Cohesiveness, productivity, and wage dispersion," *Journal of Economic Behavior and Organization,* vol. 15, pp. 237-255; Lazear, E. P., and Rosen, S. (1981), "Rank-order tournaments as optimum labor contracts," *Journal of Political Economy,* vol. 89(5), pp. 841-864; and Ramaswamy, R. and Rowthorn, R. E. (1991), "Efficiency wages and wage dispersion," *Economica*, vol. 58 (232), pp. 501-514. For a review of the empirical literature, see Mahy, B., Rycx, F. and Volral, M. (2009), "Wage dispersion and firm productivity in different working environments," IZA DP No. 4044.

It is also misleading to draw conclusions about a corporation's employee morale and investments in human capital from the pay ratio. The Proposed Rule reports that some commenters identify gaining information on a registrant's investment in human capital as a potential benefit of the pay ratio disclosure requirement.[20] Along these lines, economists have studied the relation between wage dispersion and training.[21] As noted above, these studies concern differences in pay among employees, not between the CEO and other employees.

Third, even if the pay ratio were a good measure of pay disparities and such pay disparities were shown consistently to reduce company performance and firm value, the additional disclosure of the pay ratio would only be relevant to investors if it contained information that is not reflected in existing disclosures. The contemporaneous disclosure of actual performance and value metrics, however, is likely to overshadow the informational content and materiality of pay disparities as an indicator of performance and value.

From a theoretical economics perspective, the pay ratio is unlikely to be informative. Investment theory, as taught in economics and finance classes throughout the world, focuses on the risk, return and correlation characteristics of assets.[22] In this regard, factors that affect the volatility of asset prices, or the ability of firms to generate or increase profits, are relevant to investors. Yet there is no theoretical economic basis to suggest that the pay ratio is generally informative about any of these key asset characteristics.

The same conclusion is true from an empirical perspective. Financial economists have conducted innumerable empirical studies of asset prices and their determinants.[23] As a

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[20] 78 Fed. Reg. 60,569.

[21] Bassanini and Brunello (2008) find empirical evidence of a negative relationship between wage dispersion and training in EU countries, especially among low educated workers. Bassanini, A. and Brunello, G. (2008) "Is training more frequent when the wage premium is smaller? Evidence from the European Community Household Panel," *Labour Economics,* vol. 15(2), pp. 272-290.

[22] See, e.g., Brealey, R. and Myers, S., Principles of Corporate Finance, 11th Edition, Richard D. Irwin, Inc., 2013, and Copeland, T., Weston, F. and Shastri, K., Financial Theory and Corporate Policy, 4th Edition, Prentice Hall, 2004.

[23] For a review of asset pricing literature see Campbell, J. (2000) "Asset pricing at the millennium," *Journal of Finance,* vol. 55(4), pp. 1515-1567, and Fama, E. and French, K. (2004) "The capital asset pricing model: theory and evidence," *Journal of Economic Perspectives*, vol. 18(3), pp. 23-46, among others. For an overview of the relationship between equity returns and macroeconomic

general rule, measures of pay disparity, like the pay ratio, do not find their way into such empirical studies. Moreover, while measures of productivity or employee morale may, in some circumstances, provide useful information regarding corporate performance, there is no economic evidence to indicate that the pay ratio as described in the Proposed Rule provides such a useful measure or that it provides information that is not conveyed by other more reliable or direct metrics constructed using information contained in public financial statements.[24]

The literature on corporate valuation is equally silent with respect to measures of pay disparity, like the pay ratio. Corporate valuation experts typically use one of three broad approaches to valuing companies: cost-based methods, income-based methods, and market-based methods.[25] Since pay disparities have no direct link to any of the underlying determinants of value using these three approaches, valuation methods do not rely on such inputs.

The absence of economic evidence regarding the utility of the pay ratio is itself revealing. Economic theory generally, and the economics of financial markets more specifically, relies on the fundamental principle that markets process information efficiently.[26] Relevant information is identified promptly and used to inform economic decisions, while less relevant information is discounted or ignored. This is especially true in financial markets, where information is considered plentiful and investors are assumed to process that information effectively. In that context, if the pay ratio were a particularly useful piece of information for assessing corporate value and performance or making investment decisions,

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fundamentals and monetary policy, see Hordahl, P. and Packer F. (2007) "Understanding asset prices: an overview," BIS Papers No. 34, Bank for International Settlements, pp. 8 and 9.

24 For example, Marvin Lieberman and Jina Kang show how data in corporate financial statements can be used to estimate a company's productivity and its change over time. See Lieberman M. and Kang J. (2008), "How to measure company productivity using value-added: a focus on Pohang Steel (POSCO)," *Asia Pacific Journal of Management*, vol. 25, pp. 209-224.

25 See, for example, Pratt, S., Reilly, R., and Schweihs, R. "Valuing a Business: The Analysis and Appraisal of Closely Held Companies," Fourth Edition, McGraw-Hill, 2000; and Copeland, T., Koller, T., and Murrin, J. Valuation: Measuring and Managing the Value of Companies, Second Edition, John Wiley & Sons, Inc., 1996.

26 See, Fama, E. (1970) "Efficient Capital Markets: A Review of Theory and Empirical Work," *Journal of Finance*, vol. 25 (2), pp. 383–417.

we would expect financial analysts, consultants and other market practitioners to construct and rely on estimates of the pay ratio in the absence of disclosed actual pay ratio information for purposes of making investment recommendations.[27] Yet the pay ratio is essentially absent from the economics literature – we found no articles or treatises discussing the pay ratio as a useful measure of economic performance or value. We similarly found no references to the pay ratio as a reliable tool for assessing investment decisions.

The absence of voluntary disclosure of pay ratios also is indicative of its limited incremental value to investors. Indeed, if the pay ratio were highly relevant to corporate performance or investment decisions, at least some companies would actively measure and report them as key indicators of their productivity and value.[28] Such reporting likely would pressure competitors to do the same, or take actions to "improve" their reported pay ratios. The fact that such information is absent from corporate financial reports suggests that even corporations that may view their own pay ratios favorably do not consider this information to be relevant or valuable to investors.[29]

Similarly, if pay ratios were truly material to investment decisions, stock analysts would focus on the pay ratio or an estimate of it as a key input or justification for their investment recommendations. In fact, analysts' reports contain few, if any, references to pay ratios because they are simply uninformative for making investment decisions. While some observers offer comparisons of CEO compensation (that is, CEO pay relative to the pay of

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[27] The Proposed Rule itself describes a simple estimate of the pay ratio one would expect to see if it were relevant to investors: "Statistics on the earnings of U.S. workers in various 'industries' are publicly available from the Bureau of Labor Statistics. Therefore, investors may be able to approximate the ratio using the industry median employee compensation and the information about PEO compensation for the registrants subject to Item 402(c)." See, 78 Fed. Reg. 60,583. The economic literature also identifies alternative metrics to understand the effects of relative compensation of top executives compared to average worker pay on employee incentives and performance. For example, Faleye et al. (2013) consider CEO compensation relative to average non-executive employee pay based on total compensation earned by all other non-executive employees. See, Faleye, O., Reis E. and Venkateswaran, A. (2013), "The determinants and effects of CEO-employee pay ratios," *Journal of Banking and Finance,* vol. 37(8), pp. 3258-3272.

[28] Notably, a "good" ratio from an investor's perspective in certain industries could be a high ratio while in other industries a "good" ratio could be a low one.

[29] The lack of information in pay ratios is further compounded by the fact that there are no clear definitions of what constitutes a "good" or "bad" pay ratio. Reported pay ratios will depend on many factors including the distribution of pay among employees, the corporation's organizational structure, etc. As a result, economically meaningful thresholds cannot de defined.

other CEOs), analogous comparisons of pay ratios, as defined in the Proposed Rule, are rarely discussed in analysts' reports. More generally, even if there is anecdotal evidence that a particular analyst is considering pay ratios for a particular company, this does not imply that pay ratios broadly inform corporate valuations or investment decisions. Based on their absence from analysts' reports, they clearly do not.

While the study of executive compensation disclosure has been the subject of extensive theoretical and empirical economic investigation, as well as the object of numerous regulatory and legislative initiatives, public companies already disclose information about compensation paid to senior executives. Reporting companies are required by SEC rules to provide a "Summary Compensation Table," "Option Grant" table, tables of equity granted and equity grants outstanding, and a narrative discussion of those practices in the "Compensation Discussion and Analysis" that reveal substantial information about their executive compensation practices. If the public policy concern is the purportedly high level of executive pay, that information is already provided to market participants in a straightforward and understandable way. In addition, the Bureau of Labor Statistics ("BLS") publishes extensive and detailed data on employee wages and salaries, average earnings, etc. Such data, together with existing disclosures, already can be used to construct measures of pay disparities.[30] There is no evidence to suggest that, from an investor's perspective, additional disclosures of the pay ratio will add anything material to the information that is currently available.

V. THE PAY RATIO DISCLOSURE REQUIREMENTS ARE UNLIKELY TO INFLUENCE CEO COMPENSATION

The pay ratio disclosure also has been justified on the basis of claims that it can help limit the purported growth of CEO compensation. For example, if the purported growth in CEO compensation is driven by benchmarking practices (setting compensation based on

[30] See footnote 22, *supra*.

peers), it is suggested that the disclosure of median employee compensation and the pay ratio could reduce the focus on peer compensation.[31]

These claims are unsupported by any economic theory or empirical evidence. There is no apparent economic mechanism (other than perhaps some implied and unsupported claim that it could be an effective form of public "shaming" for companies with particularly bad ratios) to link the disclosure of the pay ratio to the determination of CEO compensation. As a general matter, compensation for other functions as measured by the median employee compensation do not offer comparable benchmarks to set CEO compensation. In regards to empirical evidence, there is none to support these claims. If in fact the pay ratio were relevant for determining CEO compensation, its disclosure would not necessarily reduce CEO compensation because, as the SEC explains, "[i]t is also possible, […] that pay ratio disclosure could exacerbate any upward bias in executive pay by providing another benchmark that could be used in certain situations to increase PEO compensation (i.e., for a PEO whose company's pay ratio is lower than its peers' pay ratios)."[32]

Even if the pay ratio were effective in undermining benchmarking practices, this would not necessarily be optimal. Indeed, as the SEC notes on page 95 of the Proposed Rule, the economic literature suggests that benchmarking may be both "practical and efficient" for purposes of setting CEO compensation.[33] In light of this lack of economic support, it is incorrect to associate the weakening of benchmarking practices to a strengthening in corporate governance. To the contrary, to the extent that the pay ratio disclosure undermines efficient pay practices based on market conditions, shareholders will be made worse off.

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[31] 78 Fed. Reg. 60,585.

[32] *Id.*

[33] See J. Bizjak, M. Lemmon, and L. Naveen, (2008) "Does the use of peer groups contribute to higher pay and less efficient compensation?" *Journal of Financial Economics*, vol. 90, pp. 152-168; Core, J., Guay W. and Thomas, R., (2005) "Is U.S. CEO Compensation Broken?," *Journal of Applied Corporate Finance,* vol, 12, pp.97-104; and Fryman C. and D. Jenter, (2010) "CEO Compensation," *Annual Review of Financial Economics,* vol 2., pp. 75-102.

VI. THE PROPOSED PAY RATIO DOES NOT OFFER A RELIABLE MEASURE FOR CONDUCTING COMPARISIONS OF RELATIVE CEO PAY

The proposed pay ratio is not an informative measure of the relative size of CEO compensation to employee compensation. As explained above, it does not measure the size of CEO compensation relative to the compensation of a representative employee or, more importantly, the dispersion of compensation within a company. As a result, the pay ratio does not provide a reliable basis for evaluating relative CEO pay across companies in one or multiple industries (inter-company comparisons) or for assessing relative CEO pay over time within the same company (intra-company comparisons). Comparability is also undermined by other significant factors. Failure to recognize the actual economic meaning of the pay ratio or its misuse in conducting inter-company or intra-company comparisons is likely to lead to erroneous and misleading conclusions.

A. The pay ratio is not a good metric for comparing relative CEO compensation across corporations

If the pay ratio is not a reliable statistic of the relation between CEO compensation and representative employee compensation for a corporation, then it also fails to be a reliable metric on which to build compensation comparisons across corporations.

In addition, there is at least one additional reason that makes the comparison of pay ratios across corporations uninformative and misleading. A necessary condition for a meaningful *apples-to-apples* comparison is that the companies being compared are similarly situated. However, substantial differences among companies in terms of the number, type and skill levels of employees, whether the companies are located in the U.S. only or have a global footprint, the number of countries in which the companies operate, the industries in which they compete, among other, make *apples-to-apples* comparisons extremely difficult practically as well as cost prohibitive, as the Commission recognized in the Proposed Rule.

As a result, a meaningful economic interpretation of the results of an inter-company comparison of pay ratios is impossible without large amounts of additional information. For example, the Proposed Rule calls for the inclusion of all employees in the identification of the median, including all full-time, part-time, seasonal or temporary workers, both inside and outside the U.S.[34] Even if the pay ratio were a good metric of pay disparity, and two companies adopted identical methodologies for computing their pay ratios, the magnitudes hardly would be comparable if at least one of the companies had non-U.S. employees. At a minimum, differences in accounting standards across countries will limit the comparability of employment data. Similarly, economic comparisons across firms will be of limited value if the median employee in each of the corporations being compared is subject to significantly different taxation regimes or costs of living. It follows that inter-comparability could be achieved by reducing some of the sources of variability between companies. For example, if the computation of pay ratios is limited to full time employees in the U.S., a more meaningful comparison of pay ratios may be possible.

Beyond the complexities associated with comparing compensation metrics for companies employing non-U.S. workers, inter-company comparisons are challenging in the best of circumstances. The likelihood that differences in reported pay ratios are related to pay practices is higher if comparisons are conducted among firms within an industry.[35] These comparisons, however, are likely to be undermined by a myriad of competing explanations for the observed differences, including the degree of outsourcing of low paying jobs or the level of automation. Lacking detailed information about the organizational structure of the corporations further undermines the utility of inter-company pay ratio comparisons.

B. The pay ratio is not a good metric for comparing relative CEO compensation for a corporation over time

The pay ratio also fails to provide a good metric for comparing relative CEO compensation to other employee compensation over time within a particular company because a ratio dependent on the median compensation is generally not well suited for this purpose, and because the pay ratio is sensitive to organizational changes that are likely to limit the reliability of inter-temporal comparability.

First, as discussed in detail above, it follows from the definition of the pay ratio and its reliance on the median employee compensation that it is not a reliable measure of the

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[34] 78 Fed. Reg. 60,565-60,567.

[35] The estimates of the pay ratio by industry reported in the Proposed Rule exhibit "considerable disparity in compensation differentials between industries." 78 Fed. Reg. 60,584.

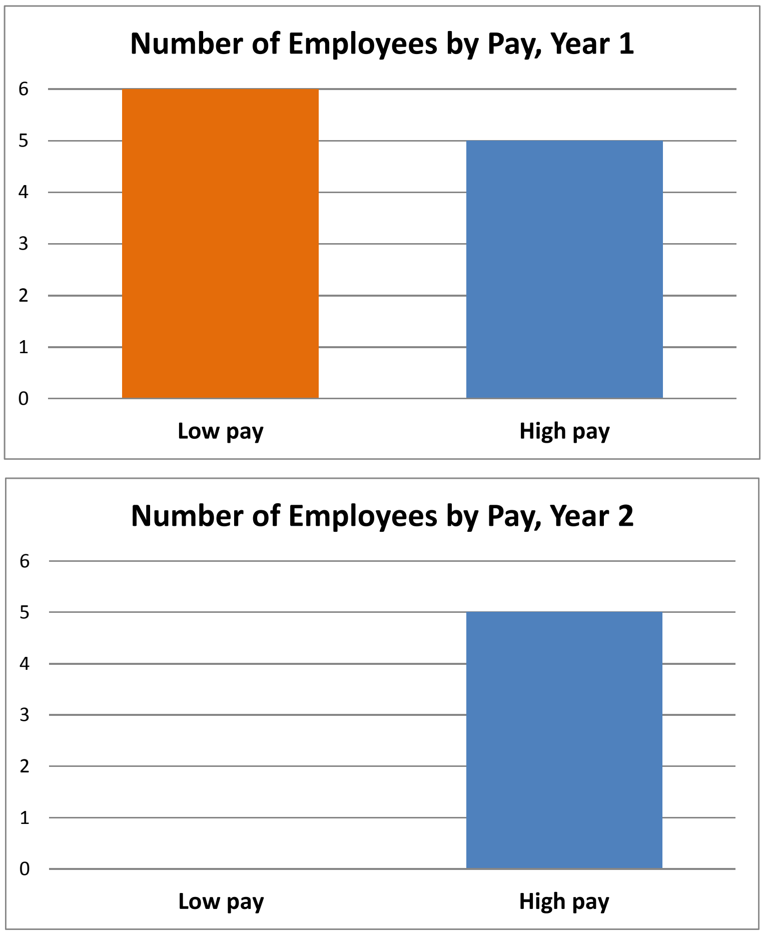
relationship between CEO compensation and representative employee compensation within a corporation. As a result, the pay ratio generally cannot be a good metric on which to build intra-company compensation comparisons over time. This conclusion can be illustrated with a stylized numerical example. For simplicity, consider corporation XYZ with a bi-modal employee compensation distribution in year 1: 11 employees (other than the CEO) are approximately equally split around high and low compensation levels. Five high-paid employees receive $50,000 each and six low-paid employees each receive $25,000. Assume that a small change in the distribution of employees in year 2 (perhaps due to a corporate reorganization) results in a similar bi-modal distribution, but now with six high-paid employees and five low-paid employees. The distributions of pay in year 1 and year 2 are illustrated in the top and bottom panels, respectively, of the figure below. Also for simplicity, assume CEO compensation remains constant from year 1 to year 2 at $100,000.

To compute the pay ratio in years 1 and 2, it is necessary to identify the median employee compensation. In year 1, the median compensation is the employee pay that leaves five employees with higher pay and six employees with lower pay. Therefore, in year 1, the median employee compensation is $25,000. Similarly, in year 2 the small shift in the distribution of employees that results in a larger number of employees receiving high pay implies that the median compensation in year 2 is $50,000. An inter-temporal comparison of pay ratios for corporation XYZ leads to the conclusion that the pay ratio has halved – a decline from four in year 1 ($100,000/$25,000) to two in year 2 ($100,000/$50,000).

This numerical example shows why the proposed pay ratio is generally a misleading metric to measure inter-temporal changes of relative CEO pay within a corporation. While it is mathematically accurate to conclude that the pay ratio significantly declined from one year to the next, it is incorrect to conclude that the gap between CEO pay and the pay of the representative employee declined significantly over time. To the contrary, the pay structure of the company remained largely unchanged; only the number of employees in each pay category differs in the two years of the example.

Second, and as importantly, changes in the organizational structure of a corporation over time may result in misleading and erroneous interpretations of inter-temporal pay ratio comparisons. Tracking CEO pay relative to a measure of employee compensation can conceivably help identify changes in compensation practices over time. In reality, however, changes in the pay ratio over time likely will be driven by many factors other than compensation practices. As with inter-company comparisons, the usefulness of intra-company pay ratio comparisons is undermined by a variety of competing explanations for observed differences in the ratio. These alternative explanations could include such factors as corporate reorganizations, acquisitions, expansions into new lines of business, and fluctuations in exchange rates. Without a complex multi-factor analysis of the determinants of an observed change in a pay ratio, a simplistic interpretation of intra-company pay ratio comparisons is likely to be misleading and incorrect.

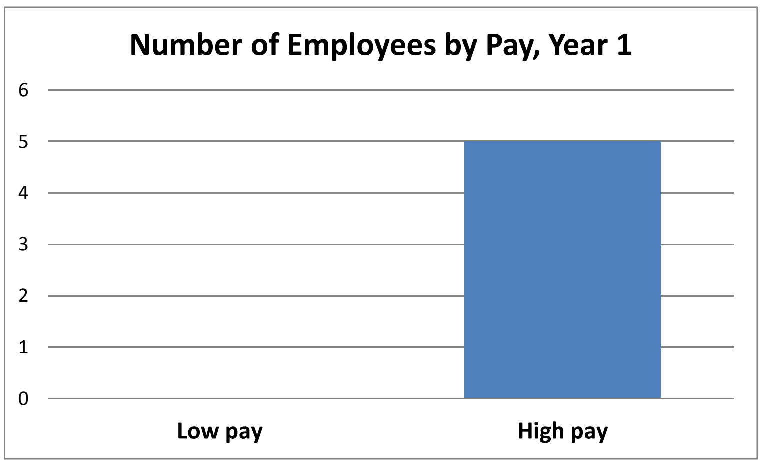
To illustrate this point, consider again the stylized numerical example above. The same corporation presents the same distribution of employee pay in year 1 (see the top panel of the figure below). Assume again for simplicity that CEO pay is constant at $100,000. Now assume that the division employing low-pay employees is sold to a competitor in year 2 (e.g., a division responsible for retail sales or customer support is sold to a competitor). The remaining employees (other than the CEO) are all high paid workers at $50,000. The compensation of the corporation's remaining workforce is illustrated in the bottom panel of the figure below.

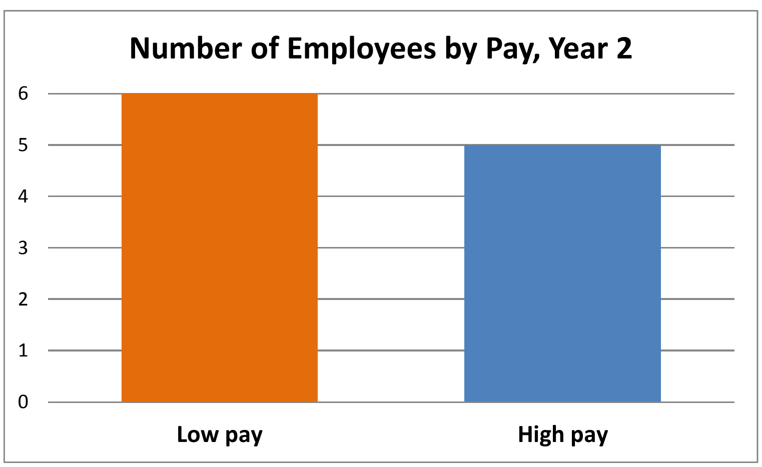


As derived in the example above, the pay ratio in year 1 equals four. In year 2, however, the number of high-paid employees has not changed and stays at five. Nevertheless, the numerical conclusion is analogous to the one derived from the prior example: the pay ratio in year 2 equals two ($100,000/$50,000), half of the pay ratio in year 1.

From these results it is mathematically correct to conclude that relative CEO pay experienced a large decline from year 1 to year 2. This conclusion, however, is misleading as it does not provide any information about the reasons for the change. The ratio thus fails in capturing meaningful changes in relative CEO pay. In the example, while the pay ratio falls dramatically, the compensation of all remaining employees (including the CEO) has not changed from one year to the next.

An analogous assessment of the pay ratio for the company acquiring the division in the prior example would be equally misleading. The panel below illustrates changes in pay structure for a company with no low-paid employees in year 1 that adds to its work force low-paid workers following the acquisition of a division. For simplicity, assume the same low pay, high pay, and CEO compensation figures as above ($25,000, $50,000 and $100,000, respectively).





The computation of the pay ratio for the acquiring company mirrors that of the seller. The pay ratio in year 1 equals two (relatively small difference between CEO compensation and median employee compensation). In year 2, the number of low-paid employees expands beyond the number of high-paid employees as a result of the acquisition (from zero to six). The numerical conclusion is the reverse of the one derived in the prior example: the pay ratio in year 2 equals four ($100,000/$25,000), twice the pay ratio in year 1.

This numerical result is again misleading. In the example, the pay ratio increases dramatically from year 1 to year 2. An inter-temporal comparison of pay ratios leads to the conclusion that relative pay differences have increased over time when in fact no employee has experienced a change in compensation (including the CEO) from one year to the next. Indeed, the dramatic change in pay ratio in the example is simply driven by an addition to the company's service offerings and the employment of more workers.

In addition, inter-temporal pay ratio comparisons are an unreliable measure of changes in employee morale, productivity, or investment in human capital. According to the Proposed Rule, some commenters "have suggested that a comparison of PEO compensation to employee compensation could be used by investors to approximate employee morale and productivity, or analyzed as a measure of a particular company's investment in human capital."[36] It is apparent from the examples above, however, that it is generally misleading to draw inferences from changes in the pay ratio within a company about the levels of employee morale, productivity or investment in human capital. A shrinking gap between CEO and employee pay is not necessarily an indication of improving employee morale. In one example, a shrinking pay ratio resulting from the sale of a division employing low-paid workers and no increase in the compensation of remaining employees surely should not be interpreted as an indication of increasing morale. Conversely, an increasing pay gap resulting from the purchase of a division should not be interpreted as an indication of declining morale.

[36] 78 Fed. Reg. 60,585.

VII. SURVEY

To shed further light on issues related to the pay ratio disclosure, The Center On Executive Compensation conducted a survey of 1,270 companies ("the survey"). A detailed description of the survey and a summary of survey results are provided in Appendix 1 and Appendix 2, respectively. The purpose of the survey is to obtain actual information from registrants that can be used to inform comments to the SEC's Proposed Rule. Among other information, the survey provides valuable information on the anticipated compliance costs associated with the Proposed Rule and their impact on respondents.

At the time this economic report was prepared, a total of 128 responses by companies that are required to file a proxy statement or an SEC form 10-K had been compiled. For purposes of this analysis, these 128 companies are collectively referred to as "respondents." 83 responses came from members of the HR Policy Association and the Center On Executive Compensation and the Society of Corporate Secretaries and Governance Professionals, seven were solely members of HR Policy Association or the Center On Executive Compensation, and 38 were only members of the Society of Corporate Secretaries and Governance Professionals. The analysis presented here covers all 128 responses.

In general, respondents are large complex organizations with a significant international presence. The average revenue of the public company respondents is $27.7 billion, with more than half (59 percent) at or exceeding $10 billion. On average, each respondent employs 65,081 employees, and half employ at least 31,500 workers. While a majority of these workers are located in the U.S. (on average, respondents report that 62 percent of their workers are located in the U.S.), a significant share of employees is located outside the U.S. This international presence is disseminated across 34 countries on average. Also, a large majority of workers at these corporations is employed full time, but a significant number of respondents (almost ten percent) have less than half on a full-time basis. In terms of employee data systems (including human resource information systems, payroll, benefits and pension, and tax reporting), these mostly complex international operations have an average of 46 separate employee data systems.

VIII. ADVERSE COMPETITIVE EFFECTS CAN BE REDUCED BY NARROWING THE SCOPE OF THE PROPOSED RULE

The Proposed Rule states that the SEC is "particularly sensitive to the competitive effects that could impact registrants" subject to the disclosure requirements and put them at a competitive disadvantage.[37] Specifically, the SEC assumes that "registrants would incur direct costs to compile the information and may incur indirect costs arising from revealing information about the cost structure of their workforce […]."[38] The survey responses indicate that these competitive effects are significant but could be attenuated by narrowing the scope of the disclosure requirements.

Before interpreting survey results related to the adverse competitive effects of the Proposed Rule, it is important to highlight three additional conclusions that can be drawn from the survey. First, the survey data do not support the notion that there is a cost-benefit tradeoff that needs to be considered. That is, the competitive disadvantage imposed on respondents in terms of additional costs does not appear to be offset by any benefits to managers or investors. Indeed, respondents were asked if any of their top ten investors had ever inquired about a ratio of CEO compensation to average employee pay, and there was not a single respondent who had ever been asked to provide this information to investors. Similarly, all respondents answered negatively to the question that inquired whether there was a business purpose for identifying the compensation of the median employee.

Second, the cost savings identified below are likely to be understated because they do not account for savings in indirect costs. The discussion below refers to direct compliance costs but, as the SEC notes, there are additional indirect costs related to compliance. Among others, these are likely to include: costs related to investor and public relations issues; increase in regulatory, competitive, and employee retention risks; brand image costs; and, internal communications costs to explain information to employees.

Finally, it is also important to note that survey respondents recognized that flexibility allowed in a provision of the Proposed Rule would help avoid certain costs that would be incurred without this flexibility. Specifically, the SEC allows registrants a flexible approach

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[37] 78 Fed. Reg. 60,588.

[38] *Id.*

when calculating the median employee compensation: "Registrants may calculate the annual total compensation for each employee included in the calculation […] to identify the median. As an alternative, registrants may identify the median employee based on any consistently applied compensation measure and then calculate the annual total compensation for that median employee."[39] The value of this flexibility appears to be significant in terms of cost. Indeed, survey respondents were asked how their compliance costs would be affected in the event they were required to calculate median employee compensation using the same method employed in the "Summary Compensation Table." This method is currently used to calculate total primary executive officer compensation and is equivalent to the first approach offered by the SEC. 99 percent of respondents answered that their costs would increase if they were forced to calculate median employee compensation using the Summary Compensation Table approach. Including all responses, the median increase is reported as 100 percent. The data strongly indicate that adhering to the Summary Compensation Table approach would lead to additional significant increases in compliance costs relative to the Proposed Rule.

A. A Pay-Ratio based only on full-time employees would reduce compliance costs

The Proposed Rule requires that all employees – including full-time, part-time, temporary, and seasonal – factor into calculating the median employee total compensation amount. The SEC acknowledges that there were commenters who raised concerns about this, such as "the inclusion of…employees that are not permanent, full-time employees would render the comparison to the PEO less meaningful."[40] The data collected from the survey reveals significant concerns about increased costs due to the inclusion of all employees. Indeed, two-thirds of respondents report that limiting the scope of the Proposed Rule to full-time employees only would decrease compliance costs. For those that anticipate lower costs, the average savings would be approximately 20 percent. It is important to note that in the set of survey respondents, only six firms (out of 128) were comprised solely of full-time employees, indicating that this is an issue that applies to a substantial proportion of the companies required to report a Pay Ratio.

[39] *Id* at 60,563.

[40] *Id.* at 60,566.

B. Exclusion of non-U.S. employees would reduce compliance costs

A concern identified in the Proposed Rule is that direct costs of compliance could "disproportionately fall on U.S. Companies with large workforces and global operations […]."[41] The views expressed by survey respondents confirm that this is likely to be the case. As described above, roughly nine out of ten corporations that responded to the survey have employees located outside the U.S., and about half of all their employees work in foreign countries. These responses indicate that the Proposed Rule imposes a much larger cost burden on multinational corporations because of their global workforce. Indeed, if the pay ratio calculation were based solely on U.S. employees, a large majority of respondents (79 percent) expect that costs would decrease relative to the Proposed Rule. When the survey answers are limited to those firms that actually have employees outside the U.S., the percentage of respondents expecting lower compliance costs (relative to the Proposed Rule) rises to over 90 percent. Additionally, the expected decrease in cost is very large: forecast savings range between 40 percent for all respondents to 47 percent on average for firms with non-U.S. employees. In sum, these data highlight the fact that if non-U.S. employees are excluded from the calculation of the pay ratio, compliance costs are expected to decrease dramatically for companies with workers abroad.

In addition to being more costly, compliance is also likely to be harder for corporations with employees in multiple countries. Respondents were asked "[d]o you anticipate your company will be prohibited or limited by non-U.S. data privacy laws in your efforts to access information necessary to collect data to identify the median employee or make the pay ratio calculation?" Approximately half of respondents answered yes. As reported above, about 90 percent of firms have employees outside the U.S., and on average, each company employs workers in 34 different countries. Reconciling dozens of countries' privacy laws is likely to be a significant burden for corporations with a large global footprint and undermine their competitiveness.

The SEC suggests that statistical sampling "could enable registrants to better manage the costs and burdens arising from local privacy laws."[42] The survey responses, however, reveal

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[41] *Id.* at 60,588.

[42] *Id.* at 60,567.

that only 17 percent of respondents would resort to statistical sampling. Ten percent of respondents would sample all employees globally and seven percent would sample a targeted subset of employees. As the SEC notes, "generating reasonable estimates through statistical sampling could result in a disproportionally higher cost to registrants with more complicated payroll systems or organization structures."[43] Hence, at least for respondents, a workforce typically spread over 34 countries, with compensation in multiple currencies, adds to the complexity of a hypothetical sample, and their responses suggest that sampling would not be an efficient approach to compliance.

More generally, the expectation that the use of flexibility under the Proposed Rule will help reduce costs for corporations, particularly among those with a large international presence, may be overstated. Compliance with Sarbanes-Oxley internal controls requirements and certification processes may limit the use of the flexibility provided by the SEC in the proposed rule.

C. Exclusion of partially-owned subsidiaries and joint ventures would reduce compliance costs

The SEC recognizes that compliance costs could be reduced if the application of the Proposed Rule to employees of subsidiaries were limited to wholly-owned subsidiaries:

> "We acknowledge that compliance costs for some registrants potentially could be further reduced if we limited the application of the proposed rules to employees of wholly-owned subsidiaries, or some other definition of subsidiary."[44]

Data from survey responses confirms the significance of these savings: 70 percent of survey respondents indicated that, if the requirements in the final rule were expanded to include employees of all minority-owned subsidiaries and joint ventures, their compliance costs would increase considerably. More specifically, the average percentage increase is 91 percent. Furthermore, the data suggest that firms with subsidiaries and joint ventures will incur nearly twice the cost of those without, giving some firms a competitive advantage over others.

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[43] *Id.*

[44] *Id.* at 60,568

IX. COMPLIANCE COST ESTIMATES REPORTED IN THE PROPOSED RULE ARE UNSUPPORTED AND UNDERESTIMATED

The SEC estimates "the total *annual* increase in the paperwork burden for all affected registrants to comply with the proposed collection of information requirements to be approximately 545,792 hours of company personnel time and total costs of approximately $72,772,200 for the services of outside professionals,"[45] (emphasis added). According to the SEC, these estimates are related to submission of annual reports on Form 10-K and current reports on Form 8-K under the Exchange Act.[46] These estimates of additional costs represent a 2.5 percent increase over current costs.[47] These conclusions, however, are built on unsupported assumptions that render these estimates unreliable. Survey evidence indicates that these cost estimates are in fact significantly understated.

The SEC's cost estimates are primarily related to increases in the burden to file Form 10-K. To estimate additional compliance costs related to Form 10-K, the SEC first computes an "Estimated Hour Burden Per Response" as the average burden estimate for the first three years (estimated at 190 hours). The annual burden for each of the first three years ("340 hours in year one, 160 hours in year two and 70 hours in year three") is assumed to be equal to a multiple of the estimated burden hours attributed to the executive compensation disclosures approved in 2006.[48] Second, this 190 hour estimate is multiplied by the number of annual responses (3,830) to yield an aggregate total (727,700 hours). Finally, total additional hours are split between company hours (estimated at 75 percent) and outside professional hours (25 percent). The first yields an estimated total increase in number of company hours needed for compliance (545,792). The second is priced at $400 per hour to yield a dollar "Estimated Aggregate Cost of Outside Professions in Connection with Proposed Requirements" ($72,770,000). These computations and an analogous set for Form 8-K are reported in the Proposed Rule as follows:

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[45] *Id.* at 60,600.

[46] *Id.* at 60,603

[47] *Id.* Current costs are reported in the Proposed Rule as 21,938,653 in "Current Burden Hours" and as 2.9 billion dollars in "Current Professional Costs."

[48] *Id.* at 60,601

Table 1 in Proposed Rule: Calculation of Increases in Burden Estimates Due to the Rule Proposal

	Estimated Annual Responses Subject to Proposed Requirements (A)	Estimated Hour Burden Per Response (B)	Estimated Aggregate Incremental Hour Burden (C) = (A) * (B)	75% Company (Hours) (D) = (C) * 0.75	25% Outside Professional (Hours) (E) = C * 0.25	Estimated Aggregate Cost of Outside Professions in Connection with Proposed Requirements (F) = (E)* $400
Form 10-K	3,830	190	*727,700*	545,775	181,925	$72,770,000
Form 8-K	22	1	22	16.5	5.5	$2,200
Total	3,852	191	727,722	**545,792**	181,931	**72,772,200**

Note: The "Estimated Aggregate Incremental Hour Burden" for the Form 10-K is incorrectly computed as 898,700 in Table 1 of the Proposed Rule, 78 Fed. Reg., 60,603. The correct number is 727,700 and is reported in the table above. The subsequent computations reported in Table 1 in the Proposed Rule that depend on this number, however, are computed using the correct number.

Source: Table 1, Proposed Rule, 78 Fed. Reg., 60,603.

The estimated costs are largely determined by four assumptions: (i) the estimated hour burden in the first year; (ii) the rate at which the first-year hour burden declines between years one and three; (iii) the percentage of the estimated hourly burden allocated to outside professionals; and, (iv) the hourly rate of outside professionals. Each of these assumptions is unsupported and contradicted by survey data with the effect of understating the estimated burden and cost.

First, as indicated above, the SEC assumes an estimated average burden in year one of 340 hours.[49] This number is derived by "multiplying the average burden estimate for the 2006 amendments by two […]."[50] The SEC provides no economic basis for assuming this multiple is two and not three, four or any other larger number. Since this multiple has a direct effect on the magnitude of the SEC's cost estimates, the use of this assumption undermines the reliability of the cost estimates.

A sound economic estimate of the hourly burden associated with the pay ratio disclosures must be related to the steps and time required to comply. Estimating these costs from those

[49] *Id.*

[50] *Id.*

associated with the 2006 amendments requires a comparative analysis of these processes. An initial comparison suggests that, because compliance with the pay ratio disclosures is a significantly more complex process, the burden associated with the pay ratio disclosures is likely to dwarf the burden associated with the 2006 amendments.

Compliance with the 2006 amendments requires companies to calculate total compensation for the CEO, CFO and the other three most highly compensated executive officers. As a result, companies track as many as 15 executives to determine who may be included in the proxy. The process of calculating total compensation as required by Section 402 is largely manual for most companies, with a team of people from human resources, compensation, finance, and legal departments working to calculate the numbers that must be disclosed and the supplemental disclosure, such as the narrative disclosure that follows the tables and the footnotes to the tables.

By contrast, compliance with the proposed pay ratio disclosures is likely to be a much larger, complex, and labor-intensive process involving in many cases collection, compilation and standardization of data from dozens of countries, data systems, and organizations. In particular, identifying the median employee and calculating total compensation will require education of team members in these countries, developing a process for collection of the information, ensuring that the information is reliable, and identifying the median employee among all employees. Once the median employee is identified, the manual process of calculating total compensation for that individual would have to take place and the disclosure be developed.

Second, actual compliance costs also are likely to exceed costs estimates reported in the Proposed Rule because of frequent updates in pay ratio methodology over time. Consistent with the executive compensation disclosures required by the 2006 amendments, the methodology underlying the estimates included in the Proposed Rule assumes that compliance cost are approximately halved between years one and two and again between years two and three.[51] This assumption appears reasonable for executive pay disclosures that largely involve the application of the same methodology over time. The pay-ratio disclosure, in contrast, by definition involves a methodology that is sensitive to changes in

[51] *Id.*

organizational structure such as acquisitions, divestitures, and entry into new markets, and hence is far more likely to change over time.[52] Further, the pay ratio is sensitive to other factors, such as: (i) changes in the distribution of employee by work status such as full-time, part-time and temporary; (ii) changes in the geographic distribution of employees across countries, (iii) changes in the regulatory limitations on the ability to access and transfer employee data in various countries, and (iv) changes in the form of benefits provided to employees in various geographies. Changes over time in any or all of these factors will make the burden of collecting and analyzing compensation data needed to comply with the pay ratio rule more time consuming and expensive. While it is not possible to estimate the exact burden corresponding to such potential changes, it is almost certain they will impose additional costs of compliance.

Consistent with these changing requirements, almost half the survey respondents anticipate having to update their pay ratio methodology every year, while nearly three out of four respondents expect that they will revise their process at least once every three years. The need to incur costs to make periodic updates in methodology may explain why half the respondents anticipate incurring more than 75 percent of first-year compliance costs in subsequent years. Furthermore, a sizable percentage of respondents (35 percent) forecast nearly identical costs to the first year in subsequent years, suggesting that implementing the pay ratio will lead to considerable costs on a recurring basis.

Accounting for the likelihood that initial compliance costs to satisfy the Proposed Rule are more persistent than those related to the 2006 executive compensation disclosures results in a significant increase in estimated compliance costs. Indeed, the survey reveals that on average 72 percent of the estimated costs of initial compliance also are expected to be incurred in subsequent years. If the three-year burden estimate reported in the Proposed Rule is recalculated assuming a higher persistence of initial costs at the levels found in the survey data, the three-year average burden increases by 47 percent. The SEC estimate of 190 hours and the revised estimate of 279 hours are reported in the table below. Note that this

[52] Several respondents note that they consistently undergo changes in their pay practices, which would necessarily lead to a need to re-calculate their pay ratio methodology. Many others stated that regardless of any changes occurring in their business, they would review the process each year or periodically to ensure that it was cost and time efficient, as well as in line with "best practices" in the industry.

revised estimate assumes the same initial number of hours in Year 1 as estimated in the Proposed Rule.

	Year 1	Year 2	Year 3	3-Year Average
SEC Estimate (Hours)	340	160	70	190
Revised Estimate (Hours)	340	248	248	279

Since the three-year average is the basis for calculating the increase in burden estimates, the revision of this assumption alone results in a 47 percent increase in company hours (to 800,870 hours) and raises costs of outside professionals to $106,782,600. The revised calculations are presented in the table below.

Recalculation of Increases in Burden Estimates Accounting for Higher Persistence

	Estimated Annual Responses Subject to Proposed Requirements (A)	Estimated Hour Burden Per Response (B)	Estimated Aggregate Incremental Hour Burden (C) = (A) * (B)	75% Company (Hours) (D) = (C) * 0.75	25% Outside Professional (Hours) (E) = C * 0.25	Estimated Aggregate Cost of Outside Professions in Connection with Proposed Requirements (F) = (E)* $400
Form 10-K	3,830	279	1,067,804	800,853	266,951	$106,780,400
Form 8-K	22	1	22	16.5	5.5	$2,200
Total	3,852	280	1,067,826	**800,870**	266,957	**106,782,600**

Note: Based on survey data, assumes Estimated Hour Burden persist over time at a higher level than assumed in Proposed Rule.

Source: Table 1, Proposed Rule, 78 Fed. Reg., 60,603.

Third, given the estimated aggregate incremental hour burden, the SEC methodology allocates the burden between company and outside professional hours.[53] The SEC assumes a 75/25 split, with 75 percent of the burden borne by internal personnel while 25 percent is covered by outside professionals. This assumption also appears to be unsupported.

Fourth, the "Estimated Cost of Outside Professions in Connection with Proposed Requirements" assumes an average hourly cost of $400. As a basis for this estimate, the

[53] 78 Fed. Reg. 60,600.

Proposed Rule explains that "[t]his is the rate we typically estimate for outside legal services used in connection with public company reporting."[54] This assumption is contradicted by most survey responses. The most common answer to the cost of respondents' external securities compliance counsel is "More than $800," with 30 percent of companies choosing this answer. Only one out of ten respondents reported that their external counsel coincided with the SEC's hourly cost estimate, $400, suggesting that the estimated figure is significantly lower than the industry norm. In particular, more than half the respondents report that the average outside securities compliance counsel charges $700 or more per hour, i.e., the median hourly rate for these services is at least $700, which is 75 percent higher than the estimate relied on in the Proposed Rule for purposes of estimating the additional cost related to outside professionals. The table below recalculates the estimates reported in the Proposed Rule to account for the hourly rate data reported in the survey with no other changes in methodology.

Recalculation of Increases Related to Outside Professionals Using Survey Data on Hourly Rates

	Estimated Annual Responses Subject to Proposed Requirements (A)	Estimated Hour Burden Per Response (B)	Estimated Aggregate Incremental Hour Burden (C) = (A) * (B)	25% Outside Professional (Hours) (E) = C * 0.25	Estimated Aggregate Cost of Outside Professions in Connection with Proposed Requirements (F) = (E)* $700
Form 10-K	3,830	190	*727,700*	181,925	$127,347,500
Form 8-K	22	1	22	5.5	$3,850
Total	3,852	191	727,722	181,931	**127,351,350**

Notes:

1. The "Estimated Aggregate Incremental Hour Burden" for the Form 10-K is incorrectly computed as 898,700 in Table 1 of the Proposed Rule, 78 Fed. Reg., 60,603. The correct number is 727,700 and is reported in the table above. The subsequent computations reported in Table 1 in the Proposed Rule that depend on this number, however, are computed using the correct number.

2. Hourly rate equal to $700 based on survey data.

Source: Table 1, Proposed Rule, 78 Fed. Reg., 60,603.

[54] *Id.*

A change in the assumed hourly rate has no impact on the total company hours. The cost of outside professionals, however, increases in proportion to the increase in rates from $72,772,200 to $127,351,350 – an increase of almost $55 million, or 75 percent.

It is important to recognize that each of the adjustments identified above are cumulative. Accounting for the two numerical adjustments presented above simultaneously (slower decline in hourly burden over time and higher hourly rate for outside professionals) results in almost 50 percent more company hours (800,870 versus 545,792 in the SEC estimate) and more than two-and-a-half times the cost of outside professionals estimated by the SEC ($186,869,550 versus $72,772,200)). These revised calculations are presented in the table below.

Recalculation of Increases in Burden Estimates Accounting for Higher Cost Persistence, and Higher Hourly Rate for Outside Professionals

	Estimated Annual Responses Subject to Proposed Requirements (A)	Estimated Hour Burden Per Response (B)	Estimated Aggregate Incremental Hour Burden (C) = (A) * (B)	75% Company (Hours) (D) = (C) * 0.75	25% Outside Professional (Hours) (E) = C * 0.25	Estimated Aggregate Cost of Outside Professions in Connection with Proposed Requirements (F) = (E)* $700
Form 10-K	3,830	279	1,067,804	800,853	266,951	$186,865,700
Form 8-K	22	1	22	16.5	5.5	$3,850
Total	3,852	280	1,067,826	**800,870**	266,957	**186,869,550**

Note: Based on survey data, assumes first year hours persist over time at a higher level, and higher hourly rate for outside professionals than assumed in Proposed Rule.

Source: Table 1, Proposed Rule, 78 Fed. Reg., 60,603.

Companies Surveyed

There were 1,270 companies surveyed in total. 1,120 companies are affiliated to the Society of Corporate Secretaries and Governance Professionals (the "Society") and 340 companies belong to the HR Policy Association ("HR Policy"), the parent of the Center On Executive Compensation, and there was considerable membership overlap between HR Policy and the Society. The Society is "comprised principally of corporate secretaries and business executives in governance, ethics and compliance functions at public, private and not-for-profit organizations."[1] HR Policy "is the lead public policy organization of chief human resource officers representing the largest employers doing business in the United States and globally."[2]

<u>HR Policy Association Members ("HR Members")</u>

Public companies account for about 260 of the 340 companies. The market capitalization ranges from $3 to $400 billion. The revenue distribution is below (all percentages are approximate):

- Greater than $100 billion: 5%
- Between $10 and $100 billion: 45%
- Between $2 and $10 billion: 40%
- Less than $2 billion: 5%

<u>Society of Corporate Secretaries and Governance Professionals</u>

Approximately 1,200 of the Society's total membership companies are public, representing all industries. The revenue of the Society Member spans from less than $1 million to more than $450 billion. The market capitalization distribution is below (all percentages are approximate and the remaining nine percent is unclassified):

- Greater than $5 billion: 40%
- Between $1 and $5 billion: 31%
- Less than $1 billion: 20%

[1] http://main.governanceprofessionals.org/Home.
[2] http://www.hrpolicy.org/.

Companies that Responded to Survey

Of the approximately 1,270 companies surveyed, 128 public companies completed the survey. Eighty-three belong to both the Society and the HR Policy. An additional seven are solely HR Policy members, while the remaining 38 are only Society members. Their revenues span from $15 million to greater than $450 billion, with the breakdown shown below (all percentages are approximate):

- Greater than $100 billion: 5%
- Between $10 and $100 billion: 54%
- Between $2 and $10 billion: 30%
- Less than $2 billion: 11%

Appendix 2 - Pay Ratio Survey Summary Results

Pay Ratio Proposed Rule Cost Survey

Is your company required to file a proxy statement or a 10-K?	Response Percentage	Response Count
a. Yes	100.0%	128
b. No	0.0%	0
answered question		128
skipped question		0

What is your company's annual revenue?	Response Percentage	Response Count
a. Less than $1 billion	5.5%	7
b. $1 billion to $10 billion	35.9%	46
c. $10 billion or more	58.6%	75
answered question		128
skipped question		0

a. Average	$27.7 billion
b. Mid-range	$14.1 billion

Approximately how many employees does your company employ (US and non-US) worldwide? *(include full-time, part-time, direct-hire temporary and seasonal)*	Response Percentage	Response Count
a. Less than 10,000	21.1%	27
b. 10,000 to 50,000	44.5%	57
c. 50,001 to 100,000	14.8%	19
d. More than 100,000	19.5%	25
answered question		128
skipped question		0

a. Average	65,081
b. Mid-range	31,500

Approximately what percentage of your employees are located in the US?	Response Percentage	Response Count
a. Less than 25%	9.4%	12
b. 25% to 50%	35.4%	45
c. 51% to 75%	16.5%	21
d. More than 75%	38.6%	49
answered question		127
skipped question		1

a. Average	62%
b. Mid-range	60%

Appendix 2 - Pay Ratio Survey Summary Results

Approximately what percentage of your employees are employed full time?	**Response Percentage**	**Response Count**
a. Less than 25%	5.8%	7
b. 25% to 50%	2.5%	3
c. 51% to 75%	8.3%	10
d. More than 75%	83.3%	100
	answered question	**120**
	skipped question	**8**

a. Average	86%
b. Mid-range	95%

Approximately what percentage of your employees are employed full time outside the US?	**Response Percentage**	**Response Count**
a. Less than 25%	38.8%	47
b. 25% to 50%	16.5%	20
c. 51% to 75%	19.8%	24
d. More than 75%	24.8%	30
	answered question	**121**
	skipped question	**7**

a. Average	44%
b. Mid-range	45%

Approximately what percentage of your employees are employed by the company on a part-time, direct-hire temporary or seasonal basis?	**Response Percentage**	**Response Count**
a. Less than 25%	86.6%	103
b. 25% to 50%	7.6%	9
c. 51% to 75%	0.8%	1
d. More than 75%	5.0%	6
	answered question	**119**
	skipped question	**9**

a. Average	12%
b. Mid-range	5%

Approximately what percentage of your employees are employed by the company on a part-time, direct-hire temporary or seasonal basis outside the US?	**Response Percentage**	**Response Count**
a. Less than 25%	96.5%	110
b. 25% to 50%	0.9%	1
c. 51% to 75%	1.8%	2
d. More than 75%	0.9%	1
	answered question	**114**
	skipped question	**14**

a. Average	5%
b. Mid-range	2%

Appendix 2 - Pay Ratio Survey Summary Results

In how many countries (including the US) do you maintain employees?	**Response Percentage**	**Response Count**
a. Fewer than 25	47.7%	61
b. 25 to 50	22.7%	29
c. More than 50	29.7%	38
	answered question	**128**
	skipped question	**0**

a. Average	34
b. Mid-range	25

Approximately how many separate employee data systems (Human Resource Information System, payroll, benefits and pension, tax reporting) do you have worldwide?	**Response Percentage**	**Response Count**
a. Fewer than 25	54.8%	68
b. 25 to 50	20.2%	25
c. 51 to 100	16.1%	20
d. More than 100	8.9%	11
	answered question	**124**
	skipped question	**4**

a. Average	46
b. Mid-range	15

Apart from collecting information for the purposes of calculating the pay ratio, does your company have a business purpose for identifying the median employee?	**Response Percentage**	**Response Count**
a. Yes	0.0%	0
b. No	100.0%	128
	answered question	**128**
	skipped question	**0**

Identifying the Median Employee and Calculating Total Compensation

Based upon your current understanding of the proposed pay ratio rule, what approach would your company be most likely to use to identify the median employee out of all employees globally? *Select only one answer.*	**Response Percentage**	**Response Count**
a. Centralized data	38.4%	48
b. Gather all data from all countries	34.4%	43
c. Limit high paid and low paid employes, or narrow target countries, then gather data	10.4%	13
d. Statistical sampling of all employees globally	9.6%	12
e. Statistical sampling of a targeted subset of employees	7.2%	9
	answered question	**125**
	skipped question	**3**

Appendix 2 - Pay Ratio Survey Summary Results

What percentage of costs do you anticipate incurring in ensuing years as part of preparing annual pay ratio disclosure?	**Response Percentage**	**Response Count**
a. Less than 25%	5.4%	6
b. 25% to 50%	19.6%	22
c. 51% to 75%	24.1%	27
d. More than 75%	50.9%	57
	answered question	**112**
	skipped question	**16**

a. Average	72%
b. Mid-range	80%

Please provide the percentage increase or decrease in the cost estimate in the first year you anticipate your company would incur if the SEC were to make any of the following changes to the proposed pay ratio disclosure:

The pay ratio calculation must include employees of all minority-owned subsidiaries and joint ventures.	**Response Percentage**	**Response Count**
a. decrease of more than 50%	0.0%	0
b. decrease by up to 50%	0.0%	0
c. No change	27.6%	29
d. increase of up to 50%	44.8%	47
e. increase of 51% to 100%	16.2%	17
f. increase of more than 100%	11.4%	12
	answered question	**105**
	skipped question	**23**

a. Average	91%
b. Mid-range	20%

The pay ratio calculation is based on full-time, permanent employees only.	**Response Percentage**	**Response Count**
a. decrease of more than 50%	8.4%	9
b. decrease by up to 50%	57.9%	62
c. No change	22.4%	24
d. increase of up to 50%	11.2%	12
e. increase of 51% to 100%	0.0%	0
f. increase of more than 100%	0.0%	0
	answered question	**107**
	skipped question	**21**

a. Average	-11%
b. Mid-range	-10%

Appendix 2 - Pay Ratio Survey Summary Results

The pay ratio calculation is based on U.S. employees only (non-U.S. employees excluded).	Response Percentage	Response Count
a. decrease of more than 50%	50.9%	56
b. decrease by up to 50%	28.2%	31
c. No change	19.1%	21
d. increase of up to 50%	1.8%	2
e. increase of 51% to 100%	0.0%	0
f. increase of more than 100%	0.0%	0
	answered question	110
	skipped question	18

a. Average	-40%
b. Mid-range	-50%

Median employee pay must be calculated by calculating the total compensation as required in the Summary Compensation Table for all employees then identifying the median employee from this calculation.	Response Percentage	Response Count
a. decrease of more than 50%	0.0%	0
b. decrease by up to 50%	0.0%	0
c. No change	0.9%	1
d. increase of up to 50%	27.7%	31
e. increase of 51% to 100%	22.3%	25
f. increase of more than 100%	49.1%	55
	answered question	112
	skipped question	16

a. Average	4592%
b. Mid-range	100%

Has one of your company's 10 largest investors ever inquired about your company's ratio of CEO pay to overall employee pay?	Response Percentage	Response Count
a. Yes	0.0%	0
b. No	100.0%	125
	answered question	125
	skipped question	3

The SEC has estimated that the average outside securities compliance counsel charges $400 per hour. What is the average hourly fee for your company's external securities compliance counsel?	Response Percentage	Response Count
a. Above $800/hour	29.9%	35
b. $700-$800/hour	23.9%	28
c. $600-$700/hour	17.9%	21
d. $500-$600/hour	17.9%	21
e. $400-$500/hour	9.4%	11
f. $300-$400/hour	0.9%	1
	answered question	117
	skipped question	11

Appendix 2 - Pay Ratio Survey Summary Results

Do you anticipate your company will be prohibited or limited by non-U.S. data privacy laws in your efforts to access information necessary to collect data to identify the median employee or make the pay ratio calculation?	Response Percentage	Response Count
a. Yes	45.8%	54
b. No	54.2%	64
answered question		118
skipped question		10

How frequently do you anticipate having to update your pay ratio methodology based on changes in business organization or structure (i.e. peer practices, acquisitions, divestitures, etc.)?	Response Percentage	Response Count
a. Every year	47.1%	56
b. Once every two years	13.4%	16
c. Once every three years	12.6%	15
d. Less than once every three years	26.9%	32
answered question		119
skipped question		9