



CENTER FOR CAPITAL MARKETS
COMPETITIVENESS

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May 22, 2014

Mr. Kevin O'Neill
Deputy Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Ms. Lynn Powalski
Deputy Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

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

Dear Mr. O'Neill and Ms. Powalski:

The U.S. Chamber of Commerce ("Chamber") is the world's largest business federation, representing more than 3 million businesses and organizations of every size, sector, and region. The Chamber created the Center for Capital Markets Competitiveness ("CCMC") to promote a modern and effective regulatory structure for capital markets to fully function in a 21st century economy. The CCMC is a supporter of strong corporate governance policies that are a fundamental cornerstone for business practices and capital formation. The CCMC welcomes this opportunity to comment on the Securities and Exchange Commission's ("SEC") proposed rulemaking ("Pay Ratio proposal") implementing Section 953 (b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").

The CCMC previously submitted a comment letter on the Pay Ratio proposal to the SEC on December 2, 2013 ("CCMC Letter I"). In filing CCMC Letter I, we stated that the CCMC was unable to provide an economic analysis of the costs of the Pay Ratio proposal. Attached you will find an economic analysis of the Pay Ratio proposal that the CCMC requests be made a part of the record for the Pay Ratio Proposal and further request that the SEC consider this analysis in developing a final cost benefit analysis for the Pay Ratio proposal.

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In summary the attached economic analysis shows that the SEC likely underestimated costs by more than 870 percent and underestimated compliance time by 560 percent, with annual costs to the private sector of over \$700 million versus the \$72.7 million estimated by the SEC. The CCMC believes that these discrepancies are significant and that the SEC should explore means to narrowly tailor the proposed Pay Ratio proposal to impose the least burdensome costs on the economy.

The CCMC continues to believe that various mechanisms, such as roundtables and pilot programs, can be used to better inform the SEC of the problems and challenges that the Pay Ratio proposal poses to competition and capital formation, while not enhancing investor protection. Additionally, with estimated costs of over \$700 million, the Pay Ratio proposal is an economically significant rulemaking and the CCMC requests that the SEC submit the Pay Ratio proposal to the Office of Information and Regulatory Affairs ("OIRA") for an enhanced regulatory review process.

We stand ready to discuss this analysis and concerns with the SEC in greater detail as well.

Sincerely,

A handwritten signature in black ink, appearing to be 'TK' followed by a long, sweeping horizontal line.

Tom Quaadman

THE EGREGIOUS COSTS OF THE SEC'S PAY-RATIO DISCLOSURE REGULATION

May 2014



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By: Ike Brannon, President, Capital Policy Analytics

THE EGREGIOUS COSTS OF THE SEC'S PAY-RATIO DISCLOSURE REGULATION

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank) includes a mandate that the Securities and Exchange Commission (SEC or Commission) issue a regulation requiring corporations to calculate the ratio between their CEO's compensation and that of their median worker. As the agency puts the finishing touches on this regulation, it has become apparent that this exercise will be significantly more costly than either Congress or the SEC are willing to admit, with no discernible benefits for investors, businesses, or the broader economy. This is reason enough to modify the regulation to reduce compliance costs, if not rescind the proposed rule altogether.

The intent behind the pay ratio rule is inherently political as it is designed to "shame" American businesses in order to placate certain special interest constituencies. It is hard to understand the economic or logical argument behind the rule, which will damage our economy by imposing unjustified high costs and burdens on businesses, investors, and end-users.

The intent behind the pay ratio rule is inherently political as it is designed to "shame" American businesses in order to placate certain special interest constituencies.

It is unlikely, of course, that the rule will be rescinded anytime soon since it was required by Dodd-Frank. But it is worth exploring how the SEC could finalize such a regulation in a way that would be consistent with its mission to facilitate capital formation, protect investors, and maintain fair and orderly markets, none of which the pay ratio regulation would advance. It is also worth examining the SEC's cost-benefit calculus for compliance costs. Based on a survey of 118 members of the U.S. Chamber of Commerce, the Center on Executive Compensation, the HR Policy Association, and the Society of Corporate Secretaries and Governance Professionals, there is strong evidence that the current analysis by the Commission woefully underestimated both direct costs and the compliance time firms will spend to adhere to the rule.

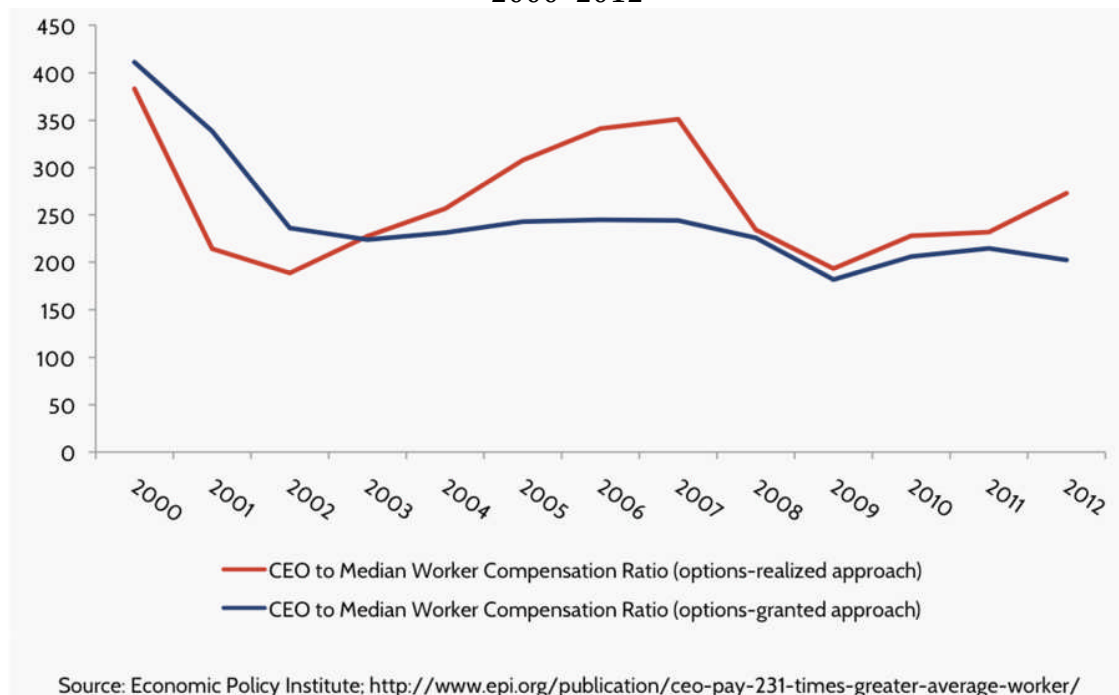
THE EGREGIOUS COSTS OF THE SEC'S PAY-RATIO DISCLOSURE REGULATION

Fixing Something that's Not a Problem | Defying conventional wisdom, the growth in CEO compensation has slowed in this century after four decades of steady growth. Changes in executive pay are often a function of the ebb and flow of market performance. It is not surprising that executive compensation decreased at a disproportionate rate compared to the rest of the workforce in the economic downturn and then the reverse in the subsequent upswing.

Figure 1 plots the ratio of CEO compensation to median worker pay for the economy since 2000. The graph shows that the pay ratio tends to be pro-cyclical, reflecting that executive compensation depends largely on stock prices. The other important pattern depicted is that executive salary gains that have come during the last two business cycle expansions were less than the downside reductions that came during the recessions. This suggests that better metrics or the nature of the current performance pay packages ameliorated this perceived problem without the need of any SEC prodding.

However, a decade long reversal in this trend was apparently not seen as sufficient evidence of any systemic change, and special interest groups pushed Congress to include in Dodd-Frank the requirement for the SEC to implement a rule requiring corporations to regularly publish the ratio of their CEO's compensation, including benefits and bonuses, to the median compensation of their workforce.

Figure 1
Ratio of CEO Compensation to Median Worker Compensation
2000-2012



THE EGREGIOUS COSTS OF THE SEC'S PAY-RATIO DISCLOSURE REGULATION

Metrics for CEO performance | Businesses are already disclosing company and industry-specific metrics for performance and their relation to compensation. The pay ratio disclosure will not provide additional insight whether pay appropriately reflects the performance of executives or the condition and circumstances of the businesses they manage.

Some believe that there is a need for advanced statistics to provide a better understanding of the true value of a CEO. This analysis is already happening. Various economists and companies that work on executive compensation issues have devised analyses that aim to capture CEO performance and ways to connect compensation to performance.

Analysts who try to capture a CEO's contribution focus on earnings growth, revenue growth, and returns, all of which have a strong correlation with Total Shareholder Return (TSR). A recent study by Farient Advisors suggests that earnings growth (whether earnings per share, net income, or operating income) has the highest correlation to shareholder value across industries.

However, those metrics do not work the same for every industry. For instance, energy, banking, and pharmaceuticals showed a particularly low correlation between earnings growth and TSR, which can be attributed, in part, to the difficulties in predicting future value in early-stage life sciences companies, as well as the inherent uncertainty faced by industries subject to considerable regulatory oversight. It is a difficult task. Although we may have better measures of company performance these days, the extent to which we can attribute a company's long-term profits to the CEO's performance is still (and will always be, at least for most industries) difficult to discern.

The pay ratio disclosure will not provide additional insight whether pay appropriately reflects the performance of executives or the condition and circumstances of the businesses they manage.

A Fundamentally Misleading and Flawed Statistic | While objecting to merely asking firms for one more datum may seem petty to some, this piece of information will not help shed any further light on company performance, investor protection, or income inequality. Whether a CEO makes 20, 200, or 2,000 times as much as the median compensation of the firm's employees provides no particular insight whether a CEO or the median employee is fairly compensated. In fact, such a statistic could present a fundamentally misleading portrait of CEO pay, particularly compared across industries.

For example, a company that operates retail outlets will have a host of workers earning an hourly wage, whereas an investment bank is likely to have very few hourly wage workers. The pay ratio calculated for the CEO of the retail company may be multiples higher than that for the CEO of the investment bank. But does this provide a clear picture as to which CEO is being "fairly"

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compensated? Perhaps, to make this metric compelling, retail employees should be excluded. No good answer exists.

Congress should have considered the implications that varying ratios from one industry to another would have on investors' ability to determine whether a CEO is being "fairly" compensated. Instead, investors are left to assume that these statistics carry some legitimacy, which could ultimately lead to unjustified investment decisions.

A pay ratio is also subject to large swings that could have little to do with an increase or decrease in

A pay ratio is also subject to large swings that could have little to do with an increase or decrease in CEO pay.

CEO pay. For instance, a few years ago one CEO chose to contract out all production and focus the company's attention on marketing and research. In one fell swoop, the CEO - median worker compensation ratio plummeted. Did it go down too much? What are the relevant

companies to compare the firm's pay ratio now? How would the ratio inform investors in any worthwhile way? If the CEO pay ratio would prove to be a meaningful metric to investors, CEOs would have a better incentive to contract out any activities primarily performed by low-wage workers. Is this necessarily good public policy? Did the CEO's decision improve company performance and benefit investors?

Significant Costs, Imperceptible Benefits | Another problem firms may face when trying to calculate the CEO pay ratio is that it necessitates compiling data in a way that most

companies do not routinely collect. The majority of large companies do not have centralized payrolls, and for those that don't, this expense is often prohibitively high. If a company is divided up among several affiliates with separate employee data systems, it often leaves them alone with such arcane issues such as meeting payroll. Companies may no longer have this luxury. As a result, it will require them to expend hundreds of hours and millions of dollars to calculate the figure.

Computing compensation—as opposed to just wages—is what makes this task difficult. It requires examining health insurance costs, pension costs, and all other fringe benefits provided and then ascribing a portion of the cost to each employee.

It is doubtful that any such rule comes close to passing a cost-benefit test, which is a requirement for most major rules issued by the federal government. In its initial request for public comments on the proposed rule, the SEC admitted that there may not even be any quantifiable benefits accruing from this exercise. Putting a price on corporate shame is obviously no easy task.

Computing compensation—as opposed to just wages—is what makes this task difficult. It requires examining health insurance costs, pension costs, and all other fringe benefits provided and then ascribing a portion of the cost to each employee. There is no quick and easy way to perform this calculation—the value of health insurance depends greatly on an employee's age and family

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situation. And, of course, pension benefits vary with income and tenure for most defined benefit plans.

Companies that have operations overseas where the government provides a large proportion of health care will need to think about how to attribute that fact to their compensation costs.

Generally, income taxes are higher in places with more generous public health benefits. This suggests that a company needs to consider those tax costs when trying to calculate the compensation of its median worker. The provision specifically includes all overseas workers as well as part-time workers. Senator Robert Menendez, one of the chief sponsors of the pay ratio disclosure, wrote that the rule “really did mean all employees of the [company] ... both full-time and part-time employees, not just full-time employees. I also intended that to mean all foreign employees of the company, not just U.S. employees.”

The Data Tell a Sorry Story | A perfunctory look at the available data indicates that compliance costs will be much greater than the SEC's initial estimates.

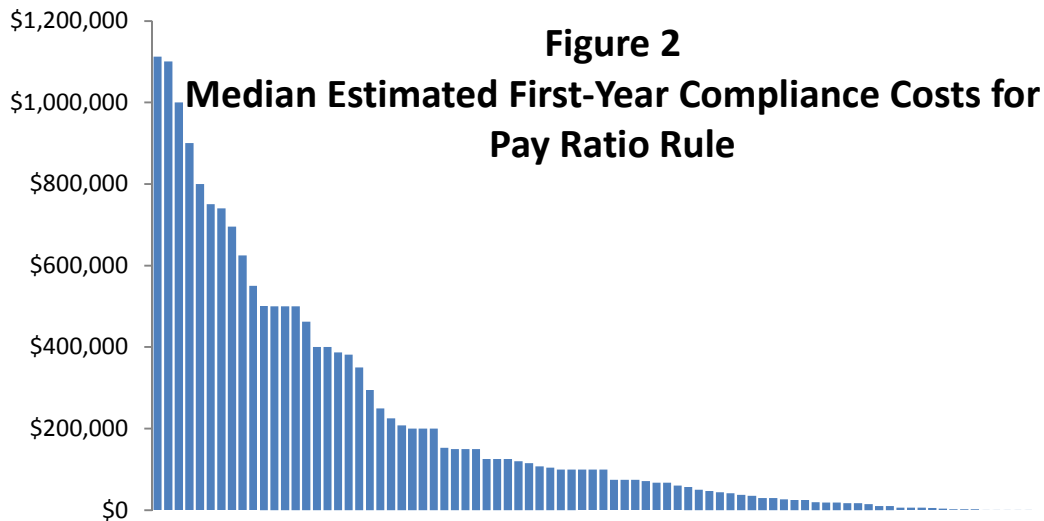
Four trade associations surveyed their members and obtained an average estimated cost that dwarfs the SEC's initial estimate. Some of these companies are multinationals operating in dozens of countries, and they have indicated that compiling data on all forms of employee compensation, dealing with third-party administrators, and then converting those figures into a pointless ratio for regulators is an expensive exercise.

The SEC grossly underestimated the cost estimate for outside attorney fees in calculating the pay ratio. In fact, 99% of the businesses surveyed estimated that the average hourly fee paid to their outside securities compliance counsel would be higher—in some cases significantly higher—than what the SEC estimated.

Not surprisingly, the SEC's cost estimates are much lower because the agency only quantified the paperwork costs of outside professionals to derive the pay ratio. The SEC estimates that the rule would impose 545,792 annual hours of paperwork, which works out to 190 hours per company, and \$72.7 million in costs. Those figures differ from the survey's figures by a couple orders of magnitude.

The Chamber believes that the SEC's figures underestimate the true compliance costs. To derive a number based on more than mere whimsy, we obtained data from a survey of 118 companies, or roughly 3.1 % of all covered businesses. The survey asked each company to estimate how many hours it would take to comply with this regulation and the value of that time (see Figure 2).

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The respondents estimated that it would take an average of 952 hours per year to do this exercise, with average labor cost of \$185,600. This adds up to an annual cost to the private sector of \$710.9 million and an annual compliance time of 3.6 million hours. Thus, the SEC likely underestimated costs by more than 870 % and underestimated compliance time by 560 %. (This figure excludes the cost to the SEC and Office of Management and Budget (OMB) of administering the rule).

Figure 2 shows that 42 companies estimated compliance costs of at least \$100,000; this compares with the SEC's figure of \$18,000 per company. On the other end of the spectrum there were 13 companies reporting less than \$10,000 for compliance. This barbell distribution, with dozens of companies reporting costs far in excess of the SEC's figure and a few companies reporting almost no compliance costs, raises a host of questions.

Figure 2 shows that 42 companies estimated compliance costs of at least \$100,000; this compares with the SEC's figure of \$18,000 per company.

The Small Business Administration states that for most rules, compliance costs are close to the same for both large and small businesses, meaning that smaller businesses have a relatively heavier compliance burden. However, the opposite holds for the pay ratio rule. Entities that do business in more jurisdictions—typically the large multinationals—have higher compliance costs.

There were 39 companies in the sample that conduct operations in more than 50 countries, and those companies average 90 different "employee data systems" worldwide, each of which would have to be included in any analysis to report total compensation for covered employees.

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For these 39 companies, the median estimate of worker-hours needed to comply with the rule is 1,825, nearly 10 times higher than the SEC's estimate. These companies also report that it would cost them an average of \$311,800 to comply with the pay ratio provision. If every regulated company had to expend this much money, the total costs of the rule would balloon to \$1.1 billion, or 15 times the SEC's initial estimate.

On the other side of the spectrum, 37 companies reported that they operate in fewer than 10 countries. For this sample, the average number of employee data systems is just 4.2. Not surprisingly, these companies reported an average compliance time of just 100 hours. Only 25 of these companies that operate in fewer than 10 countries reported cost information, estimating an average of \$67,200, far below the SEC's estimate.

Put another way, a company that has thousands of employees in dozens of countries will maintain several employee data systems. As the number of data systems increases, so, too, does the complexity of complying with the new rule. However, none of the foregoing analysis appears in the SEC's proposed rule. Although the Commission requested comment on this information, the SEC simply performed a back-of-the-envelope calculation on compliance costs, failing to evaluate that multinational companies would bear the majority of compliance costs.

To some extent, the number of employee data systems is a better predictor of escalating compliance costs. There were 20 companies in our sample that reported more than 100 data systems. The average compliance time for these companies was 2,120 hours, but only 12 of the 20 companies reported this data point. With this underreporting, there is a strong chance that many companies have no firm grasp on what the SEC's pay ratio rule will cost.

Compliance time estimates vary wildly across our sample, driven mainly by the differences between multinationals and companies that operate solely within the United States, and by the fact that large multinational corporations typically use payroll systems across dozens of countries. For example, approximately 80 % of the companies in our sample employ more than 10,000 employees, with approximately 60 % of them overseas. These multinational businesses maintain an average of 46 separate employee data systems in 34 countries. The various systems leave no easy way to calculate the pay ratio between all employees, especially ones that account for part-time and seasonal employees. Expanding the task to account for health care and pension costs makes it even more complex. To assume that someone from personnel can devote one afternoon a week to this and do a reasonable job borders on hubris.

Quick Numbers

Overall

- Average number of hours to comply: 952 hours
- Average labor cost: \$185,600
- Annual cost to the private sector: \$710.9 million
- Annual compliance time: 3.6 million hours

39 companies with an average of 90 different data systems

- Average number of hours to comply: 1,825 hours
- Average labor cost: \$311,800

20 companies with more than 100 data systems

- Average number of hours to comply: 2,120 hours

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The SEC's proposal and request for comments admit that it likely contains no notable benefits, saying "neither the statute nor the related legislative history directly states the objectives or intended benefits of the provision or a specific market failure."

Real costs and virtually zero benefits to the company add up to a rule that flunks any bona fide cost-benefit analysis, but that is of little concern to Congress and the SEC.

Using Rules to 'Send a Message' It seems that the point of forcing firms to calculate and publish the CEO - median worker compensation ratio is to generate outrage, hoping that it will provoke a lower ratio. This name-and-shame tactic will most likely not change the behavior of companies, while forcing them to expend effort and resources to calculate a statistic that will be of no use to them, their boards, their shareholders, or investors. Over the past few years, special interest groups have tried to strong-arm companies—under the guise of good corporate governance—into increased disclosures on topics that have no bearing on company performance or share price. When shareholder proposals fail to gain a majority vote during the annual meeting, special interest groups turn to Congress. Oddly, in the case of the pay ratio, there has been very little evidence that investors want this additional disclosure. It has not been a popular shareholder proposal nor has a single company that was surveyed had an investor ask for the ratio to be reported.

SEC rules are not meant to serve as an ideological bulletin board for whatever political party happens to be in power. But that is precisely what the authors of the CEO pay ratio rule had in mind; It is intended to help carry the income inequity message.

Some evidence exists that the courts have a jaundiced eye for such political shenanigans. In January, lawyers arguing over the validity of the conflicts mineral rule before the Court of Appeals for the District of Columbia suggested that the regulation is primarily intended to be a "shaming statute" or a "scarlet letter," freighted with ideological intent. The court seemed inclined to agree with that perspective.

There are ways for the SEC to lessen the compliance costs—it could apply only to U.S. employees, for instance, or else be limited to wages and leave out other compensation. It is clear, however, that a regulation with no benefits and millions of dollars in costs should not be a part of the nation's regulatory portfolio.



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