SEC Officials Question Whether Dodd-Frank Pay Ratio Mandate is Workable

Prescriptive Measure Requires SEC to Interpret Calculation and Disclosure Literally

Section 953(b) of the Dodd-Frank Act requires that companies calculate and disclose the ratio of median pay of all employees, except the CEO, to the CEO's compensation. Read literally, this provision requires companies to calculate the pay of all employees, whether full- or part-time, domestic or global, in the same manner that companies calculate the compensation of named executive officers. Often, statutory language is difficult to interpret or apply and is corrected through the regulatory process. However, several SEC officials have stated that the manner in which the pay ratio provision is written leaves no room for interpretation and thus the SEC will interpret the provision as it is written. Even Former Chairman of the House Financial Services Committee Barney Frank (D-MA) stated shortly after Dodd-Frank's enactment in 2010 that he feels the pay ratio section "is worded poorly and [he is] willing to change the section because of the disproportionate amount of information that is asked of companies." The following provides the views of the SEC on the pay ratio in the words of SEC officials and explains the problems with the mandate.

SEC Calls Pay Ratio "Difficult" and Is Unsure of its Workability Upon enactment of Dodd-Frank, members of the business community and others began explaining how onerous and immaterial this disclosure is. The SEC also immediately expressed its concerns with the provision with SEC Commissioner Mary Schapiro echoing the business community's sentiment in July 2010, stating that "[t]here are complications on the pay sections, especially when dealing with disclosure . . . the pay ratio is going to be more difficult [than say on pay]." Testifying before a House Financial Services subcommittee in March 2011, Meredith Cross noted that the SEC "always want[s] to implement the rules in a way that is workable, but we have to do what Congress has directed us to do. . . . I have concerns about how workable we can make this … [since] it is a very clear requirement and absent other direction, I believe that it is what it is."

SEC Indicates There is No Leeway for Regulatory Interpretation Unlike many provisions in the Dodd-Frank Act that were broadly drafted and allow for regulatory interpretation, the pay ratio mandate was written in such a manner that the SEC has indicated it has no room to make any adjustments through regulation. Meredith Cross, the Director of the Division of Corporate Finance at the SEC, the division in charge of drafting regulations for this provision, explained to Congress in a March 2011 hearing held by the House Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises that "[the pay ratio provision] is very prescriptive [because] of how it is written in the statute. It doesn't actually give us leeway. It is written so that it has to be in every filing, it has to be every employee, [and] it has to be compensation as calculated under Rule 402 the day before the Act was signed." (Rule 402 is the SEC's disclosure regulation.) Moreover, the BNA *Daily Report for Executives* reported on August 11, 2010, that the SEC stated that it would narrowly interpret the pay ratio provision since "the requirement applies to all employees, including foreign and part-time workers."

Ratio Does Not Provide Material Information, and Is not Desired by Investors

The costs of the pay ratio far outweigh its benefits. The disclosure does not produce material information and is meaningless at best, as investors are not particularly interested in it, and misleading at worst. Companies would be required to spend considerable resources to calculate the ratio, because no public company currently calculates each employee's compensation globally in the manner that it calculates the compensation of the named executive officers. The benefits of this provision do not justify the administrative burdens or the costs that would be incurred to develop such systems.

Second, the pay ratio requirement would not provide material information to investors. The ratio would not be comparable between companies since the pay of employees at all levels of an organization is subject to various market forces, such as competition, industry, geography and job type. In addition, the pay ratio would not add any material information that would assist investors in determining whether a company is a better investment. Given that the average compensation disclosure in a proxy statement is now 32 pages and represents approximately one-third of a proxy statement, the addition of nonmaterial information only adds to the length of compensation disclosures and makes it more difficult for investors to digest material information. One measure of gauging shareholder interest in a particular disclosure is to look at the number of shareholder proposals on a topic and review the shareholders support of those proposals. In 2010, there were nine shareholder proposals seeking reports on pay disparity. On average, those proposals were overwhelmingly opposed by 94 percent of shareholders.

H.R. 1062 Would Remove the Pay Ratio Requirement Representative Nan Hayworth (R-NY) has introduced the Burdensome Data Collection Relief Act (H.R. 1062) to repeal the pay ratio disclosure mandate in Section 953(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Consistent with President Obama's initiative to eliminate burdensome and costly regulations, this bill would eliminate a provision that creates an administratively unfeasible reporting requirement in which the costs far outweigh the benefits and does not provide shareholders with useful information. Since the SEC, the agency overseeing this disclosure, has indicated that it has concerns about its ability to implement the provision, and given the regulations the SEC still must draft under the Dodd-Frank Act, Congress should pass H.R. 1062 and remove this unnecessary requirement and allow the SEC to focus its resources on more impactful issues. H.R. 1062 was approved in the House Financial Services committee with four Democrats, Rep. Ed Perlmutter (D-CO), Rep. Jim Himes (D-CT), Rep. John Carney (D-DE) and Rep. David Scott (D-GA) voting with the Republican members in favor of Rep. Hayworth's bill and sending the bill to be considered by the full House of Representatives later this summer.