# Dodd-Frank Pay Ratio Requirement Should Be Repealed Before the SEC Drafts Implementing Regulations

*H.R. 1135 Would Repeal the Mandate, Which Would Add Little Useful Information for Investors But Is Unjustifiably Complex for Employers*

The pay ratio disclosure requirement in Section 953(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act would require employers to disclose the ratio of CEO pay to median employee pay. The requirement is exceptionally difficult for most companies to calculate because the global pay data they must collect to calculate the median employee pay number is not data they normally collect for financial reporting purposes. As noted by *CFO Magazine* recently, the provision is a "net zero:" it is "supposed to protect shareholders, but it's bogus" because it "does not tell investors anything useful about a company." The Center On Executive Compensation believes that the benefits, if any, of disclosing the pay ratio do not justify the significant expenditures that would be required in order to calculate the ratio as the law requires. The statute fortunately did not provide a deadline by which the SEC would be forced to draft implementing regulations. Given the practical reality of implementing the provision's restrictive statutory language, Congress should pass H.R. 1135, the Burdensome Datat Collection Relief Act, to repeal the requirement before the SEC promulgates implementing regulations.

**Financial Crisis Was Not Result of Compensation Ratios** The pay ratio requirement should be repealed because the ratio between the compensation of a CEO and the median employee did not contribute to the financial crisis, and there is no evidence that the disclosure of a ratio would prevent a future financial crisis.

**Provision Never Vetted Through the Legislative Process** No Congressional committee debated or discussed this provision as Dodd-Frank was drafted, leading to a requirement that will be difficult for the SEC to implement and which would be of limited to no benefit to investors. The House of Representatives never voted on this provision before the Dodd-Frank Act was finalized, and the provision was added essentially in secret, having been inserted into the 2,300-page bill prior to a twenty-minute Senate Banking Committee markup. Congress never solicited input from the regulated community regarding the impact the provision may have on business, the economy, investors or even the SEC, and it did not consider the practical implications of the mandate. The result was an overly prescriptive, burdensome and completely impractical mandate whose cost is likely to outweigh its benefits. Leaving little to no flexibility for SEC interpretation in drafting implementing regulations, the statute:

- Requires a calculation of median employee pay, which is considerably more complex than an average;
- Requires the median pay for all employees to be calculated using the definition of compensation used in the Summary Compensation Table for the top five executives;
- Prohibits the definition of total executive compensation from being altered by the SEC when it changes its executive compensation disclosure rules by requiring the ratio to be calculated using the definition in place on the day the Dodd-Frank Act was passed; and
- Requires companies to collect, aggregate and calculate compensation data on each employee in every country in which it has operations.

In addition, the global nature of the calculation layers on further complications:

- The definition of compensation varies among countries, and different countries have specific compensation, disclosure and privacy rules that limit access to companies seeking to aggregate this data for the purpose of finding the median.
- In addition to data issues, each country presents a challenge as compensation paid in those countries is done so in a currency other than the U.S. dollar, which may result in considerable fluctuations depending on the dates that are used to convert currencies for ratio calculation purposes.

**Calculation of the Median Compensation Makes Compliance Unjustifiably Complex** As noted above, the statute's requirement that companies calculate the median compensation of all employees, which, if interpreted to mean all employees globally, makes the calculation excessively complex. However, the differences between the average and the median are often confused in discussions of the ratio, and even proponents of the provision continue to refer to the ratio in terms of an average.

- A median is the number in the exact middle of a group of numbers. The calculation of the ratio would require calculating the compensation under complex SEC rules for every single employee globally and finding the employee in the middle to determine the median.
- The average is the number obtained when all numbers in a set are added and then divided by the total number of numbers in the set. Although seemingly simpler to calculate than the median, it would still require collecting pay data for all employees subject to the difficulties noted above.

As reinforced through discussions with institutional investors, the Center believes the pay ratio is not a useful disclosure because it is overly complex for companies to calculate and imposes significant costs and unnecessary burdens on them.

**The Ratio Is a Result of Market Forces, Not an Indication of Corporate Compensation Risk** SEC Commissioner Luis Aguilar recently asserted that "[t]he relative pay of different classes of employees, such as the ratio between CEO compensation and median pay, can also create risks to an enterprise, including the risk of employee, customer and shareholder discontent." This statement is misplaced as Dodd-Frank's pay ratio mandate does not impact corporate risk mitigation strategies. The pay ratio is the result of a confluence of factors, such as a company's size and global reach, competitive and geographic labor market forces, the industry in which a company operates, and the mix of jobs within a company, among other factors.

**Conclusion** The pay ratio requirement would be incredibly difficult for most companies to calculate as it would require them to collect, aggregate and compare diverse types of data from disparate systems from around the world. For this reason, the pay ratio mandate should be repealed before it requires companies to engage in an expensive and unnecessary process to develop a ratio that will not provide investors a useful data point. Representative Bill Huizenga (R-MI) has introduced the Burdensome Data Collection Relief Act (H.R. 1135) to repeal the pay ratio disclosure mandate. 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 that the SEC still must draft under the Dodd-Frank Act, Congress should pass H.R. 1135 and remove this unnecessary requirement and allow the SEC to focus its resources on more impactful issues.

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