Center On Executive Compensation

July 6, 2015

Mr. Brent J. Fields
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

RE: Supplemental Comments on Proposed Rule Implementing Section 953(b) Dodd-Frank Wall Street Reform and Consumer Protection Act in Response to the June 4, 2015 and June 30, 2015 Memoranda From the Division of Economic and Risk Analysis – File Number S7-07-13

Dear Mr. Fields:

The Center On Executive Compensation ("Center") is pleased to submit this set of comments to the Securities and Exchange Commission ("Commission") providing its perspective on the Commission's implementation of Section 953(b) of the Dodd-Frank Act, the pay ratio requirement. As proposed, the Dodd-Frank Section 953(b) will require registrants to disclose the compensation of the chief executive officer, the median compensation of the registrant's global employee population, and a ratio of the two numbers. The Commission's Division of Economic and Risk Analysis ("DERA") recently released two memoranda[1] analyzing the potential effects of excluding different percentages of employees from the pay ratio calculation on the accuracy of the disclosure. This letter provides the Center's feedback with regard to the content and impact of the DERA analysis and supplements our Comments filed on December 2, 2013 and September 26, 2014.

The Center 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 360 large companies, and the Center's more than 110 subscribing companies are HR Policy members that represent a broad cross-section of industries.

The Center reiterates the points made in its earlier comments that the Commission's proposed pay ratio rule imposes significant and unnecessary costs on U.S.-listed

[1] Memorandum from the Division of Economic and Risk Analysis regarding the potential effect on pay ratio disclosure of exclusion of different percentages of employees at a range of thresholds, available at http://www.sec.gov/comments/s7-07-13/s70713-1556.pdf (last visited 7/2/2015); Memorandum from the Division of Economic and Risk Analysis regarding an extension of the analysis of the potential effect on pay ratio disclosure of exclusion of different percentages of employees at a range of thresholds, available at https://www.sec.gov/comments/s7-07-13/s70713-1559.pdf (last visited 7/2/2015).

companies and investors.[2] Based on those points and the information in the most recent DERA analysis, the Center believes the Commission should include in the final rule a principles-based exclusion which would permit companies flexibility to exclude substantial percentages of employees where the data is difficult to obtain and where the impact would not be significant. The Center notes that the June 30 DERA memorandum finds that excluding 40% of an employee population would result in a decrease of the pay ratio of just under 11%.[3] A reduction or increase in the ratio of these amounts has a negligible impact on the pay ratio, but has the potential to materially reduce the substantial direct and indirect compliance costs facing companies as a result of the disclosure.

I. The Center Supports a Principles-Based Approach for Excluding Certain Employees in the Final Pay Ratio Rule.

The Center strongly supports the principles-based approach examined in the DERA analysis that would permit a registrant to exclude certain percentages of its employee population from the pay ratio calculation up to and exceeding 40%. If structured in a flexible and practical manner the ability of a registrant to exclude certain employee populations has the potential to somewhat reduce the costs and burdens of pay ratio compliance. For example, registrants could avoid engaging in extensive and costly data collection on employees in countries with strict data privacy laws or in areas where there are *de minimis* employee populations. However, the wide variety of corporate structures makes it unlikely that there is any "universal" exclusion which would apply equally to all registrants. For this reason, we recommend the Commission structure the exclusionary approach in a principles-based manner which can properly accommodate the unique characteristics of each registrant's geographic footprint and employee population.

Even though the DERA analysis omits recent revelatory research on the wage dispersion within and between firms, [4] we note that the analysis indicates that at a

---

[2] Center On Executive Compensation Comments on SEC Proposed Pay Ratio Rule, available at http://www.sec.gov/comments/s7-07-13/s70713-572.pdf (last visited 6/24/2015); Center On Executive Compensation Comments on SEC Proposed Pay Ratio Rule Submission #2 at Page 2, available at https://www.sec.gov/comments/s7-07-13/s70713-1043.pdf (last visited 6/24/2015).

[3] Memorandum from the Division of Economic and Risk Analysis regarding an extension of the analysis of the potential effect on pay ratio disclosure of exclusion of different percentages of employees at a range of thresholds, available at https://www.sec.gov/comments/s7-07-13/s70713-1559.pdf (last visited 7/2/2015), at 5. The data assume a standard deviation of .45.

[4] A recent National Bureau of Economic Research study reinforces research that differences across establishments explain the variation of the log of earnings of U.S. workers, rather than the differences within companies. The research is notable because it studied a slice of workers among all U.S. firms between 1978 and 2012. Jae Song et al., *Firming Up Inequality*, NBER Working Paper 21199, available at http://www.nber.org/papers/w21199 (last visited 7/2/2015) ("Covering all U.S. firms between 1978 to 2012, we show that *virtually all of the rise in earnings dispersion between workers is accounted for by increasing dispersion in average wages paid by the employers of these individuals. In contrast, pay differences within employers have remained virtually unchanged, a finding that is robust across industries, geographical regions, and firm size groups.* Furthermore, the wage gap between the most highly paid employees within these firms (CEOs and high level executives) and the average employee

standard deviation of .45, excluding a large share of employees does not have a significant impact on the ratio. For example, excluding 40% of an employee population only reduces the pay ratio by 10.77% or increases it by 12.08%.[5] Given that the average respondent to the Center's pay ratio survey has 40% of their employees located overseas[6] and excluding those employees would result in a 47% pay ratio compliance costs savings,[7] the Center strongly encourages the Commission to adopt such a principles-based exclusionary approach.

In providing our feedback on the analysis, it is important to keep in mind that, according to Center Survey data, registrants have no legitimate business purpose for actively maintaining the information necessary to determine median employee compensation and calculate the pay ratio.[8] Thus, the ability to exclude employee populations from the determination of the median employee has the potential to reduce compliance costs. However, the ability of a registrant to realize the benefits of a principles-based approach to exclude employee populations is dependent on the ability of a registrant to effectively identify the populations of employees that can be excluded without having to incur the full costs associated with ratio compliance.

A majority of large registrants do not maintain centralized payroll information, and in many cases, the information needed to calculate the pay ratio is decentralized by design, reflecting a business reality which allows registrants to effectively administer fundamental services, such as payroll, on a regional or even local basis.[9] As a result, for most registrants, absent a principles-based approach to exclusion of certain populations, the pay ratio calculation will require a large manual data collection effort to identify their employee populations outside of the U.S. and the median employee globally. These registrants will still be required to evaluate their entire workforces to determine where they may be able to make use of the ability to exclude certain employee populations. This includes, but is not limited to, factors such as the varying pay practices across the company, balance of full-time, part-time, seasonal and temporary employees, variety of geographic locations, and differing lines of business.

For the minority of registrants that have centralized data on their employee populations, the ability to exclude employee populations from the determination of the median employee has a greater potential to reduce the costs of developing the pay

---

has increased only by a small amount, refuting oft-made claims that such widening gaps account for a large fraction of rising inequality in the population")(emphasis added).

[5] *Id*. Even at a standard deviation of .55, which is probably high (see *Id*), excluding 40% of the population, and assuming that all of the excluded employees are below the median, results in a reduction of the pay ratio of just 25%).

[6] Center On Executive Compensation Comments on SEC Proposed Pay Ratio Rule, Appendix I, pages 26-29, available at http://www.sec.gov/comments/s7-07-13/s70713-572.pdf (last visited 6/24/2015).

[7] See Center On Executive Compensation Comments on SEC Proposed Pay Ratio Rule, available at http://www.sec.gov/comments/s7-07-13/s70713-572.pdf (last visited 6/24/2015).

[8] Center On Executive Compensation Comments on SEC Proposed Pay Ratio Rule, available at http://www.sec.gov/comments/s7-07-13/s70713-572.pdf (last visited 6/24/2015) at 9.

[9] See *Id.* at 10.

ratio. For example, one registrant that has access to partially centralized data estimated that its total employees in 39 countries (out of the 89 countries in which it does business) still represents less than 1% of its total employees globally.[10] It also estimated that focusing on countries that contain 1% or more of total employees would significantly reduce costs without appreciably altering the ratio.[11]

We urge the Commission to keep the data DERA has developed as well as the impact of the exclusions in mind when structuring the much needed principles-based approach to exclude certain percentages of employee populations from the pay ratio disclosure.

II. The DERA Analysis Should Also Have Examined How Excluding Portions of an Employee Population From the Pay Ratio Impacts Registrant Compliance Costs and Burdens.

Given that the pay ratio disclosure is not material information,[12] the results of the DERA analysis should also reflect the impact on registrant compliance costs and burdens of excluding certain employee percentages from the pay ratio calculation, rather than only noting the incremental impact on the accuracy of the pay ratio disclosure itself.

The pay ratio disclosure does not and cannot provide material information to investors.[13] We understand that Congress mandated that the Commission promulgate the disclosure requirement, but the known reality is that there is never likely to be a legitimate use of the pay ratio.[14] Instead, the pay ratio's only "benefit" will be realized by special interest groups, the media, and micro-minority shareholders, which will use it to shame registrants and pursue narrowly tailored agendas at the expense of shareholder value.

We therefore believe the Commission should provide a principles-based exclusionary rule which would permit companies to exclude up to and exceeding 40% of their employee population.[15] As discussed, the impact on the reported ratio will not be material, but the impact on registrant compliance costs and burdens has the potential to

---

[10] See Exxon Mobil Comments on SEC Proposed Pay Ratio Rule Submission at Page 4, available at https://www.sec.gov/comments/s7-07-13/s70713-568.pdf (last visited 7/1/2015). Exxon notes that in the 39 countries with small employee populations, the cost of developing the pay ratio information is substantially greater because payroll information is maintained in those countries through third-party vendors. Costs would be incurred both by the company directly and by the 60 third-party vendors under contract to it.
[11] *Id.* at 5.
[12] See Center On Executive Compensation Comments on SEC Proposed Pay Ratio Rule Submission #2 at Page 3, available at https://www.sec.gov/comments/s7-07-13/s70713-1043.pdf (last visited 6/24/2015).
[13] *Id. at* 2.
[14] Pay Ratio Disclosure, 78 FR 60,559, 60,585-60,587 (October 1, 2013) (to be codified at 17 CFR 229 and 249).
[15] Memorandum from the Division of Economic and Risk Analysis regarding an extension of the analysis of the potential effect on pay ratio disclosure of exclusion of different percentages of employees at a range of thresholds, available at https://www.sec.gov/comments/s7-07-13/s70713-1559.pdf (last visited 7/2/2015).

be *significant*. The use of the pay ratio by its advocates will remain consistent regardless of whether the impact of exclusions on the pay ratio is 10%, 20% or even 40%.[16]

As we have detailed in our previous comment submissions to the Commission, the ability to exclude certain portions of a registrant's employee population could reduce compliance costs by close to 70% without any resulting impact on the quality of the information provided by the pay ratio disclosure.[17] Specifically, permitting registrants to exclude foreign employees would reduce compliance costs by nearly half – 47%.[18] Doing so would also remove issues associated with foreign data privacy laws, exchange rates, and the difficulty inherent in finding a consistent compensation measure across international populations. Excluding part-time employees would reduce costs by a further 20%.[19]

DERA's analysis also fails to examine the impact of excluding *specific* employee populations from the pay ratio disclosure, although the analysis does acknowledge that the estimated impact of an exclusion on the pay ratio is highly dependent on the location of the employee and how they relate to the overall employee population.[20] For example, excluding employees located in a country which maintains strict data privacy laws may result in significant cost savings while having relatively little impact on the "accuracy" of the disclosure. As noted above, however, the wide variety of corporate structures makes it unlikely that there is any "universal" exclusion which would apply equally to all registrants. This calls for a principles-based approach to any exclusionary ability provided in the pay ratio rule; such an approach would align with the principles-based approach already envisioned by the proposed pay ratio rule itself.

---

[16] It is worth noting there is not likely to be *any* change to the pay ratio calculation which the Commission could mandate (apart from not promulgating the disclosure) which would alter or impact the use of the pay ratio disclosure by the groups which would use it in the first place. This is demonstrated by the fact that many proponents have already created ratios based on publicly available information and use those to the same ends that they will use the official disclosure (*e.g.* 2015 Executive Pay Watch by the AFL-CIO)

[17] See Center On Executive Compensation Comments on SEC Proposed Pay Ratio Rule, available at http://www.sec.gov/comments/s7-07-13/s70713-572.pdf (last visited 6/24/2015).

[18] *Id*. According to the Center's pay patio survey, the average company has approximately 40% of its workforce outside of the U.S.

[19] *Id*.

[20] Memorandum from the Division of Economic and Risk Analysis regarding the potential effect on pay ratio disclosure of exclusion of different percentages of employees at a range of thresholds, at Page 4, available at https://www.sec.gov/comments/s7-07-13/s70713-1556.pdf (last visited 7/1/2015).

III. Conclusion

For the reasons stated above, the Center believes the DERA analysis supports the establishment of a principles-based approach to exclude percentages of a registrant's employee population from the pay ratio calculation. If structured correctly, such a principles-based approach could effectively permit registrants to avoid situations where the cost of gathering the data would be substantial relative to the impact on the accuracy of the ratio.

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 tbartl@execcomp.org.

Sincerely,

Sincerely,

Timothy J. Bartl
President

cc: Securities and Exchange Commission:

Hon. Mary Jo White, Chair
Hon. Luis A. Aguilar, Commissioner
Hon. Daniel Gallagher, Commissioner
Hon. Kara M. Stein, Commissioner
Hon. Michael S. Piwowar, Commissioner