Center On Executive Compensation

September 26, 2014

Mr. Kevin M. O'Neill
Deputy 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 S7-07-13

Dear Mr. O'Neill:

The Center On Executive Compensation is pleased to submit this set of follow-up comments to the Securities and Exchange Commission ("Commission") providing its perspective on the Commission's proposed pay ratio disclosure rules implementing Section 953(b) of the Dodd-Frank Act.[1] On December 2, 2013 we submitted comments urging the Commission to implement changes in the final rule that would greatly reduce the burdens on competition, efficiency and capital formation for registrants while bearing a negligible impact on the pay ratio disclosure.[2] In the following months, certain organizations have submitted comments which characterize the pay ratio as highly material and even necessary information for to investors to evaluate a company's financial, compensation, and human resource management practices.[3] This document supplements our December 2013 comments by addressing these unsubstantiated assertions and provides answers to several additional question included in the Commission's request for comment ("RFC").

The Center On Executive Compensation ("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 100 Subscribing Companies are HR Policy members that represent a broad cross-section of industries.

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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] 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 8/13/2014)

[3] See AFL-CIO Comments on Proposed Pay Ratio Rule, available at http://www.sec.gov/comments/s7-07-13/s70713-562.pdf (last visited 8/13/2014), Calvert Investments Comments on Proposed Pay Ratio Rule, available at http://www.sec.gov/comments/s7-07-13/s70713-605.pdf (last visited 8/13/2014), Trillium Asset Management Comments on Proposed Pay Ratio Rule, available at http://www.sec.gov/comments/s7-07-13/s70713-982.pdf (last visited 8/13/2014).

I. The Pay Ratio Provides a Highly Misleading and Potentially Harmful Disclosure Which Contradicts the Goals of the Federal Securities Laws.

The pay ratio purports to communicate information about registrant pay practices, company culture, and human resource management when in reality the disclosure cannot and does not provide any meaningful information. The investor protection executed through the federal securities law disclosure regime is premised on the disclosure of material information to investors. However, by requiring companies to disclose the pay ratio in the proxy, there will be a natural and unavoidable tendency to conclude the pay ratio constitutes material information. In this respect, the pay ratio is not only inherently misleading, but potentially harmful to investors, registrants, and the public in general.

The real danger with the pay ratio disclosure is in the seemingly intuitive yet misleading and highly inflammatory information the disclosure purports to communicate. The leading proponents claim the pay ratio disclosure will provide an additional metric by which to evaluate a registrant's executive compensation program while providing insight into the registrant's management of human capital.[4] One commentator even claims the pay ratio is necessary to "incorporate compensation practices into financial analysis."[5] All of these claims share one thing in common – they amount to unsubstantiated assertions without any supporting qualitative or quantitative analysis. Even so, these commentators argue they will utilize the disclosure to create company-to-company comparisons of pay ratios and to chart the change in the pay ratio within a single company over time. However, the pay ratio cannot serve either function.

Company-to-company pay ratio comparisons will only serve to mislead investors because a company's pay ratio will be a unique result of that individual company's business structure, mix of skills of the employee population, geographic location of the "median employee" and compensation practices as well as its industry and current economic conditions thereby rendering comparisons meaningless. Even so, companies whose ratios are higher than their competitors will be criticized despite potentially subtle differences in business structure (*e.g.* owning vs. outsourcing manufacturing) which result in the variance in ratios. This will especially be the case where a union is seeking to organize a company's workforce or to reinforce collective bargaining demands.

With regard to comparing changes in the pay ratio over time for a single company, changes in business structure, employment arrangements, or pay practices will result in fluctuations in the pay ratio. Companies make such changes as a result of market forces and with the belief that the changes are in the best interests of their shareholders. However, absent lengthy and likely complex explanations about the factors that led to the changes in the pay ratio, it will be impossible to glean inferences from year to year changes in the pay ratio. The ratio is likely to

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[4] AFL-CIO Comments on Proposed Pay Ratio Rule, available at http://www.sec.gov/comments/s7-07-13/s70713-562.pdf (last visited 8/13/2014)

[5] See Trillium Asset Management Comments on Proposed Pay Ratio Rule, available at http://www.sec.gov/comments/s7-07-13/s70713-982.pdf (last visited 8/13/2014). This serves as perhaps the most egregious example of an unsubstantiated assertion for the use of the pay ratio. The average S&P 500 company already provides over 31 pages of detailed executive compensation information as part of the current proxy statement reporting requirements. If pay ratio information were relevant to financial analysis or risk analysis, sophisticated investors would have demanded it long ago.

detract from the material information which investors currently use to evaluate a company and upon which to make informed investment decisions.

Despite the proponents' arguments in favor of the pay ratio only a small subset of investors, primarily activist and union pension fund investors, have commented that they plan to use the pay ratio. These investors are likely to use the pay ratio as both a leverage point as discussed above and as an inflammatory sound bite in the media and among their constituencies to attempt to shame companies as part of their efforts to drive their own narrowly tailored agendas.[6] Meanwhile, investors generally have decisively rejected activist investor efforts to require various companies to disclose a pay ratio through the shareholder proposal process. According to Center data, since 2010 there have been only 15 separate shareholder proposals requesting a pay ratio or similar disclosure. These proposals averaged 93% shareholder *opposition*.[7] None of the proposals received over 10 percent support. The lack of shareholder support for pay ratio disclosure is particularly stark when compared against other shareholder initiatives seeking to alter executive compensation practices at companies. For example, shareholder proposals seeking to require companies to eliminate the practice of accelerating outstanding equity awards in change-in-control situations have been proposed at 54 separate S&P 500 companies since 2011. These proposals have averaged over 35% shareholder *support* with three proposals at S&P 500 companies in 2014 receiving majority support.

In addition to the inherently misleading and potentially harmful nature of the pay ratio as a disclosure, there is a complete dearth of economic research which suggests the disclosure of the pay ratio is "relevant to employee morale, productivity, investments in human capital and ultimately the value of securities,"[8] an argument made by several proponents in comments to the Commission both after and before a proposed rule was issued.[9] As we noted in our December comments, a study conducted 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."[10] 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."[11] The authors report that the same is true with respect to research on the impact of pay differentials on training.

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[6] For a prime example of this at work, see the AFL-CIO's Executive PayWatch website, available at http://www.aflcio.org/Corporate-Watch/Paywatch-2014 (last visited on 8/13/2014)

[7] Center On Executive Compensation, *Pay Ratio Proposals Since 2010*, (2013), http://www.execcomp.org/Docs/c13-56 Pay_Ratio_Shareholder_Proposals_Since_2010.pdf

[8] 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 available at http://www.sec.gov/comments/s7-07-13/s70713-572.pdf.

[9] See Americans for Financial Reform Comments on Proposed Pay Ratio Rule, available at http://www.sec.gov/comments/s7-07-13/s70713-505.pdf at 2 (last visited 8/13/2014),

[10] *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.

[11] *Id*.

II. No Legitimate Business Purpose Exists for Accumulating the Data Necessary for Calculating the Pay Ratio.

In addition to not providing benefits for investors, the expansive data gathering which will be required to calculate the pay ratio, particularly of large global companies, serves no legitimate business purpose. In a survey conducted by the Center, other HR Policy Association members, and members of the Society of Corporate Secretaries and Governance Professionals, not one out of the 128 survey respondents stated that exists a legitimate business purpose for collecting the information required to calculate the pay ratio.[12] As a result, the costs associated with complying with the pay ratio could be used in other ways to enhance shareholder value.

Particularly for global registrants, the majority of company payroll and HR information systems and the associated data are highly decentralized by design. According to the Center's survey:

- 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.
- Among HR Policy Association members, which are broader in global scope, the median company had 20 payroll systems, with nearly 30 percent having more than 50 payroll systems.

Due to the global reach of employee populations, the need for payroll to serve unique employee populations in various localities and to comply with localized data privacy laws, the decentralized nature of payroll systems reflects a rational business approach for most global registrants.

Because most companies do not have centralized pay or employee information, the pay ratio calculation will require a large manual data collection effort with companies having to evaluate their entire workforce, including, but not limited to, the varying pay practices across the company, full-time, part-time, seasonal and temporary employees, geographical locations, and lines of business. This data collection effort could also be hindered by local data privacy restrictions in certain countries which may limit a company's ability to access the data in a timely matter, if access to the data is permitted at all.

Furthermore, while under the proposed rules statistical sampling would be available for companies to utilize, it is not likely to be a widely adopted method.[13] In order to create a statistically viable random sample of their workforce, most companies would still have to obtain much of the same information and engage in similar data gathering processes as those calculating pay for the entire employee population. As one of the respondents of our survey put it, "We cannot run statistical sampling without first getting an understanding of our global population, which we currently have no need to know." For many global companies, the work required to conduct a statistical sampling-driven calculation of the pay ratio will not significantly reduce the level of work required to identify the median employee and calculate his or her compensation.

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[12] 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 8/13/2014)
[13] *Id.*

III. The Commission Underestimated the Costs of Compliance and Failed to Properly Consider Internal and External Messaging Costs.

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.[14] In sum, the review concluded that the SEC significantly underestimated costs -- by a factor of at least 2.5 times, with costs expected to be $186.9 million compared to the $72.8 million estimated by the Commission. There are three primary reasons for the shortcomings in the Commission's analysis.

First, in the proposed rule, the SEC's cost estimates are erroneously based on the Commission's unsubstantiated speculation that the compliance time for the proposed pay ratio rule will be two times the compliance hours estimate it estimated for the 2006 compensation disclosure changes. The two sets of rules are very different requirements and necessitate fundamentally different approaches; this undermines the reliability of the Commission's cost estimates.

Second, the SEC incorrectly estimated that the ongoing compliance costs will drop by 50 percent after both the second and third year of pay ratio compliance as companies become more adept at calculating the proposed pay ratio. However, the Commission's estimation is based on the calculation of total compensation for named executive officer pay; unlike officer pay programs, when calculating the pay ratio, shifts in calculation methodologies and employee populations will ensure high continued compliance costs. This led Gurrea and Neuberger to conclude there will be an increase in estimated three-year costs of 279 hours as opposed to 190 hours; nearly a 50 percent increase.

Third, 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 "typically estimate[s] for outside legal services used in connection with public company reporting."[15] 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.

In addition, the proposed rule fails to address the costs which will be associated with the internal and external communication efforts companies will be forced to engage in as a result of the pay ratio. As we outlined above, the pay ratio is potentially misleading and harmful because it purports to communicate information about a company's pay practices to guard against potential confusion and erroneous conclusions being drawn from the pay ratio disclosure companies will be required to undertake internal and external communications campaigns to put the ratio in an appropriate context and thus reduce the harmful effects of the disclosure.

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[14] *Id*.
[15] 78 Fed Reg. 60,600.

IV. The Commission Possesses Exemptive Authority Which It Should Employ in the Final Rule to Further Minimize the Costs and Burdens of the Pay Ratio Disclosure.

In the proposed rule, the Commission exercised its discretionary interpretive authority in an attempt to reduce the compliance burdens on registrants. There are, however, still significant changes which can be made to ensure a final rule properly accounts for the substantial costs of compliance when balanced against the negligible or nonexistent benefits the disclosure would provide.

It is well established that Congress has vested the Commission with extensive authority to use its exemptive authority to reduce the compliance burden on affected parties. Specifically, under both Section 36 of the Exchange Act and Section 28 of the Securities Act, the Commission is expressly authorized to utilize its exemptive powers when it is "necessary or appropriate in the public interest, and is consistent with the protection of investors." The Center believes it is appropriate for the Commission to use this authority to limit the scope of the proposed rule (*i.e.*, by limiting the ratio calculation to full-time U.S. employees and permitting a look back date and making the information furnished). Such changes would reduce the substantial burdens on companies but would not affect whether the pay ratio information would be widely used by investors (it would not be) or how the information would be used.

V. The Commission Should Significantly Reduce the Compliance Burden on Companies Without Negatively Impacting the Pay Ratio Disclosure.

In the proposed rule, the Commission took several steps to try to provide companies with much needed flexibility to comply with the pay ratio disclosure in a cost-effective manner. However, in the light of the still substantial compliance costs, the Center strongly urges the Commission to act in the interests of competition, efficiency and capital formation and adopt the following changes to the proposed pay ratio rule:

- <u>Limit the Disclosure to U.S. Employees Only</u>: According to the Center's survey, by requiring companies to only include U.S. employees in the pay ratio calculation, the Commission would reduce compliance costs by nearly half – 47 percent.[16] In addition, the Commission would remove issues associated with foreign data privacy laws, exchange rates, and issues with finding a consistent compensation measure across international populations.

- <u>Limit the Disclosure to Full-Time Employees Only</u>: By including only full-time employees in the pay ratio calculation, the Center estimates the Commission would reduce compliance costs by an additional 20 percent.[17]

- <u>Allow a 12-Month "Look-back Period" for Establishing the Employee Population Measurement Date</u>: The Commission should allow registrants to establish their employee population at any point during the fiscal year prior to the pay ratio filing. Allowing companies to do so will provide registrants with sufficient time to calculate the pay ratio disclosure and allow the disclosure to be included in a registrant's standard

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[16] 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 8/13/2014)
[17] *Id.*

proxy formulation process. However, if the Commission requires registrants to use the last day of their fiscal year as the calculation date, as is outlined in the proposed rule, the Commission creates an extremely truncated and nearly impossible compliance time frame for companies. Furthermore, this approach would preclude companies from realizing the benefits of being able to use other fiscal year-end time periods in pre-existing payroll or tax records for identifying the median employee due to interim changes in the employee population.

- <u>The Pay Ratio Should Be Considered “Furnished” Rather than “Filed”</u>: Under the proposed rule, the pay ratio is “filed” information and thus subject to Sarbanes-Oxley certification by the CEO and CFO. The high standard of rigor required by the audit and compliance functions for Sarbanes-Oxley certification for “filed” materials at many registrants will cause them not to utilize the purported flexibility provided in the proposed rule (*e.g.*, using salary or taxable compensation as a consistently applied compensation measure to identify the median employee) thus increasing the cost of compliance considerably. Therefore, in the final rule, the Commission should make the pay ratio “furnished” information, which would lift the uncertainty of using the purported flexibility thus mitigating the costs of compliance without materially impacting the accuracy of the information.

- <u>Barring Material Changes in a Company’s Workforce, Permit Companies to Determine the Median Employee Once Every Three Years</u>. The bulk of the compliance costs associated with pay ratio disclosure will be in identifying the median employee and developing the disclosure. However, barring material changes to a registrant’s workforce, a company’s median employee is unlikely to change significantly year-to-year. As a result, we recommend the Commission only require a registrant to identify the median employee no less frequently than once every three years or upon a material change to a registrant’s workforce (*e.g.,* a significant acquisition, divestiture, or merger).

- <u>The Final Pay Ratio Rule Should Include a Three-Year Sunset Provision</u>: Due to the highly questionable and likely harmful effects of the pay ratio, we recommend that the Commission include a three-year sunset provision on a final rule.

VI. Minimizing Compliance Costs Through Flexibility Should be a Key Consideration By the in Formulating a Final Rule.

In the proposed rule, the Commission made a clear effort to attempt to blunt the significant compliance costs associated with the pay ratio disclosure. We encourage the Commission to take additional actions, as outlined above, to allow greater flexibility and reduce the cost of complying with the pay ratio disclosure requirement.

VII. 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

Henry D. Eickelberg
Counsel

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

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II. DISCUSSION OF THE PROPSED AMENDMENTS

B. Scope of Section 953(b) of the Dodd-Frank Act

B.1 – *Filings Subject to the Proposed Disclosure Requirements*

1 – Should we require the pay ratio disclosure only in filings in which Item 402 disclosure is required, as proposed? Should we require the pay ratio disclosure in Commission forms that do not currently require Item 402 disclosure? If so, which forms, and why? Would disclosure be meaningful to investors where no other executive compensation disclosures are required?

We recommend the SEC only require the disclosure of the pay ratio in filings in which Item 402 disclosure is required. This will ensure the pay ratio is always included near other executive compensation-related information, allowing readers to consider the disclosure in the context of a registrant's executive compensation practices and decisions. The alternative of providing the pay ratio as a standalone disclosure, or in reports separate from Item 402 disclosure, is highly problematic due to the misleading nature of the pay ratio. Because of the multiple variables involved in calculating the pay ratio, the proposed pay ratio disclosure cannot serve a reliable indicator of a registrant's executive compensation practices or of the quality or a registrant's human resources practices and/or of the registrant as an investment. However, the number is likely to be highly inflammatory. Accordingly, providing the ratio as a standalone disclosure risks either misleading the subset of investors who would seek to use the ratio as a tool to judge the quality of a registrant's executive compensation practices without necessary additional context or requiring registrants to duplicate information that is already part of their proxy disclosures. Requiring disclosure in the proxy statement will mitigate, but not eliminate the inflammatory nature of the ratio.

2 – Do registrants need any additional guidance about which filings would require the proposed pay ratio disclosure? Are there circumstances where the requirements of a particular form call for Item 402 information in certain circumstances, but the applicability of the proposed pay ratio disclosure requirements may not be clear? If so, please provide details about what should be clarified and what guidance is recommended.

We recommend the SEC provide clear guidance on which specific filings require the proposed pay ratio disclosure and believe a registrant's proxy statement should be where the pay ratio is required to be disclosed thereby ensuring it always appears with other, necessary executive compensation information.

We also recommend the SEC make clear that if the pay ratio is required to be disclosed in multiple filings in the same fiscal year, either in full or through incorporation by reference, that registrants are not required to update the pay ratio more than once annually.

B.2 – *Registrants Subject to the Proposed Disclosure Requirements*

3 – Should the pay ratio disclosure requirements, as proposed, apply only to those registrants that are required to provide summary compensation table disclosure pursuant to Item 402(c)? If not, to which registrants should pay ratio disclosure requirements apply?

We agree with the proposed rules that only those registrants which are otherwise required to provide a summary compensation table disclosure pursuant to Item 402(c) should be required to disclose the pay ratio.

C. Proposed Requirements for Pay Ratio Disclosure

C.1 – *New Paragraph (u) of Item 402 (Pay Ratio Disclosure)*

6 – Are there any other presentation issues that companies need guidance on or that should be clarified in the pay ratio disclosure requirements? If so, please provide details about such issues and any recommended guidance that should be provided.

We would request that the Commission make it clear that issuers are permitted flexibility in crafting the presentation of the disclosure so long as the required information is included. This should include, but not be limited to the option, but not requirement to use graphical as well as narrative disclosure. We agree with the requirement that the narrative disclosure be brief and not include a detailed description of methodologies.

C.2 – *Employees Included in the Identification of the Median*

8 – Should registrants be allowed to disclose two separate pay ratios covering U.S. employees and non-U.S. employees in lieu of the pay ratio covering all U.S. and non-U.S. employees? Why or why not? Should we require registrants to provide two separate pay ratios, as requested by some commenters? What should the separate ratios cover (e.g., should there be one for U.S. employees and one for non-U.S. employees, or should there be one for U.S. employees and one covering all employees)? If separate ratios are required, should this be in addition to, or in lieu of, the pay ratio covering all U.S. and non-U.S. employees? Would such a requirement increase costs for registrants? Would it increase the usefulness to investors of the disclosure?

The Commission should only require registrants to include U.S. employees in the pay ratio calculation. However, if the Commission chooses not to follow our recommendation, the Commission should mandate only a single pay ratio, consistent with the underlying statute. The Commission should not mandate 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 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. However, the Commission should not require the disclosure of two separate pay ratios covering U.S. employees and global employees.

12 – Alternatively, should the requirements be limited to employees that are employed directly by the registrant (i.e., excluding employees of its subsidiaries)? Would such a limitation be

consistent with Section 953(b)? How would such a limitation affect the potential benefits of the disclosure? Would such a limitation have other impacts, such as incentivizing registrants to alter their corporate structure, and, if so, are there alternative ways that the rule could address those impacts?

We believe it is within the Commission's discretionary powers to require a registrant to include employees directly employed by the registrant, excluding employees of its subsidiaries, and be consistent with the language of Section 953(b) of the Dodd-Frank Act. The language of Section 953(b)(1)(a) states "the median annual total compensation of the issuer..." and makes no mention of the subsidiaries of the issuer. Furthermore, the basic construction of the term subsidiary indicates an inherent separation of the subsidiary from the parent company. This is demonstrated in other areas of the securities laws where registrants are treated distinctly from majority owned subsidiaries.[18] The extra step to ensure subsidiaries are included would be moot if the term "issuers" by its natural construction included subsidiaries. Tellingly, there is no legislative history explaining the reasoning and rationale behind 953(b). As a result, whether or not "issuers" in 953(b) should include subsidiaries is an open question within the Commission's discretionary authority to define.

As we noted in our cover memo, the pay ratio does not provide investors with any beneficial information. Therefore, only requiring registrants to include employees employed directly by the registrant will have no impact on the ratio's usefulness for investors. At the same time, the change would result in significant and substantial cost-savings for a large percentage of issuers.

13 – Should Section 953(b) be read to apply to "leased" workers or other temporary workers employed by a third party? Does the proposed approach to such workers raise costs or other compliance issues for registrants, or impact potential benefits to investors, that we have not identified? Do registrants need guidance or instructions for determining how to treat employees of partially-owned subsidiaries or joint ventures? If so, what should such guidance or instructions entail?

Section 953(b) should not be read to apply to "leased" or temporary workers employed by a third party. Section 953(b) clearly reads that only "employees of the issuer" are the employees required to be included in the pay ratio and "leased" or temporary workers are employees of a third party.

Additionally, including "leased" or temporary workers employed by a third party in the pay ratio would significantly increase compliance costs. Unlike typical full-time, part-time, and seasonal employees, employers do not keep payroll records for leased and temporary workers, as that is the responsibility of the leasing agency or temporary help firm. Thus, issuers would not be able to provide information on temporary and leased employees for the purposes of the pay ratio.

For this reason, we recommend that the Commission expressly state in a final rule that registrants are not required to include employees of partially-owned subsidiaries and joint ventures. Requiring the inclusion of such employees is highly problematic for the same reasons as including leased and non-direct hire temporary employees.

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[18] For one example, see the SEC Staff's Compliance and Disclosure Interpretation on Section 217. Form S-3 – General Instructions I.C.1 to I.C.5 – Majority Owned Subsidiaries available at http://www.sec.gov/divisions/corpfin/guidance/safinterp.htm

According to a survey conducted by the Center, only requiring full-time employees reduces compliance costs by approximately 20 percent.[19]

19 – Should registrants be required to include any individual who was employed at any time during the year, or for some minimum amount of time (and if so, what amount of time) during the year?

We do not recommend the Commission require registrants to include any individual who was employed at some point during the registrant's year in the pay ratio calculation. Nor do we recommend the Commission implement a *de minimis* employment time standard for purposes of deciding who should and who should not be included in the ratio. The inclusion of *de minimis* employees or former employees has the potential to dramatically increase the number of individuals which must be tracked for the purposes of the pay ratio calculation. The impact would be particularly onerous for registrants within industries with high turnover rates or those which go through a divestiture or asset sale. For example, typical retail and service providers can have turnover rates which approach 100% annually. These registrants would end up having to track a number of individuals which could approach or exceed 100% the size its actual workforce for the purposes of calculating the pay ratio. This would impose *exponentially* higher costs on companies while resulting in the disclosure of a median employee less likely to be representative of the registrant's actual workforce. Consistency with other Item 402 disclosures is not important in this context particularly when evaluating through a cost-benefit lens.

20 – Should the rule only apply to employees employed for the full fiscal year? Why or why not?

We do not recommend the Commission *require* registrants to include only employees who have been employed for the full fiscal year. Although conceptually, the idea is logical and one could reasonably conclude that requiring a registrant to include only employees who have worked the entire fiscal year would result in reduced compliance costs by winnowing down the number of employees included in the ratio and preventing a registrant from having to annualize compensation of partial-year employees, but the reality is much different. In reality, unless a registrant has an integrated human resources information system ("HRIS"), a registrant will not have the ability to sift the employees who worked the full year out of the general employee population. By requiring registrants to include only employees who have worked the entire fiscal year, the Commission would be imposing significant costs and administrative burdens on registrants by adding an unnecessary data collection step during which companies would have to separate employees that work for a full-year from those who are not.

We do recommend, however, that consistent with a principles-based approach, the Commission provide registrants with the flexibility to include only employees who have worked the entire fiscal year if the registrant believes it fits their own facts and circumstances. Such flexibility is consistent with the Commission's general efforts in the proposed release to ensure registrants can comply with the pay ratio mandate in a cost-effective manner.

21 – Is it appropriate to allow registrants to annualize the compensation for non-seasonal, non-temporary employees that have only worked part of the year, as proposed? Why or why

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[19] 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 8/13/2014)

not? Would allowing annualizing the compensation for these employees likely impact the median or the pay ratio?

We believe it is appropriate to permit but not require registrants to annualize the compensation for non-seasonal, non-temporary employees that only have worked part of the year. For many registrants, particularly those with high employee turnover, the ability to annualize compensation of employees who have only worked for part of the year will be necessary to ensure the resulting compensation figures are not arbitrarily understated.

The alternative would be to prohibit registrants from annualizing the compensation of non-seasonal, non-temporary employees that have only worked part of the year. By prohibiting annualization, the Commission would effectively force registrants to misrepresent the compensation of identically paid employees. For example, suppose Employee A and Employee B both make $50,000 per year as full-time permanent employees. However, Employee B joined the company exactly six months into the fiscal year. By prohibiting the registrant from annualizing Employee B's compensation, the Commission forces the registrant to understate Employee B's compensation. The understatement will present a distorted view of the registrant's pay practices, particularly if a large number of employees is involved. The possibility is particularly acute in industries like retail which experience high employee turnover.

Furthermore, because the pay ratio uses the median as a statistical measure of central tendency, and because partial-year compensation amounts will by nature be smaller than full-year amounts, the prohibition of the annualization of pay of non-seasonal, non-temporary employees that have only worked part of the year will arbitrarily result in a lower median compensation that under-represents actual median employee compensation further distorting what the pay ratio purports to communicate about a registrant's actual pay practices and structure.

22 – In the alternative, should registrants be required to annualize the compensation for these employees? Why or why not?

We do not believe the Commission should require registrants to annualize the compensation for these employees. Some registrants may have a limited number of employees who would be eligible to have their compensation annualized for the purposes of the pay ratio. In these circumstances it may be far more cost effective to include or exercise discretionary judgment to exclude these compensation figures in the pay ratio with the knowledge that there will be no resulting material impact on the ratio. Such flexibility is consistent with the Commission's general efforts in the proposed release to ensure registrants can comply with the pay ratio mandate in a cost-effective manner.

23 – Should we require all registrants that rely on the proposed instruction to annualize compensation for these employees to disclose that they have done so (or only when the adjustment is material, as would be required under the proposed instruction for disclosure of material assumptions, adjustments and estimates)? Why or why not? If so, what should the disclosure entail? For example, should the registrant only be required to state that it has relied on the instruction, or should it also be required to discuss the number or percentage of employees for which compensation was annualized?

We recommend that the Commission only require registrants to state that they have relied on the instruction to annualize compensation for non-temporary, non-seasonal employees who have only worked part of the fiscal year. Further, we recommend that the disclosure only be required when the adjustment to the pay ratio resulting from the annualization practice is material. We do not recommend the Commission require specific details concerning which employee compensation figures were or were not annualized as such detail will add little value to the overall disclosure. Further, the inclusion of anything beyond an acknowledgement that the instructions were followed threatens to bloat the "brief" disclosure expressly desired by the Commission in the proposed rule further detracting from other, actual relevant information included in the filing.

24 – Should we allow full-time equivalent adjustments for part-time employees and temporary or seasonal employees, as recommended by some commenters? Should we allow cost-of-living adjustments for non-U.S. employees as recommended by some commenters? If so in either case, please explain why. In particular, please address the potential concern that these kinds of adjustments could cause the ratio to be a less accurate reflection of actual workforce compensation. Is there an alternative way to mitigate this concern?

We recommend the SEC permit but not require full-time equivalent adjustments for part time, temporary, and seasonal employees. We understand the Commission's concerns that such equivalents could result in a misrepresentation of a registrant's workforce. We do note that according to our survey results, tracking part-time, temporary, and seasonal employees result in significant costs and burdens on issuers.[20] Accordingly, we believe the suggestion to include only U.S. employees provides a far more effective solution to the problems inherent with the pay ratio disclosure.

C.3 – *Identifying the Median*

26 – Do registrants need further guidance on the permitted use of reasonable estimates in identifying the median? If so, what should that guidance be? In the alternative, should the proposed requirement expressly disallow the use of reasonable estimates? Please explain how the usefulness of the pay ratio disclosure would be affected by the use of reasonable estimates. Should the rule specify requirements for statistical sampling or any other estimation methods, such as appropriate sample sizes for reasonable estimates or requiring the results to meet specified confidence levels? Why or why not? If so, what should the requirements be? For example, should the estimate have at least a 90% (or 85%, or some other percentage) confidence level?

We strongly believe that the final rule should allow, rather than disallow, the use of reasonable estimates. The use of reasonable estimates is necessary for registrants to mitigate the potential of exorbitant compliance costs and excessive burdens associated with finding the median employee. In addition, by allowing reasonable estimates, the usefulness of the pay ratio would not be impacted materially for two reasons. First, it is implicit that to make a reasonable estimate the registrant must make the estimate in good faith. This means registrants are required to ensure the reasonable estimates are going to provide a realistic, yet approximate, picture of the median employee. Second, the proposed rule requires registrants to disclose the basic assumptions used to create reasonable estimates (*i.e.*, to include "a succinct description of the methodology and

[20] 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 8/13/2014)

material assumptions, adjustments or estimates"). Also "registrants must briefly disclose and consistently apply any methodology used to identify the median and any material assumptions, adjustments or estimates used to identify the median or to determine total compensation or any elements of total compensation, and registrants must clearly identify any estimated amount as such." The public disclosure of the assumptions used in creating reasonable estimates and the potential for securities law liability for failure to do so, functions as a sufficient insurance against the misuse of reasonable estimates. As we stated in our overview on page 8 above, the Commission should make the pay ratio "furnished" rather than "filed" information to ensure that issuers will be able to avail themselves of the ability to provide reasonable estimates.

Neither do we recommend that Commission specify requirements for statistical sampling or other methods, such as appropriate sample sizes or confidence levels because different registrants will have different circumstances that may dictate different assumptions in order to construct a reasonable estimate. If the Commission were to adopt such requirements, it would unduly limit the flexibility it has recognized is necessary for companies to comply with the proposed rule without incurring unreasonable costs. Furthermore, keeping in mind that few investors are likely to view the ratio disclosure as material, imposing additional requirements would not provide a more valuable or beneficial pay ratio number.

C.4 – *Determination of Total Compensation*

33 – Are there other alternatives to calculating total compensation in accordance with Item 402(c)(2)(x) that would be consistent with Section 953(b)?

We agree with the Commission's determination that total compensation should be calculated in accordance with Item 402(c)(2)(x).

34 – Should the requirements provide instructions or should we provide additional guidance about how to apply the definition of total compensation under Item 402(c)(2)(x) (or any particular elements of total compensation under Item 402(c)(2)) to employees that are not executive officers? If so, what specific instructions or guidance would be useful to registrants? Please also address whether specific instructions or guidance would limit flexibility and thereby raise costs for registrants.

We do not believe that additional guidance from the Commission here would be instructive given the flexibility outlined in the proposed rule with regards to calculating total compensation, which includes the ability of a registrant to use reasonable estimates. Furthermore, as we have outlined in our response to these questions, we are concerned any additional guidance from the Commission risks inadvertently limiting the flexibility the Commission otherwise intends to provide registrants in the proposed rules through the unintentional creation of a framework or safe harbors which could limit a registrant's ability to use reasonable estimates.

35 – Do registrants need further guidance on the permitted use of reasonable estimates in determining total compensation (or specific elements of total compensation) for employees other than the PEO in accordance with Item 402(c)(2)(x)? If so, what should that guidance entail? Would the use of reasonable estimates ever be inappropriate? Please also address whether specific instructions or guidance would limit flexibility and thereby raise costs for registrants.

We do not believe that additional guidance from the Commission with regard to the use of reasonable estimates is necessary. We believe that the instructions in the proposed rules – that registrants must have a reasonable basis for concluding that the estimate approximates the actual compensation amount under Item 402(c)(2)(x) combined with the required disclosure which would clearly identify an estimate amount and include a brief description of the estimation method – function as both a sufficient guidelines as well as a check on companies.

A registrant's use of reasonable estimate will be entirely dependent on the registrant's particular facts and circumstances. As a result, we believe that additional guidance may inadvertently result in more burdensome compliance requirements than the Commission otherwise intends due to the impracticality of providing guidance which appropriately accommodates for the vast types of business structures and compensation strategies.

36 – Instead of allowing the use of reasonable estimates in determining total compensation (or any elements of total compensation) as described in this proposal, should the rules prohibit the use of reasonable estimates for that purpose? If so, why? Please include an explanation of how the potential usefulness of the pay ratio disclosure would be affected by a registrant's use of reasonable estimates in this context. Are there alternative ways to address this impact, such as requiring an explanation describing the use of estimates, rather than prohibiting the use of estimates?

We agree with the Commission's assertion in the proposed rule that the use of the reasonable estimates does not diminish the usefulness of the pay ratio disclosure while at the same time, results in a large reduction of compliance costs. We also support the Commission's conclusion that requiring the use of a brief disclosure concerning the how a registrant used reasonable estimates diminishes any concerns arising from the use of said reasonable estimates.