CENTER FOR CAPITAL MARKETS COMPETITIVENESS

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[redacted]

March 23, 2017

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

Re: **Acting Chairman Piwowar's February 6, 2017, Statement on the Commission's Pay Ratio Rule**

Dear Mr. Fields:

The U.S. Chamber of Commerce (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 global economy.[1] The CCMC welcomes the opportunity to comment on the final rules issued by the Securities and Exchange Commission (the "SEC" or "Commission") under Section 953(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), concerning the so-called pay ratio disclosure.[2]

The Chamber has long supported statutory repeal of Section 953(b). The pay ratio rule fails to promote investor protection because it provides no benefits for investors; it adversely impacts the ability of American companies, particularly those with a large overseas presence, to compete in a global economy; it makes it more difficult for businesses to engage in efficient capital formation; and, in combination with other nonmaterial disclosures mandated by Dodd-Frank, the rule makes the public company structure a less attractive business model, harming investors and the overall economy. Of the many misguided corporate governance provisions included within Dodd-Frank, the CEO pay ratio disclosure rule stands out for its audacity.

[1] The U.S. Chamber of Commerce is the world's largest business federation, representing the interests of more than three million businesses and organizations of every size, sector, and region.
[2] Release Nos. 33-9877; 34-75610, *Pay Ratio Disclosure*, 80 Fed. Reg. 50,103 (Aug. 18, 2015).

Until Congress is able to repeal this misguided mandate, the Chamber makes the following recommendations to the SEC in order to lessen the burden the rule imposes upon the capital markets and main street investors:

- The SEC should exclude all non-U.S. employees as well as seasonal and part time employees from the median employee calculation or, at a minimum, allow the foreign data privacy exemption and the *de minimis* exemption to operate independently of each other,;

- The SEC should create a safe harbor to allow issuers the option of using industry median compensation data compiled by the Bureau of Labor Statistics;

- The SEC should rely on and adopt prevailing standards regarding the definition of independent contractors;

- The SEC should exclude employees who are on a leave of absence or have been furloughed from the median employee calculation and;

- In light of "pay ratio tax" proposals cropping up in various jurisdictions across the country, the SEC should conduct a new cost-benefit analysis of the pay ratio rule that takes into account the costs such taxes would impose upon issuers, investors, and the capital markets.

We believe strongly that the SEC should use its authority under Section 953(b) to provide for some of these exemptions or clarifications. Our concerns with the rule and recommendations are laid out in greater detail below.

## Discussion

It is no secret that corporate CEOs are typically compensated at higher rates than other employees, and we believe that this point is already well understood, not just by investors, but by the population at large. Section 953(b) of Dodd-Frank serves no rational purpose other than to politicize SEC disclosure and compensation practices. Proponents of the pay ratio rule have admitted that their intent is to "shame" public companies over their executive compensation practices. It is worth noting that such use of the SEC's disclosure regime has in other instances been struck down by the courts on First Amendment grounds.[3] This further reinforces the point that materiality—not politics—should be the guiding principle in formulating this and other public company disclosures.

Section 953(b) has also precipitated a troubling development that to our knowledge was never considered by Congress or by the SEC as it promulgated the pay ratio rule. Several "pay ratio tax" bills have been introduced in various state and municipal jurisdictions around the country. For example, the city council of Portland, Oregon recently voted to tax companies doing business in Portland if such companies have a pay ratio that the council decrees is too high.[4] Such assessments ultimately serve as a tax on the shareholders of public companies, and are likely to do little except drive businesses away from jurisdictions that adopt these measures. We also believe that in light of these developments, the SEC should conduct a new cost-benefit analysis of the pay ratio rule that takes into account the costs that such taxes will impose upon companies and their investors.

We support a system of securities regulation in which investors are provided with decision-useful information to deploy capital efficiently and for businesses to raise the financial resources needed to grow and expand. This rule, however, imposes substantial costs on affected registrants without providing any corresponding benefits. Indeed, it provides no material information to investors.

Issuers who are now engaged in the implementation and testing of compliance systems designed to collect and process the information necessary for compliance are encountering unanticipated compliance difficulties that may hinder their ability to meet the reporting deadline. The rule, as currently written, imposes extreme data collection obligations on all registrants. This data collection exercise has already proven to be extremely time consuming for the Chamber's member companies. Despite some of the changes made by SEC staff in response to the comments to the proposed rule, the rule will result in a significant expenditure of resources that could

[3] *Nat'l Ass'n of Mfrs. v. SEC*, 800 F.3d 518 (D.C. Cir. 2015).
[4] Gretchen Morgenson, Portland adopts surcharge on C.E.O. pay in move vs. income inequality, New York Times (December 7, 2016).

be better utilized elsewhere.[5]

As we discuss in greater detail below, the final rule suffers from a number of deficiencies, and we continue to believe that the best policy outcome is for Congress to repeal Section 953(b) in its entirety. We acknowledge, however, that the Commission cannot act to do so unilaterally, so the focus of our comments is on improving the implementation of the current rule to the fullest extent possible.

- The pay ratio calculation includes part-time and seasonal workers while excluding up to 5% of a company's non-U.S. employees and non-U.S. employees in jurisdictions where data privacy laws prevent compliance. Most companies that operate internationally face a substantially different labor market and tax regime than in the U.S., and that difference distorts the data and median computations for reasons that reflect the disparity in wages between or among different countries. Compensation practices and pay levels vary by country, often significantly so. Equalizing or harmonizing differences among countries in terms of living standards or job markets in a rule of this nature is a sheer impossibility.

- The rule presupposes that companies, particularly entities that operate globally, maintain harmonized compensation and payroll databases. This is simply not the case at most companies for a myriad of reasons. Companies that do not operate a single HR enterprise-wide system or platform must now develop or acquire tailored systems in order to meet local data collection and filing cycles and to ensure that their data is accurate, defensible, and readily available for purposes of the rule. Solely to comply with this rule, the Chamber's member companies have been required to undertake this costly process, at the ultimate expense of their shareholders.

- Though the rule allows a company to exclude employees in foreign jurisdictions where data privacy laws prevent the company from obtaining or processing the information needed to comply with the pay ratio rule, the

[5] In the final pay ratio rule, the SEC estimated that initial compliance costs per registrant would total $368,159 and that costs would total $147,200 for the first full year of compliance. However, these statistics likely do not take into account opportunity costs in terms of the time that management and employees spend in dealing with pay ratio, when they could be engaged in more productive activities.

conditions accompanying the exemption are simply too onerous and costly. First, an issuer must seek an exemption from the local data privacy regulator. We understand that no such exemption process exists in many jurisdictions. Absent an exemption, the final rule requires a registrant to obtain and file with the Commission a legal opinion from counsel in the relevant jurisdiction (an opinion from U.S. counsel would not suffice) regarding the company's inability to comply with the rule without violating the jurisdiction's data privacy laws, including the registrant's inability to obtain an exemption or other relief under any governing laws or provisions. The Chamber has been advised by its members that obtaining the written opinion of counsel in many foreign jurisdictions with respect to this issue will be extremely difficult, if not impossible, particularly in light of the requirement that the opinion be filed with the Commission. We see no valid reason for the Commission to perpetuate such a draconian requirement.

- It is difficult to draw a direct comparison between executive pay and employee pay for a number of reasons. Most CEOs of public companies receive at least a portion (in some cases a majority) of their compensation in the form of equity, e.g., stocks and options, in an effort to align the performance of the company with the CEO's compensation. Equity pay accounted for 68% of the reported compensation for the CEOs included in a recent Equilar 200 study.[6] Moreover, equity compensation is intended to align CEO incentives with the incentives of shareholders, so that a CEO is rewarded as shareholders would be: with the increased value of their investment. There can be no direct comparison between CEO compensation and employee compensation, due to the fact that employee interests can differ from shareholder interests.

## Recommendations

As stated above, the best solution to the serious problems posed by the pay ratio rule is full repeal by Congress. Absent that outcome and in light of the rule's numerous shortcomings, set forth below are suggested modifications to the rule offered in an effort to reduce its burden on public companies and their investors.

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[6] See http://www.equilar.com/press-releases/47-200-highest-paid-ceo-rankings.html.

## Scope of Employees Included in the Rule

For the reasons cited above, and noting that foreign private issuers are not subject to the rule, we believe that the Commission should use the discretion granted to it under Section 953(b) to exclude non-U.S. employees, as well as part-time and seasonal employees from the pay ratio calculation as the costs and burdens on companies will be disproportionately higher than if the calculation were limited to full-time U.S. employees. Since the Commission has already publicly conceded that there will be little or no comparability among reported ratios, there is no logical reason for the final rule to skew the data by design, resulting in further distortion among median computations.

We believe that additional guidance regarding independent contractors is also needed, particularly concerning the scope of their exclusion from the definition of "employee" for purposes of the rule. The definition of independent contractor used in the final rule differs from the definition of independent contractor that is commonly used in the employment law context (as well as differing from IRS guidance). As currently written, the rule requires that companies consider persons that are independent contractors (for IRS and all other purposes) to be employees for the sole purpose of performing the median income calculation. The SEC rule contemplates that the compensation of most independent contractors is determined by unaffiliated third parties when, in fact, that only reflects one type of business model or arrangement. Under applicable IRS guidance,[7] for example, whether an individual is deemed an independent contractor for tax purpose should depend on a number of factors including, e.g., behavioral control, financial control, and relationship with other parties. Because of the importance of focusing on U.S. employees only, and as more companies categorize U.S. employees based on tax status rather than an SEC rule, there would be administrative efficiency in relying on the prevailing standard adopted by the IRS.

We also believe that employees who are on a leave of absence or are furloughed should be excluded from the calculation. To do otherwise will distort the pay ratio and cause companies to incur significant compliance costs. Inherent in the size and complexity of large multinational companies is the fact that at any point in

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[7] See https://www.irs.gov/taxtopics/tc762.html.

time there are potentially thousands of individuals who are considered to be on a leave of absence or furloughed. While a "facts and circumstances" determination standard contemplated by the SEC may appear reasonable on its face, companies will incur significant costs in evaluating each and every employee's human resource file to make such a determination.

Such a review would need to take into account 1) how long the individual has been on furloughed status; 2) what circumstances resulted in the individual being placed on furloughed status; 3) whether there is an expectation that the individual may return to work; 4) how the individual has been treated under the issuer's various employee benefits/retirement plans; and 5) whether the individual has any legal rights to return to employment. Answering these questions will require a tremendous expenditure of internal resources, as issuers must review the particular facts and circumstances applicable to each individual coded as furloughed before including or excluding them from the median employee pool. In addition, including employees on a leave of absence or furloughed in the calculation would require monitoring world-wide and ever-changing legal requirements to determine if their status has changed. Thus, we think employees on a leave of absence or furloughed should be excluded from the calculation.

**Exemptions for Certain Non-US Employees**

While the SEC recognizes that the data privacy laws or regulations in some countries may prohibit the transfer of compensation data outside of a country's borders, the requirements that would have to be met under the rule in order for a public company to avail itself of the exemption are simply too burdensome and unrealistic. The rule should merely require that the company make reasonable efforts to obtain the necessary information, documenting such attempts and citing the applicable laws and regulations prohibiting access to such information. Requiring that the registrant seek an exemption from the country's data privacy laws and regulations or obtain a legal opinion from foreign counsel regarding its inability to obtain the necessary information to comply with the rule is costly and unreasonable.

Separate from the foreign data privacy exemption, companies whose non-U.S. employees constitute 5% of less of their total workforce may exclude all of their non-U.S. employees when identifying their median employee. If a company with 5% of fewer non U.S. employees decides to exclude any non-U.S. employees under the *de minimis* exception, it must exclude them all. A company whose non-U.S. employees constitutes more than 5% of its total workforce may exclude non-U.S. employees up to the 5% threshold, but if it excludes any non-U.S. employees in a particular jurisdiction, it must then exclude all the employees in that jurisdiction. However, these exemptions are very much intertwined such that a company must count any non-U.S. employee exempted under the foreign data privacy exemption also against the availability of the *de minimis* exemption; in other words, as the rule is currently structured if a company excludes more than 5% of its total employees under the foreign data privacy exemption, then it may not take advantage of the *de minimis* exemption.

We recommend that these exemptions be made to operate independently of each other so that a company can consider whether making use of the *de minimis* exemption is appropriate given the nature of the compensation of employees in a certain country. For example, excluding employees located in the Philippines from the pay ratio calculation may have a different impact on the company's pay ratio than excluding employees located in Germany.

An even more effective and straightforward solution to the challenge of including overseas employees is to permit companies to exclude them from the median calculation altogether. The animating principle of Section 953(b) seems to be to spotlight the relationship between the pay of American CEOs and the pay of American workers. Thus, including non-U.S. workers in the underlying calculation serves no rational purpose.

Better still, in lieu of requiring companies to engage in an expensive calculation exercise, the Commission should provide a safe harbor for registrants by giving them the option of using industry median compensation data as compiled by the Bureau of Labor Statistics. The Bureau tracks compensation data for over 800 occupations.[8] Using industry median compensation data will still produce a pay ratio that approximates what would be required under the current system, without the need for companies to engage in costly and unproductive computational exercises to arrive at their own median employee number. Companies that choose this option could be

[8] Relevant data is available at https://www.bls.gov/oes/.

required to disclose that they selected this methodology and provide a brief explanation of why they chose to do so.

**Conclusion**

We again request that the Commission not stray from the guiding and well-settled principle of providing investors with meaningful disclosures and not burden registrants with disclosure requirements that will require a massive undertaking both in terms of labor and system changes for what ultimately will provide no benefit to investors.

We thank you for your consideration of these comments and are available to discuss them further with the Commissioners or Staff at your convenience.

Sincerely,

Thomas Quaadman

cc: The Honorable Michael S. Piwowar
The Honorable Kara M. Stein