RAMP

The Project to Raise America's Pay

March 18, 2020

Vanessa A. Countryman, Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Securities and Exchange Commission, Proposed Rule: Modernization of Regulation S-K, File No. S7-11-19

Dear Secretary Countryman:

We appreciate the opportunity to submit comments on the proposed SEC Modernization of Regulation S-K.

Background and Overall Reaction:

We come at the human capital management/reporting issue from a slightly different perspective than most of your responders in that our group has been working on an actual pre-distributive public policy solution to wage stagnation. So we are policy developers not investors, investment analysts, accountants, businesses or regulators. But we do agree with the consensus view that the human capital management area is considerably under analyzed and sparsely disclosed as a long term value driver in companies. On the issue of principles-based vs prescriptive reporting in the human capital area, once you eliminate the structural biases of parties at the margin, we concur with the need for a hybrid approach which offers both a prescriptive, metric-driven floor for comparability and a more flexible set of principle–based parameters that each registrant could adapt to "fill-in the overall picture". Many key performance indicators (KPIs) have been offered as candidates and ultimately should be screened in a SASB-like approach. However, it is our opinion that the major indicator missing from almost all the comments is wage management, and specifically the extent to which a company fairly compensates its various tiers of employees both internally and in comparison to peer companies in the same industry sector.

Investing in Employees: An Emerging Market

Our field work on wage stagnation evidences growing concern about the sustainability of an economy that features a widening income gap and the declining influence of the middle class in driving consumer demand. An increasingly seminal issue for our time, the way business gains are shared is being re-examined on a variety of fronts. Recently, 181 CEOs of major corporations in the Business Roundtable made a public commitment to invest in their employees and to move toward a less opaque model in which all stakeholders, including workers, are the recipients of long term business value going forward. And, with rising interest in the transparency of business sustainability accounting, the investor world is pressing for a better metric to assess this new direction in corporate governance, particularly how it relates to valuing intangible assets like IP and human capital. We feel it is a natural role for the SEC to help reinforce, through this rulemaking, a consistent way for the emerging ideas put forward by HCMC and SASB to coalesce in a clear and comparable picture of how firms approach workforce management practices, policies, and performance.

Wage Management as a Challenging Blind Spot

As one commenter notes: "to date, the SEC only requires two disclosures regarding (registrants') employees: their number, and the median pay." We support the human capital recommendations coming from HCMC, the IAC-Owner as Investor Subcommittee, and others with respect to a more comprehensive reporting framework, converting how companies think about human capital to a manageable set of indicators of the relative performance of their human capital strategies. These disclosures will greatly enhance non-quantitative assessment. But the fact still remains that the investor community not only lacks an index to evaluate how the business community values human capital as an asset but also an "easy-to-understand" metric for measuring how gains are being shared among all employees , not just executives. The SEC could provide that anchor metric, one that would need to meet several requirements. First, such a measure must be a credible technical tool to track how gains are shared among all levels of the workforce. Second, it must be based on audited data that all employers have and can easily and accurately automate/report. Finally, it should offer an appropriate way to compare companies within the same industries and to consistently track changes over time.

We want to make some observations and suggestions about how to approach such a prescribed, anchor metric in the compensation/wage management area.

First, a natural difficulty with prescribed metrics is that it is very easy to end up with a long list of them, each assessing one facet of HCM. When there are too many metrics, it is easy to miss the forest for the trees. A long list may be as confusing as it is clarifying, in that it inadvertently camouflages a pre-eminent issue with smaller details. As a result, this approach may not help the investor make decisions on the factors that count most. Consequently we believe that it is essential to have a foundational metric (among a small set of metrics) one that can act as a trigger point for the investor, defining a place to begin to ask more detailed questions, and a point of departure for other material disclosures companies may wish to make.

Looking at the key indicators suggested by the comments to date, there are two glaring omissions:

- _Compensation for the bottom 90% of workers._ First, there is almost no focus on compensation (specifically cash compensation plus benefits). Even more noticeable is the absence of any focus on the compensation of the bottom 90% of workers (nationally, those earning approximately $125,000 or less annually, together with benefits). This is group of about 100 million private-sector workers and mostly includes non-managerial roles.
  The compensation of this group is a natural indicator of how a company values a key part of its human capital. Higher compensation has been shown to be associated with the creation of long term value via improved productivity and retention. While it is a general index, it is also fundamental.
- _Discretionary income_. The significance of the compensation of the bottom 90% is hard to assess without understanding the total pool of discretionary monies a company has the ability to

allocate each year, including to compensation. This pool consists of the sum of all cash compensation and all profits. A company is free to allocate these resources as it sees fit.

Compensation Ratio (CR): Key Performance Indicator for Human Capital Management

A strong candidate for the kind of measure that is now missing is one we have used in our extensive analysis of wage stagnation—what we term the 'Compensation Ratio' (or CR). This is the ratio of the cash compensation, including benefits, going to the bottom 90% of workers (B90) divided by the total of all cash compensation plus profits.

The CR varies considerably between industries, and also between companies in the same economic sector. Variations relative to peer companies in the same sector reflect differences in corporate governance as it pertains to the sharing of gains. The higher the Compensation Ratio relative to a company's peers, the more gains are being shared among stakeholders. Shifts in this aspect of governance can be detected by changes in the CR over time, especially relative to peer companies. Similarly, CR changes can signal trends in workforce deployment, such as outsourcing or major offshoring, all of which would be of interest to investors who view human capital as a primary source of value. The CR provides a fundamental insight into how a company is allocating its discretionary monies to its employees who are not in the top tier (the top 10% of employees).

The CR has the advantages of being easily understood and having face validity. It is based on audited data that all companies already report to the government, and frequently to the public. In addition, the CR offers three other key benefits:

- The CR allows investors to compare performance of any company to the average for its industry and to identify shifts in governance over time. Investors who care about stakeholder value can invest in companies that most support this approach. Doing so will activate market forces to further support this kind of governance.
- Our research shows that if companies keep their CR stable in periods of economic growth, wages for the bottom 90% of workers automatically rise in a significant and sustainable way, helping to resolve the condition of wage stagnation that the economy has experienced for nearly a half century.
- If the CR became a standard investor metric, it could also be used to help guide ongoing Federal policy assessment and formation as well as regulation in the labor market.

What the CR Offers SEC Stakeholders

Benefits to corporations.

- *Minimal reporting.* We assume there will be an increased level of reporting requirements about human capital management under the new SEC rules. Given that fact, using the CR tool has twin advantages. On one hand, it involves a minimal increase in reporting while, on the other hand, it could easily win significant points with both investors and analysts since it addresses an aspect of human capital that interests them. Simply put, the CR requires little and has the potential to return a lot in terms of the SEC's mission.

Disclosing the CR is only a minor extension to what corporations already report publicly (profit and cash compensation expense) or share with the government in the form of W2's. The only new requirement would be to break down cash compensation by two tiers of employees (over and under $125,000 in compensation annually).

- *Level playing field.* Since the CR is based on data that is typically audited and already shared publicly, comparisons between peer companies in the same sub-industry are likely to be less subject to distortion than other measures might be. When peer companies are compared, it will only be on the basis of broadly comparable data that are simple and audited, and least subject to misrepresentation.
- *Material responses*. Under the 'hybrid approach' (involving both required metrics and additional clarifications), a corporation may feel the need to make additional disclosures that are material. If so, the CR provides a clear point of departure or contextual "floor" that may facilitate further principles-based communication.
- *Administrative burden*. The CR is composed of data variables already collected and often reported by corporations. Consequently, the administrative burden of incremental reporting is held to a minimum. If the SEC is trying to find the sweet spot which offers meaningful transparency for the investor while minimizing the administrative burden placed on corporations, the CR is a very good candidate.
- *Investor relations*. The CR can address additional motives shareholders may have to invest in a company. Normally investment is based on expected shorter term returns. Expanded transparency about risks associated with intangible assets, particularly those related to wage fairness, would enhance investors' longer-term perspective, supporting other reasons to invest (concerns with the needs of all stakeholders, sustainability of the consumer economy, ESG values etc.) When an investor has multiple reasons to invest, his commitment is likely to be more resilient in the face of market ups and downs. Expanded reasons for investment—both economic and values-based—is more likely to yield a base of investors that is more stable and has stronger bonds to a company.

Benefits to investors

- *Improved transparency on a subject important to many investors*. An increasing percentage of investors are looking beyond traditional "markers" for shareholder value. Many also prefer to do well with companies that are managing their human capital in a fair and sustainable way. Today this area is opaque, partly because human capital has been treated as an expense, not an asset. But it is also the consequence of insufficient transparency in human capital management. The CR provides a practical, foundational comparison for wage management behavior over an extended period, one that can be productively integrated into a 'hybrid approach'.
- *Multi-dimensional choice*. Increasingly investors (both individuals and institutions) not only want to maximize economic returns in the shorter term but also to maximize an evolving reconstruction of long term value. How human capital is placed and then managed as an asset is seen by many as an important internal asset allocation consideration in supporting a sustainable business model. So any greater transparency in how investments in areas like workforce composition/compensation or training and development might be connected with worker productivity, turnover/retention, or positive brand acceptance certainly helps investors go way beyond where current disclosure takes them. In addition to meeting financial goals, investors increasingly prefer to do so with companies that share their values. If the CR increases transparency about how companies invest in their employees, it can help investors pinpoint companies that satisfy both their economic objectives and support their values as well.

Benefits to the analyst community

- *Advanced analysis*. The CR allows analysts to offer advanced analysis helpful to investors. The CR provides a new way to compare companies to their peers in the same industry sub-sector. It also makes it possible to track a company's behavior over time, assessing the CR relative to peers. For example, the CR can be used to create a two dimensional mapping deployed in 'magic quadrant' analysis. In our unpublished work, we have shown that it is possible to create plots in which the X axis is an economic variable such as return on equity, while the Y axis is the shift in CR over time. While the average CR varies significantly between industries, in virtually every industry sub-sector we have examined, there is a wide dispersion on these two dimensions taken together. Therefore, analysts could help investors interested in identifying companies high on both economic and human capital dimensions.
- *Potential for other value added services*. Analysts also want a way to assure customers that ratings are accurate. Since all companies want to look good, there is always an incentive to game metrics if doing so cannot be detected. We have developed an application (using the statistical package 'R') that can very accurately detect attempts to game the CR. We are happy to contribute this software for free to the SEC or to analysts wanting to be able to verify the accuracy of companies' CR data, enabling their investor clients to make the best investment decisions.

Our RAMP group will continue to pursue a broader policy initiative aimed at resolving wage stagnation. However, that is a longer term undertaking. In the interim, we feel the CR concept has significant beneficial application to the SEC's role in updating investors on its assessment of the value of human capital as well as modernizing the disclosure and reporting of how issuers/companies are managing the wage component of that asset.

We are available should you have questions.

Sincerely,

Harry Lasker
Director

William Coleman
Director

See further information available at https://www.raiseamericaspay.org