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October 20, 2006

Ms. Nancy Morris
Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-9303

Re: File Number S7-03-06
Other Release No.: 43-54380
Executive compensation disclosure of "up to an additional three most highly compensated employees."

Dear Ms. Morris,

WorldatWork appreciates this opportunity to submit comments in response to the Securities and Exchange Commission's September 8, 2006, proposed rule regarding the compensation disclosure of up to an additional three most highly compensated employees (17 CFR Part 229; Release Nos. 33-8735; 34-54380; IC-27470; File Number S7-03-06).

WorldatWork is the not-for-profit global association for professionals working in employee rewards and compensation, benefits and human resources. From its founding in 1955 until 2000, WorldatWork was known as the American Compensation Association (ACA). Today, WorldatWork is more than 23,000 members strong, and 95 percent of U.S. *Fortune* 500 companies have an employee who is a member of WorldatWork. In addition, since 1976 the association has offered the premier professional certification for the compensation field: the Certified Compensation Professional designation (CCP®). To date, more than 11,000 individuals have earned the CCP® designation.

As with our comment submitted in April regarding the entire package of new proxy disclosure requirements, the following comments are based on the input of our membership, the vast majority of whom are long-term practicing professionals in the compensation and executive compensation fields. Because our membership also includes a substantial proportion of the executive compensation consultants in the United States, these comments incorporate some of their feedback on the proposal, as well.

This comment also includes references to research conducted by Professor Robert L. Clark of North Carolina State University, College of Management. With the support of WorldatWork and the HR Policy Association (HRPA), Professor Clark conducted

research in October 2006 on the topic specifically under current consideration by the SEC.[1] (See attachment.)

WorldatWork would be happy to directly respond or arrange a membership response to any questions for clarification on these or any other pending issues associated with either employee or executive compensation.

Overview

As noted in our April comment, the more than 50-year history of WorldatWork includes substantial research into compensation systems, pay-for-performance, executive and board compensation, and compensation transparency. As such, we generally support the goal of better and more understandable executive compensation information for the benefit of investors.

At the same time, however, we are hopeful that the SEC and other regulatory bodies remain cognizant of the totality of new compliance requirements that have been imposed in recent years on compensation professionals and compensation committees — notably, the requirements of the Sarbanes Oxley Act of 2002, FASB's 123(R) equity compensation changes, the recently-finalized new proxy disclosure rules, and this new proposal.

Although the re-written proposal is an improvement over the original version published in April, the nation's compensation professionals remain opposed for two primary reasons:

1. The new disclosures will cause unintended consequences for companies competing to attract, motivate and retain employees — including a potential further ratcheting up of compensation levels, and

2. The burden imposed by the new disclosures does not seem to add commensurate and meaningful shareholder and investor informational value.

The following detailed comments are directed at those portions of the proposal that would have the greatest impact on compensation and executive compensation professionals.

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[1] A sample of WorldatWork members suitable for this survey was selected by identifying within the membership all persons employed by companies with 10,000 or more employees. Using this criterion, 2,032 companies were identified. After deleting firms that were also members of HR Policy Association (HRPA), a sample of 1,354 companies was identified. Electronic surveys were successfully sent to 1,183 companies. The survey was sent to 210 HRPA publicly held member companies for whom a chief human resource officer was on file with HRPA. Usable responses were received from 139 companies for a total response rate of 10 percent. The deadline of less than two weeks clearly affected the number of firms responding to the survey. The modest response rate may result in some sample selection issues associated with the final sample of responding companies. However, if all of the firms in the survey meet the standards set out by the SEC, they would represent more than 8 percent of companies that are potentially affected by the proposed regulations.

Item 1: The new proposed rule will cause unintended consequences for companies competing to attract, motivate and retain employees — including a further ratcheting up of compensation levels.

We believe that a new requirement to disclose compensation information for up to three additional non-NEOs (albeit not by name specifically) will create a series of unintended and unhealthy consequences for companies who are operating in a vigorously competitive talent market today.

Respondents to the October 2006 survey conducted by Professor Clark for WorldatWork and HR Policy Association indicated that disclosure of the total compensation of their best and highest paid employees would make it easier for competing firms to target these employees and attempt to lure them away. A 61 percent majority of the survey's respondents said that employee "poaching" would be made either "easier" or "much easier" by the implementation of this new rule.

A number of respondents said that knowledge about these compensation packages would allow competitors to quickly develop compensation packages that either match or exceed the current compensation of the "star" employee. Thus, when companies begin to use this new data as competitive intelligence, we believe an escalation in the competition for certain employees could ensue, potentially triggering a compensation response. In the end, the luring company and the retaining company might end up having to pay these "star" employees even more to ensure they either remain, or are sufficiently attracted to the new opportunity.

WorldatWork members also expressed concern about other internal equity pressure and morale problems this proposal could raise. On one hand, some noted, there is the potential of a further ratcheting up of compensation levels inside the organization due to pressure by employees who believe they are worth what their disclosed counterpart is being paid. Other compensation professionals feared that, in addition to the pressure for this further ratcheting, disclosure might degrade the morale and job satisfaction of some workers.

And the detrimental effect on morale may not be limited to only those who are <u>not</u> on the list of those disclosed. The proposed rule would almost certainly raise privacy concerns by certain individuals — and especially if the names of the "three additional employees" are required to be disclosed. But even if the individual names are not disclosed, we believe that most observers who are familiar with a company will be able to determine who the three additional executives are through the proposed disclosure. This could necessitate that the company provide security protection for these employees, especially for those in certain foreign jurisdictions where kidnappings are known to occur.

There is also an additional possible "chilling effect" that could occur as a result of this disclosure. In this instance, companies may not want to take appropriate compensation actions — either up or down — simply because they don't want to send a leading or misleading public signal about an individual.

Yet another likely unintended consequence is the impact this requirement may have on qualified and viable candidates who might refuse to consider changing employers specifically because their new compensation package (or an initial equity grant) might thrust them into the public disclosure spotlight. A number of companies rely on the use of equity to attract senior executive candidates, often because the candidate being recruited is sitting on significant stock holdings in their current company after years of employment. For those companies that need to provide large equity packages to attract the best candidates, this "one year look" at compensation levels may only capture new executives brought on board in the past year. In turn, this could cause the "three additional highly compensated nonexecutives" to change yearly, causing investors to simply be left with a, "What happened?" reaction when a certain executive suddenly appears on the list, or when someone drops off.

In addition, we believe that this disclosure regulation could potentially have an unintended negative effect on the number of Initial Public Offerings (IPOs). A number of respondents to the survey pointed out the differential affects on companies. For example, while public companies (indeed, only large-accelerated filing public companies) will be complying with the standards, privately held companies will not.

Finally, because of the perceived threat of landing on the list of those whose compensation package is disclosed, this rule might also cause a larger, unintended consequence of stifling talent competition in a free market. We believe that ingenuity and innovation are often products of working experiences in different organizations and cultures. For instance, intellectual capital and innovation can thrive in one culture but not in another. If regulations are imposed that diminish an employee's desire to move to different cultures and environments (out of fear that their compensation might be publicly disclosed), the SEC may be unintentionally diminishing individual company (and potentially, our aggregate) competitiveness and innovation.

Item 2: The burden imposed by the new disclosures does not seem to add commensurate and meaningful shareholder and investor informational value.

We believe that requesting the disclosure of total compensation of up to three additional employees on the basis of their total compensation would create a compliance burden on companies that will not be offset by a commensurate benefit to investors. According to survey respondents, the calculations to determine total compensation (especially across large global enterprises operating in a multitude of foreign nations) are not easily performed using current HR software packages — even in the very largest companies.

From the perspective of a non-accelerated filer, it would seem appropriate to limit the rule to large accelerated filers that presumably have greater resources available to develop such disclosures. However, from the view of a large accelerated filer, this proposed rule creates and imbalanced compliance and cost burden. Although limiting this disclosure requirement to only large accelerated filers is an important step to ease the burden on small companies, our membership indicated through the October survey that a

significant proportion of large accelerated filers would need to add systems, or make substantial modifications to existing systems, to comply.

In order to comply with the proposed regulation, a company would need to compare the total compensation of all policymaking employees who might receive compensation in excess of the PEO, PFO and other named executive officers. Generating this information would be affected by: 1) the number of individuals who might conceivably have total compensation in excess of the named executive officers; 2) whether the information can be easily generated from current records (for example, whether the company's benefits and cash compensation data reside in the same database) and 3) whether a single database covers all of the company's employees.

On 20 percent of WorldatWork survey respondents indicated that their organizations had all of this information in a single database. Thus, the proposed regulations would require a large proportion of companies to merge two separate databases to identify any potential employees whose total compensation might exceed that of any of the named officers.

But perhaps more importantly, 35 percent of the large firms who responded to the survey reported that they did not have a single, unified compensation database for all of their employees. And furthermore, more than 60 percent of respondents reported that they do not currently maintain records that include total compensation for all employees whose total compensation could possible exceed that of any named executive officer, using the definition of total compensation as adopted by the SEC.

Setting aside the potential compliance difficulties of many companies, we believe very few investors would view such information as material. We believe (and we think that many investors believe) that the way a company provides compensation to its top executives gives investors and potential investors substantial insight into the company's compensation policies and programs. In addition, as noted above, because the executives disclosed in the "up to three other highly compensated" may change on an annual basis in many companies, the information provided to investors may serve to be little more than a curiosity, and perhaps even confusing.

In the end, we are skeptical that this new disclosure will achieve the SEC's goals. If the Securities and Exchange Commission is compelled to move forward with this proposal or a similar rule, we believe a reasonable approach would be to require this information beginning with the 2008 proxy. This short delay in implementation would provide welcome relief for companies that are currently grappling with implementing the new 2007 proxy disclosure requirements.

WorldatWork appreciates the opportunity to comment on this important proposal. Any questions regarding the contents of this document can be directed to Ryan Johnson at 480-905-5986.

Attachment: (Impact of SEC Proposed Disclosure Requirement for Total Compensation of Highly Compensated Employees)

IMPACT OF SEC PROPOSED DISCLOSURE REQUIREMENT FOR TOTAL COMPENSATION OF HIGHLY COMPENSATED EMPLOYEES[2]

Robert L. Clark
Professor
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INTRODUCTION

In 1992, the SEC adopted new more comprehensive disclosure rules that required publicly-held companies to report the total compensation for the chief executive officer (CEO) and the four most highly compensated executive officers other than the CEO.[3] The intent of this regulation was to provide investors with detailed information describing the compensation of these officers who have significant responsibility and oversight in the management of the company and who might be in a position to influence their own compensation. The regulations require that the company's proxy statement include the amount and form of current and long-term compensation for these named executive officers. This information was deemed to have significant value to stockholders and potential investors in evaluating the policies of the company and its management.[4]

In 2006, the SEC revised these regulations to require greater numerical and narrative disclosure designed to provide a more comprehensive overview of executive compensation. For the first time, companies will be required to provide a total compensation number for the named executive officers and include a narrative of the company's pay program. The revised rule will take effect for most publicly-held companies in 2007 when they issue their 2006 proxy statements.

When the SEC initially proposed the 2006 revisions to the proxy disclosure rule, it also proposed extending the reporting requirement to up to three employees who are not executive officers and whose total compensation for the last completed fiscal year was greater than that of any of the named executive officers. Companies would have been required to disclose the employees' job description and total compensation. However, the proposal received significant opposition because it would have required companies to disclose the compensation of some highly compensated employees who had no significant policy making responsibilities within the company including sales employees, highly skilled technical employees, entertainers, and athletes if their compensation exceeded that of the named executive officers.

The SEC is now proposing a revised rule that would require a similar disclosure for up to three employees who earn more than any named executive officer, but include executive officers in the group of employees considered. In addition, to be covered by the proposed regulations, employees must exert significant policy influence in the

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[2] This research was supported in part by the HR Policy Association and WorldatWork. The author also acknowledges the technical support of WorldatWork in developing and administering the on-line survey.
[3] These requirements also mandated that companies provide explanations of the manner in which executive compensation is determined and how compensation is related to the performance of the company.
[4] For a more detailed discussion of the exiting disclosure requirements, see Allan Afterman, *SEC Regulation of Public Companies,* Englewood Cliffs, NJ: Prentice-Hall, 1995, Chapter 7.

company and have responsibility for significant policy decisions. The new requirement would apply only to "large accelerated filers," or an estimated 1,700 publicly-held companies according to the SEC.[5]

The SEC believes that "Knowing the compensation, and job positions within the organization, of these highly compensated policy-makers whose total compensation for the last fiscal year was greater than that of a named executive officer, should assist in placing in context and permit a better understanding of the compensation structure of the named executive officers and directors."[6] Further, the stated intention of the proposed regulation is "to provide investors with information regarding the most highly compensated employees who exert significant policy influence by having responsibility for significant policy decisions."[7] Specifically excluded from consideration for disclosure are employees such as salespersons, entertainment personalities, actors, singers, and professional athletes that are highly compensated but who do not have responsibility for significant policy decisions.

Prior to approving these new regulations, the SEC should weigh the potential benefits of such disclosures against the costs companies would incur in gathering compensation data on a wider range of employees, comparing these data to the total compensation of the named executive officers, and publicly disclosing this information. Possible costs that companies might incur to comply with the proposed disclosure regulations include:

- developing or enhancing methods for evaluating and comparing total compensation for a larger set of employees, including programming of computer systems and databases;
- hiring outside auditors to monitor this process;
- internal staff time; and
- review and oversight of the data by corporate executives.

As noted above, the SEC believes that approximately 1,700 companies would be affected by the proposed regulation.

The SEC has estimated the expected cost that companies will incur in order to comply with the proposed regulations. The estimates include the cost of hiring outside counsel and the use of internal resources to determine the highly compensated employees and to calculate their total compensation. The SEC assumes that "companies will on average retain outside counsel for 8 hours in the first year and 2 hours in each of two succeeding years, at $400 per hour."[8] This estimate implies an average cost of hiring outside counsel per affected company of $3,200 in the first year and $800 per company in the following two years. The SEC concludes that this would indicate "a total estimated average annual cost of approximately $3 million per year for three years."[9]

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[5] U.S. Securities and Exchange Commission, Executive compensation Disclosure, Release No.s 33-8735; 34-54380, 71 Federal Register 53267 (September 8, 2006), at nn. 12, 13.

[6] U.S. Securities and Exchange Commission, Executive Compensation Disclosure, Release Nos 33-8735; 34-54380, 71 Federal Register 53267 (September 8, 2006) (Proposed rule), page 92.

[7] Ibid, page 92.

[8] U.S. Securities and Exchange Commission, Executive Compensation Disclosure, Release Nos 33-8735; 34-54380, 71 Federal Register 53267 (September 8, 2006) (Proposed rule), page 98.

[9] Ibid, page 98. This estimate appears to be based on the following calculations: First Year Cost = 8 hours per firm times $400 per hour times 1700 firms = $5.44 million. Annual Cost in Years Two and Three = 2

In addition, the SEC assumed that impacted companies will "spend 60 hours in the first year and 10 hours in each of the two succeeding years, with an average internal cost of $175 per hour."[10] This would represent an average cost per company of $10,500 the first year and $1,750 in the two subsequent years. The estimated total average annual internal cost burden of collecting and monitoring employee compensation over the three years for all affected companies is estimated to be "approximately 45,000 hours, or approximately $8 million."[11] Thus, the SEC's estimate of the total average cost for each company to comply with the proposed disclosure regulations is estimated to be $13,700 in the first year and $2,550 in the next two years. This represents an average impact across the three years for all impacted firms of $11 million or approximately $6,500 per affected company per year.

The compliance cost should be an important factor influencing whether these proposed regulations should be adopted. To assess whether these cost estimates are reasonable, the author in conjunction with the HR Policy Association and WorldatWork developed a survey that was sent to senior managers at firms that would be potentially affected by the proposed regulations. This report compares the estimates reported by human resource managers at firms in the survey to those presented by the SEC. The survey data indicate that cost estimates by potentially affected firms are substantially greater than those by the SEC. Respondents estimated an average cost in the first year of $27,845 and an on-going annual cost of $19,873. In the aggregate, estimated compliance costs would average $38 million per year over the three year period compared to the SEC's estimate of $11 million.

EMPLOYER SURVEY OF PROPOSED DISCLOSURE REQUIREMENTS

To assess the reasonableness of the SEC cost estimates for implementing the proposed disclosure regulations, an employer survey was developed to gather information on the estimated compliance cost of these regulations. The survey, "SEC Proposal: Public Disclosure of Three Highly Compensated Employees," was sent to a sample of large employers who would be expected to be affected by the implementation of the proposed regulations. The sample was composed of members of the HR Policy Association[12] and members of WorldatWork.[13] WorldatWork identified 1,183 member companies with 10,000 or more employees who were considered appropriate candidates for this survey.[14] The on-line surveys were sent to senior level human resources

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hours per firm times $400 per hour times 1700 firms = $1.36 million per year. Total cost for the three years is equal to $5.44 million + $1.36 million + $1.36 million = $8.16 million or $2.72 million per year.

[10] Ibid, page 98.

[11] Ibid, page 98. This estimate appears to be derived as follows: First Year Cost = 60 hours per firm time $175 per hour times 1700 firms = $17.85 million. Annual Cost in Years Two and Three = 10 hours per firm time $175 per hour times 1700 firms = $3.0 million. Total cost for the three years is equal to $17.85 million + $3.0 million + $3.0 million = $23.85 million or approximately $8.0 million per year.

[12] HR Policy Association is a public policy advocacy organization representing the chief human resource officers of over 250 companies in most major industrial sectors of the economy.

[13] WorldatWork is a not-for-profit professional association dedicated to knowledge leadership in compensation, benefits and total rewards. Its members are individual human resource managers.

[14] The WorldatWork sample was selected by searching their membership for all persons employed by companies with 10,000 or more employees. Using this criterion 2,032 companies were identified. After deleting firms that were also members of HR Policy Association, a sample of 1,354 companies was identified. Electronic surveys were successfully sent to 1,183 companies. The survey was sent to 210

managers at these large companies who are members of WorldatWork. The HR Policy Association identified 210 member companies that would probably be affected by the proposed regulations and the survey was sent to the chief human resource officer of the company.

The survey was sent to these 1,393 firms on September 29, 2006. In order to analyze the data in time to provide useful information within the SEC's commenting period, respondents were given a relatively short time to complete the survey, i.e. surveys had to be return by October 9. Usable responses were received from 139 companies for a total response rate of 10 percent. The deadline of less than two weeks clearly affected the number of firms responding to the survey. The modest response rate may result in some sample selection issues associated with the final sample of responding companies. However, if all of these firms meet the standards set out by the SEC, they would represent over 8 percent of companies that are potentially affected by the proposed regulations.

Demographics of Survey Respondents

The final sample of respondents was composed of large firms that were likely to be affected by the proposed regulations. Just under 10 percent of the firms indicated that they had more than 100,000 employees and 35 percent reported that they had between 25,000 and 100,000 employees. Slightly more than one quarter of the companies were in manufacturing, 19 percent were in the wholesale and retail trade sector with 12 percent were financial services companies. Two thirds of the companies reported having $700 million or more in voting and nonvoting common equity held by non-affiliated shareholders (i.e., were "large accelerated filers" as defined by the SEC and thus subject to the proposed rule) and another 19 percent reporting that they were unsure whether they met this criterion.

The survey asked the responding senior HR managers to provide information on how compensation records were maintained at their company, how difficult it would be to obtain the data required by the proposed regulations, and how many employees would have to be considered in order to determine if they were in the set of three highly compensated nonexecutive officers. In order to make a direct comparison with the SEC cost estimates, the survey also asked for the expected number of hours needed to gather this information in the first and subsequent years along with the estimated cost of producing this information in the first year and in subsequent years. The next section discusses the results of the survey in detail and contrasts the estimates by potentially affected companies to that of the SEC. The complete survey and the distribution of responses to the questions are provided in Appendix A of this report.

HRPA member companies that were publicly-held and for whom a chief human resource officer was on file with HRPA.

EMPLOYER ESTIMATES OF THE COST OF COMPLIANCE TO THE PROPOSED DISCLOSURE REQUIREMENTS

"Our biggest concern would be in trying to identify and accurately value the total compensation package for a number of employees in foreign countries. In most years we would probably have no one to report but would need to spend a lot of time making sure."[15]

In order to comply with the proposed regulations, a company will need to compare the total compensation of all policymaking employees who might receive compensation in excess of the CEO, CFO, and the other named executive officers. The cost impact of the proposed regulations will depend, in part, on:

- the number of individuals who might conceivably have total compensation in excess of the named executive officers;
- whether the information can be easily generated from current records (e.g. whether benefits and cash compensation reside in the same database); and
- whether a single database covers all employees of the company.[16]

The survey sought to gather information from companies on each of these points.

Resources Needed to Comply With Proposed Regulations

The first problem a company might encounter in attempting to comply with the proposed regulations is whether the compensation for all highly compensated employees throughout the entire company are kept in a single database and whether this database includes cash compensation and all other financial rewards provided during the year under the Commission's definition of Total Compensation. Only 20 percent of the responding companies indicated that they had all of this information in a single database. An additional 36 percent of firms reported that compensation and benefit records were kept for the entire company but records on cash compensation were maintained separately from benefit information. The proposed regulations would necessitate that these companies merge two separate database programs in order to identify whether any employees' total compensation exceeds that of any named executive officers.

Perhaps more importantly, 35 percent of these large firms indicated that there was no unified compensation database for all their employees. Instead, they reported that compensation information for U.S. employees and those in foreign countries were maintained in separate database systems. These companies would have a more difficult time in determining affected employees. One respondent summarized the assessment for their company by noting that "Company revenue and employee base are over 50% non-US based. Significant redesign of compensation and administrative systems" would be required to comply with the proposed disclosure standards. Clearly, the cost impact of the proposed regulations would depend on the current record keeping policies of affected firms.

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[15] All of the following quotations are responses to question 11 in the survey, "Assume that you could speak directly to the members of the SEC. Please write a short statement that would summarize the impact of the proposed rule on your company and your assessment of the value that it would add."

[16] The proposed SEC rule requiring disclosure for an additional three employees applies to any employee in the company, even if domiciled in a different country.

Furthermore, over 60 percent of the firms indicated that they do not currently maintain records that include total compensation for all employees whose total compensation could possibly exceed that of any named executive officer using the definition of total compensation as adopted by the SEC for determining the compensation of a company's named executive officers. Over 70 percent of those firms stating that they currently did not maintain such a compensation record indicated that it would be difficulty or very difficult and costly to develop and maintain such systems.

One issue related to responding to the new regulations concerns the potential number of employees that might have to be monitored in order to determine whether their salary exceeded the named executive officers. Approximately one third of the sample reported that in order to determine the three most highly compensated employees they would have to examine the compensation of less than 10 employees. Another 37 percent of companies expected the number of employees to be considered would be between 10 and 25. However, over 20 percent of the firms indicated that they would need to review the compensation of between 26 and 100 employees and just under 10 percent of companies thought that in excess of 100 employees would need to be monitored. Once again, it is clear that the compliance cost will vary substantially across impacted firms.

Cost Estimates Reported by Firms vs. SEC Estimates of Compliance Cost

The central question regarding the proposed standards is the expected compliance cost of gathering and maintaining the needed information on total compensation of relevant employees. The SEC estimated that total time of outside counsel and internal staff per company would be 68 hours the first year and 12 hours in subsequent years. There was substantial variation in the estimates across companies represented in the survey. Three quarters of the sample indicated that compliance would require 50 hours or less in the first year, an estimate below the SEC's. However, the firm's estimated compliance time in subsequent years was considerably above the estimate by the SEC. Only 31 percent of firms indicated compliance time of less than 10 hours per year while 20 percent thought 26 to 50 hours would be need to provide this information and 15 percent expected to spend over 50 hours per year to provide the needed information.

Firms were then asked to quantify the total expected cost of complying with the proposed regulations in the first year and in subsequent years. The SEC estimated that the total cost of compliance would average $13,700 in the first year and $2,550. The firms responding to the survey provided a wide range of estimates for the total cost of complying with the disclosure requirements. At the low end, 42 percent of the firms estimated their compliance cost of less than $10,000 in the first year or somewhat below the SEC estimate. In contrast, 38 percent of companies expected the costs to exceed $25,000 and 20 percent of responding firms reported cost estimates of between $10,001 and $25,000. Thus, while the SEC's estimate of first year compliance cost are close to the median response in the survey, some firms clearly anticipate much higher compliance costs including 11 percent indicating first year costs between $50,001 and $100,000 and 6 percent expecting costs to exceed $100,000. These data suggest that they SEC may have failed to consider the distribution of possible compliance cost and the relative high cost that some firms will face in complying with the proposed regulations.

In contrast, the SEC's estimate of the continuing compliance costs of $2,550 is much lower than that reported by the firms in the survey. Two thirds of the responding

firms believe that the on-going compliance cost will exceed $5,000. One fifth of the respondents reported expected costs of between $10,001 and $25,000, 14 percent of companies thought the costs would be between $25,001 and $50,000, and 11 percent of firms believed the on-going annual costs would exceed $50,000.

Perhaps the lower SEC cost estimates are the result of not considering all the cost of complying with the regulations. In the survey, over 60 percent of the firms indicated that they expected to have the following costs associated with providing the needed information to comply with the disclosure standards:

- cost of employees or contractors collecting the data;
- developing new systems and computer programs;
- fees for consultants, lawyers; and
- other outside professional advisors, and the time of executive officers and Board members reviewing the data.

OTHER CONCERNS OF HR MANAGERS

"The proposed rule would highlight our key talent for our competition along with the specifics of their compensation packages making it much easier to siphon off talent. In addition it will introduce a whole new round of internal comparisons (resulting in) low morale and unproductive time associated with these comparisons."

Beyond the cost of complying with the proposed regulations, many firms expressed concerns about the impact of disclosing this information. Respondents reported that the disclosure of the total compensation of their best and highest paid employees would make it easier for competing firms to approach these employees and try to lure them away. In essence, knowledge about the total compensation would allow competitors to develop compensation packages that match or exceed the current compensation of these star employees. The survey asked respondents if the disclosure of this information would make it easier for competing firms to recruit their highly compensated employees. One third of the respondents replied "much easier" and another 28 percent thought it would make such raiding "easier".

In addition to their concern about the proposed regulations making it more likely that top employees would be hired away by competitors, some respondent also worried about the impact of compensation disclosure on the morale and job satisfaction of other workers. One respondent summed up these two potential effects by stating:

"Total reward(s) is a complex and confidential matter. To expose the value we place on our most highly paid non-executive employees would be embarrassing for these employees and demotivating for their peers. In addition, the threat of competitive poaching – when an employee is otherwise engaged and happy with their current company – puts us at a competitive disadvantage."

Some of the respondents also pointed out how the proposed disclosure regulations would differentially affect companies. For example, public companies would have to comply with the standards but privately held companies would not. Companies that contract out significant components of their activities also would tend to be less likely to have to identify top performers. Thus, the increased probability of competitors raiding top talent

would fall on large public companies that use their own employees throughout their enterprise instead of relying on outside contractors.

VALUE OF DISCLOSURE TO SHAREHOLDERS

"Significant policy decisions in public companies are almost always made by the named executive officers in conjunction with the Board of Directors the compensation of whom is now clearly disclosed. From a shareholder perspective it is difficult to imagine how the proposed additional disclosure will influence one's investment decisions."

In order to justify the regulatory cost of implementing any new disclosure rules, one should be able to clearly articulate the benefits to investors, regulators, and society. Having identified these benefits, one should be able to conclude that the benefits outweigh the cost of complying with the regulations. In general, the respondents felt that if implemented, the proposed disclosure regulations would provide little, new useful information to shareholders and investors. Only 7 percent of the sample felt that the new information would be useful and important in assessing the company's compensation programs and governance practices while 27 percent thought the information would be useful but of only limited value. Nearly two thirds of the firms replied that they did not think the information would be useful to those trying to determine the value of the company.

COMPLIANCE COST ESTIMATES: EMPLOYERS AND SEC

"This additional proposal will require significant work from both an internal manpower and external cost perspective. I fail to see the value in this approach and have concern about raising visibility of these 3 highly paid non-executives to the outside market."

This report seeks to provide new estimates concerning the cost and benefits of the SEC's proposal for enhanced disclosure concerning the compensation of highly compensated employees who are not named executive officers. The approach has been to survey senior human resource managers at firms that are likely to be covered by the proposed regulations. The survey responses show the cost and benefit evaluations of these executives associated with their company having to comply with the proposed regulations. How do the cost estimates of these companies compare to those of the SEC?

The SEC estimated that the total cost of compliance would average $13,700 per company in the first year and $2,550 in subsequent years for a total cost over a three year period of $11 million or approximately $6,500 per affected firm per year. To estimate a comparable cost per company from the survey, we use the data reported in question 6. The estimated average cost per firm is found by multiplying the percent of firms with each answer times the mid-point of the cost range and then adding these values.[17] This method indicates the average compliance cost for an affected company in the first year is expected to be $27,845 or twice the estimate of the SEC. Using the same approach for the subsequent years yields an average per company compliance cost of $19,873 in the

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[17] A value of $100,000 is used for those firms selecting option f in question 6, the highest cost estimate. This will introduce a slight downward bias in the calculated cost estimates.

subsequent years or eight times the estimate of the SEC for the on-going cost of complying with the proposed regulations.

Following the SEC, assume that 1,700 companies will be affected by the disclosure proposals. Using the estimates from the survey, the total compliance cost would be over $47 million in the first year and $34 million in subsequent years. Thus, survey respondents estimated an average annual cost over the three years of $38 million or more than three times the SEC's estimate of $11 million per year. The survey responses suggest that the SEC substantially underestimated the on-going cost of complying with these regulations. In addition, the survey responses illustrate that the cost of compliance is expected to vary substantially across firms. One potential reason for the underestimate of the total compliance cost by the SEC is the rather large costs expected by some firms.

While the SEC provided estimates of the compliance cost, they did not attempt to measure the value to investors of the proposed disclosure rules. Thus, it is difficult to develop any systematic cost benefit analysis of the proposals. It is clear that the respondents in the survey thought that the compliance costs far exceed the benefits of the proposed regulations or as one wrote:

"The additional burden on the company of calculating the SEC's version of total compensation for up to 25 non-NEOs far outweighs the incremental benefit to investors of having the compensation on 8 employees as opposed to 5" employees disclosed.

APPENDIX A
SEC PROPOSAL: PUBLIC DISCLOSURE OF THREE HIGHLY COMPENSATED EMPLOYEES

The following survey was sent to senior human resource managers of companies that are members of the HR Policy Association and WorldatWork. The survey was sent electronically on September 29, 2006 with a return deadline of October 9, 2006. By the stated deadline, 139 responses were received. The percentages to the left of each response indicate the percentage of respondents checking that option.

1. Check the single answer that most closely describes the current method of maintaining total compensation records for company employees:

20.1% a. Compensation and benefits records are kept for the entire company in a single database.
36.0% b. Compensation and benefits records are kept for the entire company, but in separate databases for compensation and benefits.
8.6% c. There is no unified compensation database on employee compensation; each major division or subsidiary maintains its own set of compensation records.
35.3% d. There is no unified compensation database on employee compensation; U.S. compensation and compensation in foreign countries are kept on separate database systems.

2. Does your company currently maintain records that report the total compensation, as defined under the SEC rules adopted in July 2006 for determining a company's named executive officers, for all employees whose total compensation could exceed that of any named executive officer?

27.3% a. Yes
11.5% b. No, but systems for generating this data will be operational by Dec. 31, 2006
61.2% c. No

3. If you answered no to question 2, how difficult and time consuming would it be to calculate total compensation for these employees on an annual basis?

8.0% a. Not very difficult; this could be done with a one-time processing cost.
21.0% b. Somewhat difficult; this could be done with a one-time processing cost.
53.0% c. Difficult; varying costs would be incurred each year.
18.0% d. Very difficult; it would require substantial administrative processing time and costs each year.

4. In order to determine the three employees whose "total compensation" exceeded any of the named executive officers, and who had responsibility for significant policy decisions (as defined by the SEC), approximately how many employees would your company need to monitor each year?

32.4% a. less than 10
36.7% b. 11 to 25
12.2% c. 26 to 50
9.4% d. 51 to 100
3.6% e. 101 to 500
5.8% f. more than 500

5. Compliance Time Under the New Rules
To comply with the proposed rule and identify the three most highly compensated employees who are not executive officers or directors, **in the first year the rule is effective**, I estimate that my company would need to spend:

18.5% a. less than 10 person hours
25.9% b. 11 to 25 person hours
31.1% c. 26 to 50 person hours
11.1% d. 51 to 100 person hours
13.3% e. more than 100 person hours

To comply with the proposed rules and identify the three most highly compensated employees who are not executive officers or directors, **in the second and subsequent years**, I estimate that my company would need to spend:

31.0% a. less than 10 person hours per year
32.8% b. 11 to 25 person hours per year
19.8% c. 26 to 50 person hours per year
12.1% d. 51 to 100 person hours per year
4.3% e. more than 100 person hours per year

6. Compliance Costs Under the New Rule
To comply with the proposed rules and identify the three most highly compensated employees who are not executive officers or directors, **in the first year,** I estimate that my company would incur total costs (*i.e.*, internal costs and costs for outside professional advisors) of:

20.9% a. less than $5,000
20.9% b. $5,000 to $10,000
20.1% c. $10,001 to $25,000
20.9% d. $25,001 to $50,000
11.2% e. $50,001 to $100,000
6.0% f. more than $100,000

To comply with the proposed rule and identify the three most highly compensated employees who are not executive officers or directors, **in the second and subsequent years,** I estimate that my company would incur total costs of:

33.3% a. less than $5,000
21.7% b. $5,001 to $10,000
20.0% c. $10,001 to $25,000
13.9% d. $25,001 to $50,000
10.4% e. $50,001 to $100,000
0.9% f. more than $100,000

7. Please identify all types of significant costs that you expect to incur to collect and organize the data needed to respond to the proposed rule.

57.6% a. Cost of employees or contractors collecting the data
23.7% b. Development of new systems and computer programs
43.2% c. Fees for consultants, lawyers and/or other outside professional advisors
43.9% d. Time of executive officers and Board members reviewing the data
38.1% e. All of the above (a-d)
5.0% f. Other – please identify

8. To what extent will providing compensation and job description information on your three highest paid employees having significant policy influence and who are not Named Executive Officers make it easier for competing firms to recruit them?"

14.4% a. not easier at all
23.7% b. a little easier
28.1% c. easier
33.8% d. much easier

9. Which of the following best describes the compliance burden in terms of administrative time and systems development costs, if any, on your company of the proposed SEC rule if adopted?

2.9% a. No new compliance burden at all.
23.0% b. Minor compliance burden;
48.2% c. Moderate compliance burden;
20.1% d. Substantial compliance burden;
5.8% e. Significant compliance burden;

10. Do you think that the proposed rule will provide useful information to shareholders, analysts, and the general public so that they can more effectively assess the value of your company and its compensation structure and practices?

27.3% a. Yes, but this new information will be of only limited value.
6.5% b. Yes and this information would be important in assessing the company's compensation programs and governance practices.
65.5% c. No, I do not see how this information would be useful to those trying to determine the value of our company.

11. Assume that you could speak directly to the members of the SEC. Please write a short statement that would summarize the impact of the proposed rule on your company and your assessment of the value that it would add (no more than 100 words).

Demographic Information

12. Does your company have $700 million or more in voting and nonvoting common equity held by non-affiliated shareholders and thus will be required by the proposed rule to provide new information on highly-compensated employees?

67.6% a. yes
13.7% b. no
18.7% c. unsure

13. Check the major industry of your company:

2.9% a. Health Care
0.0% b. Education
12.3% c. Financial Services
1.4% d. Telecommunications
18.8% e. Retail/Wholesale Trade
5.1 f. Transportation
7.2% g. Energy/Utilities
26.1% h. Manufacturing
26.1% i. Other

14. Indicate the number of full-time employees in your company:

18.7% a. less than 10,000
36.7% b. 10,001 to 25,000
22.3% c. 25,001 to 50,000
12.9% d. 50,001 to 100,000
9.4% e. more than 100,000