

THE DODD-FRANK PAY RATIO IS UNDULY BURDENSOME  
AND CONTRARY TO SOUND DISCLOSURE POLICY

Hearing on Legislative Proposals to Promote Job Creation, Capital  
Formation, and Market Certainty

Subcommittee on Capital Markets and Government Sponsored Enterprises

House Committee on Financial Services

March 16, 2011

Statement Submitted for the Record



Chairman Garrett, Vice Chairman Schweikert, Ranking Member Waters and Members of the House Financial Services Committee:

The Center On Executive Compensation is pleased to submit testimony supporting H.R. 1062, the Burdensome Data Collection Relief Act, which would repeal the pay ratio mandate required by the Dodd-Frank Wall Street Reform and Consumer Protection Act. The statute requires the Securities and Exchange Commission to draft regulations requiring companies to disclose the ratio of the median pay of all employees to the total pay of the chief executive officer. The Center believes that this mandate would impose significant costs on public companies, causing them to redirect resources from more productive uses, such as job creation, without providing meaningful or material information to investors. For this reason, the Center urges the Subcommittee to repeal the pay ratio and focus on assisting the SEC in ensuring that existing disclosures provide a clear explanation of the link between executive compensation and performance.

The Center On Executive Compensation 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 and represents companies from a broad cross section of industries. Because the senior human resource officers play a unique role in supporting the compensation committee chair, we believe that our Subscribers' views can be particularly helpful in understanding the complexities that would be required to implement the pay ratio requirement.

## **I. The Costs of the Pay Ratio Requirement Far Outweigh Its Benefit**

The pay ratio provision in Section 953(b) of the Dodd-Frank Act requires companies to disclose in their proxy statements the ratio of the median pay of all employees to the total pay of the chief executive officer. SEC officials from Chairman Mary Schapiro, to the Director of the Division of Corporation Finance Meredith Cross, have indicated that due to the prescriptive nature of the provision, the SEC has very little interpretive authority and thus would interpret it narrowly. For this reason, it is likely that companies would be required to calculate the pay of every employee globally, whether full- or part-time, in the same manner as compensation is calculated for the named executive officers.

The burden of this median pay calculation requirement is significant. It would require a company to gather and calculate compensation information for each employee as required for senior executives under the SEC disclosure rules, determine the pay of each employee from highest to lowest, and then identify the employee whose pay is at the midpoint between the highest- and lowest-paid employee. No public company currently calculates each employee's total compensation as it calculates total pay for CEOs on the proxy statement; therefore, companies would be required to invest considerable resources to implement this mandate to produce a meaningless statistic.

The Center has engaged its Subscribers to gain a better understanding of the burden and difficulty in gathering and calculating this information, and based on those conversations have developed the following real-world examples:

- A company that employs 108,000 people in 52 countries has over 100 vendors that maintain its 115 different pay systems.
- A company that employs 137,000 employees in 68 countries maintains over 1,000 different pay systems.
- A company that employs 42,000 individuals in 60 countries has 15 different pay systems.
- A company that has 360,000 employees globally in 19 countries has more than 10 different pay systems;

Under the pay ratio requirement, the scope of the information gathering requirement presents significant hurdles for companies. Accuracy is a significant concern, since compensation data is housed in dozens of computer systems and subject to the compensation and benefits rules of different countries worldwide. Furthermore, these illustrations say nothing with respect to the impact that exchange rate fluctuations will have on the calculations. Companies would be required to develop and coordinate a consistent calculation across all countries and then ensure that the results were accurate since Section 302 of Sarbanes-Oxley requires the CEO and the CFO to sign the proxy statement certifying its accuracy.

In sum, the pay ratio requirement is administratively burdensome and costly to develop. As discussed below, the information produced will not be useful for investors.

## **II. The Pay Ratio Requirement Would Not Provide Material Information and Is Inconsistent With Purposes of Proxy Statement Disclosure**

As the Committee reviews H.R. 1062, the Center notes that pay ratio mandate is inconsistent with the purpose of the SEC disclosure rules. The SEC generally requires that companies disclose in the proxy statement all material information necessary to inform an investor of how and why a company compensates its named executive officers. Material information is that which would impact an investor's decision to invest in the company or its vote for directors. Therefore, the addition of nonmaterial information simply lengthens the disclosure and dilutes the impact of material information. Further, the inclusion of this ratio could mislead investors who seek to compare ratios between companies.

The ratio would not be comparable between companies as the pay of employees at all levels of an organization is subject to various forces in the market, such as competition, geography and job type. Companies employing more highly paid employees will likely have a smaller ratio due to the structure of their workforce as opposed to those employing

a larger share of lower paid employees, such as retail clerks. However, the difference would not tell investors whether the company with the lower ratio is a better investment. Moreover, the ratio does not account for a company's global operational structure or business strategy, which would certainly have an impact. One company may rely on third parties for certain services like manufacturing or information processing whereas another company outsources it. Again, comparing the ratios between two such companies would provide little useful information.

Since 2006, the SEC has made significant changes to its executive compensation disclosure rules relating to executive compensation in an effort to expand the material information that is available to investors. Because of these rules, the average compensation disclosure in a proxy statement of Center Subscribers is now 26 pages. That is over a quarter of the length of proxy statements for large companies, which now routinely are 100 pages long. The addition of nonmaterial information in the form of the ratio and any narrative disclosure to explain the ratio would only add to the length and make it more difficult for investors to digest the material information.

## **Conclusion**

In sum, the pay ratio requirement would not provide material information, would be extremely costly to implement and it is inconsistent with the purposes for disclosing compensation in the proxy statement. Repealing the pay ratio disclosure requirement would be a helpful step in executing President Obama's initiative to eliminate unnecessary, burdensome and costly regulations as the pay ratio requirement is an example of the types of mandates that are "not worth the cost."

The Center appreciates the opportunity to provide its views on this extremely important policy matter. We look forward to working with you and members of your staff to ensure that the Dodd-Frank Act will lead to the positive reform that was intended when it was enacted.