

SEC Pay Ratio Rules Expected by End of Year and Recent Comment Letter Challenges SEC Cost Assumptions

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SEC Chair White [signaled](#) that the proposed rules on CEO pay ratio would be adopted before the end of the year at a Senate Banking Committee hearing last month, or at least that was her “hope and expectation.” Senator Menéndez, Congressional author of the rule under the Dodd-Frank Act, responded that he wanted “more expectation and less hope” for meeting that timetable, indicating that the proposal in its current form reflects the “legislative intent.”

Chair White had also cautioned that the SEC staff was still working through 128,000 comment letters received on the topic. Since the hearing, the Center on Executive Compensation submitted a set of [follow-up comments](#), in part responding to letters from other organizations, namely the AFL-CIO, Calvert Investments and Trillium Asset Management, that characterize the pay ratio as highly material information for investors to evaluate a company's financial, compensation and human resource management practices.

The Center's letter warns that the pay ratio provides a misleading and potentially harmful disclosure. Simply by requiring the disclosure, investors may conclude that it constitutes material information. There will be an expectation of company-to-company comparisons that obscures the fact that pay ratio differences will be caused by each company's business structure, skills in the employee population and geographic location of the “median employee.” For example, owning vs. outsourcing manufacturing between two companies in the same businesses could account for a significant difference in pay ratios reported. The Center notes that the strong opposition (average 7% support) for shareholder proposals to require the disclosure since 2010 evidences that only a small subset of investors consider the information useful.

As payroll information is decentralized by design because employee compensation is uniquely local, the Center argues that a large manual data collection effort is likely to be required to determine the ratio, even for the initial purpose of running statistical sampling as permitted under the proposal. Under its own analysis, the Center believes that the Commission has underestimated compliance costs by at least 2.5 times, and is expected to exceed \$186 million, compared to the \$73 million estimated by the SEC.

The Center challenges three central assumptions in the proposed rule related to cost. First, the Commission's estimates are based upon speculation that the compliance hours will be doubled what was needed under the 2006 compensation rule changes, although that was a vastly different set of requirements. The Center also posits that instead of compliance costs dropping after the first year based upon its analysis of the work necessary to calculate NEO pay, changes in employee populations and shifts in methodologies will mean costs will actually increase in future years. Finally, the Center disputes the SEC's use of \$400 per hour as a reasonable estimate for outside professionals, which is apparently the rate the SEC assumes for legal services in connection with public company reporting.

The letter urges the SEC to reduce the compliance burden on companies through the use of its exemptive authority and to make significant changes to the proposed rule, such as limiting the disclosure to U.S. full-time employees only, and requiring the disclosure once every three years.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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