April 14, 2017

The Honorable Michael Crapo
Chairman
Senate Committee on Banking, Housing, and Urban Affairs
United States Senate
534 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Sherrod Brown
Ranking Member
Senate Committee on Banking, Housing, and Urban Affairs
United States Senate
534 Dirksen Senate Office Building
Washington, DC 20510

RE: Center On Executive Compensation Response to Request for Proposals to Foster Economic Growth

Dear Chairman Crapo and Ranking Member Brown:

On behalf of the Center On Executive Compensation, we are pleased to recommend proposals for the Banking Committee's consideration, if adopted, would promote economic growth and enable consumers, market participants, and financial companies to participate better in the economy. The Center believes the Committee can effectively promote economic growth and enhance economic participation by pursuing three policy changes which are discussed in detail below:

1. Repeal of the Dodd-Frank Pay Ratio Mandate;
2. Implementation of a Proxy Advisory Firm Regulatory Regime; and
3. Revisit and Revise the Executive Compensation Disclosure Requirements.

Although the Center acknowledges that some of these issues have generated spirited debate, the Center believes these recommendations would have significant impacts on both market participants and economic growth.

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, which represents the chief human resource officers of over 370 large companies, and the Center's Subscribers represent a broad cross-section of industries.

Repeal the Dodd-Frank Pay Ratio Disclosure

Description of the Proposal. The Center strongly urges the Committee to repeal the pay ratio disclosure in section 953(b) of the Dodd-Frank Act. The provision requires public companies to disclose the compensation of the median paid employee of their entire global workforce, including all full-time, part-time, temporary, and seasonal employees, and then to compare that compensation figure to the compensation of the company's Chief Executive Office in the form of a ratio in the company's annual proxy statement. The Securities and Exchange Commission finalized rules implementing the pay ratio in August 2015, and absent regulatory or legislative changes, first disclosures for most companies will appear in 2018 proxy statements for fiscal year 2017.

Impact on Economic Growth. The repeal of the pay ratio would remove enormous compliance burdens and costs on public companies. In the final rule, the SEC estimated that initial annual compliance costs would exceed $1.3 billion with annual compliance burdens approaching $370 million.

Shareholders and employees bear the brunt of these costs, which, in the absence of the pay ratio mandate, would otherwise be used to enhance stakeholder value and create American jobs. In fact, the addition of this disclosure – which most shareholders have not actively sought – will make finding material information in the proxy statement more difficult.

From a company perspective, no legitimate business purpose exists for collecting and maintaining the data required to compile and calculate the Dodd-Frank pay ratio disclosure. In fact, optimal operational efficiency for companies, particularly for those operating globally, often dictates keeping payroll and human resources-related systems – the systems which provide the data needed to compile the pay ratio – purposefully separate. This allows these systems to be tailored to localized human resources, taxation, and compensation practices. Compliance with the pay ratio disclosure, therefore, forces the creation of an otherwise wholly unnecessary process to gather data from purposefully separate systems. Thus, as recognized by the SEC, the resulting creation, implementation, and ongoing systems maintenance associated with annual pay ratio compliance imposes tremendous costs and resource burdens on registrants.

Impact on Ability of Consumers and Market Participants to Participate in the Economy. Repeal of the pay ratio will eliminate non-material and misleading information in proxy disclosures.

As a securities disclosure which will appear alongside core financial and governance information, the pay ratio not only fails to provide any material information to investors but also acutely risks misleading readers by purporting to provide insight into a company's human resources and compensation practices. The pay ratio cannot provide shareholders with a measure by which to legitimately evaluate a registrant because it fails as both a tool by which to compare a registrant against itself over a set period and as a tool to compare a registrant against its peers.

First, the pay ratio will compare the Summary Compensation Table definition of pay for CEO and median employee, which may differ considerably year-to-year for the CEO since it includes items such as pension fluctuations, hiring incentives and accounting-based valuations of equity grants. This will cause the annual pay ratio calculation to fluctuate because of accounting requirements or changes in the structure of CEO pay even though there are no material changes in how the median employee is paid. Thus, the ratio is not a good barometer of internal trends in compensation, which, in any event, academic research has shown has not been the source of growing inequality.[1]

Second, each registrant's pay ratio will differ based on that registrant's unique business structure. For example, a company that owns its manufacturing capabilities will have a higher ratio than those who outsources such operations. Similar disparities exist among different industries as well as the different markets in which companies do business. This renders a peer-to-peer comparison (or any other

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[1] Jae Song et al., *Firming Up Inequality*, NBER Working Paper 21199, available at http://www.nber.org/papers/w21199 (last visited 7/2/2015) ("Covering all U.S. firms between 1978 to 2012, we show that virtually all of the rise in earnings dispersion between workers is accounted for by increasing dispersion in average wages paid by the employers of these individuals. In contrast, pay differences within employers have remained virtually unchanged, a finding that is robust across industries, geographical regions, and firm size groups. Furthermore, the wage gap between the most highly paid employees within these firms (CEOs and high level executives) and the average employee has increased only by a small amount, refuting oft-made claims that such widening gaps account for a large fraction of rising inequality in the population").

comparison) of the pay ratio incoherent and misleading. Even the SEC acknowledged that direct comparison between companies may not be useful.

Today, there exists a broad consensus that, as a disclosure and a metric, the pay ratio cannot provide material value. Only a small cadre of labor unions, certain pension funds, special interest groups, and micro-minority shareholders unsurprisingly continue to argue that the pay ratio provides useful information to investors.[2] In reality, and despite claims to the contrary, the pay ratio's only value rests in its ability to be used as a shaming and inflammatory talking point to admonish companies by those with certain agendas.

Legislative Language. In the 114th Congress, Senator Mike Rounds introduced the Salary Collection Regulatory Relief Act (S. 1722) which would have repealed the pay ratio disclosure, section 953(b).[3] The Center urges the Committee to use this existing template as the framework through which to pursue pay ratio repeal. On the House side, the House Financial Services Committee has adopted pay ratio repeal in three consecutive sessions of Congress.[4]

Other Background Material.

- The Center's 2013 Comments on the Proposed Pay Ratio Rule – http://www.execcomp.org/Docs/COEC_Pay_Ratio_Comments_12-02-13.pdf
- The Centers 2015 Comments on the Proposed Pay Ratio Rule – http://www.execcomp.org/Docs/c15-31_PR_DERA_Comments Final.pdf
- The Center's 2017 Comments on the Pay Ratio Reconsideration – http://www.execcomp.org/Docs/c17-22_PayRatio_Comments.pdf
- Center Policy Brief on the Dodd-Frank Pay Ratio – http://www.execcomp.org/Docs/c17-07_DF_PayRatio_Hill.pdf

Implementation of Meaningful Proxy Advisory Firm Oversight

The Center urges the Senate Banking Committee to act to address the significant conflicts of interest which exist in the proxy advisory firm industry by implementing a regulatory regime which applies specifically to proxy advisory firms.

Description of the Proposal. The proposal would require proxy advisory firms to register with the SEC, including the procedures and methodologies used in advising clients, the proxy advisory firm's organizational structure, how the firm addresses potential and actual conflicts of interest, and how the firms are paid for conflicting services, such as consulting services. Due process requirements would

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[2] Shareholder support, beyond the small group of micro-minority special interest groups, fails to exist. The extreme infrequency of pay ratio shareholder proposals and the absolute lack of shareholder support for the few proposals voted on make this abundantly clear. Since 2010, only 17 shareholder proposals addressing or requesting a pay ratio have gone to a vote at S&P 500 companies. These proposals averaged less than 7% shareholder support with no proposal receiving more than 9.5% support. When compared against other governance initiatives, the lack of investor desire for pay ratio becomes even more stark. For example, in 2016 alone 48 S&P 500 companies received proxy access proposals. These proposals averaged 51% support and 23 of the 48 received majority support. Comparatively, in 2016 only two S&P 500 companies received proposals addressing pay ratio and pay disparity. These two proposals received average support of only 6%. If pay ratio disclosure was material information to shareholders, it can be assumed that such proposals would receive broad support.

[3] See https://www.congress.gov/bill/114th-congress/senate-bill/1722/text

[4] See 112th Congress – https://www.congress.gov/bill/112th-congress/house-bill/1062; 113th Congress – https://www.congress.gov/bill/113th-congress/house-bill/1135; and 114th Congress – https://www.congress.gov/bill/114th-congress/house-bill/414

apply to the application process. The proposal would also require firms to maintain disclosures on conflicts of interest in services provided and ownership structures, as well as formulation of voting policies and require regular submissions to the Commission detailing how voting methodologies were formed, a statement of financial condition and an annual report designed to reinforce the principle that proxy advisory firms have sufficient resources to analyze the proposals on which they are making recommendations. The rationale for the proposal follows.

Proxy advisory firms have played a significant, yet controversial role by providing proxy voting recommendations to investors (and in some cases, determining and casting votes for certain investors) on the growing number of proposals voted on at company annual meetings, including proposals to elect directors, approve mergers, shareholder proposals, and say on pay votes. The influence has increased considerably since mandated say on pay votes started in 2011. Most investors lack the resources in-house to analyze and make proxy voting decisions on every vote they must cast for the hundreds or even thousands of companies in their portfolios. As a result, many smaller and medium-sized investors rely heavily, if not exclusively on the research and analysis proxy advisory firms provide. Because of this reliance, proxy advisory firms enjoy remarkable influence over corporate governance and executive pay standards. This influence has led to a greater homogenization of corporate governance and executive compensation practices across a wide spectrum of companies that is sub-optimal for company performance and economic growth.

At the same time, proxy advisory firms are largely unregulated. Two firms hold 97 percent of the U.S. market and exert disproportionate influence over corporate governance and executive pay practices. The lack of a regulatory regime specific to the industry has facilitated proxy advisory firm business practices which include significant conflicts of interest. For example, the largest U.S. proxy advisory firm provides consulting services to issuers on whose proxies it provides voting recommendations to investors. At the same, time, the firm advises shareholder proponents on proposals on which the proxy advisory firm later will provide recommendations. The lack of transparency regarding how proxy advisory firms determine their voting policies and actual votes is also highly problematic. The significant workload and low margins of the proxy advisory firm business also can lead to errors or inaccuracies in making voting recommendations which can have a material impact on voting outcomes.

Impact on Economic Growth. The above concerns with proxy advisory firm business models have a significant and negative economic impact on companies. The proposal would help restore balance between the research proxy advisory firms provide to their clients and the documented homogenization of compensation and corporate governance practices that have been heavily influenced by proxy advisory firm voting methodologies. Greater oversight would reduce the negative influences and thus encourage issuers to adopt policies and practices that are best suited to promoting shareholder and stakeholder value, while recognizing the value the proxy advisory firms provide to institutional investors.[5] This would help foster more competitive companies that are able to retain top talent, and maximize stakeholder benefits.

Impact on the Ability of Consumers, Market Participants, and Financial Companies to Participate in the Economy. The status quo oversight of the proxy advisory firm industry and its influence over small and medium investors, has resulted in many issuers deviating from the highly tailored corporate strategies developed by their board of directors to those designated as "best practices" by proxy advisory firms. The resulting homogenization of company pay and governance practices harms the ability of companies to structure pay in a way that aligns with long-term strategy and performance to drive results. Not only can

[5] Between 2011 and 2016, S&P 500 companies which received an "Against" recommendation from ISS on their say on pay proposal averaged 65% shareholder support. Companies which received a "For" recommendation averaged over 94% support.

this have significant implications for company performance and talent retention, other market participants, including consumers, bear the costs.

Legislative Language: The Center urges the Committee to adopt a tailored regulatory regime which would limit the conflicts of interest and lack of transparency currently present in the proxy advisory firm industry. In the 114th Congress, Congressman Sean Duffy introduced the "Corporate Governance Reform and Transparency Act of 2016" (H.R. 5311) which would create a comprehensive regulatory regime for proxy advisory firms.[6] This bill provides a framework for the carefully tailored and yet comprehensive regulatory regime needed for proxy advisory firms.

Other Background Material:

- Center On Executive Compensation Testimony at House Hearing on Impact of Proxy Advisory Firms – http://www.execcomp.org/Docs/c13-33%20House%20Subc%20on%20Capital%20Markets%20Bartl%20Testimony%20PAF%206-5-13%20Final.pdf
- Center On Executive Compensation Policy Brief on the Corporate Governance Reform and Transparency Act – http://www.execcomp.org/Docs/c16-20_DuffyBill_PB.pdf

Direct the SEC to Revisit of the Executive Compensation Disclosure Requirements

The Center urges the Committee to request that the SEC embark on a comprehensive revision of the executive compensation disclosure requirements for U.S. public companies pursuant to the requirements in Regulation S-K Item 402.

Description of the Proposal: The current framework of executive compensation disclosure requirements in Item 402 was promulgated in 2007, before the introduction of mandatory say on pay as well as a significant evolution of executive pay best practices and shareholder engagement leading to improved disclosure practices. The current requirements are themselves not defective; however, they were promulgated at a very different time, before both Dodd-Frank as well as mandatory Say on Pay, and thus do not and cannot adequately accommodate the interim changes in executive compensation policy and practice which have occurred since 2007. The result is that proxy statements and executive compensation disclosures have ballooned to become overly long and complex documents, leading to consistent criticism by those who use the disclosures, including companies, investors, and retail investors.

Disclosures mandated under the Dodd-Frank Act which have not yet been finalized have the strong potential to further lengthen and complicate the executive compensation disclosures of public companies. Even worse, these mandates could duplicate or muddy best practice developments that have occurred since 2010. For example, companies will be required to include disclosures on pay ratio, as discussed above as well as the Dodd-Frank clawback requirement, which under the SEC's proposed implementing rules, is unnecessarily complex. Further, the Dodd-Frank "pay for performance" disclosure, which, due to very convoluted legislative text, has resulted in a proposed disclosure that is overly prescriptive which the SEC's own economic analysis states has the potential to be as misleading as it is informative.[7] This is hardly a standard that suggests clarity or improvement.

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[6] See https://www.congress.gov/bill/114th-congress/house-bill/5311

[7] According to the Pay for Performance Proposed rule, "the possibility of confusion is mitigated by allowing registrants to provide supplemental measures of pay and performance in the proposed disclosure, as well as the ability of registrants to provide further explanatory disclosures." In other words, the proposed rule assumes that the ability to include additional supplemental disclosures functions as a sufficient remedy of any misleading or

Impact on Economic Growth: The current length and complexity of executive compensation disclosures renders it difficult to find and identify material information in an efficient and often workable manner. Investors desire concise disclosure which informs them on executive compensation design and amounts. However, even though many companies go to great lengths to make their proxy disclosures shorter and clearer, for many reasons, the current disclosure requirements still often yield extremely long and complex disclosures.

Impact on the Ability of Consumers, Market Participants, and Financial Companies to Participate in the Economy: The current executive compensation disclosure requirements limit the ability of retail investors and even investors to fully participate in informed share ownership and proxy voting. First, the extreme length and complexity of executive compensation disclosures inhibits the ability of "Main Street" retail investors from participating in the proxy voting process because it is overly difficult to understand. Second, the extreme length and complexity of the disclosure has given rise to the need for proxy advisory firms as well as other third party sources which distill the information down to allow investors to vote on potentially hundreds or even thousands of proxy proposals at all the companies in their portfolios. As we have explained in the section above, the proxy advisory firm industry status quo negatively impacts the economy.

Legislative Language:

(1) "Not later than the end of the 180-day period beginning on the date of the enactment of this Act, the Securities and Exchange Commission shall carry out and publish a study of the requirements of Regulation S-K Item 402 for the purposes of conducting a comprehensive reexamination and redrafting of the requirements of the Item 402 disclosures."

(2) "Not later than the end of the 180-day period beginning on the date of the publication of said report, the Securities and Exchange Commission shall engage in a comprehensive reexamination and redrafting of the requirements of Regulation S-K Item 402."

We believe that the time is ripe for a comprehensive review of the current executive compensation disclosure regime and believe the SEC should be directed to engage in such review.

Thank you for the consideration of the Center's views on these proposals. We look forward to meeting with the Committee staff to further discuss our thoughts. If you have any questions, please contact me at tbartl@execcomp.org or Henry Eickelberg at heickelberg@execcomp.org.

Sincerely,

Timothy J. Bartl
Chief Executive Officer

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contradictory information otherwise communicated by the proposed rule. Such logic is clearly misaligned with the goal of disclosure in the federal securities laws. https://www.sec.gov/rules/proposed/2015/34-74835.pdf See page 92.