NATIONAL ASSOCIATION OF
Manufacturers

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The Honorable Michael S. Piwowar
Acting Chairman
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090
Submitted electronically rule-comments@sec.gov

Re: Reconsideration of Pay Ratio Rule Implementation

Dear Acting Chairman Piwowar:

The National Association of Manufacturers (NAM)—the largest manufacturing association in the United States, representing small and large manufacturers in every industrial sector and in all 50 states—appreciates the opportunity to provide further comments to the Securities and Exchange Commission (SEC) on the “pay ratio” rule implementing Section 953(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) under the February 6, 2017, request for comment in “Reconsideration of Pay Ratio Rule Implementation”. Thousands of U.S. manufacturers are public companies that would be subject to this new reporting requirement.

Overview

As stated in the NAM’s comment letters dated December 2, 2013, and July 6, 2015, in response to the proposed rule implementing this Section, the NAM, during Congressional consideration of the Dodd-Frank Act, urged Congress to focus their efforts on strengthening the U.S. financial system and avoiding new regulations that could be costly and hinder job creation for manufacturers and other non-financial companies that had nothing to do with the financial crisis. One example of a costly regulation that raised manufacturers’ concerns is the so-called “pay ratio requirement.”

Manufacturers continue to believe that requiring companies to regularly disclose the ratio of employees’ median pay to the compensation of the company’s chief executive represents a costly and onerous administrative burden on companies that will not produce useful information for investors.

The NAM concurs with the SEC that, “neither the statute nor the related legislative history directly states the objectives or intended benefits of the provision or a specific market failure, if any, that is intended to be remedied.”[1] Yet, despite the absence of a clear benefit, companies will be required to incur significant financial cost, dedicate substantial man-hour resources and overcome numerous administrative challenges in order to attempt to comply with the proposed rule.

Given the lack of benefit, the significant cost and administrative barriers to compliance,

[1] 78 Fed. Reg. at 60582.

and the unexpected challenges arising with compliance, the NAM is pleased that Acting Chairman Piwowar has focused on pay ratio as a rule for reconsideration. The NAM urges the SEC to indefinitely suspend implementation of the rule and encourages Congress to repeal this requirement.

Current Efforts to Repeal or Limit Sec. 953(b)

The NAM recognizes that the SEC had a statutory requirement to promulgate the pay ratio rule. However, Sec. 953(b) was inserted into the Dodd-Frank Act without consideration to the cost of collecting this information, whether other information was already available to simplify the reporting of wage data, or the overall benefit of reporting the information. There is broad acknowledgement among policy makers of the burden this provision creates and there has historically been bipartisan support to alter this requirement.

The NAM has supported legislation entitled the *Burdensome Data Collection Relief Act* (H.R. 414 in the 114th Congress) approved by House Financial Services Committee in the 114th Congress to repeal Sec. 953(b). In the 113th and 112th sessions of Congress, the bill received bipartisan support when approved by the House Financial Services Committee in 2013 (H.R. 1135) and 2011 (H.R. 1062), respectively. In the 114th Congress, the bill was also included in the Financial CHOICE Act of 2016 (H.R. 5983), approved by the House Financial Services Committee to repeal and replace several aspects of the Dodd-Frank Act.

A Rule without a Benefit

As discussed above, and acknowledged by the SEC in the September 2013 release, the purpose of Sec. 953(b) is unclear. “(T)he legislative record includes only a few brief references to the pay ratio disclosure requirements, each opposing the provision.”[2] The SEC’s proposal also notes that, “neither the statute nor the related legislative history directly states the objectives or intended benefits of the provision.”[3]

Some commentators have suggested that the pay ratio rule could help shareholders by adding another disclosure that may help inform investment decisions. In manufacturers’ experience, this assumption is false. Many NAM member companies have robust shareholder outreach programs where they discuss a range of subjects with shareholders, including corporate governance issues. Indeed, one manufacturing company that regularly meets with shareholders explained that no shareholder has ever asked for or about a CEO pay ratio. Other NAM members have echoed this same point: investors do not care about the ratio, but instead are focused on strategy, performance and whether shareholder value is increasing. Furthermore, public companies must already file comprehensive disclosures about chief executive compensation and the addition of a pay ratio requirement adds another layer of duplication in the already lengthy annual proxy statement.

Moreover, others have suggested that the pay ratio provision may provide shareholders with an additional tool to compare data across companies. Again, this narrative completely

[2] 78 Fed. Reg. at 60562.
[3] 78 Fed. Reg. at 60562.

misses the mark. The idea that a single statistic, like the pay ratio, could be an indicator of a company's approach to compensation practices, business strategy, or hundreds of other decisions that comprise a company's business plan is false and overly simplistic. Manufacturers agree with the SEC, "that using the ratios to compare compensation practices between registrants without taking into account inherent differences in business models, which may not be readily available information, could possibly lead to potentially misleading conclusions and to unintended consequences."[4]

Compensation can be based on a huge and varying array of factors ranging from location to size of the business to tenure and experience of executives, factors that could vary dramatically depending on the individual company. In order to grow a strong and competitive manufacturing economy, manufacturers need to find and attract world-class talent at all levels. The NAM has long supported flexibility in the design of executive compensation benefit packages to ensure manufacturers can recruit and retain leaders that will grow the business, create more jobs and contribute to economic growth. That flexibility enables manufacturers to stay competitive, but creates diversity among the ways executives are compensated that is not easily comparable from company to company.

Accurate comparisons across companies are virtually impossible, as are comparisons of a single company over time. For example, take the case of a manufacturing company that acquired a company several years ago with tens of thousands of employees and recently spun many of those employees off to a new company. The company's "pay ratio" would vary wildly when computed before the acquisition, during the years as a combined company, and after the divestment. If the aim of this requirement is to provide investors with greater insight into the company and its pay practices as an employer, the information rendered and the resultant numeric figures are essentially meaningless given the wide range of business decisions that can impact the ratio.

Thus, companies will be required to comply with a provision that has no stated benefit but that will require them to incur significant costs and overcome substantial barriers to do so.

Cost of Compliance

Manufacturers continue to have serious concerns about the cost of compliance with the pay ratio rule. Some NAM member companies are already incurring costs and increasing resources to prepare for compliance with the rule. One company described the costs as primarily related to working with an external consultant to assist the company in identifying data needs, collecting demographic information, performing model calculations and determining the best approach to use for a preliminary pay ratio estimate. This company anticipates "considerable" additional related costs this year as they plan to engage an external consultant to assist in drafting the 2018 Proxy disclosure, as well as assistance with the development of materials designed to communicate the CEO pay ratio to the organization and external stakeholders. These costs are piled on top of the time and resources spent directly on planning, data collection and drafting of the disclosure.

While compliance costs will be significant for all manufacturers covered by the rule, the cost burden will be particularly high for global companies with multiple payroll and human resource systems, particularly if those systems are not part of a centralized unit. Almost 50 percent of U.S. global companies are manufacturers and these entities will bear the largest

[4] 78 Fed. Reg. at 60589.

compliance costs. Companies that operate in hundreds of countries, have employees in most of these jurisdictions and still have tens of thousands of employees in the United States tend to maintain dozens of different payroll systems. Companies like these struggle to ascertain what "consistently applied compensation measure"[5] they could use, given the massive breadth and complexity of their workforce, particularly because employees in foreign jurisdictions must be included in the calculus.

Some NAM member companies have been able to quantify the costs they are already facing, or expect to face in complying with the pay ratio rule. For example, a Midwestern manufacturing company, "Company A" has been in the process of working toward compliance since last year. The company has significant foreign operations and has found the data collection to be extremely challenging. Domestically, there is less of a challenge because the company has a centralized payroll system in the United States. However, they do not have the same consolidated system in their foreign jurisdictions, not by country or by business unit. Adding different currencies and data privacy issues on top of the lack of a central system increases the amount of time and burden for data collection. Indeed, the five percent *de minimis* exemption for foreign jurisdictions built into the final rule is so minimal that it does not assist Company A in mitigating these challenges. Company A estimates that between last year and this year, they have already spent $50,000-$100,000 on compliance, including the involvement of staff to work on pay ratio.

Another manufacturer, "Company B" estimates that they would incur third party costs of up to $300,000 to develop a reliable pay ratio methodology to comply with the rule. This is in addition to the significant internal costs of HR, payroll and other personnel across the world to extract the necessary data from numerous and diverse enterprise resource planning (ERP) and payroll systems. For a company with over 50,000 employees located in over 90 countries with highly differentiated pay practices, Company B believes that any CEO pay ratio would be of little probative value to the investor, and could potentially be misleading as companies with a significant presence in emerging markets would undoubtedly compare less favorably to companies that are primarily located in North America and/or Europe. There has not been any clearly defined benefit to the availability of this measure to justify the substantial costs of this rule.

"Company C" estimates their company will expend more than 2,500 internal hours to calculate the ratio. Along with external resources, this company anticipates the cost could exceed $1.5 million for the first year's disclosure. The number of people involved in the data collection process may be well over 100; with the range of represented functions including Legal, Human Resources, Finance, Payroll, and Communications.

The costs expected to be incurred by "Company D" are truly astronomical. Company D is a U.S. multinational manufacturer with approximately 80,000 employees in about 250 locations worldwide, including 25,000 employees in the United States and 55,000 overseas. Currently only about 20,000 employees are on two common payrolls accessible to the human resources team; the rest of the company's employees are on over 500 separate payrolls that may or may not be outsourced by local human resource teams. The company has no centralized human resources information system (HRIS) function. Company D expects that the cost to build the global HRIS system needed to comply with the proposed rule would exceed $18 million and the system would have no other business purpose for the company.

[5] 80. Fed. Reg. at 50125

As mentioned above, manufacturers share the SEC's concern that, "the provision does not identify a specific objective and therefore, the appropriateness of the costs in relation to the statutory objective is not readily assessable."[6] The lack of an objective is exacerbated by the fact that, based on the estimates of impact and costs calculated by NAM members, the SEC's estimate[7] in its proposed rulemaking that companies will spend 545,792 hours of company personnel time and pay $72,772,200 for the services of outside professionals to help them comply with the requirement is grossly underestimated. While the SEC's final rule increased the estimated[8] total annual increase in burden and compliance to 2,367,573 hours of company personnel time and approximately $315,390,720 for the services of outside professionals, the NAM still believes the SEC's estimate is far too low and the costs of the rule outweigh any benefit.

The cost of compliance with this proposed rule will require a substantial diversion of company resources from productive investment to compliance activities. Manufacturers also continue to have significant concerns about the impact of the cost burden of this requirement on competitiveness. According to the SEC, the registrants covered by the rule "could be at a competitive disadvantage to registrants (including private companies, foreign private issuers, smaller reporting companies and emerging growth companies) that are outside the scope of Section 953(b)."[9]

M&A Challenges

Many manufacturers go through merger and acquisition (M&A) activity for many reasons, including changing factors in particular industries, proximity to particular resources, or as part of their growth strategy. Yet, M&A activity has emerged as one of the major unexpected challenges of the pay ratio rule. As stated above, M&A is a prime example for how the pay ratio cannot be an appropriate means of comparison between companies or for one particular company over a period of time. In addition, a manufacturing company who just acquired another company in 2016 feels a significant challenge in trying to develop the process for determining the median employee at the same time as they are working to integrate their new acquisition. This company feels that their resources and time would be better spent on true integration activities rather than the pay ratio reporting requirement. This is another reason that the pay ratio rule should be rescinded, but at a minimum, additional time should be provided to accommodate special situations, such as an acquisition.

Legal and Administrative Barriers

There continue to be a number of real legal and administrative barriers for companies in complying with the proposed rule.

In terms of legal hurdles, companies with international operations face data privacy laws in some countries that could make it extremely difficult, if not impossible for them to identify the median employee. The barriers to sharing this information are not limited to Europe. Indeed, an NAM member operating in Russia found that, according to that nation's data privacy laws, the company will need to get the personal sign-off from every Russian employee to share the data with the corporate headquarters. The final SEC rule does allow issuer companies to exclude

[6] 78 Fed. Reg. at 60587.
[7] 78 Fed. Reg. at 60600.
[8] 80 Fed. Reg. at 50180
[9] 78 Fed. Reg. at 60588.

non-U.S. employees where the data privacy laws would not allow compliance, but the issuer would still need to obtain legal opinion from counsel in these cases, adding additional man hours to the already burdensome requirement. Manufacturers are also concerned that obtaining the written opinion of counsel in foreign jurisdictions with respect to this issue will be extremely difficult, if not impossible.

Furthermore, manufacturers are concerned that the SEC has not adequately considered the challenge posed by the varying types and standards of compensation in different countries. NAM members are finding that there are many different types of compensation structures in these different jurisdictions with significant incentive pay plan differences. Obtaining data on these various incentive pay plans has been extremely difficult in many cases. Diverse defined benefit plans brought on by M&A activity is another area that poses additional complexities for manufacturers in collecting data and calculating the pay ratio.

Given these complexities one option, which the NAM mentioned in previous comments, is to consider using base salary as the consistent measure. This approach however has its own challenges in a global context because base salary is not consistently defined across countries. For example, in India, the usual measure of what we would call “base salary” is really “fixed cash” or “guaranteed cash” compensation, which includes several types of benefits including car, cell phone and housing allowances. Thus just using just the “basic salary” for employees in India would not be a true reflection of base salary for these employees. Indeed, these allowances can sometimes total more than the basic salary itself.

Furthermore, as stated in the NAM’s 2013 comments, cost-of-living adjustments may help to provide some companies with a tool to more accurately reflect the costs of doing business across the world. While the final SEC rule differs from the proposal in that it allows companies to apply a cost-of-living adjustment to the median employee calculation, the final rule still requires companies to disclose the pay ratio with and without that cost-of-living adjustment, basically making the allowance worthless since shareholders would still be looking at the skewed number. Many global companies believe the cost-of-living adjustment does not provide assistance due to their multinational presence, in some cases, in over 80 countries.

Another cross border concern is the challenge of normalizing data from foreign currency fluctuations for companies with international operations. These fluctuations would impact the accuracy of the data collected from day to day and month to month. For example, “Company E” has payrolls in over 35 currencies, a U.S.-based and a “global” payroll system. However, the global system is a Human Resources Management System with separate payrolls in over 40 countries. In addition, this company also has more than 25 subsidiaries, each of which has their own payroll system or multiple systems that include international employees. The currency and data consolidation concerns raised by this proposal for a multinational company are significant.

While we appreciate the SEC’s efforts to address companies’ concerns about their ability to comply with the pay ratio requirement and the flexibility in the rule, the NAM still has some concerns with the way companies must gather data, calculate the median employee and ratio, and file this information. The NAM continues to believe that if the pay ratio rule is implemented, that the disclosure should be “furnished” and not “filed.” Given that the disclosure will necessarily be based on assumptions and estimates and will naturally be subject to some unintended inaccuracies, a Sarbanes-Oxley certification is inappropriate. Moreover, the additional validation work that necessary to support a “filed” disclosure is unduly burdensome under the circumstances. While manufacturers will strive to file the pay ratio information to the best of their abilities, the “good faith” standard described in the final rule is of little comfort given the severe penalties that stem from filing misleading statements under Section 18 of the Securities Exchange Act. The NAM encourages the SEC to address this issue as soon as possible.

Additional Impact of Pay Ratio Rule

Another unintended consequence of the pay ratio rule is the growing interest from cities and states in legislation that would impose additional taxes on companies based on the results of their pay ratios. For example, the city of Portland approved a tax on companies with a pay ratio greater than 100:1, applicable to companies that pay business taxes in Portland, effective in 2018 after the pay ratio disclosures are filed. Legislation has also been introduced in several state legislatures to impose fees or additional taxes on companies based on their SEC pay ratio. By placing a financial penalty on companies over a certain pay ratio threshold, these proposals are taking steps to erode the ability of companies to implement their own corporate governance policies and develop their own competitive executive compensation packages.

Initiating these proposals also makes the intent of the pay ratio proposal even less clear. Instead of providing more information to shareholders, these proposals indicate the pay ratios are more of a “name and shame” tool that can be used by states and localities to provide an additional revenue stream from corporations. The NAM strongly opposed the pay ratio requirement and also oppose any efforts to impose taxes or fees on company pay ratios that exceed certain arbitrary levels.

Conclusion

Manufacturing supports an estimated 17.6 million jobs in the United States, about one in six private-sector jobs. There are 12.3 million manufacturing workers in the United States. Manufacturers strive to compete in a global world and are committed to ensuring that their workforces are highly trained and well compensated. In 2015, the average manufacturing worker in the United States earned $81,289 annually, including pay and benefits whereas the average worker in all nonfarm industries earned $63,830. Manufacturers are proud of their commitment to their workforces and want to dedicate resources to competing, growing and investing in their companies, their products and their employees and are concerned about regulatory burdens, like the pay ratio rule that will distract them from this goal.

In sum, the cost of complying with this rule will divert company resources from needed investment and job creation without providing a benefit to shareholders, companies or the broader economy. On behalf of the NAM and the 12 million men and women that work in manufacturing, thank you for your attention to these concerns.

Sincerely,

Christina Crooks