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SEC Unveils Expensive Rule on CEO Pay Ratio

By Walter Olson - Senior fellow at the Cato Institute's Center for Constitutional Studies

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Last month, over sharp dissents from two Republican commissioners, a three-member majority of the Securities and Exchange Commission proposed a new rule to implement a mandate under the Dodd-Frank law that U.S. corporations disclose the ratio between the pay of their chief executive officer and that of their workers. (For more background, and a harsh description of the bind in which Congress placed the Commission, see Michael Greve's take here. The rule is open for public comments through December 2.)

Labor advocates were pushing for a tough rule, and the one they got requires compliance methods that for international companies in particular are likely to prove quite burdensome, the cost often reaching into the six and even sometimes the seven figures. Notes Marc Hodak, "we are almost certain to see quite a few companies paying more than they actually pay their CEO to figure out how much more their CEO makes than their median worker. If this rule [were] really being implemented for the benefit of the shareholders, then Congress could have let each company's shareholders opt in or opt out of this disclosure regime. Clearly, the people pushing this ratio had no interest in giving actual shareholders a veto over this racket."

Wrote dissenting commissioner Daniel Gallagher: "There are *no* - count them, *zero* - benefits that our staff have been able to discern. As the proposal explains, '[T]he lack of a specific market failure identified as motivating the enactment of this provision poses significant challenges in quantifying potential economic benefits, if any, from the pay ratio disclosure[.]'" "Proponents have acknowledged the sole objective of the pay ratio is to shame CEOs, but the shame from this rule should not be put on CEOs - it should be put on the five of us," said dissenting commissioner Michael Piwowar. "Shame on us for putting special interests ahead of investors."

When I wrote up a version of the above in a post at Overlawyered, a commenter named Allan responded that cost-based opposition to the rule was "simply ludicrous":

Just take the amount paid to all employees and divide it by the number of employees. [Voila] - you have the average salary.

It is ridiculous to assert that it would cost more than a calculator to figure out the average employee's pay or the CEO's pay. If a company does not know how much it is paying its employees, it needs a new CFO and a new director of HR.

It is never a sound idea to lose one's patience with commenters but I fear I may have done so just a bit with my reply:

Before Allan opens up his promising "Here, let me work it out for you on the back of an envelope" business consultancy, he might want to check out some relevant sections of the proposed SEC rule. Here are excerpts (footnotes omitted) from the commission's explanation of its controversial decision to include overseas employees in the median wage pool:

According to [critical commenters], the international variation in compensation arrangements and benefits, in addition to cost-of-living differences and currency fluctuations, could distort the comparability of employee compensation to that of a PEO based in the United States. In addition, these commenters noted that the types of compensation that are recorded in payroll and benefits systems outside the United States may vary from those recorded as compensation in the United States due to local accounting standards and tax regulations. ...

We acknowledge the concerns of commenters that the inclusion of non-U.S. employees raises compliance costs for multinational companies, introduces cross-border compliance issues, and could raise concerns about the impact of non-U.S. pay structures on the comparability of the data to companies without off-shore operations. ...

In particular, we are cognizant that data privacy laws in various jurisdictions could have an impact on gathering and verifying the data needed to identify the median of the annual total compensation of all employees. Commenters have asserted that, in some cases, data privacy laws could prohibit a registrant's collection and transfer of personally identifiable compensation data that would be needed to identify the median. We also understand that in many cases, the collection or transfer of the underlying data is made burdensome by local data privacy laws, but is not prohibited.

"So remember" (I concluded), "the SEC might throw the book at you if you use a currency conversion formula it doesn't agree with, and foreign governments might throw the book at you if you export pay data on their citizens for purposes of doing the required calculation. Other than that, and maybe a few dozen other complications, Allan's advice is perfectly safe to follow."

Hodak further points out that even the benefits of the rule *to unions* are at best speculative:

...since the unintended consequences of this rule are difficult to fully predict. For instance, it might encourage further outsourcing of relatively low-wage work to foreign companies, depressing employment of union workers. In other words, we could very well see the average pay of the median worker go up in public companies falling under the rule, but only if you don't count the zero wages being earned by those who are laid off as a result of this law.

To gain short-term fuel for the stoking of demagogic envy, in short, this whole exercise undercuts the competitiveness of American employers overseas and even at home. If Congress had its eye on the ball, it would be revisiting this section of Dodd-Frank with a mind toward repeal.