

SEC Commissioner Addresses Prospects for CEO Pay Ratio

July 1, 2017 – Governance & Compliance Insider
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This week, during his opening remarks at the 2017 National Conference of the Society for Corporate Governance, SEC Commissioner Michael Piowar remarked on prospects for repealing or delaying the CEO pay ratio rule.

Under the rule, most public companies must disclose the median of the annual total compensation of all employees (including non-U.S., part-time, temporary and seasonal workers), except for the CEO; the annual total compensation of the CEO; and the ratio of the two amounts, as calculated under proxy rules. The disclosure must be prepared for fiscal years beginning on or after January 1, 2017, which would be disclosed in 2018 proxy statements. Emerging growth companies, smaller reporting companies and foreign issuers are not subject to the rule.

Commissioner Piowar expressed his support for repealing the rule, which would require Congressional action. In terms of delaying effectiveness of the rule, he stated that public commentary would determine whether that alternative is feasible in light of the associated costs and benefits of implementing the rule. Though the latest comment period on the rule has ended, he urged interested parties to continue to submit comment letters describing specific reasons why the rule is burdensome, as well as proposed fixes. During the latest comment period, the SEC received approximately 180 unique comments, with 150 of those comments in favor of the rule.

Given the approaching 2018 proxy season, we advise companies not to count on a repeal or delay of the rule. Companies should continue preparing for the CEO pay ratio disclosure, and keep in mind that there is significant latitude for how the ratio may be calculated, in accordance with Item 402(u) of Regulation S-K and related guidance in C&DIs 128C.01-128C.05. In particular:

- The **median employee**, which must be identified once every three years absent a significant change, may be identified from a survey of the entire employee population, a statistical sample or other reasonable method.
- A **de minimis exemption** allows companies to exclude non-U.S. employees who

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account for 5% or less of their employees, including employees whose inclusion would result in a violation of foreign privacy data laws. If certain employees are excluded, then all employees from that jurisdiction must be excluded.

- Companies may use a **consistently applied compensation measure** (“CACM”) other than annual total compensation to identify the median employee, as long as the CACM reasonably reflects the annual compensation of employees. For example, total cash compensation could be a CACM unless the company also distributed annual equity awards widely among its employees.
- Companies may select a **determination date** within three months prior to the end of their fiscal year, in order to determine employee population from which to identify the median.
- In applying the CACM to identify the median employee, companies are not required to use a **compensation period** that includes the determination date. Nor are they required to use a full annual period. As an example, the SEC states that a company may use annual total compensation from its prior fiscal year so long as there has not been a change in the registrant’s employee population or employee compensation arrangements that would result in a significant change of its pay distribution to its workforce.
- Workers whose compensation is determined by an **unaffiliated third party** may be excluded from the pay ratio calculation. This population may include leased workers, independent contractors who determine their own compensation, and even workers whose minimum level of compensation is set by the company.
- Companies should consider **testing alternative methodologies** in order to assess the quality and consistency of results.

While there is considerable latitude to design a pay ratio methodology, companies should let reason be their guide and be prepared to explain the decisions that they make.

Companies are required to describe in their proxy statements the methodology used, as well as any material assumptions, adjustments and estimates.

Not surprisingly, CEO pay ratios have varied significantly depending on the companies surveyed and the methodology. The [AFL-CIO’s annual report on CEO pay](#) calculated a CEO-to-worker-pay ratio of 347-to-1 for 2016, based on the average total compensation package for 400 of the S&P 500 CEOs of \$13.1 million last year, and the average annual cash income only (excluding fringe benefits) for America’s 100,525,000 rank-and-file workers of \$37,632. In contrast, [a 2016 Mercer study](#) found the ratio among respondents to be less than 200-to-1.