AGENDA

A Financial Times Service

Opinion

Boards Should Strategically Engage on Pay Ratio Now

August 7, 2017

Jim Barrall

Jim Barrall is a senior fellow in residence at the Lowell Milken Institute for Business Law and Policy at the **UCLA** School of Law. He is Of Counsel and a retired partner of **Latham & Watkins**.

In February, when the acting chairman of the **SEC** announced the agency was opening a 45-day comment period to allow arguments for reconsideration of the final CEO pay ratio disclosure rule, I and many others thought it was likely the rule would be delayed and that companies would not be required to disclose their CEO pay ratios in 2018. While anything can happen in Washington these days, it now looks likely the rule will not be delayed because the SEC is still short two members, the current three are not likely to agree to delay the rule, and time is running out.

Given busy fall and winter calendars, boards should now be making certain their companies are preparing to disclose the ratios of their CEOs' pay to that of their median compensated employees in their 2018 proxies. They should also be careful to make sure their calculations are strategically based on employee population, circumstances and intended messaging. Here are the key points for boards to consider:

First, while institutional investors do not need CEO pay ratio disclosures to vote their shares on say-on-pay and director elections, some members of Congress, some academics and some members of the press strongly support the rule as a tool for naming and shaming companies to possibly drive down CEO pay. Most importantly, organized labor, as the main proponents of the statute, will use CEO pay ratios as a weapon in labor organizing and other campaigns, and some employees may be upset to find they are below median. This means the primary focus of boards should be on how a company's employees and any unions that represent them will perceive the disclosure and react to it.

Second, boards should consider whether their companies have views or policies regarding CEO pay ratios, or more generally, pay equity. While few companies are likely to have the former, a few companies out of the 10 or so that voluntarily disclosed CEO pay ratios in 2017 stated that they believed their executive compensation programs should be equitable to motivate employees, and that they monitored the relationship between the compensation of executive officers and non-executive employees. If a company has any such policies or views it should consider disclosing them.

Third, to provide flexibility and reduce the burdens and cost of compliance, the rule as finally adopted gives companies much discretion in how they identify their median employee. Among other things, the rule permits companies to use entire workforces or statistical sampling, annual total compensation or "any other compensation measure that is consistently applied" (such as cash compensation) to identify the median employee, and any date within the last three months of the 2017 fiscal year-end to determine the employee population from which to find median employee (which is important for companies that hire seasonal employees at year-end, as in the case of many retailers). The rule also permits companies to exclude non-U.S. employees if they represent less than 5% of the total population and exclude employees of companies acquired during the fiscal year. All this discretion gives companies opportunities not only to save time and money but to present the compensation story they believe is most important to them and their employees.

Fourth, the rule only requires proxy disclosure of the total annual compensation of the CEO and that of the median employee, the ratio of the two and the methodology used to identify the median employee, including any material assumptions, adjustments or estimates used to determine compensation or identify the median employee.

However, companies may provide supplemental information about their ratios, and may disclose additional ratios, such as for U.S. employees only. Additionally, companies can provide non-proxy disclosures to various constituencies, such as investors, employees, customers or the press.

All of this means that this is not just a number crunching exercise. Boards should begin shaping the strategies that best fit their companies now and not wait until they are asked to sign off on 2018 proxies to ask questions or provide guidance.

See law firm Latham & Watkin's recent Client Alert for more details on how to do it.