WINSTON & STRAWN LLP

CLIENT ALERT

Review of Voluntary CEO Pay Ratio Disclosure Yields Mixed Results

MAY 30, 2017

On February 6, 2017, Michael S. Piwowar, acting chairman of the Securities and Exchange Commission (SEC), invited the public to comment on unexpected challenges experienced in preparation for compliance with the SEC's final rule, regarding disclosure of the ratio of the compensation of a registrant's chief executive officer (CEO), to that of its median employee and directed the SEC to reconsider implementation of the rule based on any comments received. By opening up another round of comments at this late stage, the SEC has signaled that implementation of the final rule is all but certain. However, absent further action by the SEC, reporting companies will need to comply with the final rule with respect to executive compensation disclosure to be included in annual reports and proxy statements that will be filed beginning in 2018. In light of the broad discretion afforded by the SEC to registrants in the final rule with respect to determining the employee population and measuring compensation, registrants should consider developing an approach to this disclosure well in advance of the 2018 proxy season.

The final rule, which was adopted by the SEC in August 2015 and supplemented by the Compliance and Disclosure Interpretations (CDIs) released in October 2016, requires a registrant to disclose (i) the annual total compensation of the registrant's CEO, (ii) the median of the annual total compensation of all of its employees, other than its CEO, and (iii) the ratio of the amount determined in (i) to the amount determined in (ii). In addition to disclosure of the pay ratio itself, the registrant is required to disclose the date (within the last three months of its last completed fiscal year) that it selected in order to determine its employee population and briefly describe the methodology it used to identify the median employee—including any material assumptions, adjustments, or estimates used to identify the median employee or determine total compensation.

Certain registrants have elected to voluntarily provide pay ratio disclosure in their 2017 proxy statements in anticipation of the implementation of the final rule. A review of such disclosures demonstrates mixed approaches, and questionable compliance with the requirements of the final rule. Seven companies—Range Resources Corp., Novagold Resources Inc., Northwestern Corp., Noble Energy Inc., Gencor Industries Inc., Texas Republic Capital Corp., and First Real Estate Investment Trust of New Jersey—have included pay ratio disclosure in their proxy statements filed in 2017. The pay ratio disclosure provided by each of these registrants has generally been brief and, in certain cases, perhaps too brief. Only two of these registrants included disclosure that appears to fully comply with the final rule. Four registrants did not disclose the date on which the employee population was determined, and two registrants did not indicate the methodology used to measure compensation and identify the

median employee. In addition, one registrant failed to express the relationship between the compensation amounts as a ratio and instead indicated a percentage—which is not expressly permitted by the final rule.

From a substantive standpoint, the ratios disclosed range from approximately 6:1 to 79:1, with four of the seven registrants disclosing pay ratios of less than 20:1 and two registrants disclosing pay ratios exceeding 70:1. Of the five registrants that indicated the methodology used to measure compensation, four chose to measure compensation in accordance with the rules applicable to the summary compensation table, and one registrant used total cash compensation as its measure.

Under the final rule, a registrant must determine its employee population as of a date that is within three months of the end of its fiscal year. Registrants that employ seasonal or temporary employees and independent contractors should pay special attention to this part of the rule as the date selected could impact the size and composition of the workforce. And, while a registrant may annualize the total compensation paid to permanent full-time and part-time employees who were employed for less than the full fiscal year, a registrant may not annualize compensation paid to seasonal or temporary employees. In addition, registrants are not permitted to make full-time equivalent adjustments, for example, with respect to part-time employees.

After determining its employee population, a registrant must then identify its median employee from the employee population using total annual compensation as determined under the existing rules for the summary compensation table or any other consistently applied compensation measure (CACM), including the use of data reported in payroll and tax records. A registrant is not required to measure compensation across a time period that includes the date on which the employee population is determined, and a registrant may use compensation data with respect to its prior fiscal year, so long as there has not been a change in the registrant's employee population or compensation arrangements that would have a significant impact on its pay distribution to its workforce. The appropriateness of the CACM selected by a registrant will depend on the registrant's particular facts and circumstances. In the CDIs released in October 2016, the SEC suggested that total cash compensation may be an appropriate CACM in circumstances where the registrant does not widely distribute equity awards among its employees. In addition, the SEC indicated that social security taxes withheld would likely not be an appropriate CACM unless all of the registrant's employees earned less than the social security wage base. Whatever method a registrant selects in order to determine compensation and identify its median employee, the registrant must briefly disclose the compensation measure used and any material adjustments or assumptions.

While it is still possible that the implementation of the final rule may be delayed, given the flexibility in the final rule with respect to identifying the median employee, it may be worthwhile for registrants to be proactive in addressing the forthcoming pay ratio disclosure. In particular, registrants should consider determining the appropriate CACM to be utilized in identifying the median employee and ensuring that computer systems and adequate resources to process all measurements and calculations are in place in advance of the 2018 proxy season. Registrants that fail to stay ahead of this new disclosure requirement may find themselves scrambling in 2018 if the SEC does not take further action to delay implementation of the final rule.

4 Min Read

Related Locations

Charlotte | Chicago | Dallas | Houston | Los Angeles | New York | San Francisco | Silicon Valley | Washington, DC

Related Topics

Securities and Exchange Commission (SEC) | CEO Pay Ratio

Employee Benefits and Executive Compensation

Related Capabilities

Labor & Employment

Corporate Governance

Related Regions

North America

Related Professionals

Scott Landau

Maria Kenny

Jennifer Stadler

Marissa Sims