



Comp Talks: Pay Ratio Calculations and Disclosure

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attorney advertisement

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What Are We *Required* to Do?

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What Is the Pay Ratio Rule?

- Requires disclosure of:
 - the median of the annual total compensation of all employees of the company, except the CEO (that is, the point at which half the employees earn more and half earn less);
 - the annual total compensation of the CEO; and
 - the ratio of the two amounts above
- For example, “1 to 500” or “CEO total compensation is 500 times that of the median of the annual total compensation of all employees”

What Else Are We Required to Disclose?

- Must briefly describe (and consistently apply) the methodology used to identify the median employee, and any material assumptions, adjustments, or estimates used to identify the median or to calculate total compensation
- SEC emphasized avoiding dense technical analyses or formulas, confidence levels or the steps used in data analysis
- If methodology, material assumptions, adjustments or estimates are changed in a future year, will need to describe the change, reasons for the change and provide an estimate of the impact of the change on the median and ratio

When Are We Required to Comply?

- Must calculate pay ratio for first fiscal year that begins on or after January 1, 2017 and disclosure must be filed no later than 120 days after the end of the fiscal year (and so if a company with a fiscal year ending December 31 does not file its annual proxy statement by April 30, 2018, the company would need to amend its Form 10-K to include pay-ratio information for 2017)
- Transition rules for companies that have just completed IPOs and companies ceasing to be EGCs or SRCs

Where Does It Go?

- Disclosure required in registration statements, proxy statements, and annual reports on Form 10-K that require executive compensation information
- Pay-ratio information will be deemed filed rather than furnished and therefore subject to potential liabilities under the Securities Act and Exchange Act
- As such, the process relating to the calculation should be rigorous and well-documented

What Else?

- Multiple state and city governments have proposed tax code changes or local ordinances that would base local income tax or licensing fees on public company's CEO pay ratio
- Proposal was approved in Portland, Oregon

Do We *Really* Have to Do This?

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Are You Exempt?

- Emerging Growth Companies
- Smaller Reporting Companies
- Foreign private issuers filing on Form 20-F
- Companies that file reports and registration statements with the SEC in accordance with the requirements of the US-Canada Multijurisdictional Disclosure System

Repeal? Delay?

- Financial CHOICE Act of 2017 passed by the House would repeal the pay-ratio provision; unlikely to advance in the Senate
- SEC rulemaking unlikely despite Acting SEC Chair Michael Piowar seeking public input on unexpected challenges and directing the Corp Fin Staff to revisit the rules



Draft Day

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Internal Team

- Legal
- HR
- Compensation and payroll
- Finance
- Investor relations
- Internal communications

External Team

- Compensation consultant
- Other consultant
- Legal
- Audit
- Public relations

How Long Will It Take?

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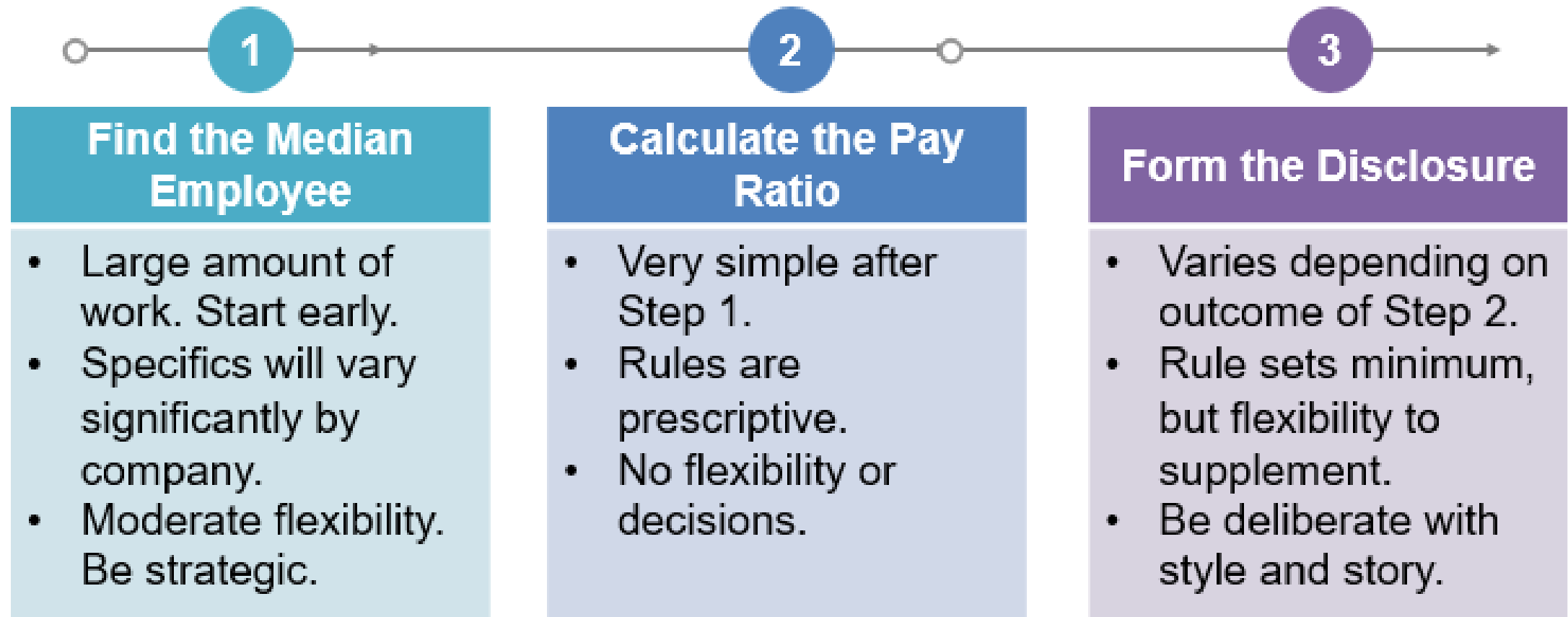
How Did It Get So Late So Soon?

- What's the real deadline?
 - Compensation committee meeting schedule
 - Employee communications
 - Consider other demands on the team (e.g., the rest of proxy season)
- What can be done now? What can wait?
- Sample scenarios

The Only Way Out Is Through

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Easy As 1, 2, 3?



Identify Universe of Workers and Compensation Data Systems

- Overall number of workers in each country
- Make a note of the status of each worker (employee, independent contractor, leased worker; full time/part time; temporary/seasonal)
- How are workers in each country compensated? What system houses each element of compensation? What system houses tax records, hire/termination data, leave of absence dates?
- Where is the data? How many systems? Do they coordinate with each other? How do we access it?

Which Workers Count as Employees?

- (Almost) all employees must be considered, including full-time, part-time, seasonal, and temporary employees of company and any of its consolidated subsidiaries
- Treatment of independent contractors

Are Exemptions Potentially Available?

- Non-U.S. employees in jurisdictions where access to information would violate data privacy laws
- Non-US employees representing up to 5% of the total workforce (with employees excluded due to privacy laws counting towards this 5% limit)
- Employees of acquired companies

Selecting the Pool

- Entire population
- Statistical sample
- Any other reasonable method

What's the Measurement Date for Identifying Your Employees?

- Any date within three months of the end of the last completed fiscal year
- Choice of date may be particularly important to companies with seasonal employees near year-end
- Year-to-year measurement date changes must be explained

Determine the Period Over Which to Measure Compensation of Employees in the Pool

- Entire fiscal year
- Period less than fiscal year
- Prior fiscal year

How To Find the Median Within Your Pool

- Perform summary compensation table calculation for every employee
 - Unlikely to be feasible for most companies
- Use a consistently applied compensation measure (CACM)
 - E.g. total direct cash compensation or W-2 wages

Merge the Data and Find the Median Employee

- Consolidate all compensation data
- Adjustments and conversions
- Other considerations

Calculate Annual Total Compensation

- Total compensation as calculated for purposes of the Summary Compensation Table
- What if median is a non-salaried employee?
- Reasonable estimates
- Cost-of-living adjustments

Sensitivity Testing Based on Different Methodologies?

- Examples of potential methodologies that could be used for comparison purposes
- Situations in which this would be useful
- Keep in mind that any change in methodology in future years needs to be explained, so “cherry-picking” each year is not advisable

Draft Proxy Disclosure

- Required disclosure
- Optional disclosure
 - Must not be misleading or presented with greater prominence than the required pay ratio disclosure
 - Possible supplemental disclosures and when they would be useful

Who's On First?

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Employee Communication

- Half of your employees will soon learn (or wrongly believe) they make less than the median
- An explanatory communication may be advisable in order to explain some of the nuances of the pay ratio calculation
- For example, employees may believe that this represents cash compensation
- Potential morale hit should be addressed

Investor Communication

- Will they care about the ratio?
- Will they care about the methodology/assumptions?
- Will they care about ratio relative to peers?
- What types of alternative pay ratio calculations might help tell the story?
- What narrative might help tell the story?

Public Relations

- What if your number is going to be high?
- Are you a big player in a small town?
- Do you have unique worker arrangements or a unique workforce structure?
- Potential for director or executive embarrassment in the event of media attention?

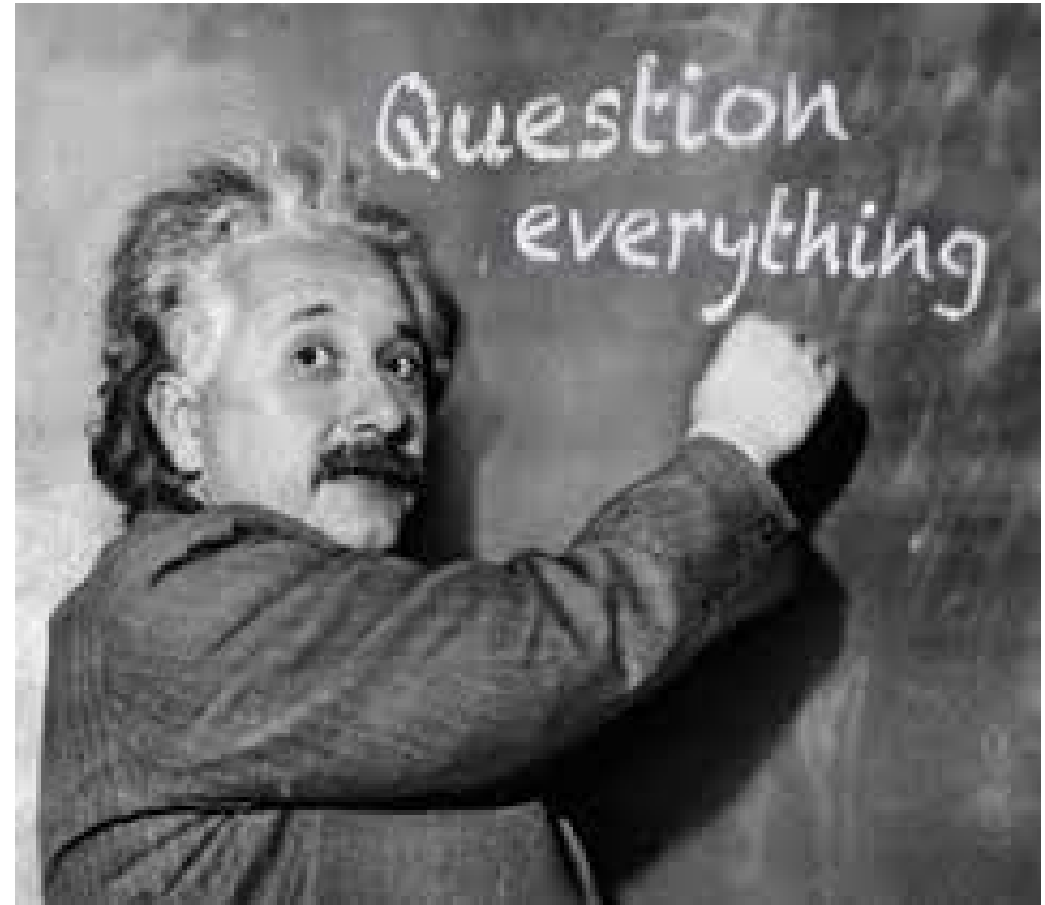
Questions????

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Thank you for joining us!

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