Human Resource Executive Online

Thursday, August 20, 2015

HR and the CEO Pay-Ratio Rule

After two years in development with extensive input from both critics and supporters, the CEO pay-ratio rule is set to go into effect in January 2017. Here's what HR leaders need to know beforehand.

By Maura C. Ciccarelli

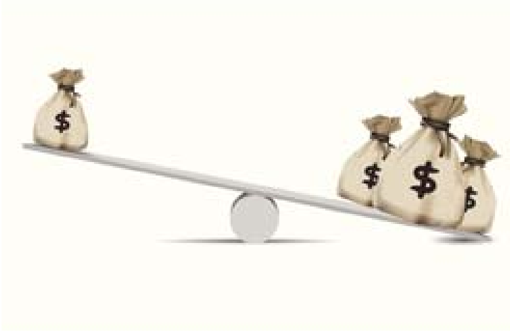
A new Securities and Exchange Commission financial reporting rule means HR leaders should start thinking about a new metric: the ratio comparing their CEO's total compensation to their median employee total compensation.

The rule, which applies to proxy statements for fiscal years that start in January 2017, was passed on Aug. 5 by the Commission on a 3-2 party-line vote and is subject to Sarbanes-Oxley CEO and CFO certifications. It satisfies a requirement of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. After two years in development with extensive input from critics and supporters, the rule will take effect in another couple of years—if itsurvives expected judicial and legislative challenges.

"The SEC's delay in [implementing the rule] is the result of the many comments about the difficulty of doing this," says Andrew C. Liazos, a partner in the law firm of McDermott Will & Emery and head of its executive compensation practice in Boston. "Suffice it to say that companies are going to have to spend time trying to figure out how they're going to go about compiling the data."

The rule says that companies must identify the employee salary that straddles the midpoint of all employee salaries once every three years if there is no significant employee population change. They also can use statistical sampling as well as data from the three months before the end of the fiscal year.

The challenge, says Alan Johnson, managing director of Johnson Associates, a boutique executive pay consultancy in New York, is that the calculation must include all employees worldwide, including part-time, temporary and seasonal workers.



"I just wish the numbers were real," Johnson says. "It's going to make people unhappy for no good reason."

The SEC said companies can exclude employee populations in countries where privacy laws prohibit such data use. They also can exclude up to 5 percent of small non-U.S. employee populations but the 5 percent cap must include the foreign workers excluded by data privacy laws.

David M. Rubenstein, a partner with WeiserMazars, a New York-based accounting, tax and advisory services firm and chairman of the firm's SEC practice group, says companies can annualize the salary of a full-time employee who arrives mid-year but cannot make annualized adjustments for part-time, temporary or seasonal workers.

"As long as you consistently imply the compensation measures, they give latitude around that," he says. "If you select a particular methodology, obviously they don't want you changing that from time to time."

Rubenstein adds that the industries expected to be hardest hit with a wide CEO-median employee pay ratio will be those in the retail, hospitality, manufacturing and seasonal industries which have part-time employees and/or overseas operations.

Aside from sifting through the ratio data with their legal and financial colleagues and consultants, HR professionals will have to communicate the company's compensation approach.

Indeed, for employees who think their organization explains its compensation approach well and who also believe that their senior leaders are paid based on the performance they deliver, the employees are more likely to believe that they are paid fairly themselves, says Steve Seelig, senior regulatory advisor for Towers Watson in Arlington, Va., citing the firm's recent *Global Workforce Study* on employee views on leadership and pay.

"They are more likely to be highly engaged and they are less likely to be retention risks," he says. "That's why we think this whole issue of communicating to workers transparently about how they are paid … is going to be extremely important."

"Everything is focusing on the CEO and there's a time and place for that, I agree," says Liazos. "However, there will be a number of people who are not so highly compensated and they will ask [why they make less than the median]. HR people will have to think about them."

Seelig says the biggest challenge companies are going to have "is taking this very difficult pay-setting process and gleaning it down to the focused elements that make sense to their workforce. That has always been an HR challenge and will become a bigger one going forward."

As for how publicity about the ratio may affect CEO pay rates, that remains to be seen. "The intention of this ratio [was] that any company whose ratio increases from year to year is going to be thought of as not doing the right thing," says Seelig. "As long as median pay for workers kept up with what the CEO's pay was and the ratio didn't move from year to year, the company was seen to be doing just fine."

There are a lot of different questions employees will have related to the ratio, but Seelig says they all end up boiling down to one question: "Am I paid fairly?"

This also is "a wake-up call for companies to develop a good comp system," adds Johnson, "and, if necessary, adjust CEO pay if he or she is truly overpaid."

Send questions or comments about this story to ***hreletters@lrp.com****.*

http://www.hreonline.com/HRE/view/story.jhtml?id=534359177&