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Firms to reveal ratio of CEO pay to average worker

By CLAUDE SOLNIK

The Securities and Exchange Commission has approved a rule requiring public companies as of 2017 to calculate and disclose the ratio of their CEO's compensation to that of their workers' average pay.

The hotly contested regulation, which the SEC commissioners approved by a vote of 3-2 on Aug. 5, arose out of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

It takes effect 60 days after being published in the Federal Register for all fiscal years beginning in 2017.

The goal is to provide more information to investors and analysts regarding compensation in order to let them better understand and compare firms.

It also is designed to help inform shareholders when voting on "say on pay," an advisory vote in which investors support or oppose compensation proposals.

Firms must include all full-time, part-time, temporary and seasonal employees in pay ratio calculations, although independent contractors are excluded.

"The commission adopted a carefully calibrated pay ratio disclosure rule that carries out a statutory mandate," SEC Chair Mary Jo White said in a written statement. "The rule provides companies with substantial flexibility in determining the pay ratio, while remaining true to the statutory requirements."

Some say the disclosure mandate could keep executive pay in check, by revealing typical ratios of CEO to worker pay and identifying outliers.

"I understand the sentiment behind this kind of rule. Society has become less equal," said Martin Lewison, assistant professor of business management at Farmingdale State College. "Ordinary, working people's wages have stagnated. And there is some feeling of injustice that the top 1 percent makes gains, while ordinary peoples' wages don't increase."

He added that this "may lead some businesses to consider inequalities in wealth when they make compensation policies."

But Lewison, like many others, wondered whether the government in demanding this information may be reaching too far.

"You could make an argument that it's really not the business of the state to comment on what entrepreneurs, capitalists or managers make," Lewison said.

The new regulation imposes one more burden on firms to provide information that, some say, may be of little interest to the public.

"I believe that providing useful information to a sophisticated investor is always better than not," said David Rubenstein, a partner at WeiserMazars, which has offices in Woodbury. "The question here is how useful is this information?"

Photo by Bob Giglione

DAVID RUBENSTEIN: There will be more information, but it is unclear how it will be used.

Others also questioned how useful this metric will be and whether it will have an impact when there are so many other ways to evaluate CEO pay.

"The thinking behind it was if we show the ratio of pay of the CEO to the median employee and it's a big multiple, stockholders will say, 'Maybe the CEO shouldn't make so much,'" said Larry Waldman, an adviser at EisnerAmper, whose Long Island operations are in Syosset. "I think it's a meaningless number at the end of the day."

The information, however, could put one more spotlight on CEO pay, by putting it in a new context. A CEO's pay is typically evaluated against that of his peers.

"It's a different way of looking at compensation," Rubenstein said of these multiples of average worker pay. "Somebody may raise a question. 'Why is that CEO making so much more than that CEO? Is there better performance? Are they better managers or are they just taking more money?'"

The SEC said it will let firms choose their method of identifying median employee compensation, including statistical sampling of its employee population or "other reasonable methods." But flexibility could create problems.

"The concern about the flexibility is it could be confusing when comparing from statement to statement," said Steve Mannhaupt, partner in charge of accounting and auditing at Jericho-based Grass & Co. "If you have diversity in how it's being calculated, that reduces the usefulness of the information."

Waldman said it's unclear whether shareholders will care, or remain more interested in compensation as it compares to earnings and sales, which already is available.

A highly compensated CEO at a thriving firm with a rising share price is likely to raise few eyebrows.

But an executive who is highly compensated while shares and income fall could spark concern, regardless of the ratio to worker pay.

"Is the everyday investor going to look at this? I'm not sure they'll know it exists," Waldman continued. "Is the institutional investor going to look at this? They know it exists. But I don't think they'll use it to measure a company."

Different industries will probably have

different norms in terms of ratios and some companies will show a more even-handed approach to pay.

But simply because a ratio is low doesn't mean a company is more socially responsible than another.

"Let's say I'm a CEO of a company and I make $2 million and the median employee makes $75,000. Does that mean I'm socially responsible?" Waldman said. "Maybe I'm in an industry where the average pay is $75,000."

The rule lets companies calculate median employee pay every three years, which could reduce costs.

And firms can exclude employees in countries where data privacy laws prevent compliance.

"There are privacy issues with regard to the sharing of information," Rubenstein said. "In some countries, you may not be able to get access to the details of the compensation."

There could be a public relations price (or benefit) to this information, as differing ratios appear at firms. Data could lead to pressure to raise average worker pay or to put CEO payments in check.

"I think it will have at least an impact on the perception of CEO pay," Rubenstein continued. "This is meant to inform shareholders with regard to additional information."

Greg Giugliano, the partner-in-charge of Marcum's assurance services division, which includes its SEC audit practice, said the new information is related to the legal part of SEC filings rather than audits.

Some companies are likely to compile the information themselves, while others will hire consultants and accountants.

"It will be costly and time consuming," Rubenstein added. "If companies have the internal resources, they can do it internally. You can use software or companies may outsource to outside service providers."

The rule could lead to more work for accounting departments at firms at a time when staffers already face a wide range of regulations.

"This is the kind of calculation a company could do internally," Mannhaupt said. "It will take those individuals away from working on other accounting changes."

While the new rule could provide more information to help with say-on-pay advisory votes, some say those votes are likely to reflect many other factors.

"Are there people who make more than they should? Probably," Waldman said. "I bet stockholders [already address] that. They even have advisory votes on compensation."

This only applies to public companies, but private industry sometimes adopts public company rules as a best practice. At least in this case, though, the rule may not reach beyond firms traded on public exchanges.

"Private companies are different," Rubenstein said. "With public companies, you have investors and shareholders and analysts."

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