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What the SEC's Final CEO Pay Ratio Rules Mean for Companies

The SEC's final CEO pay ratio rule as adopted earlier this month has some key departures from the proposal, including a delayed implementation period.

The SEC took an important step this month in fulfilling its obligations to pass executive compensation rules under the Dodd-Frank Wall Street Reform and Consumer Protection Act. The agency approved by a 3-2 vote a final rule mandating corporate disclosure of the ratio of the CEO's annual pay compared to that of the median employee. The final rule is available at the SEC website here. This article summarizes the major takeaways from the new disclosure rule. It's worth noting the SEC made several concessions when adopting the final provision.

Most importantly, the rule takes effect for companies' fiscal years beginning on or after January 1, 2017. This means the new disclosure would first show up in proxy statements for the 2018 proxy season. Many were expecting the first disclosure in the 2017 proxy season, so this gives companies an additional year. Additionally, the SEC is permitting companies to calculate median employee compensation once every three years, assuming there are no changes in the employee population that would significantly affect the ratio. Companies will also be allowed to use any date within the last three months of their last completed fiscal year to identify the median employee compensation.

The crux of the disclosure is to compare the CEO's total compensation to that of the median employee's. One of the major concerns is the administrative difficulty of managing and comparing employee compensation figures across different business lines and countries. Also, companies with large employee populations in lower cost countries are concerned that their pay ratios will look disproportionately higher than other companies. The final rule provides that companies may use cost-of-living adjustments to identify the median employee and calculate that employee's total compensation for purposes of the ratio; however, the adjustments would have to be applied to all employees in all countries other than the CEO's country of domicile. For most large global companies this will likely not be practicable. Furthermore, companies will still have to disclose the ratio with and without the adjustments.

There is the possibility of repeal and/or legal action associated with this rule, but if it remains in effect, companies will need to consider how much they want to say about the ratio in the proxy. The final pay ratio disclosure rule allows issuers to present additional information such as additional ratios to supplement the required ratio, but companies are not required to do so. Human resources professionals will also need to consider what, if anything, they want to say to their workforce through internal communication channels about the total compensation of the median employee compared to that of the CEO.

There is still more to learn about this disclosure, but for now it seems the new rule will roll out for proxies filed in 2018 with some flexibility in the process behind calculating this metric.

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