Aon Hewitt
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Four Steps to Tackling the CEO Pay Ratio Rule

In preparation for CEO pay ratio disclosures that begin in 2018, taking the following steps will ensure you think about the disclosure from every stakeholder's perspective.

The CEO pay ratio rule is scheduled to go into effect with 2018 proxy statements and many companies are proceeding cautiously with internal planning. The SEC issued a statement on February 6, saying it was accepting public comments for 45 days from companies that have run into compliance difficulties and would consider amending or delaying the rule. The new administration and Congress have expressed a desire to repeal the rule altogether. While there wasn't broad support for the disclosure when it was added to the Dodd-Frank Act, there are many shareholder groups capitalizing on the anticipated disclosure and will be asking questions and scrutinizing the pay gap. For example, in December , the city of Portland, Oregon, passed legislation that would charge an addition 10% in business tax at companies where the chief executives earns more than 100 times the median employee.

If we were to break down the complicated task of calculating and disclosing the CEO pay ratio we could put it into four steps, with each one having their own set of tasks:

- **Step 1**: Determine how to calculate your ratio to be compliant with SEC rules. The SEC has released five new Compliance and Disclosure Interpretations (CDIs) that clarify some of the calculations for identifying the median employee and the treatment of contingent and furloughed workers. For more details about what the rule requires and help with calculating the ratio, please see our client alert *What the SEC's Final CEO Pay Ratio Rules Mean for Companies*.

- **Step 2**: Assess your ratio compared to peers. To take this step, you need to determine who your peer group is. Should you use your executive compensation peer group, and what if you have more than one? What other companies do you anticipate your shareholders comparing your ratio to? You also want to think beyond your shareholder base. For example, employees might compare the ratio of their company to their prior employer or local media might compare ratios for the local businesses in that market (particularly for mid-sized markets where the local business press actively reports on executive compensation of the companies headquartered in that region). For more guidance on putting your ratio in the context of industry peers, please see our paper *In Calculating Your CEO Pay Ratio, Relativity to Peers is the New Math*.

- **Step 3**: Create a disclosure and engagement strategy. There are likely to be several action items within this one step. First, you need to determine what your narrative is going to be around the actual CEO pay ratio number. If the ratio is well within the limits of your peer group(s), then you may feel compelled to keep your narrative disclosure brief. If the ratio appears outside the bounds of the median for your industry and peer group, then further explanation is warranted. There is little you can do to change your ratio at this point and we would caution against making larger statements about changing this ratio over time. The best strategy is to address the reasons why your ratio is what it is. In the most extreme cases, it might seem warranted to engage with shareholders on this issue; in the majority of cases, this is best done during the normal course of proxy season meetings with large investors unless you have an exceptional case or some of your large investors have raised concerns ahead of time.

- **Step 4**: Address all constituents. The most obvious group you will speak to about your ratio will be shareholders and proxy advisors since they are the main audience for your proxy statement. But it shouldn't go unnoticed that employees may also look at this figure. Institutional Shareholder Services (ISS) has said it is most interested in reviewing the ratio and how it changes at each company over a multi-year period. We can assume many institutional shareholders will take the similar step. Employees, on the other hand, may not have the same approach. As we stated above, employees may also be comparing their company's ratio to a different set of peers and the story you tell internally may have a wider impact on talent engagement.

Next Steps

Radford offers CEO pay ratio services to our existing and new clients. Using our extensive survey data, we can help you calculate the pay ratio and put the figure into context among a wider set of peers. With the broader resources of the Aon Hewitt global governance team, we can also assist you in messaging, disclosure and engagement related to this rule. To learn more about our CEO pay ratio services or for any questions about this topic, please write to consulting@radford.com.

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