

Will the Pay Ratio Disclosure Affect U.S. Competition?

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Among the commenters who responded to then Acting Commissioner Piwowar's request to examine the pay ratio disclosure rules, one company declared that the rule "is one more nail in the coffin for U.S. manufacturers...who are already at a significant disadvantage to competitors overseas."

Companies and their representatives stressed the cost burdens associated with putting together the data. Besides the direct costs of hiring consultants and advisers, companies cited internal man hours spent locating and compiling the information, and facing multiple unforeseen complications. Equally burdensome and no less challenging will be the additional time and effort after the ratio is disclosed in managing both external and employee communications, with many concerned about employee morale.

Supporters of the pay ratio rules strongly emphasized that the disclosure would serve as an additional metric for evaluating a company's executive compensation structure, but some unabashedly also hoped that it can be used to achieve social objectives, noting that the disclosure "may help stem excessive executive pay." The ratio becomes another flashpoint in the discussions on widening pay gaps and income inequality.

Unlike traditional executive compensation disclosure under current SEC rules that focuses on management, supporters of the pay ratio believe that it will provide information about the adequacy of employee pay. They want to use that measure to then assess the appropriateness of what executives earn when going to cast the say-on-pay vote. The ability to determine whether "employees are fairly compensated" was the key for the nearly 40 members of Congress who wrote in to urge implementation without further delay.

This bolsters companies' concerns that the ratio when disclosed will become a "name and shame" game. But companies and their representatives warn that there will be widespread misunderstanding about what the ratio actually represents. The ratio itself could end up giving very little, and perhaps misleading, information about employee pay generally, particularly since the SEC rule allows for flexibility in finding that single median employee. Commenters also noted that it seems paradoxical that as CEO pay is further aligned with performance, the ratio could increase in a year with good performance and then lead to criticism.

Those opposed to the disclosure additionally dispute the notion that the ratio will be comparable across companies, which many of the supporters of the rule have extolled as a great benefit of having the disclosure. The rules surrounding part-time, seasonal and temporary employees, as well as non-U.S. employees, along with companies' varying use of those types of employees in their overall workforce, could produce widely varying ratios across companies in the same industries that otherwise seem quite similar. Companies' reliance on independent contractors, which the SEC rules define differently than for other legal purposes, could further complicate the picture for comparability. Of course, as commenters emphasized, all of this complexity also adds to the cost.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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