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Dodd-Frank Pay Ratio Disclosure Requirements—Is this really worth it?

By Rob Rogers

Section 953(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act requires public companies to disclose the ratio of the CEO's total compensation to that of the median of all other employees in the work- force. Against the back drop of the financial collapse in 2008, this massive piece of legislation sought to curb abuses that led to the collapse and also to protect consumers from misdeeds within banking and corporate entities.

While much of the Act effectively deals with specific issues with clarity and purpose, the Pay Ratio requirement was born more out of a political view that the level of CEO compensation had gotten out of line in comparison to the average worker. Something needed to be done in an effort to slow the growing gap.

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Some rationale suggested that investors would welcome this measurement as a means to assess the company's effective management of human capital. It was hoped that this measure would allow an investor to compare such ratios within an industry for example, and draw conclusions about the company's treatment of employees which would impact both morale and productivity. Unfortunately, care was not taken in truly evaluating what use such a ratio would have for investors—could you assume that a higher ratio of CEO to median pay would portend future performance problems? Could you assume that a higher ratio would impact worker productivity and morale which would certainly lead to fundamental problems in the future? No one would argue that the effective use of human capital is an important measurement for any company; however countless workforce surveys reveal pay levels are rarely the true drivers for satisfaction and ultimate productivity. There are usually other more intrinsic issues that really drive behavior.

At its core, this legislation is flawed because while it represents itself to be an effective guide for investors, it is really more of a political statement about the need to force pay equity within corporate America. With that said, it is the law, so now what?

In September 2013, the SEC proposed rules that would serve as guidance for compliance under the new Pay-Ratio reporting requirements. The main provisions included:

1. The determination of workforce—it would include all components of the company whether domestic or international.
2. Calculating the median employee pay while admittedly difficult was given some latitude by the SEC as long as the method was disclosed and used consistently by the company. For example, the company could use a statistical sampling rather than the entire workforce in order to simplify the procedure.
3. All employees would be included in the calculation including part-time, temporary or seasonal. There would be no annualization of compensation for these positions unless the person was hired during the middle of the year. The measurement date for the ratio would always be the last day of the fiscal year.

The SEC welcomed comments which came in large numbers. Probably the biggest issue was the complexity and cost associated with trying to determine the median employee. Companies cited millions of dollars of system programming necessary in order to comply and related to that, the addition of foreign payrolls would add to the cost on an exponential basis. Cited specifically were certain data privacy laws in some countries which would preclude transmission of such data as well as the complexity from multiple payrolls in which to interface.

Another significant issue surrounds the requirement that all employees be utilized without regard to the number of hours worked or classification. Without the ability to annualize pay, a person working 10

hours a week would be included in the comparison to a full-time CEO. Requiring a year-end data point was also challenged based upon different employment patterns within certain industries and the fact that the SEC was putting yet another year-end reporting requirement on corporations.

Generally, corporations are finding it difficult to justify the cost of compliance. The law is viewed as a distraction that generally is ineffective as a means to truly educate investors. What the SEC will do in response to these comments in unclear however it is expected that final rules will be issued this fall. If that is the case, proxies for the fiscal year beginning in 2015 and reported in 2016 will need to provide the required disclosure.