Pearl Meyer

SVCA | Silicon Valley Compensation Association

How Tech Companies Can Prepare for the CEO Pay Ratio

SVCA Luncheon Meeting

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Be Prepared…for Potential 2018 Headlines?

San Francisco Chronicle

CEO Pay Ratio Casts New Spotlight on Bay Area Pay Disparity Issues

San Jose Mercury News

Not Everyone Is a Software Engineer: Local Workforce Takes Issue With Median Employee Pay

SFGATE

Tech Company Disclosures Expose Huge Pay Gaps Between CEOs and Rank-And-File Employees

San Jose Mercury News

AFL-CIO Continues to Advocate for Lower CEO Pay Increases: Silicon Valley Is Not Immune

San Francisco Chronicle

Top Bay Area Employers Scrutinized for Excessive Gaps Between CEO and Employee Pay

SFGATE

CEO Pay Levels in Silicon Valley Tower Above the Rest

CEO Pay Ratio Rules – Refresher

- CEO Pay Ratio rule – requires disclosure of the ratio between the CEO and the median paid employee, including:
  - The median annual total compensation of all employees (except the CEO)
  - The annual total compensation of the CEO; and
  - The ratio between the two, e.g., 1 to 300
- The SEC approved Final Rules on the CEO pay ratio on 8/5/15 in a 3-to-2 party line vote
  - Disclosure delayed until 2018
- Recent developments (Feb/March 2017)
  - Executive Order on Dodd-Frank review – directed Treasury secretary to meet with other top financial regulators and deliver a report re: what is working/not working for Dodd-Frank
  - SEC public statement and request for additional comments
    - Chairman Piwowar issued a public statement and requested additional commentary on the hardships of the rule by the third week of March [Pearl Meyer issued comment letter]

It is difficult to estimate how long it may take the SEC and Treasury to react to the comments.

As a result, we suggest that clients ***continue to prepare to comply with the CEO pay ratio rules*** *as written, recognizing that the outcome of this recent activity may be delayed effectiveness of the rule.*

CEO Pay Ratio Rules – Refresher (cont'd)

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Provision	Summary of CEO Pay Ratio Rules
Implementation Date Delayed to 2018	• For calendar year filers, first disclosure in the 2018 proxy filing, with ratio based on fiscal 2017 compensation. Applicable to the first full fiscal year beginning on or after 1/1/17 • Pay ratio will be calculated and disclosed annually as a ratio (300-to-1) or as narrative text, along with a brief description of the company's methodology, assumptions and estimates • Pay ratio will be "filed," not "furnished" and therefore subject to SEC anti-fraud rules and Sarbanes-Oxley • Disclosure of supplemental ratios is allowed, provided that it is clearly identified, not misleading and not presented with greater prominence than the required ratio
All Employees Covered	• "Covered employees" would include all full-time, part-time, temporary and seasonal workers determined globally • SEC rules exclude employees of subsidiaries which are not consolidated and individuals whose compensation was determined by an unaffiliated third party (e.g., certain leased workers and independent contractors)
Determination of Median Employee	• The Median Employee may be ***determined once every three years***, unless there is a change in employee population or employee compensation arrangements that could result in a significant change to the pay ratio • The Median Employee may be ***determined on any day within the last three months*** of the completed fiscal year, e.g., during Q4 2017 for calendar year filers • Companies have flexibility to choose the methodology used to identify the Median Employee, e.g., statistical sampling, reasonable estimates, or use of any consistently applied compensation measures (payroll, W-2, etc.)
Limited Exclusions for Non-US Employees in Determining the Median Employee	• Only two limited exclusions, both of which require supporting documentation and extra disclosure: – ***Data Privacy***: may exclude all non-US employees in jurisdictions with data privacy laws which would be violated by the pay ratio disclosure. Company must first seek relief from such laws and file a legal opinion – ***5% De Minimis***: may ***exclude all*** non-US employees if they total 5% or less of total employees, or ***exclude up to 5%*** if non-US employees make up > 5% of the total. The 5% exclusion test must apply to all employees within a jurisdiction, no cherry-picking. Exclusions based on data privacy count against the 5% limit

CEO Pay Ratio Rules – Refresher (cont'd)

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Provision	Summary of CEO Pay Ratio Rules (cont'd)
CEO Compensation	• Total compensation as reported in the proxy Summary Compensation Table • In years where multiple CEOs are reported, companies may combine compensation for all CEOs or annualize the compensation of the CEO in the position on the date the Median Employee is determined
Median Employee Compensation	• Total compensation must generally be calculated in accordance with proxy rules for calculating named executive officer total compensation • Companies may include or exclude (must use same approach for CEO and Median Employee): − Personal benefits of less than $10,000; and − Value of non-discriminatory benefit plans (including pension, 401(k), profit-sharing, disability, leave policies, and medical benefits) • Companies may consistently apply COLA adjustments (purchasing power parity) in determining the Median Employee, calculating compensation for the Median Employee and calculating the pay ratio, provided that: − The Median Employee is not in the jurisdiction in which the CEO resides; and − The COLA adjustment must be applied to all employees in the jurisdiction • Companies may not make a full-time equivalent adjustment for part-time employees. Annualization is not allowed for seasonal or temporary workers. However, companies may annualize compensation for full- or part-time employees who have not been employed for a full fiscal year (apply same approach for entire population)
Entities Excluded	• Emerging Growth Companies (EGC), Smaller Reporting Companies (SRC) and Foreign Private Issuers are excluded from reporting pay ratios
Transition Rules	• The SEC provided certain transition rules for IPOs, EGCs and SRCs. Essentially, pay ratio reporting will be required after the first full fiscal year following IPO or exit from EGC or SRC status, but not before 2018 • M&A: companies may initially omit the employees of a newly-acquired company from the pay ratio (must be included beginning in the first full fiscal year following the acquisition)

- An Economic Policy Institute report in June 2015 estimated the CEO pay ratio among the Top 350 largest US companies to be 303-to-1

"How To" Guide to Preparing for Disclosure

- Getting started – following are suggested process steps and decision points involved in gathering and analyzing the data and preparing the CEO pay ratio disclosure

Step 1 – Identify the team; develop a work plan

Form a working group including representatives from:

- HR – especially compensation and workforce analytics
- Legal
- IT
- Accounting/finance
- Investor relations and/or corporate communication

Identify a project manager to coordinate workflow and timing/deadlines

- PM develops goals and specific dates for drafts, iterations and final versions of proxy disclosure

Engage and consult with outside advisors

- Legal, compensation consultants, public relations, etc.

“How To” Guide (cont’d)

Step 2 – Identify pay data sources

Determine where compensation data is housed for all employees

- HRIS
- Payroll
- Stock plan admin

Develop a plan to centralize the information

- May require modification of existing systems or development of new ones
- Non-U.S. payrolls/systems may complicate this

"How To" Guide (cont'd)

Step 3 – Determine the median employee

All employees employed by company or subsidiaries in U.S. and globally must be included

- Full-time, part-time, seasonal/temporary/furloughed
- Excludes independent contractors and leased employees
- May exclude up to 5% of overseas employees or due to data privacy laws
- Consult with counsel for additional requirements if exemptions utilized

Determination date – employee population

- Companies may use any date in last 3 months of fiscal year
- Only employees as of the date are included; all others excluded
  - Implications for seasonal employers, e.g. retail; distribution

Determination date – median employee

- Companies must choose time period for collecting compensation data to determine median employee
  - Does not need to include the employee population determination date
- Does not need to be full annual period, e.g. could be prior fiscal year as long as no change to pay distribution of employees

"How To" Guide (cont'd)

Step 3 – Determine the median employee (cont'd)

Compensation measure used to rank employees…introducing the CACM

- Needs to be a "consistently applied compensation measure" (CACM) that reasonably reflects the annual compensation of employees who could be identified as the median
  - Base salary, bonus, equity grants or any combination (e.g. total cash)
  - W-2 box 3 Medicare wages
- Additional considerations
  - Pay may be annualized (employed < full year)
  - COLA (purchasing power) adjustments for non-U.S. jurisdictions
  - Exclusions for mergers/acquisitions
  - ***Statistical sampling may be used***

CACM must be described in proxy and must be reasonable

- Must try to include all significantly widely used elements, i.e. equity grants not excluded if equity is widely used
- Model different measures if possible

Once CACM selected, consolidate and "sterilize" the data

- Strip out all identification of the actual employee as disclosure only requires pay data

“How To” Guide (cont’d)

Step 4 – Calculate compensation and the pay ratio

Determine the median employee’s total compensation

- Recalculate the median employee’s compensation using the same rules used to report NEO compensation on the Summary Compensation Table
- Includes grant date fair value of equity (if any), other compensation, etc.

Determine the CEO’s compensation

- Taken directly from the Summary Compensation Table

Calculate the pay ratio

- Presented as a ratio where the median employee’s compensation is “1”, i.e. 200:1 or 1:200
- Can be presented narratively by referencing the CEO’s pay as a multiple, i.e. “200 times larger than the median employee’s annual total compensation.”

Step 5 – Draft proxy narrative; develop communication strategy

Determine placement in proxy and extent of discussion

- How much discussion will be provided regarding methodology and/or meaning?
  - Assumptions, how data derived, currency translations, statistical sampling size (if used)
- Consider need for supplemental disclosures or additional ratios, i.e. U.S. employees only, etc.

Consider implications and develop communications strategy

- Inventory anticipated questions and answers by stakeholder group
  - External – press, shareholders, unions
  - Internal – managers, employees
- Determine who within company is best suited (and can be trained) to address

Weak responses to pay questions can lead to negative press, misinformed employees and frustrated investors.