Compensation Advisory Partners

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Pension Funds and Institutional Investors Weigh in on CEO Pay Ratio

▪ By Eric Hosken, Ryan Colucci and Melissa Burek

The new disclosure of the CEO pay ratio in 2018 was met with a surprisingly muted response from the press and shareholders. Companies had been concerned that the CEO pay ratio would be used as a way to shame companies with high levels of CEO pay relative to the median worker, yet for the most part criticism of CEO pay was mild.

Near the end of 2018 however, institutional shareholders began to express greater interest in the CEO pay ratio from two directions:

1. A group of 48 institutional investors recently sent a letter to many large companies requesting more robust disclosure about their workforces.

2. The Office of the New York State Comptroller (NYSC) recently issued a press release stating that they have submitted shareholder proposals to several companies to incorporate considerations about the broader workforce into their CEO pay decision making and pay philosophy.

Shareholder Letter from 48 Institutional Investors

The group of institutional investors believe supplemental information will provide reference points for understanding the company's workforce and will help investors put the pay ratio into context. Their perspective is that human capital is a critical asset of the company and that investors will benefit from a better understanding of a company's approach to human capital management. The 48 companies are for the most part made up of unions and pension funds (e.g., CalPERS, NYSC, AFL-CIO) so their view may not be representative of other institutions (e.g. index funds, hedge funds, etc.). Supplemental disclosures cited as useful by these investors are largely focused on workforce demographics (i.e. use of seasonal workers, geographic locations, etc.), median employee detail (i.e. job function, education levels, etc.) and the company's overall compensation philosophy. The letter acknowledges that some of this information has already been voluntarily disclosed by companies and some may be available elsewhere.

New York State Comptroller Proposal

Based on the NYSC's press release, companies responding and reaching agreement with the NYSC in 2018 are CVS Health, Macy's, Microsoft, Salesforce.com, The TJX companies; companies reaching agreement in 2017 are BB&T, Discovery Communications and Regeneron Pharmaceuticals. The NYSC withdrew the proposals after the companies agreed to reexamine their CEO and executive pay and adopt policies that take into account the compensation of the rest of their workforces. The proxy disclosure for two of these companies, CVS Health and Discovery Communications, provided more robust disclosure around CEO pay ratio than what is typically seen, such as enhancements to employee base pay/benefits and pay considerations for their global workforce. It is unclear if there are other pending shareholder proposals from the NYSC on this topic.

Current CEO Pay Disclosure Practice

Very few companies currently provide the kind of supplemental disclosures requested by the institutional investors. With approximately 90% of the S&P 500 having disclosed 2018 CEO pay ratios at this point, Compensation Advisory Partners researched the prevalence of the requested information. Among the S&P 500, only about 25% of companies disclosed any specific geographic information on their employee population as part of the pay ratio disclosure. This was primarily discussed as the number of U.S. employees versus non-U.S. employees or in the context of the de minimis exemption, where companies can exclude up to 5% of the non-U.S. employee workforce. Further, the type of workers employed by the companies (i.e. seasonal, part-time, temporary, etc.) was typically disclosed with minimal detail on the relative size of the employee populations. Only 1% disclosed a headcount of part-time employees and a minority of companies provided context around their workforce demographics.

Median employee detail was included in a minority of disclosures, with 14% providing any detail at all. The most common disclosure (85%) provided was the geographic location of the median employee's employment. Employment/pay type (full/part time, salaried/hourly) was also prevalent; approximately two-thirds and one-third of these disclosures included this information, respectively. Half of the companies providing median employee detail gave information on the role of the median employee, often related to job title, job function, or place of employment (e.g. factory). Incentive compensation eligibility, education level, and compensation mix were rarely provided, with less than 5% of companies sharing such detail.

Detail on Median Employee

Type of Description	Prevalence of Disclosure
Median Employee	62 of 446 (14%)
Geographic Location of Employment	53 of 62 (85%)
Employment Type (full/part time)	41 of 62 (66%)
Pay Type (salaried/hourly)	23 of 62 (37%)
Role (job title or type of work)	30 of 62 (48%)
Bonus Eligibility (eligible/non-eligible)	3 of 62 (5%)
Equity Eligibility (eligible/non-eligible)	1 of 62 (2%)
Compensation Mix	2 of 62 (3%)

Looking Forward

We do not expect that many companies will significantly expand their disclosures around workforce demographics in 2019 proxy statements. We think that what these shareholders are requesting would require fundamental change to the CEO pay ratio disclosure and is substantially different from the original intent of the CEO pay ratio. For the most part, we expect the information disclosed to remain consistent with what companies provided in 2018, with any changes in disclosure being modest (e.g. how many companies will exercise the option of reusing the same median employee, will they provide a comparison of the 2019 pay ratio to the 2018 pay ratio).

Looking beyond 2019, companies should recognize that there is an appetite among some of the larger institutional investors for greater information on the makeup of a company's human capital. We suspect that the requests in these shareholder letters, combined with some of the requests in shareholder proposals around gender pay equity, may serve as a basis for new legislation from the Democratic majority in the House of Representatives requiring disclosure of workforce demographics and pay equity statistics. While any proposed legislation is unlikely to become law before 2021, we expect that shareholder requests for additional information may evolve from a letter into actual shareholder proposals similar to those submitted by the NYSC.