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2021 CEO Pay Ratio Disclosure – New Considerations and Expectations

▪ By **Ryan Colucci, Matt Vnuk** and **Joshua Hovden**

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Companies should now be thinking about – and most will soon begin to work on – their 2021 proxy statements. Such disclosure this year will be impacted in many ways by the COVID-19 pandemic. This includes SEC-required CEO pay ratio disclosure, which compares the compensation of the CEO to that of the median employee.

2021 CEO Pay Ratio Disclosure

Selected practical considerations for 2021 proxy statements related to CEO pay ratio disclosure are outlined below.

1. **New Median Employee**. For most companies, 2021 proxies will be the fourth year of required CEO pay ratio disclosure. Given this, companies that have been using the same median employee for three consecutive fiscal years will have to determine a new median employee for 2021 proxy disclosure.

   Companies can use the same median employee for three consecutive fiscal years, assuming no changes to employee population and/or compensation arrangements that would be reasonably believed to significantly affect CEO pay ratio disclosure. Many companies experienced material disruption to their employee populations during the last year, and many companies made changes to their compensation arrangements during the last year. Given this, companies may have additional reason to re-calculate the median employee for 2021 proxy-based CEO pay ratio disclosure.

2. **Furloughed Employees**. Many companies furloughed employees during 2020, and this needs to be considered when determining the CEO pay ratio for purposes of required 2021 proxy statement disclosure.

   The SEC has directed companies to "determine whether furloughed workers should be included as employees based on the facts and circumstances." To-date, CAP has worked through this issue with several companies with non-calendar fiscal year ends. Several issues need to be considered, such as the timing and duration of the employment actions.

3. **Consistently Applied Compensation Measure ("CACM")**. For 2021 proxy disclosures, we expect the approach companies use for their CACM to be consistent with what has been used in the previous years.

   Among the S&P 500, approximately 43% of companies used base salary plus other cash and equity compensation for their CACM in 2020, which was the most prevalent approach.

4. **Determination Date**. Many companies saw their employee population permanently or temporarily disrupted during 2020 due to the COVID-19 pandemic. Given this, companies should consider if selecting a determination date later in the fiscal year would likely lead to a less atypical result from the required CEO pay ratio calculation for 2020.

   CEO pay ratio disclosure rules dictate that companies may identify the median employee with an effective date any time within the final three months of the fiscal year. If a company decides to shift the determination date used for 2020, versus what was done in past years, the company must include a rationale for the change in the 2021 disclosure.

5. **Supplemental Ratios**. 2020 is likely to be viewed by many companies as having "one-time" events. As a result, there may be a significant increase in the prevalence of supplemental CEO pay ratio disclosures in 2021 proxies to reinforce that year-over-year change in the CEO pay ratio (up or down) should not be viewed as an ongoing expectation.

   Disclosing supplemental CEO pay ratios is allowed under SEC rules, as long as the prescribed CEO pay ratio is clearly disclosed as such. While disclosure of supplemental CEO pay ratios has been limited (approximately 12% of S&P 500 companies), when provided, supplemental CEO pay ratios are typically disclosed to explain a one-time event (e.g., CEO transition) that materially increased or decreased the ratio versus the prior year.

6. **Narrative Disclosure**. For the most part, we do not expect that companies will significantly expand their disclosures around median employee or workforce demographics in 2021 proxy statements, as it relates to CEO pay ratio disclosure. This is despite requests from certain large institutional investors and the New York State Comptroller.

   Any changes to CEO pay ratio narrative disclosure in 2021 proxies will likely be modest and focus on year-over-year comparability, and, where appropriate, use of a different median employee. It remains minority practice to include any description of the median employee as part of CEO pay ratio proxy disclosure. When descriptive information for median employee is included, companies most often disclose the geographic location, employment type and/or role of the median employee.

   When additional narrative disclosure is used, it will be important to not lose sight of what was disclosed in the newly required Human Capital Management section of the 10-K, to ensure consistent messaging around the employee workforce.

7. **Comparability**. Since inception, comparing CEO pay ratios across companies has been of limited usefulness. For example, beyond variability across industries, when looking at two competitors, the workforce of one may be largely U.S.-based while the workforce of the other may be mostly located in lower cost countries. Inconsistent disruptions in business and workforces in 2020 due to the historic COVID-19 pandemic, that may significantly impact the numerator and/or denominator of the CEO pay ratio calculation, has only reinforced the inherent issues with comparing CEO pay ratios across companies.

   Year-over-year comparability of CEO pay ratios may also be difficult in 2021. For example, CEO salaries could have been temporarily reduced in 2020 and bonuses may pay out substantially lower than a typical year. In other instances, front line workers may have received additional pay, in the form of one-time bonuses, additional overtime and/or enhanced benefits.

Looking Ahead

While new considerations need to be addressed for 2020 CEO pay ratio calculations, we expect 2021 CEO pay ratio disclosures to remain primarily compliance-focused, in most cases with limited to no supplemental information. There will also continue to be pressure from outside stakeholders for greater disclosure around median employee information and related workforce demographics, though such workforce demographic information will most often be addressed and disclosed in other areas of the proxy statement and/or 10-K.

Additional CEO Pay Ratio Resources – Compensation Advisory Partners

- ***CEO Pay Ratio Tracker.*** *CAP's CEO Pay Ratio Tracker uses each company's most recent pay ratio disclosure, and can be filtered on revenue, market capitalization and industry sector. The CEO Pay Ratio Tracker can be accessed here: https://www.capartners.com/cap-thinking/ceo-pay-ratio-tracker/*

- ***A Deep Dive into the Second Year of CEO Pay Ratio Disclosures:*** *https://www.capartners.com/cap-thinking/deep-dive-second-year-ceo-pay-ratio-disclosures/*

- ***Pension Funds and Institutional Investors Weigh in on CEO Pay Ratio:*** *https://www.capartners.com/cap-thinking/ceo-pay-ratio-shareholder-letter/*

- ***Pay Ratio Disclosure: A Practical Guide to Implementation:*** *https://www.capartners.com/cap-thinking/2017-pay-ratio-disclosure-practical-guide-implementation/*

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