



EQUILAR
EXECUTIVE COMPENSATION
Summit2016

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An Advanced Course on Pay Ratio



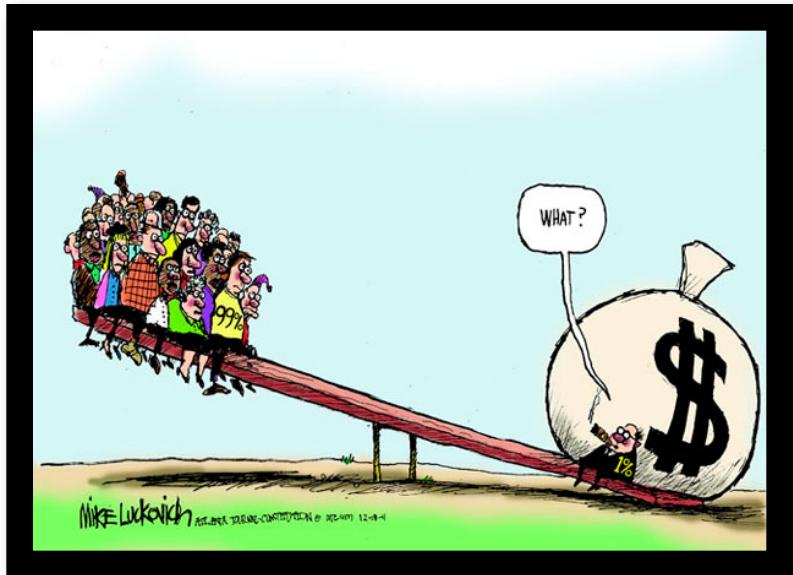
Panelists:

- Rachel Kane, Bank of America Corporation
- Daniel Laddin, Compensation Advisory Partners
- Art Meyers, Choate
- Nathan O'Connor, Equity Methods



Agenda - What Do We Mean by an “Advanced” Course?

- A Quick Review of the Pay Ratio Rule
- Identifying the Median Employee: 3 Key Questions You Must Answer
- Disclosure and Communication
 - Telling the Right Story in the Proxy
 - Communicating Effectively to Employees



A Quick Review of the Pay Ratio Rule

- One of the more controversial elements of Dodd-Frank related Executive Compensation
- Requires determining the median employee of the company
- Then comparing their total pay to that of the CEO's total pay
- The SEC did mitigate some of the biggest concerns around Pay Ratio by allowing for sampling

$$\frac{\text{CEO Salary} + \text{Bonus} + \text{Equity} + \text{Other Compensation}}{\text{Median Employee Salary} + \text{Bonus} + \text{Equity} + \text{Other Compensation}} = \text{Pay Ratio}$$

Some Important Details

- Companies will be required to disclose pay ratio in 2018 proxy statements for the first fiscal year beginning on or after January 1, 2017
- Identify median employee once every three years unless significant changes in population
- Can exclude non-U.S. employees from determination of median employee in two circumstances:
 - Data privacy laws
 - Up to 5 percent of its non-U.S. employees, including any non-U.S. employees excluded using the data privacy exemption.
- Need to briefly describe methodology

Who is going to care about pay ratio?

- Shareholders (and ISS) when it is outside the norm
- Unions / Labor groups / Employees
- Big Companies in “Small” Towns
- The Press



The Big Problem: Identifying the “Median” Employee

1

Selecting the Median Employee

- Significant methodological flexibility

Employee #	Base Salary
1 (CFO)	\$900,000
2 (CIO)	\$750,000
3	\$700,000
4	\$650,000
...	
749	\$51,000
750 (Joey)	\$50,000
751	\$48,000
...	
1,499	\$15,500
1,500	\$15,000

2

Calculating the Pay Ratio

- Very little flexibility in how the ratio itself is computed (plug CEO and median employee into the SCT framework)

	Salary	Bonus	Stock Awards	Non-Equity Incentive Plan Comp	Change in Pension & NQDC Earnings	All Other Comp	Total
CEO	\$3,000,000	\$0	\$9,000,000	\$7,000,000	\$800,000	\$200,000	\$20,000,000
Median	\$50,000	\$1,500	\$0	\$0	\$0	\$0	\$51,500

$$\text{Pay Ratio} = \frac{\$20,000,000}{\$51,500} = 388.34$$

Identifying the Median Employee: 3 Key Questions

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1. What is the best measure of compensation to use to identify our median?

Evaluate Various Alternatives:

- Base salary
- Base salary + actual bonus
- Base salary + target bonus
- + Fair value of stock awards
- + Pension value changes
- Application of cost of living adjustments

2. Should we use “statistical sampling” to identify the median employee?

For many companies, statistical sampling has drawbacks, so consider population analysis

3. What populations should be excluded?

1. International employee exclusion (5% threshold)
2. Exclusions due to data privacy

Pay Ratio Data Complexity



- Pay ratio data inputs come from many different systems/sources
- Finding the optimal “cutoff” date for your data
- Analyzing a full population vs. a random sample decreases the volatility of the pay ratio over time
- How frequently should our data be re-analyzed to determine a new median employee?

The Proxy: Contextualizing Your Pay Ratio Estimate

- Tell your story
- Put the pay ratio in the context of your pay strategy
- Potentially show it over time to show the link to performance
- Consider showing it vs. realizable pay as opposed to Summary Compensation Table pay only



Communicating Effectively to Employees



- Should you communicate to employees? What is your culture?
- Being below median employee in the company does not mean you are below median for your job
- Discuss the pay philosophy and the risk profile of compensation at different levels in the organization

Next Steps

- “Experiment” early with collecting and analyzing the data. Develop answers to the 3 key questions
- Model your proxy disclosure
- Give a heads-up to the Compensation Committee in 2016, but don’t present to the full Board until you have a polished presentation in 2017
- If not done already, open lines of communication with HR team members around the world that will be providing you data
- Assess the costs and benefits of population analysis vs. statistical sampling



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