2018 CEO Pay Ratio Disclosure: **Risks & Strategies**

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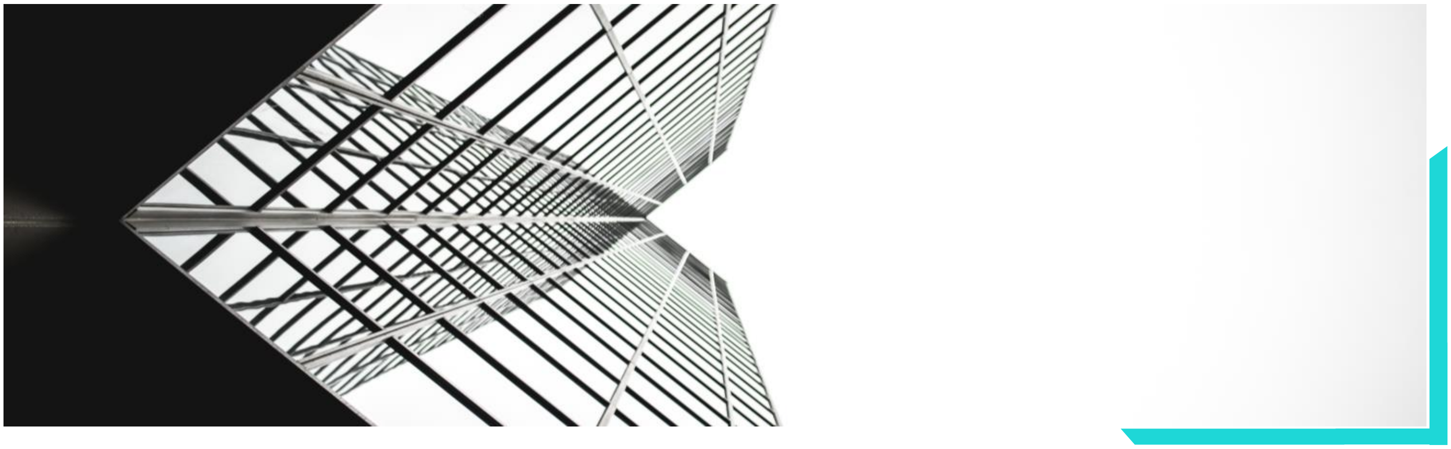
BRUNSWICK



Starting this year, public companies are required for the first time to disclose new details on compensation in their annual proxy filings. In particular, they are required to report CEO compensation, median compensation of their employees, and — most significantly — the ratio between the two numbers.

The disclosure of this data, mandated by the 2010 Dodd-Frank Act, creates potential communications challenges:

- To state the obvious, half of every company's workforce will now be aware that they earn less than most of their fellow employees.
- Employees will be able to compare median salaries to other companies in the same industry.
- The wide gap between CEO compensation and median employee compensation at some companies will receive employee and public attention.
- A higher ratio relative to companies in the same sector or index may create openings for shareholder and labor activists to call for more equitable pay.
- There are already efforts in some states to apply higher income taxes to companies with large pay ratios.

Companies can use this moment to educate employees about compensation — and to articulate a narrative tying successful implementation of a strategic vision to executive pay. **As with any challenge, a successful communications strategy must integrate legal, investor relations, employee communications, and external communications/media relations.**

Landscape Overview and Public Reactions

Companies have begun filing their 2018 proxies, providing some early insights into how companies are handling their CEO pay ratio disclosures and how the media and other third parties are responding.

A February 2018 Equilar survey of 356 public companies provides useful context:

- The survey found that the average ratio will be 140-to-1, with wide variation by company size, distribution chain complexity, and industry. Ratios are likely to be especially high in companies with many part-time workers, such as retailers and restaurants.
- Large companies tend to have above-average ratios, given their generally higher CEO compensation packages. This fact is also true for companies with a high percentage of employees outside the U.S.

These ratios are generating headlines due to the media taking a closer look at the disclosures and calculating industry benchmarks.

- The companies with the highest reported ratios all have large groups of modestly paid employees working part-time or seasonally.
  - Manpower, the temporary help firm, reported a ratio of 2,438-to-1. The company has 600,000 part-time employees, with a median salary of under $5,000.
    - Under the SEC rules, the calculation includes all employees — and pay is not annualized.
  - Six Flags, the theme park operator, which employs many part-time and seasonal workers, reported a ratio of 1,804-to-1.
  - Fresh Del Monte Produce, the fresh fruit company, notes that 80 percent of its staff are in low-wage countries such as Costa Rica, Guatemala, Kenya, and the Philippines. The company reported a pay ratio of 1,465-to-1.
  - Marathon Petroleum, which operates a chain of more than 2,700 gas station convenience stores employing more than 32,000 employees — many of whom work part-time — reported a ratio of 935-to-1. Marathon notes that if these workers are excluded, the ratio drops to 156-to-1.
    - The SEC does not prevent companies from providing this kind of additional contextual disclosure in proxy statements.
- As of right now, the companies with the lowest ratios reported tend to have an element of executive compensation excluded for the purpose of calculating the ratio.
  - For example, Apollo Management Group and The Carlyle Group reported ratios of 1-to-1 because the firms are structured as limited partnerships. Within these organizations, a large proportion of remuneration comes in the form of dividends from the partnership — and these dividends are excluded from the ratio calculation.
- Financial services companies, many of which are already under scrutiny for offering large executive compensation packages, are receiving additional attention related to their pay ratios. Blackstone's pay ratio of 575-to-1 reflects a CEO pay package exceeding $130 million. Bank of America reported a ratio of 250-to-1.
- On the other end of the spectrum, local companies with smaller workforces will see significantly smaller ratios, *e.g.*, in the 30-to-1 range. Pittsburgh-based chemical company Calgon Carbon reported its ratio at 28-to-1, while regional telecom player Cincinnati Bell reported a 32-to-1 ratio.

These wide ranges go to show that, if taken at face value, the numbers can be misleading. **This further underscores the need for every company to understand where it falls and how its ratio will affect its communications strategy.**

Engaging Your Audiences Effectively

The pay ratio information will be of interest to many audiences, including:

- **Employees** – Companies should develop a strategy to proactively communicate to employees and leadership in a way that addresses likely questions and concerns about the median salary and pay ratio information. It is better for employees to learn the news and surrounding context from the company itself rather than by reading it in the newspaper or hearing about it anecdotally from third parties.

While the overall approach will vary based on the nature of each company's workforce, leaders, HR representatives, and managers should be prepared to answer questions about compensation practices from employees and during interviews with job candidates.

- **Customers** – The disclosure may generate interest from customers and clients. This is far more likely with larger retailers, which generally have large numbers of modestly paid staff.
- **Labor and Shareholder Activists** – Particularly for large companies with high ratios, this issue could attract attention from labor groups or activists focused on pay equity that want to apply pressure for higher wages. Activist investors could also use the ratio as leverage in an attack.
- **Investors** – Reactions from the investment community may be muted in the short term, but this audience will likely consider the ratio in a broader context over the long term. Down the line, some investors could use the pay ratio as leverage to encourage companies to tie executive pay more closely to corporate strategy — and as a broader measure of how companies tell their human capital management story. The pay ratio is likely to increase attention on CEO pay and incentives for the broader workforce in the years ahead, which makes it critical for companies to define their compensation strategies and communicate them to the investor community. The disclosure may also find its way into Environmental, Social and Governance (ESG) ratings from MSCI and others. It is likely that investors will monitor how the company's ratio evolves in absolute terms and relative to its peers in the years ahead.
- **Government Stakeholders** – An array of D.C. and state government stakeholders are closely following this debate. Government audiences may take the ratio into account when considering policies that could affect companies located in their states or districts.

  As The Washington Post pointed out, the ratios are being disclosed not long after many corporations received what has been termed a "massive windfall in the form of a corporate tax cut," which could raise further questions about workforce inequality. Moreover, legislation has been introduced in some states, including California, that would link state corporate tax rates to the CEO pay ratio. Government relations representatives will need a clear strategy and corresponding communications materials to support their interactions with federal and state legislators, possibly coordinated with industry trade groups.

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