EXECUTIVE COMPENSATION

INSIGHT

Pay Ratio Disclosure Requirements Under Dodd-Frank:

What Not-for-Profits Need to Know

By a narrow vote of three to two, the Securities and Exchange Commission (SEC) approved proposed rules for the disclosure of pay ratios under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank). As with the other provisions of Dodd-Frank, these do not apply to not-for-profit organizations. However, they indicate the government's position on compensation disclosure so it is worthwhile for executives, board members and compensation committees to consider the extent to which the proposed pay ratio rules could affect them.

The regulations consist of the following provisions:

Disclosure

The proposal under Dodd-Frank requires disclosure of the following:

- The median of the annual total compensation of all its employees except the CEO.
- The annual total compensation of its CEO.
- The ratio of the two amounts.

A narrative discussion of the disclosure is not required, but organizations must disclose the methodology used to identify the median, any material adjustments used in the calculations and any estimates.

SullivanCotter
AND ASSOCIATES, INC.

Median Employee

One of the challenges of the proposed rule is that organizations must consider their entire workforce in calculating the ratio. This includes all full-time and part-time, seasonal, temporary and international employees. The total compensation for full-time and part-time employees may be annualized for those who were not employed for the entire year. Outside consultants, independent contractors and leased workers employed by a third party are not included in the calculation.

The SEC proposal allows for flexibility in determining the median employee total compensation for all employees. Organizations may calculate this using actual data or apply a reasonable statistical sampling approach.

Total Compensation

Total compensation is calculated by the same methodology used to complete the summary compensation table. An exclusion is allowed for personal benefits of less than $10,000 as long as that exclusion is applied consistently across all employees.

The SEC does allow for estimates to be used when calculating median employee total compensation, but CEO total compensation must be calculated in accordance with the proxy rules related to the summary compensation table. Any estimate methodology used must be reasonable and considered applicable across all classes of employees.

CEO total compensation must be consistent with the information provided in the summary compensation table. As such, total compensation must include the following:

- Base salary.
- Bonus or other cash-based incentive pay.
- Equity awards based on grant date fair value.
- Changes in pension valuation or other nonqualified deferred compensation.
- All other compensation.

While estimates are permitted in calculating all-employee total compensation, they are not allowed in calculating CEO compensation.

Issues

The SEC has received thousands of comments covering more than two hundred separate issues relating solely to this specific section of Dodd-Frank. Significant comment has been made regarding the cost and complexity involved with collecting the data and calculating the elements of the ratio. The SEC clearly states their understanding of these compliance issues in explaining their reasons for providing flexibility in the calculation. Unfortunately, this flexibility is also causing a great deal of consternation as many believe that these ratios indicate the use of inconsistent methodologies. Critics of the rule also believe that this will provide little to no value to investors due to the lack of comparability, that it will have little impact on governance and that it could significantly affect employee morale.

Because neither Dodd-Frank nor its CEO pay ratio rules apply to not-for-profit organizations, they pose no concern from a regulatory standpoint. However, many non-regulatory bodies, such as the press, may cite the CEO pay ratio as justification in their crusade against perceived excess compensation of executives.

Looking Ahead

Once the rules are finalized and final guidance is provided, organizations would be well-served to monitor this pay ratio within their own organizations in order to compare themselves to their own and to other industries. Since the CEO pay ratios for those publicly traded organizations is unlikely to affect proxy statement filings until 2016, there is no need to expend much energy on creating “as if” calculations.

SullivanCotter will continue to monitor the rulings and, once finalized and reported, collect data that could be relevant to our clients. Once the regulations are finalized, we will develop a standard calculation for our clients to help ease the potential burden. Even though the law does not apply to not-for-profit health care, we recommend that our clients continue to consider its potential implications.

About Sullivan, Cotter and Associates, Inc.

SullivanCotter is the leading independent consulting firm in the assessment and development of tailored total compensation and reward programs for tax-exempt, not-for-profit organizations. For more than 20 years, the Firm has provided executive, physician and employee compensation and governance counsel to a wide variety of health care and higher education organizations, public charities, associations and foundations. A recognized leader in compensation benchmarking, trends and analyses, SullivanCotter has also developed the most widely recognized physician and health care executive compensation surveys in the United States. Building from this unparalleled data, the Firm works closely with executives, boards and compensation committees to devise innovative solutions to attract and retain talent while satisfying not-for-profit missions and regulatory requirements.

CONTACT US

WWW.SULLIVANCOTTER.COM

888.739.7039