CEO Compensation Is Off the Charts

Ah, spring. The sun is shining, the birds are chirping, and the flowers are blooming. But it's an entirely different thing that gets us investors excited this time of the year… the new proxy statements most public companies are now filing with the Securities and Exchange Commission (SEC)! A proxy statement, officially known as Form DEF 14A, includes some useful information for shareholders such as the background of the company's directors, the compensation of board members, who serves on the different committees, and executive compensation—including salary, bonus, stock awards, and deferred compensation. This year, investors are particularly scrutinizing proxy statements due to a new figure that is being included regarding executive compensation: the CEO pay ratio.

The Dodd-Frank Act

As a consequence of the Great Recession ten years ago, new financial regulations were put in place to try to prevent future calamities to our financial system. The marquee piece of legislation that sought to accomplish that was 2010's Dodd-Frank Wall Street Reform and Consumer Protection Act. Two of the main goals of the bill was to subject banks to more stringent regulation through the creation of the Financial Stability Oversight Council and to protect bank consumers through the creation of the Consumer Financial Protection Bureau.

These regulations brought criticism from both the banking industry and those in government, with detractors arguing that all these rules would put too heavy a burden on the financial industry, thus making it more difficult for U.S. companies to compete around the world. One of the most controversial provisions of the legislation was one that comprised just 18 lines out of the 2,300-page bill. Section 953(b), the pay ratio measure, mandated that companies disclose the ratio between the CEO's compensation and the paycheck of the company's median worker. After much delay in enacting the rule, the annual proxy statements appearing now are the first ones to provide this information.

CEO Pay Ratio

As with any new regulation from Washington, this provision has its advocates and critics. Advocates say that executive compensation has gotten out of hand, with CEO pay increasing exponentially while wages for the average worker remaining stagnant. They say that investors should not be kept in the dark about what companies pay their employees. Critics, on the other hand, call the pay ratio a useless metric due to the fact that companies differ in the way that they structure their work force. For example, a company that employs people in low-wage countries can drive lower the pay figure for their median employee, thus raising the ratio.

Calculating the median employee's pay is no easy task, either, especially for large, global companies. These companies typically have different payroll systems in different countries, offering different compensation arrangements—pension contributions, bonuses, profit-sharing plans. As a result, companies have some discretion in how to make the calculation. Companies can use the number of employees they have on a single day within three months of the most recent fiscal year end. They may exclude contractors and some non-US workers, but no more than 5 percent of the total workforce. All part-time employees must be counted.

Some Results

A recent analysis by the Wall Street Journal of the proxy statements of more than 100 of the largest U.S. companies shows that median pay for CEOs reached an all-time high of $11.6 million in 2017. Total pay—including salary, cash incentives, equity grants, and pensions—rose at least 10% for half the executives. Most of the gains in compensation came from stock awards, as opposed to cash compensation and stock options.

As is no secret, the average CEO makes hundreds of times more than the median worker in his or her company. Whirlpool, for example, notes in its proxy statement that its median worker is a full-time hourly employee located in Brazil. That person earns $19,906 a year, while the CEO's annual total compensation was $7,082,024. That gives a ratio of 356 to 1. The most egregious disparity we have found is at Marathon Petroleum, where the CEO was paid $19.7 million, while the median worker made $21,034, for a CEO to worker ratio of 935 to 1.

It is interesting to look within one industry to see the similarities and differences in pay. Below is a list of U.S. banks ranked by total assets. The CEO pay ratio ranges between 150 to 1 and 369 to 1. You might expect that the smaller banks would pay their CEO and/or employees less, but that is not necessarily the case. Some smaller banks, like BB&T pay their employees more than a much bigger bank like Wells Fargo or Bank of America.

Bank	CEO salary	Median worker salary	Pay Ratio
Bank of America	$21,791,812	$87,115	250:1
Wells Fargo	$17,564,014	$60,446	291:1
Citigroup	$17,814,131	$48,249	369:1
Goldman Sachs	$21,995,266	$135,165	163:1
US Bancorp	$11,960,654	$58,269	205:1
PNC Financial	$13,917,986	$69,190	201:1
Bank of New York Mellon	$19,837,535	$55,970	354:1
BB&T	$12,692,776	$84,550	150:1
SunTrust	$9,592,062	$60,477	159:1

Source: Company proxy statements

One positive outlier in CEO pay and its ratio versus the median worker is Berkshire Hathaway and its CEO Warren Buffett. Berkshire Hathaway's proxy statement shows that Mr. Buffett's annual salary is $100,000 and has been unchanged for more than 25 years. Additionally, he receives no bonus or any form of equity-based compensation. The ratio between Mr. Buffett's compensation and Berkshire Hathaway's median worker is a mind-blowingly low 1.87 to 1. This is the greatest bargain for shareholders in all of corporate America: you get the best investor of all time to work for you for just $100,000 a year.

Conclusion

It will be interesting to see if the new CEO pay ratio disclosure will have any impact in executive or median worker compensation. While this information gives new transparency to what companies are paying their employees, it remains to be seen if there is enough pushback from investors for companies to significantly change their compensation policies.

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