"Pay Equity: What Compensation Committees Need to Know"

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Audio Archive

Amid the focus on human capital management and diversity & inclusion, there are growing calls for transparency on gender & racial pay equity information. Investors want to know where companies stand, what they are doing to reduce unexplained pay discrepancies, and how the board is overseeing company approaches to this issue. While most large companies are now conducting equal pay audits, collecting the data — and presenting it to the board — is only the first step in the lengthier and more strategic process of resolving inequities.

Join these experts:

- **Anne Bruno**, Special Counsel, Mintz
- **Tanya Levy-Odom**, Director of Investment Stewardship, BlackRock
- **Josh Schaeffer**, Director, Valuation Practice Leader, Equity Methods
- **Heather Smith**, Lead Sustainability Analyst, Impax Asset Management | Pax World Funds

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Among the topics of this program are:

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Liz Dunshee, *Managing Editor, CompensationStandards.com:* Hi. This is Liz Dunshee, Managing Editor of CompensationStandards.com. Welcome to today's webcast, "Pay Equity: What Compensation Committees Need to Know."

I'm very excited for this program because it's such a timely topic. We have a great group of speakers today, and I want to thank them for participating. We have Anne Bruno, Special Counsel at Mintz; Tanya Levy-Odom, Director of Investment Stewardship at BlackRock; Josh Schaeffer, Director and Valuation Practice Leader at Equity Methods; and Heather Smith, Lead Sustainability Analyst at Impax Asset Management and Pax World Funds.

The first topic we're going to touch on today is why pay equity is in the spotlight. Anne, do you want to kick that off?

Why Pay Equity Is in The Spotlight

Anne Bruno, *Special Counsel, Mintz***:** Sure. Thank you, Liz. Hello, Tanya, Heather and Josh. It's really a pleasure to be here with all of you. As Liz noted, this topic is timely because pay equity has become an important piece of a much larger conversation that companies, and society in general, are having right now about ESG issues. There's been an expanded focus on ESG for public companies, and human capital management is one of the topics on the front burner for that.

Pay equity issues specifically are some of the most critical issues for companies to address under that umbrella of human capital management, or HCM. This really is a long time coming. Even prior to the pandemic, human capital management issues in an increasingly technological economy were becoming seen as critical factors for companies in terms of their long-term financial health, and that led to expectations for oversight at the board level and required disclosures about human capital resources.

Then we add on the more recent drivers of the #MeToo campaign and Black Lives Matter movement, that have really focused attention on stakeholder interest in social justice issues. The pandemic has really underscored the importance of board level oversight of human capital management, and pay equity is at the forefront of all of this as an important and obvious place for companies to see opportunities for measurement and progress.

Everyone on the panel has a different perspective on how we got here. We have the focus on data, Josh, which will be really helpful to hear your perspective on. Tanya and Heather, it'll be really helpful to hear how you come to this from the investor point of view.

Heather Smith, *Lead Sustainability Analyst, Impax Asset Management | Pax World Funds:* I couldn't agree more that gender and racial pay equity today is now more important than ever, particularly as we see that women and people of color have been disproportionately impacted by the pandemic and its fallout. There is a real risk that this ongoing crisis exacerbates what are well-documented gender and racial pay gaps, and also impedes advancement for opportunities for diverse talent.

From the investor perspective, pre-pandemic, we saw a lot of evidence that greater transparency around pay had positive implications and was really a key part of human capital management. We saw studies showing that large-scale adoption of pay transparency had the potential to reduce gender differences in pay, while increasing diverse talent hires and promotions. This also drives better diversity outcomes across organizations, which is important because we know that greater diversity is correlated with better company performance and decision making, increased innovation and better sustainability performance. For investors and organizations working to advance diversity, pay equity is another tool in the toolkit, so to speak, that can really help companies gain a competitive advantage.

Josh Schaeffer*, Director, Valuation Practice Leader, Equity Methods:* That's a great point, and we also see a kind of linking of the two. You can do similar analyses both for pay equity and for diversity & inclusion. Seeing that people at the same level are paid the same regardless of gender or ethnicity, doesn't inherently improve diversity & inclusion outcomes, but there are links between the two that we can see as far as retention, and making sure gender and ethnicity do not impact hiring and promotions. This is a critical part both for your current workforce and for the future.

Tanya Levy-Odom*, Director of Investment Stewardship, BlackRock:* I agree. The crisis has highlighted an area where we really want to focus on the relationships with employees, customers and all stakeholders, to get a clear sense of how companies are engaging internally and externally. This crisis has definitely brought to light a focus on ensuring that companies are assessing internal equity issues, particularly in light of furloughs and reduction in force related to the crisis.

Dunshee: Good points, everyone. Anne, do you want to briefly explain some of the terminology here? These terms and concepts can get confusing. We have pay equity, pay gap, pay ratio. How do you tell those apart?

Differences Between "Pay Equity," "Pay Gap" & "Pay Ratio"

Bruno: Sure. It is a little bit of a soup of jargon, but I'll lay out some of that jargon so we can all be on the same page. The pay gap is the average difference in pay between compared groups, whether that comparison is looked at by gender, race or ethnicity. For instance, when people talk about the gender pay gap, there's an approximately 20% gender pay gap for men and women working full-time in the United States. It's a very broad measure, but the pay gap is used to compare two different groups.

Pay equity is really the broader question we're addressing today, which is the question of whether members of different groups are essentially paid equally for equal work. Pay equity is part of the broader issue of workplace equity, which falls under the category of human capital management as a company governance topic.

Equal pay and median pay are two related concepts, and both are important. Equal pay focuses on how groups are paid at a corporation or an organization for the same work. So, adjusting for the role, for seniority, for location, are people paid equally? Median pay focuses on a slightly different metric, which is whether women and minorities are holding as many high-paying jobs as men and non-minorities within the organization.

Finally, pay ratio. Of course, we all remember CEO pay ratio in SEC filings, but pay ratio can be looked at either as a comparison of the CEO or executives to median workers or as a comparison of one group's pay to another group's pay, so you can have a pay ratio between two different groups of people at the company. There are a lot of terms out there, but they're all useful. They all provide some insight into what we might want to measure and how we might want to judge progress.

Dunshee: Thanks Anne, that's helpful. Tanya and Heather, do you want to speak a little bit to the shareholder expectations on these topics?

Shareholder Expectations

Levy-Odom: With respect to human capital management, we're definitely focused on how companies are engaging internally and measuring pay equity across the board. We're starting to see a number of companies really address this, not only CEO to median employee pay, but company-wide. For example, if there is an hourly workforce, what does that look like in terms of those with and those without full benefits? We're starting to see greater disclosure there, and then it can be compared to their peer groups.

To the degree that we are seeing, broadly, more human capital management disclosure, we're able to get a little more granular into this particular area with respect to pay equity, and that's going to be a real highlight going into next year.

Smith: With all of the current attention on diversity, equality & inclusion, a lack of transparency from companies really stands out and gives an impression, which we often find is not accurate at all, but it gives the impression that a company might not be taking proactive steps to manage pay equity issues related to human capital management.

We have seen the movement in the US, but we've primarily seen companies reporting on that pay equity piece that Anne defined, with a lesser focus on median pay gaps. There's value for companies to be examining and reporting on both measures to their stakeholders.

A couple of expectations that we have of companies when they're talking about pay equity is, first, just simply an outline of how a company is approaching or thinking about pay equity. So, what is the philosophy? The second piece would be disclosure of processes or policies in place to promote pay equity, and what mechanisms are in place to address unexplained pay gaps if they're identified in an analysis.

Most companies are well-equipped to address those first two points, but where we sometimes see disclosure falling short is around the results of the outcome of those pay analyses. What we're looking for is an affirmation that the policies are really functioning as they're intended. Emerging best practice is going to call on companies to be reporting on that median pay gap number, and I think that will be particularly the case for companies that are already conducting a median pay gap analysis in another jurisdiction. There's required reporting in the UK, and that's probably the most visible, but for companies already doing that analysis on certain portions of their workforce, investors will be increasingly looking for companies to expand that to the global workforce and report on the company as a whole.

Dunshee: Heather, that's an interesting point on how there are different laws in different jurisdictions, and certainly we've seen a lot about that UK requirement. Have you dealt with companies where there are restrictions in other jurisdictions that would prevent them from collecting data in different categories of employees? If so, do you adjust your expectations for that? How do you handle that?

Smith: That's a great question. There certainly are markets and countries in Europe where collecting some of this disaggregated data is not legal and thus, it's not publicly disclosed. That's something we do consider in our work, but where companies can disclose and where they can provide this data on a significant portion of their workforce, that is what we like to see.

Obviously, we recognize that each market has its own standards. But to the degree that a company can standardize what it's doing across the organization, notwithstanding those potential regulatory challenges, that's most helpful to investors.

Schaeffer: We see companies that have a hesitation about collecting this data in general, and it's difficult, but there's sometimes a notion that if we don't have the data, we can't be culpable of doing something based on it. It's kind of a "not-knowing" answer. It's a tough hump to get over. You want to have the information, but what do you do if you feel that you're putting yourself in a potentially uncomfortable situation? Or you have employees who are worried and wondering, "why are they asking me my gender? Why are they asking me my ethnicity?"

Levy-Odom: That's definitely a challenge that we have discussed with companies during our engagements, about the lack of self-reporting outside the US. If it's a multi-national company, they are really trying to figure out the best way to report more broadly and holistically as a company, in terms of the various cohorts that we normally identify in the US.

Disclosure Trends: Pay Gaps & Pay Equity

Bruno: That's probably a good segue to a discussion on disclosure trends that we had on our list of things that we wanted to cover together.

Tanya, as you said, there's certainly a building momentum towards more of this disclosure. We're seeing it as a trend towards more ESG disclosure, and human capital management metrics as an important part of that.

The human capital management piece is especially significant in terms of ESG disclosure, since it provides information that satisfies the desire for both social justice related disclosure and personnel management disclosure. It really covers the "S" and the "G" of ESG, the internal personnel management issues and the reputational aspects of being focused on social justice issues.

We're going to continue to see that growing trend for disclosure of more demographic information. Like many disclosure trends, as Heather mentioned, it starts with large companies and then becomes more prevalent at smaller companies, where Josh mentioned, there might be more of a hesitancy to delve into these statistics with a smaller workforce, and the risk that you feel like your data might not serve you and stakeholders well as opposed to being explanatory and helpful.

Levy-Odom: That's going to be particularly important for those companies that have made public statements, commitments, or have goals as part of their ESG initiatives with respect to human capital management. Whether it's a certain percentage of women at certain levels, a certain percentage of people of color across the organization, without the disclosure we would not be able to track the progress and the efficacy of those initiatives. Those are going to go hand in hand.

Smith: I totally agree. We've been having these conversations with companies around pay equity and in the context of broader human capital management for several years. At the outset, to Josh's point, the existence or the potential existence of pay disparities made companies reluctant to speak with us about those issues, and they were reluctant to put out public statements.

Over the last couple of years, the momentum has shifted and we see the benefits of being more transparent. The norm is certainly shifting towards more disclosure and not less. That greater transparency, particularly when it's honest about challenges experienced or lessons learned, really gives more authenticity to a company's efforts, and those disclosures have generally been well-received in the marketplace.

Dunshee: I have one question on that. Is there a preference or expectation for where that disclosure appears? Whether it's in the proxy statement or in a separate report that's on the company's website?

Levy-Odom: We are not really prescriptive about where it's disclosed as long as it's easy to find for all investors. Many companies have tried to have either an ESG or sustainability tab on their IR website in addition to disclosing it in other documents, such as a proxy statement or 10-K.

Smith: I agree. We don’t tend to prescribe where companies should make the disclosure either. In the majority of cases, we've seen it in sustainability reporting or CSR reports, or those sections of the website that address ESG issues. Some companies have standalone diversity & inclusion reports.

Over the last year, I did see a trend for companies to increase disclosure, or include this disclosure in their proxy statements, not just around pay equity specifically, but around human capital and diversity & inclusion more broadly.

Bruno: It'll be interesting to see how the changes to the Regulation S-K required disclosures in the Item 101 business section affect that, because that will require 10-K disclosure of information that companies have traditionally put in their proxy statement. So, maybe we'll see it in both places. Maybe we'll see it in the 10-K, in the proxy statement, and on the website.

I'm curious whether people are seeing any of these third-party frameworks driving the analysis that people are asking for. There are several of them out there. There doesn't seem to be one that's more prevalent, although there are certainly some that seem more agreed to by investors. Is there any piece of the third-party framework milieu out there that is driving any of the discussion?

Schaeffer: I haven't seen much come in from that. There are frameworks outstanding for median pay and other pay by levels as you see in the UK, such as pay gap disclosure.

As far as these other types, going more specifically to the more complicated pieces, I haven't seen too much driven on that. Our general impression is, as we'll discuss here, running these analyses does need to be company specific. Every company's data, what they collect and what they have, do look different. Even from year to year, there can be changes that need to be done. We don't really believe a one-size-fits-all approach is going to produce great results.

Now, unfortunately, that customization is always going to cause issues in comparability between the companies. With that said, we haven't seen the drive towards too many standardized frameworks at this point.

Dunshee: If no one has anything further to add on that point, let's move on to discussing how exactly to collect and interpret the data, and then what steps to take after you get that data.

How to Collect & Interpret Data

Schaeffer: That's a great question and concern here. At the end of the day, you do need to have an analysis as part of your pay equity effort. We focus on typically using a regression framework.

Without going into deep statistics, which nobody wants to hear me do, regression is simply a way of trying to use the data that you have to forecast how much people should be getting paid. It's a forecast based on things like roles, experience, etc. You can also look at whether you have performance ratings, or even how many direct reports somebody has and whether that's consistent with others at their roles. All of those things go into this model, and that model gives you an idea of the pay.

As far as data requirements, we need good data on how much people are being paid. We'll go back to that in a second because that's tricky enough as it is, but then there are factors that we believe should predict pay. Things like what role somebody is at, what their experience is, what their location is, how their performance has been, and anything else that the company believes would reasonably be able to predict pay.

We also need their variables, such as their gender or their minority status or whatever other pieces, to test. This isn't limited to factors of real concern, right? You can look at your whole workforce in many ways, although gender and minority status are good starting points.

We have gotten the data sets before without that data in it, and we've had to go back and say, “We're not going to be able to do your gender pay analysis unless you get us some gender data.” That is the way that works. As far as pay, the question is, what pay do we want to test? Do we want to test base pay? Do we want to test base and bonus? Stock option awards? The interesting answer there is, you test wherever you believe there could be an issue happening or a discretion that’s causing treatment that's different between men and women or whatever group you’re testing.

For example, you have people who are solely on a commission structure, it's unlikely that you would have discretion and even be able to discriminate. If bonuses are formulaic or all wages are set by a union, you're set in the same pay structure for everyone. But, on the other hand, if you have discretion in who gets paid what within a role, that's a valuable piece. If bonuses are assigned by managers, again that's something where bias can appear.

We collect all of that data and once we have it all, we run this model. The model aims to say how much everybody should be getting paid, and the key for pay equity is, we add one extra variable. Now, in statistics we call this an "indicator variable," or sometimes it's referred to as a "dummy variable." That variable takes on only a value of 0 or 1, basically either you are or you aren't. While we're not making judgments, I learned early on in my statistics career that if you're doing a male/female analysis, you always assign the dummy variable to the male; it's just that much safer. Once we do that, we can see if there's a systemic difference in between the two.

Remediation Strategies

Schaeffer: If being male predicts a higher level of pay and the model says that that's statistically distinguishable from 0, we see it as something that is a concern. Then we have to think about how we're going to fix this, because once we've got a problem, there are two things that can happen. One is that we find individuals who are paid less than we expect them to be paid. We want to deal with that because that could be people for whom we have incorrect or incomplete information – maybe they're part-timers and they were labeled as full-timers, maybe they just got promoted and their pay hasn't reflected it yet, or it could be indicative of people who are really underpaid for their position. It's very important to consider those individuals.

In addition to the individuals, we want to consider the whole group and whether we need to make an adjustment because we start to see something like the fact that men are paid more than their female counterparts. We then need to think about how we want to deal with that and how much we want to raise the pay of the individual people.

I know that was a lot to digest. I tried to stay away from the stats, but I'd like to hear other people's thoughts on how they're dealing with companies and getting the results, what data will you use and what we can test.

Bruno: It will be interesting to see how this new California equal pay reporting law is going to play out for companies because the employee number, 100 employees, is low. It's going to bring in a lot of companies and require people to provide that federal-type data on race, ethnicity and gender on each of the job categories and the pay scale from the Department of Labor's pay band. I wonder if it's going to make this a lot more rote for a lot of companies, at least to collect some of that most basic data.

Schaeffer: We do typically find that companies have better data for the US. When we're dealing with large, multi-national companies, the quality of the data can drop off very quickly and the complications of collecting the data can pick up.

We always deal with the fact that we have a number of employees who haven't disclosed that data, so the collection task becomes whether we want to simply exclude them from the analysis or include them in certain analyses. We typically we see that 1-2% don't disclose gender information, and usually a higher percentage, maybe between 5 and 10% of employees at most companies, don't disclose minority stats.

Levy-Odom: I have a question in terms of gender. As that definition becomes more fluid, how do you think that's going to modify how you analyze the data?

Schaeffer: We haven't gotten enough of other classifications to put people into a full third class yet because it is a smaller portion of the population. With that said, we can look at individuals and see if there are, say 15 individuals within a corporation that don't identify as either male or female, we can look at them on average and see how they compare. It does raise a number of statistical challenges if you have three different groups and you're trying to do all of these pieces together. There are ways around it, but without a large third group, maybe 20% of your workforce, you're going to get very iffy results.

The reason for that is that data on pay is not perfectly distributed. There are a lot of other factors that go into pay, such as what you're doing specifically in your role, maybe you travel more, maybe you've been with the company for longer and have a supervisor who has given you raises for special projects. Those kinds of things are very difficult to capture in the data. Because the data can get noisy when you don't have enough employees falling into a group, it's tough to make these broader statements.

Levy-Odom: That's fair, thanks.

Bruno: One additional point to note about that is, I'm sure you all saw that recent *Cahill v. Nike* case that addressed the attorney-client privilege and work product issues related to some of this data. It shows how unhelpful results from a pay audit could potentially be harmful in litigation, so it's important to really focus on that before this work starts.

You want to set up with the compensation consultants that the analysis will be work-product at the beginning of the engagement and have the report delivered to the company's counsel, and have anything done by non-lawyers actually flow through the company's legal office. You want to make sure that you retain that attorney-client privilege before you start this work by, for this purpose at least, focusing on the fact that a reason to obtain the information is to protect the company from liability, even though another important piece of the work is to be able to analyze where you stand right now.

Schaeffer: That can be especially important in various jurisdictions. In Oregon's law, for example, there is an affirmative defense that you've carried out an analysis and are working to fix it. Being able to prove that you've done that but also not wanting to disclose too much information definitely weighs in for companies that we're dealing with.

Dunshee: Excellent points. Anne, do you want to talk a little bit about the mechanics of board and committee oversight?

Mechanics of Board & Committee Oversight

Bruno: I'd be happy to start that off. As we've all been saying, because these issues are so important now for companies' longer-term financial prospects, board oversight is important. Those issues will usually sit with the compensation committee of the board.

Historically, compensation committee policies and their marching orders addressed executive compensation. But to the extent that companies' compensation committees are not yet thinking of their agenda in a broader way to encompass issues relating to all employees, the first order of business is probably to make sure that the work on this topic sits somewhere on the board, and typically that will be with the compensation committee. So, an important first step would be to make sure that your compensation committee charter gives this to the compensation committee as something to focus on.

Then, it's always important to think about both short- and long-term goals. Short- term goals fall into the category of corrective actions to solve some immediate salary-setting realignment that might be necessary based on what you discover in terms of pay equity. Long-term issues relate more to those median pay issues, where you're focused on issues of hiring and recruitment, issues of integration and training, and mentoring and trying to make sure that your workforce is being incentivized and compensated in a way that makes good business sense.

This is all connected, but it's impossible to do without having the actual information. Being able to use the data that you have, and a lot of companies actually are already tracking this type of information, either internally or with some external help, is important in trying to figure out how to use that information. A lot of companies were already tracking information because they were doing CEO pay ratio calculations, so this isn't a completely foreign concept. It adds some additional matrices to the analysis because most companies wouldn’t have started out collecting that information by group within the company, but it's certainly a good starting point.

The next step is to really figure out where you want to put the disclosure and how much disclosure you want to provide. It will be very interesting to see where this information starts showing up for companies, whether it's in the 10-K, in the proxy statement or on the website, or if it's in all three places. We're going to see a lot of that be fleshed out over the next couple of months.

The final thing to think about, and we're seeing this a little bit more, is how to motivate and measure progress. For example, there was a statistic on the NASPP’s website that I saw recently that showed a significant number of companies are thinking about adding performance criteria to their incentive compensation programs that will use progress in these areas as a way to determine senior executives' pay. We already see that to a certain extent in terms of the setting of performance criteria at companies, but it's interesting to think about how companies will put their money where their mouth is in terms of incentivizing management to then make progress in these areas once they decide what they think progress looks like for their company.

Schaeffer: A very interesting piece to add to that. I did a NASPP presentation at the annual conference a few months ago on including ESG in performance awards. We are seeing that more in short-term plans than long-term plans, and part of that is this notion of what things look like and how this becomes measurable. How we look at one thing year-over-year and determine what the differences are. With pay equity, you can get an average number, but is that the only number you're concerned about? Or are you concerned with median equity, diversity & inclusion, equal work for equal pay and all of these other things? These are very interesting questions that companies are having to deal with more and more as they move forward here.

Dunshee: That's a good segue to talk about what companies should be thinking about as they are preparing for both shareholder engagements and potential shareholder proposals on some of these topics. Heather and Tanya, do you want to cover that a little bit?

Preparing for Shareholder Engagements & Proposals

Smith: Sure. I can start. We outlined at the outset of our conversation, that the scrutiny of companies' efforts, with respect to human capital management and diversity & inclusion, is likely to remain high over the coming year as a result of the pandemic and increased calls for social justice.

At Impax, we really view engagement as a tool to increase our understanding of how a company is thinking about managing and evolving on material ESG issues. In this case, for pay equity and diversity & inclusion, we find that how companies respond to engagement and their willingness to engage really provides us with insights into their outlook and their philosophy.

We're not trying to play “gotcha” with companies. These are very complex topics. As Anne and Josh were saying, pay equity isn't a conversation about pay equity; it's about equality of opportunity and equality of advancement opportunities for women and minorities. We're not trying to be adversarial; we really want to help influence for stronger and more resilient companies.

We recognize that each company's circumstance is unique. Each company is at a different stage of its diversity & inclusion journey, so we don’t necessarily expect companies to have all of the answers or the perfect disclosure right out of the gate. It's a process.

We try to build long-term relationships with companies. We want to collaborate over the longer term. It's worth noting that engagement isn't over in one step or one meeting. It can span over the course of several months or even years, but by building these collaborative relationships between investors and companies, we're well-positioned to keep learning from one another and to address new sustainability issues as they emerge.

Levy-Odom: Definitely. Human capital management has been one of our key engagement priorities for a number of years and has evolved year to year. This year has been very unique with a heightened focus on health & safety and social justice. More broadly, companies are focusing on how they are engaging their employees, how they're retaining company culture through all the vagaries, whether they have more frontline workers or more workers working remotely, and how they are continuing to enhance business continuity and success through a human capital management lens.

There is going to be a lot more scrutiny going forward, which will lead to more conversation and engagement around how a company is really engaging across the board with its employee base. Have they really assessed themselves in terms of equity across every cohort, and what's the plan going forward? Have they made commitments or stated goals for going forward? How are they going to perpetuate the long-term health of the company and their corporate strategy with their employees in mind, and what does that look like? What does that inclusive culture look like going forward?

Dunshee: That's really helpful. Thank you, all. This was very informative. I enjoyed this program. Thank you to Anne, Tanya, Josh and Heather for participating today and sharing their insights. Thank you to all of our listeners who joined us today. The audio archive for this program will be available shortly, and we will post a transcript of the program in a few weeks. Have a great day.

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