CEO Pay Ratio Disclosures among Biotechnology and Pharmaceutical Companies

As the traditional 2018 proxy season draws to a close, we have reviewed the newest executive compensation disclosure item appearing in corporate proxy statements for the first time – the CEO pay ratio. Mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act, beginning with proxy statements filed for fiscal years beginning on or after January 1, 2017, companies are required to disclose:

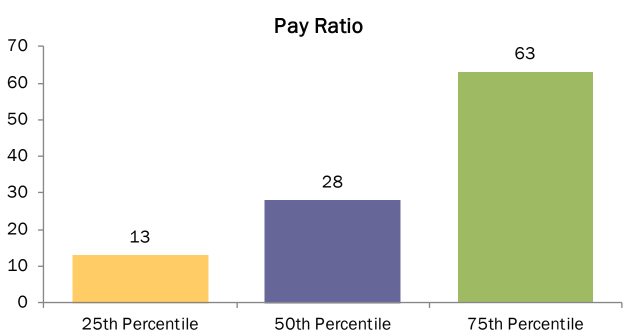
- The median of the annual total compensation of all their employees (other than their Chief Executive Officer);
- The annual total compensation of their CEO; and
- The ratio of these two amounts.

This Thoughtful Disclosure Alert summarizes our findings based on a review of the proxy statements filed since the beginning of the year by 75 U.S.-based biotechnology and pharmaceutical companies.

CEO Pay Ratios

Our review has determined the median pay ratio among the companies that have made their initial disclosure to be 28 to 1. So far, the CEO pay ratio distribution is highly concentrated below 50 to 1, with 51 of the reviewed companies (~68%) disclosing pay ratios lower than 50 to 1. Similarly, of the 24 companies disclosing pay ratios of 50 to 1 and above, only 12 companies reported a ratio above 100 to 1.

The percentile rankings of the disclosed pay ratios are as follows:



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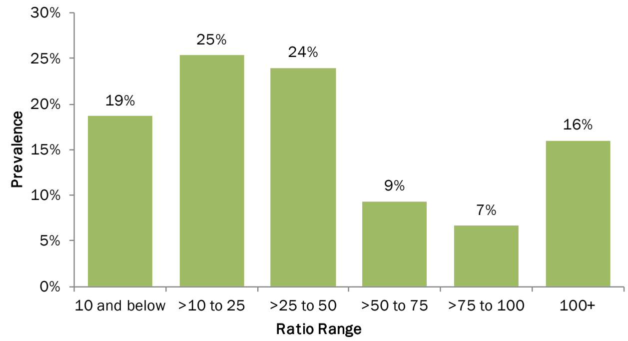
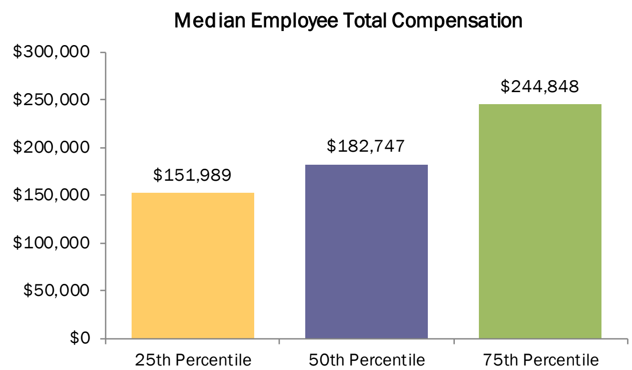


Median Employee Compensation

Our review has also determined the annual total compensation of the median employee among the companies that have made their initial disclosure to be $182,747, with annual total compensation ranging from a low of $58,795 to a high of $500,250.

The percentile rankings of the median employee total compensation are as follows:



Supplemental Pay Ratios

While the CEO pay ratio rule permits companies to present additional information, including additional ratios, to supplement the required pay ratio, they are not required to do so. To date, only five of the companies that we have reviewed (6.7%) have provided a supplemental pay ratio. These supplemental ratios have been provided for the following reasons:

CEO Pay Ratio Disclosures among Biotechnology and Pharmaceutical Companies (continued)

Reason for Supplemental Pay Ratio	Number of Companies	Required Pay Ratio	Supplemental Pay Ratio
CEO received an equity award intended to cover multiple years	1	349 to 1	187 to 1
Comparing base salary only	1	30 to 1	5 to 1
Excludes special performance-based equity award to CEO	1	313 to 1	223 to 1
CEO's SCT-reported compensation included equity based on 2016 performance; supplemental ratio includes total compensation with equity based on 2017 performance	1	203 to 1	98 to 1
Excluded change in pension value	1	118 to 1	171 to 1

Other Notable Findings

Location of Disclosure

The CEO pay ratio rule does not specify where the disclosure should be placed in a company's proxy statement. Consequently, while consistently included as part of companies' executive compensation disclosure, it is showing up in a variety of specific locations. To date, the overwhelming choice is at the end of the executive compensation disclosure, following the discussion of Potential Payments upon Termination or Change in Control, which has been the placement of more than half of the companies reviewed. The most popular locations for presenting the CEO pay ratio disclosure are as follows:

Location of Disclosure	Number of Companies Reviewed	Percentage of Companies Reviewed
After Potential Payments upon Termination or Change in Control section	43	57.3%
After Summary Compensation Table	12	16.0%
After other compensation tables (for example, the Options Exercises and Stock Vested Table)	7	9.3%
After Director Compensation Table	6	8.0%
In Compensation Discussion and Analysis	2	2.7%
Between Compensation Discussion and Analysis and Summary Compensation Table	1	1.3%
Other location	4	5.3%

Consistently Applied Compensation Measure

For purposes of identifying the median employee, the CEO pay ratio rule permits companies to use one or more compensation measures, as long as such measures are consistently applied across the employee population. Our review indicates that companies took full advantage in the flexibility of the rule to develop a methodology for identifying their median employee that reflected their individual situation. Reflecting the prevalence of equity awards in the biotechnology and pharmaceutical sectors, we found that total direct compensation (total cash compensation plus equity awards) was the most popular compensation measure, employed by 37 companies (49.3%). This contrasts with other industry sectors, where broad-based equity compensation programs are less common.

The most commonly used compensation measures are as follows:

Determination of Employee Population

Compensation Measure	Number of Companies	% of Companies
Total cash compensation plus equity awards	37	49.3%
Total cash compensation	12	16.0%
Form W-2 (or its equivalent) compensation	6	8.0%
Base pay or wages	5	6.7%
Full SCT Compensation	3	4.0%
Other compensation formulations	12	16.0%

All of the companies reviewed have disclosed that they used a full employee census file to identify the median employee (subject to the application of the de minimis exemption in a few instances as noted below). To date, no company has indicated that it used statistical sampling to identify its median employee.

While the CEO pay ratio rule permits companies to exclude non-U.S. employees from their employee population where a country's data privacy laws prevent the procurement or processing of the relevant compensation data, none of the reviewed companies have disclosed their use of this data privacy exemption.

In addition, the CEO pay ratio rule contains a "de minimis" exemption, which permits the exclusion of non-U.S. employees, on an all-or-nothing basis, from one or more countries that, in the aggregate, account for 5% or less of a company's total employee population. To date, 14 companies (18.7%) have indicated their use of the de minimis exemption when determining the employee population from which they identified their median employee. While it may be premature to draw any conclusions, this outcome is likely a reflection of the relative ease with which life science companies can access compensation data for their global workforce.

Final Observations

With a significant number of biotechnology and pharmaceutical companies having now filed their 2018 proxy statements, certain patterns are beginning to take shape. Most notably, the pay ratios being disclosed are not as large as expected. As illustrated above, the majority of the pay ratios are well below 50 to 1. On the other hand, median employee compensation is trending higher

CEO Pay Ratio Disclosures among Biotechnology and Pharmaceutical Companies (continued)

than in many other industry sectors, perhaps a reflection of the highly-educated workforce needed to power biotechnology and pharmaceutical companies as well as the broader distribution of equity awards. Finally, as permitted by the CEO pay ratio rule, companies have taken a pragmatic approach to addressing the most complex – and potentially expensive – aspect of compliance: the identification of the median employee. By tailoring their compliance methodology to their specific facts and circumstances, it appears that most companies have been able to complete this disclosure exercise without encountering undue difficulties.

In the months ahead, we will see whether these trends continue to hold firm.

Need Assistance?

Compensia has extensive experience in helping companies develop an appropriate methodology for identifying their median employee, as well draft the required disclosure that must accompany their CEO pay ratio.If you would like assistance in preparing your CEO pay ratio disclosure, or if you have any questions on the subjects addressed in this Thoughtful Disclosure Alert, please feel free to contact Mark A. Borges or Christine McGrory.

About Compensia:

Compensia, Inc. is a management consulting firm that provides executive compensation advisory services to Compensation Committees and senior management. ■

CEO Pay Ratio Disclosures among Biotechnology and Pharmaceutical Companies (continued)

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