Study: A controversial SEC rule did little to rein in excessive CEO pay

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Publicly traded companies are required to disclose the ratio of their CEO compensation to the median pay of their employees—a rule that was adopted beginning in 2018 by the U.S. Securities and Exchange

Commission (SEC) in response to criticism over excessive CEO pay.

But new research from the University at Buffalo School of Management shows the average CEO's total earnings did not change as a result.

In fact, the study found that companies merely adjusted their CEO compensation mix to limit components—like stock awards and non-cash perks—that could generate negative headlines.

Forthcoming in the *Journal of Accounting Research*, the study is among the first to examine the consequences of the pay ratio disclosure mandate.

"Our results clearly show that having to report this ratio did not motivate boards to proactively lower CEOs' total pay or tie compensation more closely to company performance," says Michael Dambra, Ph.D., associate professor of accounting and law in the UB School of Management. "Instead, many boards moved to reduce the sensitivity of the CEO's wealth to equity price changes—particularly at companies that expected more external scrutiny."

After public backlash over rising executive compensation, the pay ratio measure was proposed by the SEC under the 2010 Dodd-Frank Act. The SEC received more than 287,000 comment letters about the controversial measure, but ultimately adopted the final rule, which dictated that public companies must disclose this pay ratio beginning with fiscal years ending on or after Dec. 31, 2017.

"Critics questioned the effectiveness or appropriateness of this measure, while proponents argued that it could help inform shareholder decisions and reduce income inequality," says Inho Suk, Ph.D., associate professor of accounting and law in the UB School of Management. "We wanted to see what effect the measure actually had on executive compensation."

To do so, the researchers compared firms with a Dec. 31 fiscal year-end with firms whose fiscal years ended earlier in 2017. In total, they obtained data from more than 2,600 companies on the Russell 3000 Index, looking at five components of CEO compensation: salaries, cash bonuses, stock awards, option awards and other non-cash perks. In addition, the researchers reviewed the media coverage and shareholder reaction around firms' initial ratio disclosure.

The study showed the media often sensationalized the disclosures with negative coverage, particularly over CEO salaries, stock awards and perks. In addition, when firms had high pay disparities that were not explained by company performance, shareholders voiced their displeasure by selling shares or casting negative votes on the CEO compensation package, called "say-on-pay votes."

"Our study should inform policymakers that regulations intended to 'name and shame' wealthy executives can lead to unintended consequences," Dambra says. "Overall, we find that pay ratio reform did not lower total compensation. Instead, it weakened the link between firm performance and executive compensation. In our opinion, this disclosure mandate did not benefit shareholders."

Dambra and Suk co-authored the study with UB School of Management alumnus Wonjae Chang, Ph.D. '22, assistant professor, City University of Hong Kong, and Bryce Schonberger, Ph.D., assistant professor, University of Colorado Boulder.

More information: Wonjae Chang et al, Does Sensationalism Affect Executive Compensation? Evidence from Pay Ratio Disclosure Reform, *Journal of Accounting Research* (2022). DOI: 10.1111/1475-679X.12458

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