The SEC's New Equation: CEO Pay Divided by Average Employee's Pay = Good Policy

The topic of executive pay has been central to discussions of wealth disparity in America, and the healthcare industry is certainly not exempt. Amid the large number of hospitals who claim non-profit status are a great number of publicly-traded healthcare firms for whom the chickens may be coming home to roost come January 2017 (and let's not forget about Big Pharma). At last, the SEC has passed a rule under the Dodd-Frank Act of 2010, which passed a range of financial reforms not specific to healthcare, that will require firms to disclose just how much more their CEOs make than the compared with the average employee.

The Pay Ratio Disclosure Rule amends Reg S-K, which prescribes disclosures for public companies,

to require disclosure of the median of the annual total compensation of all employees of a registrant (excluding the chief executive officer), the annual total compensation of that registrant's chief executive officer, and the ratio of the median of the annual total compensation of all employees to the annual total compensation of the chief executive officer.

To summarize, these companies will have to publish|(1) the CEO's compensation, (2) the average of the total compensation of the sum all the employees except the CEO|and (1) divided by (2). This disclosure will be required in multiple SEC filings, including annual reports, registration statements, proxy statements, and anywhere else executive pay is disclosed. In other words, it will be easily accessible to anyone with an Internet connection and the most basic understanding of what

Google does. Usually, companies' annual reports are even available on their own websites. So, there will be no hiding it.

Not surprisingly, the rule has been controversial and faced much opposition from would-be compensation reporters. The SEC received almost 300,000 comment letters after publishing the draft rule. As Modern Healthcare explains, healthcare CEOs have some of the biggest pay packages out there. Pharmaceutical CEOs have been known to collect in the $40 million (!) range, and hospital CEOs are often not far behind. Last year, Community Health Systems, a for-profit provider system, paid its CEO $26.4 million.

Aside from the obvious effects at the consumer level (even more outrage than present levels, we suspect), it will be interesting to see how these disclosures play out on the non-profit vs. for-profit healthcare executive pay landscape. The non-profits have been in the hot seat of late for bulging reserves, high executive pay, and high prices. Non-profit healthcare executives are certainly paid very large salaries, but, because their pay must be limited to "market rates," by laws applying to non-profits that aim to avoid misuse of charitable assets, they typically are paid much less than the large, for-profit, public hospital corporation CEOs. This may be their chance to argue that anything in the single digit millions is really quite reasonable.

We at The Source applaud this effort by the SEC to promote transparency (even if it did take 5 years post-Dodd-Frank). We are only sorry that we will have to wait until 2017 to start seeing it play out!