Combating Pay Equity Risk in a Recharged Climate

Pay Discrimination Suits in a New Era of Federal Scrutiny

by Michael Burniston & Brian Levine

As if employers don't have enough to worry about in these unprecedented economic times, they are suddenly exposed to new risks arising from pay discrimination claims. The economic decline in itself, and organizational responses to the decline, are driving discrimination claims to record levels. On top of that, following enactment of the Lilly Ledbetter Fair Pay Act, the Obama administration has stepped up funding for increasing government resources targeted at enforcement of equity laws, and such looming legislation as the Paycheck Fairness Act means that companies that haven't already done so need to take proactive steps to identify and mitigate risks.

A crucial consequence of the Ledbetter Act – which essentially eliminates the deadline for incumbent employees to file charges of pay discrimination based on race, color, religion, sex, national origin, age or disability – is that it could force employers to defend pay decisions made many years ago. Named for a plant supervisor who sued her employer for alleged pay discrimination, the Ledbetter Act restarts the 180-day

time period (300 days in some states) for filing a charge of discrimination each time an employee receives wages, benefits or compensation negatively affected by an employer's allegedly discriminatory decision or practice, regardless of when that decision or practice occurred. If discrimination is found, each plaintiff is entitled to up to two years back pay. Compensatory and punitive damages also may be awarded in some circumstances. In the context of a class action suit, the potential liability can be very significant.

Meanwhile, the pending Paycheck Fairness Act (PFA) would dramatically increase potential awards for Equal Pay Act (EPA) claims by allowing for uncapped compensatory and punitive damages in addition to the EPA's current remedies of back pay and liquidated damages. The PFA would shift the evidentiary burden from employees to employers, making it considerably more difficult for employers to defend against discrimination claims. It would eliminate the requirement for claimants to provide anecdotal evidence of discrimination and force employers to substantiate legitimate drivers of pay differences. The PFA would also increase the size of class actions by requiring potential plaintiffs to "opt out" of claims, replacing a prior "opt in" standard.

Inherent liabilities

These new realities raise the stakes for employers with respect to various business risks, prime among them litigation risks associated with significant financial exposure. Well before the Ledbetter Act, the Office of Federal Contract Compliance Programs (OFCCP), which enforces affirmative action requirements for federal contractors in the U.S., made compensation assessments a top priority, adopting regression analysis as its new

evaluation standard to increase its effectiveness in seeking out remedies. Further, both the OFCCP and Equal Employment Opportunity Commission (EEOC) have moved to prioritize investigations of systemic risk, which are more likely to lead to class actions. Pay equity enforcement and associated discrimination lawsuits have resulted in hundreds of millions of dollars in agreements and judgments in recent years.

Perhaps more significant than the direct financial exposure is the risk to corporate and product reputations, especially with regard to high-visibility brands, which can be threatened and quickly affected by public reports of workforce unfairness. Bad press can cost a company customers—never a good thing, but especially dangerous at a time such as this, when revenues are threatened by the economic downturn and heightened consumer sensitivity. Pay inequity also can threaten the ability of companies to attract and retain increasingly scarce, diverse talent.

Perhaps the greatest challenge facing employers under the Ledbetter Act is the prospect of having to defend compensation and other employment decisions made so far in the past that documentation, witnesses and relevant decision makers may no longer be available. Other provisions of Ledbetter, however, also create challenges – and risks – for employers. For example, the law potentially expands the pool of potential plaintiffs beyond current and former employees to include "affected" parties (arguably employees' family members and beneficiaries). It also opens benefit programs to litigation threats due to claims that reduced benefit levels (e.g., pension benefits) were based on discriminatory pay actions made years, even decades, earlier. In addition, the

law specifically states that it applies to a discriminatory compensation decision "or other practice." Consequently, the law's reach, ultimately, may extend broadly to cover all manners of workforce practices.

While it's hard to predict how courts will judge the merits of such actions, or how far back into the past they may reach, the potential for increased litigation requires that employers act now to mitigate risk. That means, on a basic level, spending today's limited compensation dollars wisely by assessing the match between actual pay practices and compensation philosophy, highlighting cases where pay is out of alignment, and making pay adjustments to limit the ability of employees to credibly raise discrimination claims.

Standards and recommendations

In light of these risks, pay equity assessment needs to be on employers' 2009 agenda. To make efforts most effective, the approach should be consistent with legal standards of evaluation – in this case, regression analysis.

In 2006, the OFCCP declared regression analysis to be the new standard of statistical assessment for its compensation reviews, moving federal contractors to use that approach to effectively insulate themselves from audit risk. Regression analysis is, in fact, the definitive defense accepted by the courts; in moving to follow the OFCCP's lead, organizations can more effectively address increasing litigation risk as well. The government's emphasis on "systemic discrimination" cases also is likely to continue, covering more employees and creating situations that are more likely to lead to class-action suits.

Thus, Mercer recommends that employers conduct regression analyses to find business areas with potential issues, and, within those areas, specific employees for

whom pay changes should be considered. Specific cases for pay changes then should be further investigated and acted upon, as appropriate. To ensure optimal protection in the face of the Ledbetter Act, efforts should be made to level the field on pay, year after year, to make potentially discriminatory past decisions irrelevant. Such analyses can also serve to check rewards-system performance at the aggregate level to ensure that the company is spending its limited compensation dollars as needed to drive company performance objectives.

To further minimize risk, employers need to: implement guidelines for compensation decisions; carefully review and document the basis for pay and promotion decisions to ensure objective support; and train managers and supervisors to clearly define and communicate employee roles, objectives and performance criteria. Employers also should review and potentially revise their document retention policies in order to ensure records supporting past workforce decisions are preserved and readily accessible.

In the course of conducting pay equity assessments, we have found that organizations should keep in mind seven principles to ensure success:

1. Seek the truth

Knowing how the organization will fare in the event of litigation or government audit will allow you to address any existing problems and mitigate related threats. For this reason, the analysis should be conducted with the objective of identifying "systemic" issues.

While the need for apples-to-apples comparison is clear, analyses should not solely focus on job-by-job, location-by-location and/or pay grade-by-pay grade review. Such narrow examination ignores the benefits of statistical

analysis, which can account for multiple differences between employees simultaneously. An effective analysis will balance the need for workforce segmentation against the loss in statistical power to identify key issues. Ultimately, key differences in compensation philosophies across segments should serve to define break points.

2. Don't wait for the data to be perfect

Multiple regression analysis is a starting point. Results are suggestive: they point to areas where action might be critical. Following the analysis, research should be done on pay levels for specific employees.

Because this work is in itself a research process, every element of data available need not be available before moving ahead. Instead of focusing on the impossible task of collecting comprehensive data and/or scrutinizing the validity of data elements across the enterprise, focus on a small subset of the workforce that is revealed to be out of alignment with observed, internal compensation norms.

3. Support – and strengthen – compensation philosophy

In considering adjustments for specific employees who are out of alignment on compensation based on a multiple regression analysis, there is limited potential distortion of the compensation system's intent, provided that the intent matches with actualized practices. What is generally rewarded is simply reinforced, and so the integrity of the compensation system can be strengthened. In contrast, across-the-board changes – based on membership in a protected class, such as increasing pay for all women in a group by 2% – can drastically change relative pay distributions and create inequities.

4. Consider systemic solutions

Multiple regression analysis can also point to specific policy changes to improve pay equity in the long term. Among questions that can be assessed are the following:

- Do pay inequities by gender or ethnicity stem from the point of hire? (If so, target initial pay-setting processes for change.)

- Are full-time equivalent pay differences driven by full-time status and/or past leaves of absence? (Because women are more likely to work part-time and to take leave, gender equity might be at risk.)

- Do pay inequities arise from potential performance-rating bias? (If so, train supervisors to ensure that ratings are fair and that reviews are thoroughly documented and checked.)

- Do promotions into key positions depend upon specific experiences and/or credentials? (If so, ensure that women and minorities have access to such experiences, potentially by providing training; also consider the need for such hurdles for these positions.)

5. Solicit broad support

Various constituents have vested interests in and/or have knowledge that should be brought to bear on proactive pay equity evaluation. For example:

- Senior leadership wants to ensure the integrity of organizational brands, limit financial risk, and enforce organizational diversity and inclusion policies.

- Counsel needs to be consulted to implement the process in a manner that minimizes potential exposure. Together with risk managers, inside counsel can provide guidance on enterprise-wide risks.

- HR and compensation managers can ensure that populations are segmented and models are built to reflect actual rewards policies and practices.

- Employee relations and affirmative action personnel provide critical context and serve to ensure that the evaluation is performed in a manner consistent with related compliance efforts.

- Diversity leaders have a responsibility for programs to increase representation and inclusion. Pay equity is a key condition for success.

6. Ensure neutrality and consistency

Implement a review process that ensures broad workforce coverage and in which all employees have an opportunity to have their own pay levels reviewed: Agree on the level of review (e.g., by business, job family and/or by geography) in advance. Be consistent on employee-level pay change exceptions (e.g., no pay adjustments for poor performers to ensure clear rewards messaging; pay changes to be constrained by the official range for the pay grade).

7. Do good – again and again

Because the workforce is dynamic, with hiring, terminations, promotions, transfers and pay changes, pay equity processes should be ongoing. For federal contractors, annual review is required; however, for nearly all employers, annual review makes sense given the risks and associated benefits of the effort. Optimally, the review should coincide with the annual compensation evaluation process. Sudden, even planned, changes to the workforce

and related pay programs – in the face of the economic recession and business climate – could easily disrupt and change a seemingly strong pay equity position.

Summary

In the face of the Ledbetter Act explicitly, it is important to reduce the risk that a claim will be made based upon past actions. In correctly structuring pay equity analysis now, one can ensure that everyone's pay is in line with norms generated on an appropriate basis. As a result, differences based upon past, now irrelevant decisions will be reduced over time, as will potential claims and threats to your organization's brands and reputation. Indeed, proactive assessment is like insurance: a small premium – in terms of dollars and effort – can serve to mitigate significant risk.

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To learn more about the implications of the Lilly Ledbetter Fair Pay Act, its potential impact and how to take appropriate action in response, please visit http://www.mercer.com/rewardsfairness.

Confronting Fraud in a Downturn

Old Scams and Evolving Risks

by Richard Abbey, Alan E. Brill & Brian G. Lapidus

The global economic downturn and uncertainty in market conditions have created an environment that both exposes existing financial scams and engenders new frauds.

With banner headlines publicizing massive frauds around the world, individuals and businesses are paying increased attention not only to investments but also to questionable operations. Swindles that rely on a continuous supply of new victims are harder now; people have less money to invest and often switch to safer investments. Furthermore, companies watching costs are more likely to investigate unusual spending. As old frauds come to light and regulatory bodies inevitably take action, businesses can benefit by anticipating and preparing for the consequences.