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COMPENSATION

Four Steps NYC-Based Fund Managers Should Take in Light of Newly Enacted Law Prohibiting Compensation History Queries When Interviewing Prospective Employees

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On May 4, 2017, New York City Mayor Bill de Blasio signed into law legislation prohibiting firms based in New York City from inquiring about or relying upon the compensation history of applicants in connection with the hiring process.[1] The new law parallels a November 2016 pay history law applicable to New York City agencies.[2]

Following on the heels of last year's amendments to the New York Equal Pay Act, the new law is intended to help close the gender-based pay disparity gap by largely removing reliance on current compensation levels at the time of hire. Critics argue that the law introduces considerable inefficiencies into the recruiting process, will have an inflationary impact on wages and will create traps for the unwary. The pay history law is just the latest in a raft of recent state and local legislation regulating the employment practices of New York City-based firms.[3]

This article describes the new pay history law, including what practices will be permitted to continue once the new law comes into effect, and provides four steps that advisers to private funds and other financial institutions should take now to prepare for the new law's effective date.

What the Law Prohibits

The new pay history law will make it an unlawful discriminatory practice for a firm or its agents to inquire about the salary history of an applicant for employment, including the applicant's current or past wages, benefits or other compensation.[4] Firms also will be prohibited from searching public records to discover an applicant's compensation history.[5] While firms will continue to be able to verify an applicant's disclosure of non-salary-related information, and to conduct background checks for proper purposes, they will be prohibited from considering or relying upon any salary history information revealed through this process.[6] The law addresses only the hiring of new employees; it does not apply to existing employees being considered for potential internal transfer or promotion.[7]

The new measure amends the New York City Human Rights Law, Section 8-107 of the New York City Administrative Code.[8] Complaints for alleged violations may be initiated either by an allegedly aggrieved individual or by the New York City Commission on Human Rights (Commission).[9] Remedies include injunctive relief, back pay, front pay, compensatory damages and an award of attorneys' fees to a prevailing applicant.[10] The Commission also can impose a civil penalty of up to $125,000 (or up to $250,000 for willful, wanton or malicious behavior) on firms found to have violated the law.[11]

The new law, which is similar to measures recently enacted in Massachusetts and Philadelphia,[12] will go into effect on October 31, 2017 (i.e., 180 days from the date it was signed by Mayor de Blasio).[13] The Commission is expected to issue guidance regarding the new measure prior to its effective date.

What the Law Permits

Compensation obviously is the "elephant in the room" in any recruiting process, and few highly qualified candidates will consider a move that does not at least

match (or, more likely, exceed) their current level of income. Until now, hiring firms and recruiters could use a candidate's existing compensation as a measuring stick for his or her likely level of interest in a position and the financial package necessary to attract him or her. With this avenue soon to be foreclosed, firms will be left with a few other options for addressing compensation.

First, firms will be permitted to inform applicants and recruiting firms of the anticipated salary range of the available position.[14] This approach would allow a firm to anchor compensation discussions in an acceptable range, hopefully helping guide negotiations with any successful candidate. At the same time, broadcasting the expected rate of pay in an unsolicited fashion comes with some risk, including the risk of alienating highly qualified candidates who might otherwise have taken a meeting. Depending on such factors as the nature and importance of the position at issue, the available market of qualified candidates and a firm's flexibility regarding compensation ranges, the firm may prefer a more circumspect approach to a compensation discussion.

A second option permitted by the new law is to "engage in a discussion with the applicant about [his or her] expectations with respect to salary, benefits and other compensation."[15] While such an approach avoids scaring off applicants with a lowball figure, it could be inflationary, as it surrenders control of the compensation discussion to the candidate, who will be free to craft his or her initial demand on a blank canvas.

Lacking information about a candidate's current income, firms will have limited ability to assess a candidate's true "bottom line." Whether and at what level the parties can reach an agreement may depend heavily on such factors as the negotiating acumen of the personnel involved in the recruitment, the availability of other similarly qualified candidates and the firm's flexibility on acceptable compensation ranges.

Somewhat mitigating this concern is a provision of the new law allowing firms to inquire about applicants' "expectations with respect to . . . unvested equity or deferred compensation that [the] applicant would forfeit or have cancelled by virtue of the applicant's resignation from their current employer."[16] The scope of this provision is unclear, however, particularly given its awkward syntax. That being said, if firms are free to inquire about and consider any deferred compensation a candidate will leave behind, they will have an important data point for estimating the individual's broader compensation package at his or her current firm.

For more on how firms use equity compensation to motivate and retain top performers, see "*How Can Hedge Fund Managers Use Profits Interests, Capital Interests, Options and Phantom Income to Incentivize Top Portfolio Management and Other Talent?*" (Aug. 22, 2013); and "*Hedge Fund Manager Compensation Survey Addresses Employee Compensation Levels and Composition Across Job Titles and Firm Characteristics, Employee Ownership of Manager Equity and Hiring Trends*" (Feb. 21, 2013).

Third, if a candidate "voluntarily and without prompting discloses salary history" during the recruitment process, a firm can lawfully consider that history or seek to verify it.[17] The precise line between lawful questions and comments and those that improperly "prompt" the disclosure of compensation history is likely to be heavily litigated. When this information is lawfully disclosed, however, firms will be free to use, verify and consider it in setting compensation, much as they have done in the past.

What Now?

Whether intentionally or not, New York City's new pay history law introduces an increased level of uncertainty and gamesmanship into the hiring process. As any seasoned human resources professional knows, the recruitment of a highly desired candidate is much like a romance, with the hiring firm seeking to develop a rapport and level of comfort with a candidate while avoiding clumsy or awkward moments. No one wants to lowball the candidate and kill the mood. At the

same time, investment managers operate in an extremely challenging business environment and must look to contain costs across the board, including when onboarding new talent.

Firms should consider taking the following steps in preparing for the new law prior to its effective date.

Think Strategically About Hiring

First, firms should begin thinking more strategically about the hiring process, including:

- their anticipated hiring needs (either due to growth, attrition or otherwise);
- the elasticity of the market of available, qualified candidates for each of the positions at issue;
- their existing compensation structures, including the pay bands across different job categories;
- any challenges they anticipate in filling needed positions; and
- their ability or willingness to be flexible in compensating for particular roles.

A firm's approach to hiring may (and likely should) vary depending on the particular position at issue and its assessment of the above factors. It should remain cognizant of these considerations in connection with any specific search.

Educate Employees About the New Law

Second, firms should educate their employees – particularly, those involved in the recruiting, hiring or interview process – about the pay history law and about the scope of permitted activity. Whatever one's views of the new law, it is anything but intuitive. Consequently, even the most well-intentioned interviewer could unwittingly violate it. The risk is perhaps particularly acute in the hedge fund community, where many firms lack a dedicated human resources department or infrastructure.

At the same time, interviewers should be instructed regarding the scope of permissible inquiries, including in the event that a candidate voluntarily offers his or her own compensation history.

Note the Broader Context of the New Law

Third, firms should take note of the broader context in which this new law was passed, including the dramatically increased scrutiny on disparities between the pay of men and women in the workplace. Firms should consider reviewing their existing pay structures to ensure that there are no such disparities (or if there are, that they can be explained by valid job-related criteria that is not based solely on the prior pay history of different individuals).

One logical time to accomplish this review is in connection with the year-end bonus cycle, in which employee compensation levels typically are reviewed and adjusted. Obviously, firms also should be vigilant in setting employee compensation when hiring personnel in the future.

Seek Advice of Counsel

Finally, as with all legal and compliance-related issues, firms should seek the guidance of qualified counsel in ensuring their compliance with the new law. Particularly to the extent firms engage in self-critical analysis or evaluation, they should involve internal or external counsel in ensuring any such process is conducted in a privileged manner.

See our three-part series on protecting the attorney-client privilege when engaging consultants: "*Key Considerations for Fund Managers When Utilizing, Invoking and Waiving the Kovel Privilege for Consultants*" (Oct. 20, 2016); "*Practical Tips for Preparing an Engagement Letter for, and Implementing, a Compliant Kovel Arrangement*" (Oct. 27, 2016); and "*Specific Circumstances Where Fund Managers May – and May Not – Be Able to Use Kovel Arrangements*" (Nov. 3, 2016).

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[1] See N.Y.C. Council Int. No. 1253-A (2016).
[2] See Mayoral Exec. Order No. 21, Nov. 4, 2016.
[3] Other recent New York State and City legislation include New York City's Stop Credit Discrimination in Employment Act, governing inquiries into applicant and employee credit history (Local Law No. 37 (2015)); New York City's Fair Chance Act, governing criminal background checks (Local Law No. 63 (2015)); New York City's Earned Sick Time Act, governing the provision and use of employee sick time (Local Law No. 46 (2013), amendedby Local Law Nos. 6, 7 (2014)); New York State's Women's Equality Act, expanding the protection of women in multiple ways (2015 N.Y. Laws ch. 362-369); and New York State's Paid Family Leave Benefits Law, requiring family and medical leave (2016 N.Y. Laws ch. 54; New York State Budget, S. 6406-C, A. 9006-C (Apr. 4, 2016) at Part SS), which will become effective January 1, 2018.
[4] See Int. No. 1253-A, § 1 at ¶ 25(b).
[5] Id. at ¶¶ 25(a), (b).
[6] Id. at ¶ 25(e)(3).
[7] Id. at ¶ 25(e)(2).
[8] See Int. No. 1253-A, § 1.
[9] See NYC Admin. Code § 8-109(a), (c).
[10] See id. at § 8-120(a).
[11] Id. at § 8-126.
[12] See 2016 Mass. Acts ch. 177 (amending Mass. Gen. Laws ch. 149, §105A), to take effect July 1, 2018; Philadelphia City Council Bill No. 160840 (2016), signed by Mayor Michael A. Decker January 23, 2017. The Philadelphia law was scheduled to go into effect on May 23, 2017, but has been stayed by a stipulated court order by the U.S. District Court for the Eastern District of Pennsylvania, pending resolution of a federal lawsuit filed by the Chamber of Commerce for Greater Philadelphia seeking to enjoin the law on the grounds that it is unconstitutional and violates Pennsylvania's Home Rule Act. See The Chamber of Commerce for Greater Philadelphia v. City of Philadelphia, No. 17-01548 (E.D. Pa. filed Apr. 6, 2017). Constitutional challenges to the New York City law are possible as well.
[13] See Int. No. 1253-A, § 2.
[14] See Int. No. 1253-A, § 1 at ¶¶ 25(a)-(c).
[15] Id. at ¶ 25(c).
[16] Id.
[17] Id. at ¶ 25(d).