

Client Alert

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SEC Proposes Pay Ratio Disclosure Rules

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At an open meeting on September 18, 2013, the Securities and Exchange Commission (“SEC”) approved for public comment proposed rules to implement Section 953(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (2010) (the “Dodd-Frank Act”) regarding the requirements for new pay ratio disclosures.

The proposed rules are set forth in Release No. 33-9452 (the “Proposing Release”) which is available at <http://www.sec.gov/rules/proposed/2013/33-9452.pdf>.

BACKGROUND AND OPEN MEETING

Section 953(b) of the Dodd-Frank Act directed the SEC to expand the existing required compensation disclosures by amending Item 402 of Regulation S-K to require companies to disclose:

- the median of the annual total compensation of all employees of the issuer (excluding the chief executive officer);
- the annual total compensation of the chief executive officer; and
- the ratio of the median of employee compensation to chief executive office compensation.

Section 953(b) of the Dodd-Frank Act has generated extensive debate while the SEC considered approaches for implementing the provision. Proponents, including many consumer and shareholder advocacy groups, argue that the disclosure of this pay ratio will provide investors with the data to judge whether a CEO’s pay is commensurate with a company’s performance. Opposition has been just as vigorous from companies and business organizations, such as the U.S. Chamber of Commerce, maintaining that the rule is onerous, unnecessary, complex and prohibitively expensive.

At the open meeting, SEC Chairwoman Mary Jo White noted that the proposal has “generated significant interest” — evidenced by more than 22,000 public comment letters to date. Chairwoman White credited this pre-vote input with providing the SEC staff with the information needed to draft a proposal that would “provide companies [with] significant flexibility in complying,” rather than stipulating a one-size-fits-all reporting regimen.

The recommendation to issue the proposed rules passed by a split 3-2 vote, with the SEC’s two Republican members vocally opposing the proposal. Newly confirmed Commissioner Michael Piwowar stated that the proposed rule “represents what is worst about our current rulemaking agenda,” adding “shame on us for putting special interests ahead of investors.” Commissioner Daniel Gallagher said the sole purpose of the proposed rule was to name and shame CEOs and concluded that “there are no, count them, zero economic benefits” of the proposal.

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PROPOSED RULE

New Pay Ratio Disclosure Requirement. Under the proposed rule, a new Paragraph (u) of Item 402 of Regulation S-K would require disclosure of:

- the median of the annual total compensation of all employees of the registrant, except the principal executive officer of the registrant;
- the annual total compensation of the principal executive officer of the registrant; and
- the ratio of the median of the registrant's employee compensation to its principal executive officer compensation.

Pursuant to the proposed Paragraph (u)(3) of Item 402 of Regulation S-K, "all employees of the registrant" would be defined to mean all individuals employed by a company's or any of its subsidiaries and would include any "full-time, part-time, seasonal or temporary worker" as of the last day of the company's prior fiscal year. The Proposing Release further clarifies that the definition for "all employees for the registrant" shall not include any carve-outs for specific categories of employees and the proposed rule thus includes non-U.S. workers in such definition. Moreover, the Proposing Release states that companies would not be permitted to make full-time equivalent adjustments for part-time workers, annualizing adjustments for temporary or seasonal workers or cost-of-living adjustments for non-U.S. workers. As much of the opposition to date has focused on the time and costs associated with complying with this new disclosure requirement for a company with thousands of employees located across the globe, we would anticipate that this broad definition requiring the inclusion of non-U.S., part-time, temporary and seasonal employees will be one of the most strongly debated elements of the proposed rule during the comment period.

These proposed new disclosure requirements would not apply to emerging growth companies (as provided for in the JOBS Act), smaller reporting companies or foreign private issuers.

Methodology for Identifying the Median Employee. In an effort to respond to concerns voiced by large multinational companies that the tallying of total compensation for a global workforce would be extremely costly, the proposed rule would not specify any required calculation methodologies for identifying the median employee in terms of total compensation for all employees. Instead, proposed Instruction 2 to new Item 402(u) takes a flexible approach by allowing companies to "use a methodology that uses reasonable estimates to identify the median and reasonable estimates to calculate the annual total compensation or any elements of total compensation for employees other than the [principal executive officer]." Additionally, when determining the employees from which the median is identified, a company may use either its entire employee population or a statistical sampling or other reasonable methods. Companies would be required to disclose the specific methods they used to calculate the median figure, as well as any material assumptions, adjustments or estimates used to identify the median or to determine total compensation.

Filings Requiring New Pay Ratio Disclosure. Under the proposed rule, companies would be required to provide the new pay ratio in any registration statements, proxy and information statements and annual reports that are required to include executive compensation information pursuant to Item 402 of Regulation S-K.

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Implementation of Pay Ratio Disclosure. Generally, the new pay ratio disclosure would first be required in a company's first fiscal year commencing on or after the effective date of the final rule. The proposal would provide a transition period for newly public companies, allowing for initial compliance for the first fiscal year commencing on or after the date the company becomes subject to the reporting requirements of the Securities and Exchange Act of 1934, as amended.

REQUEST FOR PUBLIC COMMENT

The Proposing Release includes 60 specific requests for comments. Public comments must be received on or before a date 60 days after publication of the Proposing Release in the Federal Register.

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