

Corporate Finance and Securities Law Update

08/06/2015

Securities and Exchange Commission Adopts Final Rules Regarding Pay Ratios

Yesterday, a sharply divided Securities and Exchange Commission (SEC) adopted final rules regarding disclosure of executive pay ratios as required by the Dodd-Frank Wall Street Reform and Consumer Protection Act. The rules, which were originally proposed in September of 2013, will be effective for most companies beginning with their first fiscal year starting on or after January 1, 2017. Under these rules, SEC Regulation S-K Item 402 will be amended to require most public companies to determine and disclose the median total annual compensation of all of its employees, excluding the principal financial officer, as well as the total annual compensation of its principal executive officer, and the ratio between those two figures. A company will only be required to determine the median total annual compensation of all employees once every three years, subject to a more frequent determination in the event of a change in its employee population that it believes would significantly impact the pay ratio disclosure.

Companies complying with these new obligations will be given some latitude in determining how to calculate the total annual compensation for employees. Specifically, the rules permit the registrant to either use the same methodology as is required for use with respect to the company's named executive officers, or any other methodology so long as it is described in the company's disclosures and consistently applied.

Notably, companies will not be permitted much discretion in determining who is included in the definition of "employee." Under the rules, a company must include any and all individuals who were on the company's payroll, or the payroll for any of the company's subsidiaries, on the last day of the fiscal year. This determination will include any part-time employees. Non-U.S. employees must be included as well, although there are exceptions for non-U.S. employees working in jurisdictions where data privacy laws preclude the gathering of the information necessary to comply with the rules. A company may also exclude non-U.S. employees from the calculation of median total annual compensation if the company's total non-U.S. employees make up less than 5 percent of its global workforce. Additionally, while a company is permitted to annualize compensation for employees who were employed at year-end but did not work for the entire year, full-time equivalent adjustments for part-time employees, or annualizing adjustments for temporary or seasonal employees, will not be permitted.

Emerging growth companies, as defined in Section 2(a)(19) of the Securities Act of 1933, as amended, are not required to comply with these new rules. However, any company that previously met the definition of an emerging growth company but no longer meets that definition will be required to comply with these new disclosure obligations beginning with the later of its first fiscal year starting on or after January 1, 2017, or the first fiscal year starting after the company no longer qualifies as an emerging growth company.

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