

SEC Approves Proposing Pay Ratio Rules for Public Comment

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At the SEC's open meeting today, the Commissioners approved in a 3 to 2 vote (Commissioners Gallagher and Piwowar dissenting) the proposed so-called "pay ratio" rules, mandated by Section 953(b) of the Dodd-Frank Act, that require companies to disclose the median annual total compensation of all employees and the ratio of that median to the annual total compensation of the company's chief executive officer.

Based on the summary read at the meeting, the proposed rules will provide companies with "significant flexibility" to determine the median total compensation for their employees. Companies will be allowed to use any "consistently applied compensation measure" (for example, wages recorded for tax filing purposes), including the use of reasonable estimates. Companies may calculate this number by using a sample group of employees or through the compensation of a single employee. Companies can use their own statistical sampling method to find that median employee (for example, using a statistically representative sampling of employees and comparing the compensation of those in the sample). Disclosure will be required of all methodologies, estimates and assumptions used in preparing these calculations.

The proposed rule is not as flexible in terms of the employees covered. All employees employed on the last day of the fiscal year, other than the CEO, must be included in the evaluation. This would include all full-time, part-time, seasonal and temporary employees on an enterprise-wide and global basis (i.e., both U.S. and non-U.S. employees) of the issuer and its subsidiaries. The compensation of full-time employees who did not work for the entire year may be annualized, but this will not be permitted for temporary or seasonal employees. No cost of living adjustments will be allowed.

The proposed rules would require that the median employee's total annual compensation then be determined pursuant to the methodology mandated for the Summary Compensation Table under Item 402(c) of Regulation S-K. That calculation of total annual compensation will be required to be disclosed and will be used to determine the ratio to the CEO's total annual compensation, which would be derived under the same method. The disclosure must be based on information for the most recently completed fiscal year.

The ratio will be required to be included in any annual report, proxy statement or registration statement that requires Item 402 disclosure. However, companies that are not required to provide Item 402(c) disclosure, including emerging growth companies and foreign private issuers, are exempt. Subject companies will be permitted to omit this disclosure for its first fiscal year commencing on or after the effective date of the final rule until the filing of its annual report on Form 10-K or, if later, a proxy or information statement relating to its next annual meeting of shareholders (and in any event not later than 120 days after the end of such fiscal year).

Discussion at the open meeting made it clear that the proposing release will solicit comments on numerous questions, and that detailed, technical responses would be the most persuasive.

This is a summary based on the meeting. The release was just posted moments ago and is now available on the SEC [website](#). A more detailed memo will follow.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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