

Frequently Asked Questions Regarding the SEC's Proposed Pay Ratio Rule

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As companies begin digesting the SEC's proposed pay ratio rule (which we discuss [here](#)) and analyzing its impact, here are answers to some frequently asked questions. Final rules may affect the responses.

Is there a safe harbor for the use of any particular method to identify the median employee?

No, the SEC specifically declined to establish any "safe harbor methodologies" or a "menu of alternatives" for determining the median employee.

Do the compensation measures used to identify the median employee need to meet any requirements?

The proposal requires the use of "any consistently applied compensation measure" and mentions several possibilities, such as total direct compensation (salary or wages and performance-based pay); annual cash compensation; or amounts reported in payroll or tax records such as W-2s. The compensation measure can be for a different time period than the company's fiscal year.

How should different elements of compensation be calculated to arrive at the median employee's total compensation?

The rule permits the use of "reasonable estimates" that are disclosed, and companies must have a "reasonable" basis to conclude that the estimate for any compensation component, or total compensation, approximates the actual amount of compensation. This includes benefits provided to non-U.S. employees that are not provided to U.S. employees. Personal benefits that are less than \$10,000 in the aggregate may be excluded.

When can a full-time employee's pay be annualized?

A full-time employee's pay may, at the company's option, be annualized if that employee did not work the entire fiscal year. This might apply to an employee who was hired during the course of the year, or who was on unpaid leave during part of the year.

When can a part-time employee's pay be annualized?

A permanent part-time employee's pay, may at the company's option, be annualized if that employee only worked part of the fiscal year. However, companies cannot adjust the part-time schedule to a full-time equivalent schedule.

What other adjustments are not permitted?

Companies cannot annualize pay for temporary or seasonal employees or make cost-of-living adjustments for non-U.S. workers.

What if more than one CEO is reported in the summary compensation table?

As a technical matter, the proposed rule requires a ratio using "principal executive officer" as defined in Item 402(a)(3) of Regulation S-K, which could be more than one individual.

Are directors included as employees for purposes of calculating the ratio?

No, directors are not included. Neither are independent contractors or leased employees.

Can we disclose more than one pay ratio?

Yes. As with the non-GAAP disclosure rules, the required ratio must be the most prominent. Companies can disclose one or more other ratios as supplemental information if they are clearly identified and not misleading. For example, if the supplemental ratio excludes the effect of non-U.S. employees, it should be explained as such.

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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