Corporate Alert

September 20, 2013

SEC Proposes CEO Pay Ratio Disclosure Rule

On September 18, 2013, the SEC commissioners voted 3-2 to propose a new rule that would amend existing executive compensation disclosure rules by requiring public companies to disclose the ratio of a CEO's annual total compensation and the median total annual compensation of all other employees of the company (including part-time, seasonal, temporary and foreign employees). The proposed rule, which is intended to fulfill a requirement of the Dodd–Frank Wall Street Reform and Consumer Protection Act, provides companies with some flexibility in determining the median compensation for employees by permitting the use of estimation and statistical sampling in order to ease the compliance burden. However, the proposal has already sparked controversy, with detractors questioning its utility and bemoaning anticipated compliance burdens and proponents touting the rule as providing meaningful information to shareholders. The comment period on the proposal ends 60 days after the publication of the rule in the Federal Register. Whatever the ultimate outcome, the new rule will not apply until after the 2014 proxy season. The rule also will not apply to smaller reporting companies, emerging growth companies or foreign private issuers.

The SEC Fact Sheet summarizing the proposal is set forth in its entirety below.

FACT SHEET

Pay Ratio Disclosure

SEC Open Meeting

Sept. 18, 2013

Background

Section 953(b) of the Dodd-Frank Act directs the Commission to amend existing rules to require companies to disclose:

- The median of the annual total compensation of all employees of the company.
- The ratio of that median to the annual total compensation of its CEO.

Under SEC rules, companies are required to provide extensive information about the compensation of their CEO and other named executive officers. Companies are not, however, required to disclose the same compensation information for other employees.

SEC rules require compensation information to be calculated and presented in accordance with U.S. Generally Accepted Accounting Principles (GAAP), which differs from the tax accounting and reporting standards that companies may use for purposes of determining employee compensation. As a result, Section 953(b) calls for new disclosure about employee compensation that is not currently required.

SEC Proposal

New Pay Ratio Disclosure Requirement
As required by the Dodd-Frank Act, the proposal would amend existing executive compensation disclosure rules to require companies to disclose:

- The median of the annual total compensation of all its employees except the CEO.
- The annual total compensation of its CEO.
- The ratio of the two amounts.

Methodology for Identifying the Median Employee
The proposed rule would not specify any required calculation methodologies for identifying the median employee in terms of total compensation for all employees. Instead, it would allow companies to select a methodology that is appropriate to the size and structure of their own businesses and the way they compensate employees.

For example, a company would be permitted to identify the median employee based on total compensation using either its full employee population or a statistical sample of that population. A company could, for example, identify the median of its population or sample:

- Using annual total compensation as determined under existing executive compensation rules.
- Using any consistently used compensation measure such as compensation amounts reported in its payroll or tax records. A company would then calculate the annual total compensation for that median employee in accordance with the definition of total compensation set forth in the SEC's executive compensation rules.

Determination of Total Compensation
As required by the Dodd-Frank Act, median employee total compensation would be calculated using the definition of "total compensation" in existing executive compensation rules, namely Item 402(c)(2)(x) of Regulation S-K. Item 402(c)(2)(x) requires companies to provide extensive compensation information about the CEO and other named executive officers, which is not ordinarily calculated for all employees. "Annual total compensation" would mean total compensation for the last completed fiscal year, consistent with the Commission's existing executive compensation disclosure requirements. The proposal would allow companies to use reasonable estimates when:

- Calculating the annual total compensation.
- Calculating any element of total compensation.
- Determining the annual total compensation of the median employee.

Identification of Employees Covered by the Proposed Rule
“All employees of the registrant” would include:

- All employees (including full-time, part-time, temporary, seasonal and non-U.S. employees)
- Those employed by the company or any of its subsidiaries.
- Those employed as of the last day of the company’s prior fiscal year.

Companies would be permitted but not required to annualize the total compensation for a permanent employee who did not work for the entire year, such as new hires. In contrast, full-time equivalent adjustments for part-time workers, annualizing adjustments for temporary and seasonal workers, or cost-of-living adjustments for non-U.S. workers would not be permitted.

Disclosure of Methodology, Assumptions, and Estimates
Companies would be required to disclose the methodology used to identify the median, and any material assumptions, adjustments or estimates used to identify the median or to determine total compensation. If a company identifies a median employee based on a consistently applied compensation measure, the proposed rule would require disclosure of the measure that it used. Also, companies would be required to clearly identify any amounts that are estimated.

Additional Disclosure Permitted But Not Required
Companies would be permitted but not required to supplement the required disclosure with a narrative discussion or additional ratios if they choose to do so.

Filings Where Disclosure Is Required
Companies would be required to describe the information in registration statements, proxy and information statements, and annual reports that must already include executive compensation information as set forth under Item 402 of Regulation S-K.

Companies would not be required to:

- Disclose the pay ratio information in reports that do not require executive compensation information such as current and quarterly reports.
- Update their disclosure for the most recently completed fiscal year until the company files its proxy or information statement for its annual meeting of shareholders (or annual report for companies that do not file proxy or information statements for annual meetings).

Companies Subject to the Proposed Disclosure Requirement
As provided by the JOBS Act, the proposed rule would not apply to emerging growth companies. In addition, the proposed rule would not apply to smaller reporting companies or foreign private issuers.

The proposal would provide a transition period for newly public companies. For these companies, initial compliance would be required with respect to compensation for the first fiscal year commencing on or after the date the company becomes subject to the reporting requirements.

Proposed Compliance Date
A company would be required to report the pay ratio with respect to compensation for its first fiscal year commencing on or after the effective date of the final rule.

What's Next?

The proposal will be subject to a 60-day public comment period once it is published in the Federal Register.

Contact Information

If you have any questions regarding this alert, please contact:

Kerry E. Berchem
kberchem@akingump.com
212.872.1095
New York

Seth R. Molay
smolay@akingump.com
214.969.4780
Dallas

Robin M. Schachter
rschachter@akingump.com
310.728.3363
Los Angeles

Bruce S. Mendelsohn
bmendelsohn@akingump.com
212.872.8117
New York

Frank Reddick
freddick@akingump.com
310.728.3204
Los Angeles

Rolf Zaiss
rzaiss@akingump.com
212.872.1050
New York

