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LEGAL UPDATES

PUBLISHED: SEPTEMBER 19, 2013

SEC Proposes New Pay-Ratio Disclosure Rules

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Securities & Corporate Governance

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On Sept. 18, 2013, the Securities and Exchange Commission (SEC) issued proposed rules to implement the pay-ratio disclosure requirements under the Dodd-Frank Wall Street Reform and Consumer Protection Act. Specifically, public companies would be compelled to disclose how the compensation of the chief executive officer compares with that of employees.

As proposed, covered companies would be required to disclose (i) the median annual total compensation of all employees (excluding the principal executive officer, referred to here as the CEO), (ii) the annual total compensation of the CEO, and (iii) the ratio of the two totals. The ratio must be expressed as a multiple of one – for example, 1 to 268 or the CEO's "annual total compensation is 268 times that of the median of the annual total compensation" of all other employees. The information must appear in any annual report, proxy, information statement or registration statement requiring executive compensation disclosure under Item 402 of Regulation S-K. Emerging growth companies, smaller reporting companies and foreign private issuers would be exempt from the proposed rules.

The SEC explained that the proposed amendments attempt to reduce the potential costs and burdens on covered entities while satisfying what the commission perceives to be the potential benefits within the context of other executive compensation disclosure under Item 402. To this end, the proposal allows companies to select the methodology by which they calculate employee compensation, including the use of statistical sampling.

The proposed rules provide as follows:

Identifying the median employee group: The proposed rules define "employee" to include any full-time, part-time, seasonal or temporary worker employed by the company or any of its subsidiaries as of the last day of the fiscal year. The definition would not include independent contractors, “leased” workers or other temporary workers who are employed by a third party. The SEC did not propose a specific method by which companies must identify the median within the employee group but permit each company to select a method that is workable for the company based on the its particular facts and circumstances. The SEC suggested this allows the greatest degree of flexibility while remaining consistent with the statutory provision. Companies may use the entire employee population, statistical sampling or other reasonable methods.

Identifying the median employee: The SEC noted that a company would be permitted to identify the median employee based on total compensation by using either its full employee population or a statistical sample of the population. As proposed, companies may use annual total compensation or any other compensation measure that is consistently applied to all employees included in the calculation, such as payroll or tax records to identify the median employee.

Calculating total compensation: The proposed definition of “total compensation” tracks the requirements of Item 402(c)(2)(x), which sets forth the current total compensation calculation for those executives whose compensation must be disclosed in the summary compensation table. The proposed rules would permit companies to use reasonable estimates in their calculations. Companies would be allowed, but are not required, to annualize compensation for permanent employees who were employed for less than the entire fiscal year. Companies also would be allowed to include perquisites and benefits such as health insurance in the calculation of total compensation for employees, if they also include such amounts in the calculation of the CEO’s total compensation.

Describing the methodology: Regardless of the approach taken, all companies must include a brief description of the “methodology used to identify the median and any material assumptions, adjustments or estimates used to identify the median or to determine total compensation or any elements of total compensation” in their disclosure. Companies must also “clearly identify any estimated amount.” The proposal allows, but does not require, companies to provide supplemental ratios with appropriate disclosure.

Comment period and compliance date: The SEC requested comment on a number of issues and established a 60 day comment period beginning on the date the proposed rules are published in the Federal Register. The proposed compliance date would begin for compensation paid in each registrant’s first fiscal year starting on or after the effective date of the final rule. Therefore, if the final rules are adopted in 2013, companies with a fiscal year ending on December 31, 2013, will have to include the disclosure for 2014 compensation in Form 10-K or proxy statements filed in 2015.

What This Means to You

Public companies subject to the SEC's disclosure rules should anticipate a disclosure requirement along the lines of what has been proposed and begin formulating a methodology to calculate the median employee compensation and then identify the pay ratio between the median and the chief executive officer. Companies wishing to participate in the comment process should anticipate the commencement of the 60 day comment period in the near future.

Contact Information

For additional information about this or any securities or corporate governance issue, please contact your Husch Blackwell attorney or any attorney in our Securities & Corporate Governance group.