

# LEGAL UPDATE

September 2013 By: Michael T. Campoli

## PAY RATIO DISCLOSURE RULES FINALLY PROPOSED BY THE SEC

On September 18, 2013, the U.S. Securities and Exchange Commission (the “SEC”) proposed amendments to Item 402 of Regulation S-K to require disclosure of: (i) the median of the annual total compensation of all employees of an issuer (excluding the principal executive officer (“PEO”)<sup>1</sup>), (ii) the annual total compensation of that issuer’s PEO, and (iii) the ratio of the median of the annual total compensation of all employees to the annual total compensation of the PEO. The proposed amendments were mandated by Section 953(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. Comments on the proposed amendments are due 60 days after their publication in the *Federal Register*.

### COVERED ISSUERS

Only those issuers required to include summary compensation table disclosures in their public filings pursuant to Item 402(c) of Regulation S-K are subject to the proposed pay ratio disclosure rules. Thus, emerging growth companies, smaller reporting companies and foreign private issuers will not have to disclose their pay ratios<sup>2</sup>. The SEC clarified in the proposing release that the pay ratio disclosure will be considered “filed”, rather than

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<sup>1</sup> The proposed rules use the term “PEO”, instead of the term “chief executive officer” as used in Section 953(b) of the Dodd-Frank Act, for consistency with existing Item 402 requirements.

<sup>2</sup> Issuers that file with the SEC in accordance with the requirements of the U.S.-Canadian Multijurisdictional Disclosure System also would not be required to provide the pay ratio disclosures.

“furnished”, for purposes of the Securities Act of 1933 and the Securities Exchange Act of 1934 and, accordingly, would be subject to potential liabilities under such acts.

### COVERED FILINGS

Pay ratio disclosure will be required in filings that mandate executive compensation disclosure under Item 402 of Regulation S-K, including annual reports on Form 10-K, and, to the extent that disclosure under Item 402 is required therein, registration, proxy and information statements.

### COVERED EMPLOYEES

All employees of the registrant and its subsidiaries must be included in the process of identifying median total compensation. For purposes of the calculation, any person employed on the last day of the registrant’s last fiscal year counts as an employee. This includes part-time, temporary and seasonal employees, as well as employees outside the United States and officers other than the PEO. Independent contractors and leased employees are excluded.

Issuers may, but would not be required to, annualize the total compensation for permanent employees who did not work for the entire year, such as new hires or employees who took an unpaid leave of absence during the applicable year. However, issuers may not annualize the total compensation for temporary or seasonal employees. Full-time equivalent adjustments for part-time employees and cost-of-living adjustments would also be prohibited.

## IDENTIFYING THE “MEDIAN” EMPLOYEE

Recognizing the numerous difficulties involved, the proposed rules do not prescribe a specific methodology for identifying the median employee in terms of annual total compensation for all employees. Instead, the SEC proposed a flexible approach that gives registrants the discretion to utilize several alternative methods that are appropriate to the unique size and structure of their own businesses to identify the median in a cost effective manner, so long as each registrant consistently applies its chosen methodology to all employees included in the calculation.

Among the methods that registrants may use include: (i) calculating total compensation for each employee using Item 402(c)(2)(x) of Regulation S-K, (ii) using reasonable estimates of total compensation based on more readily identifiable figures, such as compensation amounts reported in payroll or tax records and/or (iii) using statistical or random sampling.

Once the median employee is identified, his or her annual total compensation for purposes of the pay ratio disclosure must be calculated in accordance with Item 402(c)(2)(x). However, to ease the burden of compliance, registrants would be permitted to use reasonable estimates when calculating the annual total compensation and any element of total compensation of the median employee, so long as the estimation methods and any material assumptions or adjustments are disclosed.

## WHEN EFFECTIVE

Issuers would be required to provide the pay ratio disclosure in any public filings that call for Item 402 disclosures for the first fiscal year commencing on or after the effective date of the rules. Thus, if the final rules are effective in 2014, an issuer with a fiscal year ending on December 31 would first be required to include pay ratio disclosure in its Form 10-K covering the 2015 fiscal year or, if such information is incorporated by reference, in its

proxy statement with respect to its 2016 annual meeting of shareholders, but in any event not later than 120 days after the end of the 2015 fiscal year.

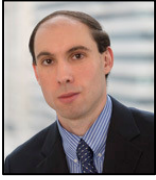
Similarly, a new registrant that does not otherwise qualify for an exemption would be required to first comply with the proposed rules for its first fiscal year commencing on or after the date such registrant becomes required to file periodic reports under the Securities Exchange Act.

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*If you would like to learn more about this topic or how Pryor Cashman LLP can serve your legal needs, please contact Michael T. Campoli at [mcampoli@pryorcashman.com](mailto:mcampoli@pryorcashman.com), or any Pryor Cashman attorney with whom you are working.*

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Michael Campoli devotes his practice to counseling public and private companies of all sizes and at all stages of development on a broad range of corporate matters, including securities law compliance, Securities Exchange Act reporting, corporate formation and governance, M&A, public and private financing transactions (including early-stage financing initiatives), joint ventures, and limited liability company and partnership counseling.

Mr. Campoli is a 2000 graduate of New York University School of Law, and a 1997 Phi Beta Kappa graduate of Columbia College.