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Practice Update

SEC Proposes Pay Ratio Rules

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On September 18, 2013, pursuant to Section 953(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Securities and Exchange Commission issued proposed rules that will amend Item 402 of Regulation S-K to require issuers to disclose the median annual total compensation of all employees other than the issuer's principal executive officer, and the ratio of that amount to the annual total compensation of the issuer's principal executive officer. A copy of the rule release relating to the proposed pay ratio rules can be found here.

Proposed Rules

Flexible Methodology to Identify Median Employee

The proposed rules would require annual disclosure of (i) the median annual total compensation of all employees other than the issuer's principal executive officer, (ii) the annual total compensation of the issuer's principal executive officer and (iii) the ratio of the two amounts. The proposed rules do not mandate a specific methodology for calculating the median annual total compensation of all employees. Each issuer would have discretion to use the most appropriate method of calculation that is appropriate to its size, business structure and its manner of compensating its employees. The proposed rules provide that issuers may determine median annual employee compensation by

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determining total compensation for each employee or by using statistical sampling or a consistently applied compensation measure other than total compensation, such as amounts reported in its payroll or tax records.

Identifying "All Employees"

Under the proposed rules, "all employees" would include full-time, part-time, temporary, seasonal, U.S., and non-U.S. employees employed by an issuer or its subsidiaries as of the last day of its last completed fiscal year. The proposed rules would allow, but not require, issuers to annualize the total compensation of a permanent employee who did not work for the entire year, such as new hires. However, the proposed rules would not allow full-time equivalent adjustments for part-time employees, annualizing adjustments for temporary and seasonal employees, or cost of living adjustments for non-U.S. employees.

Determining Total Compensation

After the median employee has been identified, the issuer would then calculate the total compensation of the median employee in accordance with Item 402(c)(2)(x) of the Regulation S-K, which states generally that total compensation is the sum of an individual's salary, bonus, stock awards, option awards, non-equity incentive plan compensation, change in pension value, nonqualified deferred compensation earnings, and all other compensation, including perquisites.

The principal executive officer's total compensation would continue to be calculated in accordance with current SEC rules.

Use of Estimates and Disclosure of Methodology

Issuers may use reasonable estimates in calculating annual total compensation, or any element of annual total compensation, for employees other than the principal executive officer.

Issuers would be required to disclose the specific methods used to calculate the median annual employee compensation as well as any material assumptions, adjustments or estimates used to identify the median or to determine total compensation. If an issuer changes methodologies or material assumptions, adjustments or estimates from those used in a prior period and the effects of any such change is material, the issuer would be required to briefly describe the change, the reasons for the change, and provide an estimate of the impact of the change on the median annual employee compensation and the ratio.

Filings Requiring Pay Ratio Disclosure

Issuers would be required to disclose the pay ratio in annual reports on Form 10-K, proxy statements, and registrations statements, which require executive compensation disclosure under Item 402 of Regulation S-K.

Timing

Proposed Rules Will Not Affect the 2014 Proxy Season

Issuers would be required to comply with the new rules with respect to compensation for the first fiscal year beginning after the effective date of the rules. If the proposed rules are adopted in 2013, the earliest the new rules would be effective would be the 2015 proxy season (with respect to disclosure of compensation for the 2014 fiscal year).

The proposed rules provide a transition period for newly public companies. Newly public issuers would be required to comply with the pay ratio disclosure requirements for the first fiscal year commencing on or after the date an issuer becomes subject to the reporting requirements.

Exemptions

The proposed rules would not apply to emerging growth companies, smaller reporting companies, and foreign private issuers.

Comment Period

The proposed rules will be open for comment for a period of 60 days after the date of publication of the proposed rules in the Federal Register.
