# SEC Proposes Rules to Implement CEO Pay Ratio Disclosure Requirement

The Securities and Exchange Commission has proposed rules to implement Section 953(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which requires public companies to compare and disclose the relationship between the annual total compensation of their Chief Executive Officer and the median of the annual total compensation of all their employees.

This article summarizes the key aspects of the proposed rules. For a more detailed explanation of the proposed rules, as well as our initial observations as to their likely impact on technology and life sciences companies, please see our Thoughtful Pay Alert on this subject on the Compensia website.

## Disclosure Required

Section 953(b) requires public companies (other than emerging growth companies) to disclose:

- The median of the annual total compensation of all its employees except its Chief Executive Officer;
- The annual total compensation of its Chief Executive Officer; and
- The ratio of the two amounts.

The proposed rules seek to implement this disclosure requirement by providing a framework for determining the "median of the annual total compensation of all employees" and clarifying several other relevant terms. Note that,

## Highlights of the Proposed Rules

- **Must Determine Median Total Compensation of All Employees**. Companies will be required to consider the compensation of "all" employees in calculating the median of annual total compensation. This includes full-time, part-time, temporary, seasonal, and non-U.S. employees, as well as employees of subsidiaries, as long as the employees were employed as of the last day of the company's last completed fiscal year.
- **No Specific Calculation Methodology Required**. Companies will not be required to use a specific methodology to determine the median of the annual total compensation of all their employees. Instead, companies will be permitted to select a methodology that is appropriate to the size and structure of their own businesses and the way they compensate employees. This may include, where appropriate, statistical sampling.
- **Some Flexibility in Calculating Total Compensation of Employees**. "Total compensation" is to be calculated using the SEC's executive compensation disclosure rules. When calculating the median of the annual total compensation of their employees, companies will be permitted to use reasonable estimates of various compensation elements.
- **Disclosure of Calculation Methodology**. In addition to the pay ratio itself, companies will be required to disclose the specific methodology used to identify the median of the annual total compensation of all employees, as well as any material assumptions, adjustments, or estimates used to identify the median or to determine total compensation or any elements of total compensation.
- **Disclosure Required in Filings That Include Executive Compensation Disclosure**. Companies will be required to provide the CEO pay ratio disclosure in any filing that includes the executive compensation information required by SEC rules, including registration statements, annual reports on Form 10-K, and proxy and information statements.

## SEC Proposes Rules to Implement CEO Pay Ratio Disclosure Requirement (continued)

given the 60-day public comment period, it is unlikely that the rules will be adopted until sometime in mid to late 2014.

### Disclosure Not Required for Most Companies Until 2016

We do not expect the proposed rules to be adopted and become effective until sometime in 2014, at the earliest. Further, the proposed rules contemplate a transition period that would allow companies to omit the CEO pay ratio disclosure from their SEC filings during the first year the rules are in effect. Thus, companies with calendar year fiscal year-ends will first provide the disclosure during the 2016 proxy season with respect to 2015 compensation information. Companies with mid-year fiscal year-ends (such as June 30th or September 30th) will be required to disclose the information in their proxy statements filed in late 2015 or early 2016 with respect to their 2014 or 2015 fiscal year, as applicable.

### SEC Soliciting Public Comments

The SEC is soliciting comments from the public on the proposed rules for 60 days from their publication in the Federal Register. We expect this publication will take place shortly. Accordingly, comments will be due sometime in mid to late November.

### Need Assistance?

Compensia has extensive experience in helping companies understand how the corporate governance and executive compensation-related disclosure provisions of the Dodd-Frank Act will affect the design, operation, and disclosure of their executive compensation program. If you would like assistance in analyzing how the proposed rules are likely to impact your executive compensation disclosure, or if you have any questions on the subjects addressed in this Thoughtful Pay Alert, please feel free to contact Mark A. Borges.

### About Compensia

Compensia, Inc. is a management consulting firm that provides executive compensation advisory services to Compensation Committees and senior management. ■

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