

## SEC Proposes Amendments to Item 402 of Regulation S-K Requiring Disclosure of Ratio of CEO Pay to Median Employee Pay

On September 18, 2013 (by a 3-2 vote), the SEC proposed amendments to Item 402 of Regulation S-K to implement Section 953(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Section 953(b) directs the SEC to amend Item 402 of Regulation S-K to require disclosure of the median of the annual total compensation of all employees of an issuer (excluding the chief executive officer or any equivalent position), the annual total compensation of that issuer's chief executive officer (or any equivalent position) and the ratio of the former to the latter (such disclosure is referred to as "Pay Ratio Disclosure").<sup>1</sup> Section 953(b) also requires that total compensation be determined in accordance with S-K Item 402(c)(2)(x) as in effect at the time Dodd-Frank was enacted.<sup>2</sup>

The proposal would require Pay Ratio Disclosure<sup>3</sup> in any annual report, proxy or information statement or registration statement that requires executive compensation disclosure pursuant to Item 402 of Regulation S-K. This disclosure requirement would apply to registrants subject to S-K Item 402 other than emerging growth companies, smaller reporting companies, foreign private issuers that file annual reports on Form 20-F, and Canadian issuers utilizing the multi-jurisdictional disclosure system.

The "employees" whose compensation would be covered by the proposal include all full-time, part-time, seasonal or temporary workers, whether based in the US or anywhere else in the world, employed by the registrant or any of its subsidiaries (including officers other than the PEO) on the last day of the registrant's last-completed fiscal year. In contrast, non-employees such as independent contractors, or "leased" workers or other temporary workers who are employed by a third party, would not be covered. "Total annual compensation" would, as noted above, be determined in accordance with S-K Item 402(c)(2)(x) and can only be annualized for permanent employees who were employed for less than the full fiscal year (i.e., the annual total compensation of a retail sales employee hired for only the period from Thanksgiving through and including New Year's Eve is his or her compensation for that period). A registrant may not, however, annualize the compensation of some permanent employees and not others.

The proposal recognizes that a requirement to calculate the compensation of every employee in accordance with S-K Item 402(c)(2)(x) – which was designed for application to a small group of senior executives – to determine median compensation could be very burdensome, particularly for large multi-

<sup>1</sup> In the proposal, to maintain consistency with the terminology used in S-K Item 402, the term "principal executive officer," or "PEO," is used instead of the term "chief executive officer or any equivalent position."

<sup>2</sup> There have been no material changes since that date.

<sup>3</sup> Which will be deemed "filed" and not "furnished."

national issuers, and accordingly permits some flexibility in approach. Registrants may determine median total annual compensation by calculating the annual total compensation for each employee or each employee in a statistical sample using S-K Item 402(c)(2)(x). Alternatively, registrants may identify a median employee based on any consistently applied compensation measure, and then calculate the annual total compensation for that median employee in accordance with S-K Item 402(c)(2)(x). As an example, the proposal specifies that an employer with a large number of employees could take a random sample of employees (the size of the sample would typically depend on the overall distribution of compensation across employees), and determine the median employee on the basis of annual cash compensation, compensation reported for tax purposes or any other consistently applied compensation measure. Once the registrant identifies the median employee on this basis, the registrant would calculate that employee's annual total compensation for the last complete fiscal year in accordance with S-K Item 402(c)(2)(x) and disclose that amount as part of the Pay Ratio Disclosure. In addition, registrants would be permitted to use reasonable estimates in determining any elements of total compensation of employees other than the PEO under S-K Item 402(c)(2)(x), including when disclosing the annual total compensation of the median employee identified using a consistently applied compensation measure.

The proposal would require that the methodology and any material assumptions, adjustments or estimates used to identify the median be briefly disclosed and consistently used, and any estimated amounts be clearly identified as such.

Pay Ratio Disclosure would be required with respect to the registrant's first fiscal year beginning on or after the effective date of the rule, commencing with the filing of its annual report on Form 10-K for that fiscal year or, if later, the filing of a proxy or information statement for its next annual meeting of shareholders (or written consents in lieu of a meeting) following the end of such year. Accordingly, if the rule is adopted in 2014, registrants reporting on a calendar year basis would first need to include Pay Ratio Disclosure in reports filed during 2016 (with respect to 2015).

The SEC received extensive comments before proposing these rules, which are subject to further comment for a 60-day period, and the SEC has requested comment on virtually every aspect of the proposal, including the costs of compliance.

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