



## SEC Proposes Pay Ratio Disclosure Rule

On September 18, 2013, the SEC [proposed a rule](#) to implement the CEO pay ratio disclosure mandated by section 953(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The SEC's press release also contained a [fact sheet](#) summarizing this proposal. The proposed rule would require that an issuer disclose:

- the median of the annual total compensation of all of its employees except the CEO,
- the annual total compensation of its CEO, and
- the ratio of those two amounts.

*Compliance Date.* As proposed, this rule would not be in effect for the 2014 proxy season, as effectiveness would begin with disclosures regarding compensation for the first fiscal year beginning after the effective date of the final rules. Thus, the earliest this rule would take effect is the 2015 proxy season (reporting 2014 compensation), with the most likely scenario being effectiveness in the 2016 proxy season (reporting 2015 compensation).

*Disclosure Tied to Executive Compensation Disclosure.* An issuer would be required to include this pay ratio disclosure, proposed as new Regulation S-K Item 402(u), in any registration statement, information statement, or annual report in which it discloses other executive compensation information under Item 402.

*Exemptions.* Smaller reporting companies, emerging growth companies, and foreign private issuers would be exempt from this disclosure requirement.

*Mechanics of Making the Determinations.* As described below, the proposed rule offers issuers some flexibility in making these determinations including, in some instances, using statistical sampling and reasonable estimations.

*Step 1 – Identifying “All Employees.”* The proposed rule defines “all employees” to include all employees (including full-time, part-time, temporary, seasonal and non-U.S. employees) who are employed by the issuer or any of its subsidiaries as of the last day of the issuer's fiscal year. An issuer would be permitted, but not required, to annualize the compensation of a permanent employee who did not work for the entire year (for example, in the case of an employee who was hired in the middle of the fiscal year). However, no other compensation-related adjustments would be permitted (e.g., for part-time or seasonal status or cost-of-living adjustments for non-U.S. employees).

*Step 2 – Determining the Median Employee.* The proposed rule does not specify how an issuer must identify its median employee; rather, an issuer would be permitted to select an identification methodology appropriate to its size, business structure, and compensation structure. Such methodologies could include statistical sampling or use of reasonable estimates. In addition, an issuer would be permitted to use a consistently applied compensation measure, such as compensation amounts reported in the issuer’s payroll or tax records. An issuer is not required to follow the executive compensation rules of Item 402 to identify its median employee in this step.

*Step 3 – Calculating “Annual Total Compensation” for CEO and Median Employee.* Once the issuer has identified its median employee, the issuer would need to calculate that employee’s “total compensation” as defined under Item 402(c)(2)(x). However, the proposed rule would permit the issuer to use reasonable estimates when making these determinations for the median employee (although not for the CEO). In addition, an issuer would be permitted to include other types of compensation that are typically not disclosed under Item 402(c)(2)(x), such as health insurance premiums, but, for purposes of this ratio, the issuer would need to include (and disclose the existence of) those additional items for both the median employee and the CEO to ensure a fair comparison.

*Step 4 – Determine and Disclose the Ratio.* Although the statutory language requires the ratio to be expressed by dividing the CEO’s compensation by the median employee’s compensation (which, as written, would yield a number less than 1), the proposed rule allows the pay ratio to be expressed in the more typical fashion, such as “CEO to median employee pay equals XX to 1.”

*Additional Disclosure Requirements – Methodology and Any Assumptions or Estimates Used.* An issuer would be required to disclose the methodology used to identify the median and clearly identify any material assumptions, adjustments, or estimates used in identifying the median or determining total compensation. The issuer would be permitted, but not required, to supplement the required disclosure with a narrative discussion or additional ratios.

*Sixty-Day Comment Period.* Once the proposed rule is published in the Federal Register, the 60-day comment period will begin to run. The proposed rule contains 60 requests for comment on specific issues raised by the proposal. Given the significant number of open questions raised by the SEC, and the potential cost and complexity of compliance, issuers should consider submitting comments, either directly or through an industry group.

— [Kelly C. Simoneaux](#) and [Hope M. Spencer](#)

Remember that these legal principles may change and vary widely in their application to specific factual circumstances. You should consult with counsel about your individual circumstances. For further information regarding these issues, please contact your Jones Walker relationship attorney or:

**Kelly C. Simoneaux**  
*Partner, Jones Walker LLP*  
201 St. Charles Ave.  
New Orleans, LA 70170-5100  
504.582.8326 tel  
[ksimoneaux@joneswalker.com](mailto:ksimoneaux@joneswalker.com)  
[www.joneswalker.com](http://www.joneswalker.com)

**Hope M. Spencer**  
*Associate, Jones Walker LLP*  
201 St. Charles Ave.  
New Orleans, LA 70170-5100  
504.582.8130 tel  
[hspencer@joneswalker.com](mailto:hspencer@joneswalker.com)  
[www.joneswalker.com](http://www.joneswalker.com)

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