

On September 18, 2013, the Securities and Exchange Commission (SEC) voted 3-2 to propose amendments to the executive compensation disclosure rules to implement the controversial “pay ratio” disclosure requirements of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The proposed rules would require US public companies to disclose (i) the median of the annual total compensation of all employees (except the chief executive officer), (ii) the annual total compensation of the chief executive officer and (iii) the ratio of the median of the annual total compensation of all employees to the annual total compensation of the chief executive officer. Approximately 23,000 comment letters were submitted to the SEC in advance of the rule proposals, and numerous additional requests for comment are made throughout the [release](#). A few highlights of the proposed rules and release are provided below.

Flexibility in Finding the Median Employee

The proposed rules do not require companies to use a particular method to determine the median-compensated employee, but rather provide flexibility to select the method that works best in light of a company’s particular facts and circumstances. Companies could use their entire employee population or a statistical sampling or other reasonable method to determine the employees from which to identify the median. Companies also would be permitted to use reasonable estimates and could look to annual total compensation or any other compensation measure that is consistently applied to identify the median. Once the median-compensated employee is identified, that person’s annual total compensation would be computed in generally the same manner as computed for the company’s named executive officers under existing rules, though reasonable estimates could be used for that employee. Companies would be required to disclose and consistently apply the methodology used to identify the median, to identify any estimated amounts, and to disclose material assumptions, adjustments or estimates involved in identifying the median-compensated employee or determining total compensation or any compensation elements. The flexible approach may help companies manage compliance costs, as they could identify the median employee using compensation data they already collect or using data that could be less costly to collect than if they were required to calculate total compensation for every employee in accordance with the existing rules.

Complexities of Statistical Sampling

The proposed flexibility raises its own complexities, both for companies that may not regularly use statistical analysis in managing their businesses and for those with more complicated payroll systems and organizational structures. The release includes detailed discussion of statistical sampling and certain factors that may need to be considered in determining an appropriate sampling method. For example, it notes that factors such as variation in compensation distributions around the mean or across business

units or geographical regions can materially affect the sample size needed for a reasonable statistical sample or add complexity to the procedure. The SEC estimates that approximately 50% of affected companies have compensation distributions that would support using simple random sampling models, but that statistical sampling could involve additional steps or more complicated assumptions for the other 50%. Depending on the nature of a particular company’s organizational structure and scope of business, determining the sampling methodology could require significant analysis and, potentially, significant costs.

All Employees at Year End Count

The proposed rules would consider all employees of a subject company and its subsidiaries as of the last day of the most recently completed fiscal year, including US and non-US employees, including any full-time, part-time, seasonal or temporary workers employed on that day. Independent contractors or workers “leased” from third parties would not count. The inclusion of non-US employees in calculating the median may increase compliance costs due to data privacy and other issues for multinational companies, and may reduce the comparability of disclosures provided by global companies versus those of companies without off-shore employees. In addition, the inclusion of seasonal employees could create further complexity for companies with significant seasonal workforces.

“Filed” Not “Furnished”

Although commenters sought “furnished” status for the pay ratio disclosures, the proposed pay ratio disclosures would be considered “filed” for purposes of the federal securities laws. As a result, the new disclosures would subject affected companies to additional securities law liability risk for those disclosures.

Final Rules; Transition Period; Companies Not Subject to the Rules

The proposed rules are subject to a 60-day comment period. The final rules could differ from the proposals, and companies will not be required to provide pay ratio disclosures until final rules are adopted by the SEC and any transition periods have run. The SEC has proposed to require that companies begin to comply with the new rules with respect to compensation for the first fiscal year commencing on or after the effective date of final rules, acknowledging that it expects it will take companies a full reporting cycle to implement and test any necessary systems to compile and verify the disclosure. The release notes, in particular, that if final rules were to become effective in 2014, the first pay ratio disclosures for a company with a December 31 fiscal year end would relate to 2015 compensation and would be provided in the company’s proxy statement for its 2016 annual meeting or in its 2015 annual report. The proposed pay ratio disclosure requirements would not apply to

emerging growth companies, smaller reporting companies or foreign private issuers. The rules would provide a transition period for newly public companies.

For additional information about the proposed rules, please contact your principal Squire Sanders lawyer or any of the lawyers listed in this publication.

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