September 18, 2013

SEC Proposes Pay Ratio Rules

Pursuant to Section 953(b) of the Dodd-Frank Act, the SEC today proposed the long-awaited pay ratio rules, which the Commission approved by a three to two vote. The rules would require an issuer to disclose annually (1) the median of the annual total compensation of all employees (MATC), excluding the CEO, (2) the annual total compensation of the CEO, and (3) the ratio of the MATC to the CEO's annual total compensation. The two commissioners who voted against the proposal voiced strong, thoughtful opposition to the rules based on their anti-competitive impact, the cost of compliance and the absence of any identifiable benefits to investors. Below is a brief summary of the proposed rules.

Covered Filings: Issuers would have to include the pay ratio disclosure in annual reports on Form 10-K, registration statements, and proxy statements, whenever these forms would require other executive compensation disclosures under Item 402 of Regulation S-K.

Compliance Date: 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 final rules are adopted in 2013, an issuer with a calendar year fiscal year would be required to include the disclosure in its Form 10-K or proxy statement filed in 2015.

Determining the Employees from which the Median is Identified: In determining the employees from which the median is identified, (1) the rules would allow an issuer to use its entire employee population, a statistical sampling of employees, or any other reasonable method, and (2) "employees" would include all worldwide full-time, part-time, temporary and seasonal workers employed by the issuer and its subsidiaries as of the issuer's fiscal year end.

Determination of the Median: Under the rules, issuers could identify the median employee using annual total compensation or any other compensation measure that is consistently applied to all employees included in the calculation, such as amounts derived from the issuer's payroll or tax records.

Determination of Total Compensation: Total compensation would be determined in accordance with Item 402(c)(2)(x) of Regulation S-K, which prescribes the calculation of total compensation for a named executive officer for purposes of the summary compensation table. An issuer could use reasonable estimates to calculate annual total compensation or any elements of total compensation for employees other than the CEO.

Explanatory Statements: The rules would require an issuer to briefly describe its methodology for making all determinations, including material assumptions, adjustments, estimates, and any changes in methodology from one year to the next.

Excluded Issuers: Emerging growth companies, smaller reporting companies and foreign private issuers would not be subject to the rules.

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SEC Commissioner Daniel M. Gallagher best characterized the proposed rules in his dissenting statement: "The pay ratio computation that the proposed rules would require is sure to cost a lot and teach very little. Its only conceivable purpose is to name and, presumably in the view of its proponents, shame U.S. issuers and their executives….There are no – count them, zero – benefits that our staff have been able to discern." The proposal includes more than 60 specific requests for comments. Comments are due 60 days after publication in the federal register (approximately November 18, 2013). We encourage issuers and investors to provide feedback to the SEC.

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