



Securities Law ADVISORY ■

SEPTEMBER 20, 2013

Securities and Exchange Commission Proposes New Rule for CEO Pay Ratio Disclosure

On September 18, 2013, the Securities and Exchange Commission (“Commission”) held an open meeting at which it proposed a new rule on chief executive officer (CEO) pay ratios as mandated by Section 953(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“Dodd-Frank”).¹ Consistent with Dodd-Frank, the proposed rule would require a covered issuer to disclose annually the ratio of (1) the median of the annual total compensation of all employees, excluding the CEO, to (2) the annual total compensation of the CEO.

The proposal provides flexibility as to how companies may determine the median employee, but retains the statutory requirement that annual “total compensation” for the pay ratio disclosure be calculated as provided in the proxy rules as in effect July 20, 2010. The proposed rules also follow the statutory prescription that compensation of all employees must be considered. Specifically, all employees enterprise-wide, including international, part-time, temporary and seasonal employees, as of the end of the most recent fiscal year, would be included to determine the ratio.

At the open meeting, the Commission staff emphasized that the proposed rule is intended to reduce the burden of complying with the disclosure requirement by providing companies with significant flexibility in calculating the pay ratio, while ensuring that the Dodd-Frank mandates are satisfied. The proposal was approved by the Commission by a vote of three to two over the strong objection of two Commissioners.²

The proposing release acknowledges that neither the statute nor the related legislative history states the objectives or intended benefits of the pay ratio disclosure. Proponents of the disclosure say the ratio will allow investors to determine whether a company’s pay practices are fair and put downward pressure on rapidly

¹ This advisory is based on the comments made at the September 18, 2013, open meeting; the Commission press release (available at: <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539817895>); and the proposed rule (available at: <http://www.sec.gov/rules/proposed.shtml>).

² Chairman White and Commissioners Aguilar and Stein voted for the proposal, while Commissioners Gallagher and Pivowar voted against the proposal.

increasing CEO pay.³ However, critics have asserted that the sole objective of the provision is to publicly shame companies and their CEOs⁴ and that the expense and effort required to gather the requisite data and to calculate the pay ratio will far outweigh any possible benefit to investors.⁵ The Commission received more than 22,000 comment letters on the pay ratio disclosure before the vote on the proposed rule.

Companies subject to the proposed rule.

Under the proposed rule, only those companies required to include summary compensation table disclosures in their public filings pursuant to Item 402(c) of Regulation S-K must disclose their pay ratios. As a result, a number of companies are exempt from the proposed rule, including:

- emerging growth companies (as provided by the JOBS Act);
- smaller reporting companies;
- foreign private issuers that file on Form 20-F; and
- Multijurisdictional Disclosure System (MJDS) filers that file on Form 40-F.

Employees included in identification of median compensation.

Under the proposed rule, all employees of the registrant must be included in the process of identifying median compensation. For the purpose of the calculation, any individual employed on the last day of the registrant's last fiscal year counts as an employee. This:

- includes part-time, temporary and seasonal employees;
- includes employees outside the United States, without adjustments based on differences in cost-of-living; and
- covers employees on an enterprise-wide basis, including employees of the registrant's world-wide subsidiaries.

Registrants may, but would not be not required to, annualize the total compensation for permanent employees who did not work for the entire year. However, registrants may not annualize the total compensation for temporary or seasonal workers.

Methodology for identifying the "median" employee for purposes of the disclosure.

No specific methodology is prescribed in the proposed rule for calculating annual total compensation for purposes of identifying the median employee. The Commission proposed a flexible approach, permitting companies to select a methodology that is appropriate to the size and structure of their own businesses and the way they compensate employees, so long as the methodology is disclosed.

³ See "CEO-to-Worker Pay Ratio Disclosure Proposed by SEC," *Bloomberg Law* (Sep. 18, 2013), available at <http://www.bloomberg.com/news/2013-09-17/ceo-to-worker-pay-ratio-disclosure-proposal-to-be-issued-by-sec.html>.

⁴ See comments of Commissioners Pivowar and Gallagher at open meeting, Sep. 18, 2013.

⁵ See comment letter from 23 organizations, including the American Benefits Council, Center on Executive Compensation, National Association of Manufacturers and the U.S. Chamber of Commerce (Jan. 19, 2012).

For example, a company with a small number of employees may choose to calculate the median by using the compensation data of its full employee population, while a company with a large number of employees may choose to base its calculation on a statistical sampling of its employees. Either way, for the purpose of identifying the median employee, companies may use “total compensation” as defined in the proxy rules or any other compensation measure that is consistently applied to all employees included in the calculation, such as amounts derived from payroll or tax records. This flexibility in determining the median employee is intended to reduce the overall effort and cost of compliance.

Once the median employee is identified, his or her annual total compensation for purposes of the pay ratio disclosure must be calculated using the definition of “total compensation” in Item 402(c)(2)(x) of Regulation S-K, which includes:

- salary;
- bonus;
- incentive awards;
- year-over-year changes in pension value; and
- all other compensation.

The proposal allows companies to use reasonable estimates when calculating the annual total compensation and any element of total compensation of the median employee, provided that the estimation methods and any material assumptions or adjustments are disclosed.

Disclosure timing.

Companies would be required to provide the pay ratio disclosure in any public filings that call for Item 402 disclosures—which would include registration statements, proxy and information statements, and annual reports—for the first fiscal year commencing on or after the effective date of the rule. Assuming that the final rule is effective in 2014, a calendar year registrant would be first required to include the pay ratio disclosure relating to compensation for fiscal year 2015 in its proxy or information statement for its 2016 annual meeting of shareholders.

Opportunities for public comment.

The comment period for the proposed rule is 60 days following its publication in the Federal Register (approximately mid November 2013). Comments on the proposed rules may be submitted to the Commission via online form, email or mail.⁶

⁶ Instructions on how to submit a comment are available at <http://www.sec.gov/rules/submitcomments.htm>.

ALSTON & BIRD LLP

WWW.ALSTON.COM

© ALSTON & BIRD LLP 2013

ATLANTA: One Atlantic Center ■ 1201 West Peachtree Street ■ Atlanta, Georgia, USA, 30309-3424 ■ 404.881.7000 ■ Fax: 404.881.7777
BRUSSELS: Level 20 Bastion Tower ■ Place du Champ de Mars ■ B-1050 Brussels, BE ■ +32 2 550 3700 ■ Fax: +32 2 550 3719
CHARLOTTE: Bank of America Plaza ■ 101 South Tryon Street ■ Suite 4000 ■ Charlotte, North Carolina, USA, 28280-4000 ■ 704.444.1000 ■ Fax: 704.444.1111
DALLAS: 2828 North Harwood Street ■ 18th Floor ■ Dallas, Texas, USA, 75201 ■ 214.922.3400 ■ Fax: 214.922.3899
LOS ANGELES: 333 South Hope Street ■ 16th Floor ■ Los Angeles, California, USA, 90071-3004 ■ 213.576.1000 ■ Fax: 213-576-1100
NEW YORK: 90 Park Avenue ■ 12th Floor ■ New York, New York, USA, 10016-1387 ■ 212.210.9400 ■ Fax: 212.210.9444
RESEARCH TRIANGLE: 4721 Emperor Blvd. ■ Suite 400 ■ Durham, North Carolina, USA, 27703-85802 ■ 919.862.2200 ■ Fax: 919.862.2260
SILICON VALLEY: 275 Middlefield Road ■ Suite 150 ■ Menlo Park, California, USA, 94025-4004 ■ 650-838-2000 ■ Fax: 650.838.2001
WASHINGTON, DC: The Atlantic Building ■ 950 F Street, NW ■ Washington, DC, USA, 20004-1404 ■ 202.756.3300 ■ Fax: 202.756.3333
VENTURA COUNTY: 2801 Townsgate Road ■ Suite 215 ■ Westlake Village, California, USA, 91361 ■ 805.497.9474 ■ Fax: 805.497.8804

**For more information, contact your Alston & Bird attorney
or one of the attorneys in the firm's *Securities Group*.**

For other related securities advisories, [click here](#). If you or a colleague would like to receive future *Securities Law Advisories* and *Special Alerts* electronically, please forward your contact information, including your e-mail address, to securities.advisory@alston.com. Be sure to put "subscribe" in the subject line.