

SEC Division of Corporation Finance Issues Five Additional C&DIs Relating to Pay Ratio Disclosure Rule

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On October 18, the Securities and Exchange Commission's Division of Corporation Finance (Division) issued five new Compliance and Disclosure Interpretations (C&DIs) with respect to Item 402(u) of Regulation S-K, the rule that requires a registrant to disclose the ratio of its principal executive officer's total annual compensation to the total annual compensation of their median employee (the "Pay Ratio Disclosure Rule"). The new C&DIs include the following interpretive guidance:

1. The Pay Ratio Disclosure Rule permits registrants to identify the median employee by using annual total compensation or any other consistently applied compensation measure (CACM) that is applied to all employees. C&DI 128C.01 provides that registrants may use any CACM that *reasonably reflects the annual compensation of employees*. For example, (a) total cash compensation might constitute a CACM for a registrant, but not if equity awards are widely distributed among such registrant's employees, and (b) Social Security taxes withheld would likely not be a CACM for a registrant unless all of such registrant's employees earned less than the Social Security wage base.
2. C&DI 128C.02 provides that a registrant may not exclusively use hourly or annual rates of pay as its CACM for purposes of identifying the median employee without, for example, taking into account the number of hours actually worked by hourly employees or the portion of the year actually worked by employees with an annual compensation rate.
3. C&DI 128C.03 provides that, in applying the applicable CACM, a registrant need not use (a) a period that includes the date on which the employee population is determined nor (b) a full annual period. Furthermore, C&DI 128C.03 provides that a registrant may use a prior fiscal year's annual total compensation as its CACM so long as there have not been changes in such registrant's employee population or compensation arrangements that would significantly impact pay distribution within such population.
4. C&DI 128C.04 provides that the inclusion of the compensation of furloughed employees in identifying the median employee needs to be determined by each registrant, based on the

facts and circumstances specific to that registrant. Furloughed employees are not defined or addressed specifically in the Pay Ratio Disclosure Rule, and the Division's interpretation is that a registrant must determine whether a furloughed employee belongs, as of the date the employee population is determined, in one of the four classes of employees identified in the Pay Ratio Disclosure Rule—full-time, part-time, temporary and seasonal. The registrant must then determine such furloughed employee's compensation using the applicable CACM, on the same basis as non-furloughed employees in that category (e.g., annualizing the compensation of a full- or part-time permanent employment, but not of a temporary or seasonal employee). The C&DI also reminds registrants that they may not make a full-time equivalent adjustment for any employee.

5. Under the Pay Ratio Disclosure Rule, an “[employee](#)” of the [registrant](#) does not include a worker who is employed, and whose compensation is determined, by an unaffiliated third party but who provides services to the [registrant](#) or its consolidated subsidiaries as an independent contractor or leased worker. C&DI 128C.05 makes clear that, in determining when a worker is an “employee” of the registrant under the Pay Ratio Disclosure Rule, a registrant has to take into account the composition of its workforce and its overall employment and compensation practices. A registrant should include those workers whose pay it determines, regardless of how those workers are classified for employment or tax purposes. The Division further indicates that the registrant's specification of a minimum level of compensation for workers whose service the registrant obtains by contracting with an unaffiliated third party should not make those workers employees for purposes of the Pay Ratio Disclosure Rule. Additionally, an individual independent contractor may be the “unaffiliated third party” who determines his or her own compensation.

The original text of the C&DIs is available [here](#).

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