

Pay Ratio Compliance is Around the Corner; Is Your Company Ready?

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Rule Expected to Take Effect Without SEC Delay

For two years, the pay ratio rule has loomed in the distance with uncertainty regarding its fate. On September 15, 2017, in remarks made at the ABA's Business Law Section Annual Meeting, William Hinman, Director of the Division of Corporation Finance, indicated that the Securities and Exchange Commission (SEC) had no current plans to delay implementation of the pay ratio rule. Mr. Hinman also indicated that the SEC staff may be releasing additional guidance on implementation of the rule in the near future. Given Mr. Hinman's remarks and the fact that it is unlikely Congress will act to repeal the pay ratio rule prior to the compliance deadline, companies should begin assessing their pay ratio compliance strategy now and anticipate that it could take months to prepare the disclosures.

Required Disclosures

The SEC adopted the pay ratio rule (Regulation S-K Item 402(u))^[1] in August 2015 to require new disclosures for most public companies starting in 2018 with respect to fiscal years beginning on or after January 1, 2017. The rule implements Section 953(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which requires disclosure of the median of the annual total compensation of all employees of a company (excluding the CEO), the annual total compensation of the CEO and the ratio of these amounts in any annual report, proxy or information statement or registration statement that requires executive compensation disclosure under Regulation S-K 402.^[2]

First Steps

If it has not already done so, each company should first assemble a cross-company team, including members from departments such as Human Resources, Legal, Payroll, Finance, Investor Relations, Corporate Communications and IT. Members of this team will identify the company's median employee, calculate median employee and CEO annual total compensation and prepare the pay ratio disclosures. As an initial step, companies should generally determine where, what and how personnel and compensation information is stored. Throughout the process of developing the disclosures, careful records should be kept so as to assist with future pay ratio calculations and provide support in the event that the disclosures and/or methodology behind the calculations are ever questioned.

To identify its median employee, a company subject to the pay ratio rule must assess compensation across its employee base, which includes determinations regarding its employee population and compensation measures. Additionally, issues relating to statistical sampling, treatment of foreign employees, contractors and employees working for less than a full fiscal year and appropriate cost of living adjustments may arise. Once identified, the median employee's annual total compensation (but no other personal information) must be reported, along with the CEO's annual total compensation (which should be calculated in an identical manner) and the ratio of these numbers. SEC rules also require a brief explanation of how the median employee and annual total compensation calculations were determined. The median employee need only be identified once every three years, absent changes in a company's employee population or compensation that would result in significant changes to the pay ratio disclosures. However, the annual total compensation of the median employee must be recalculated each year. If significant changes related to the median employee occur (e.g., employment termination; significant compensation changes), a company may substitute another employee who closely approximates the original median employee. Otherwise, the company must go back through the full process of identifying its median employee notwithstanding the fact that it may have conducted such analysis within the last two years.

[1] The SEC's adopting release (SEC Rel. No. 34-75610) may be found here: <https://www.sec.gov/rules/final/2015/33-9877.pdf>.

[2] For additional information, please see our previous Client Alert linked [here](#).

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