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SEC Proposes CEO Pay-Ratio Disclosure Rules

The SEC, by a 3-2 vote, proposed rules to implement the "CEO pay-ratio" disclosure requirements under the Dodd-Frank Act. The proposed rules would require certain SEC reporting companies to publicly disclose:

- median annual total compensation of all employees of the company (including all full-time, part-time, temporary, seasonal and non-U.S. employees, but excluding the CEO);
- annual total compensation of the CEO; and
- the ratio of the median annual total compensation of all employees to the annual total compensation of the CEO.

In an attempt to address the concerns raised by numerous observers regarding the compliance burdens of the CEO pay-ratio disclosure, the SEC's proposed rules would provide companies with a certain level of flexibility when complying with the rules.

Following is a brief overview of the key provisions of the proposed rules.

Use of methodologies and estimates. The proposed rules would allow, but not require, companies to employ a methodology using reasonable estimates to identify the median employee and reasonable estimates to calculate the annual total compensation or any elements of total compensation for employees other than the CEO. For example, under the proposed rules companies may base median employee compensation on a representative sample of the employee population, as opposed to the entire employee population. Companies also may use actual employee compensation data. Additionally, the proposed rules would allow a company to determine median compensation based on employees' annual total compensation or any other measure that is "consistently applied" to each employee, such as W-2 reportable wages. The compensation of the median employee used for purposes of the ratio disclosure, however, would need to be calculated in accordance with the requirements of Regulation S-K Item 402. Companies also would be required to briefly disclose and consistently apply any methodologies and estimates used.

Location of disclosure. The pay-ratio disclosure would be required in all annual reports, proxy statements, information statements and registration statements that already require executive compensation disclosure in accordance with Item 402 of Regulation S-K.

Companies excluded. Emerging growth companies, smaller reporting companies and foreign private issuers are exempt from the proposed pay-ratio disclosure requirements. Private companies that go public are exempt from the proposed rules until the first year commencing on or after the date of their initial public offering.

Compliance timeline. The SEC noted in the proposing release that it expects the new rules to apply in the first fiscal year following the date the final rules become effective. Assuming the SEC adopts the final rules in 2014, companies with a December 31st fiscal year end first would be required to disclose the pay-ratio information relating to 2015 compensation in their proxy or information statements for their 2016 shareholder meetings.

Next steps. There will be a 60-day comment period on the proposed rules. The final rules are not expected to be adopted until sometime in 2014.

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A copy of proposing release for the rules is available here. We intend to issue a more detailed memorandum on the proposed rules shortly, including our recommendations for actions companies should consider taking prior to the potential approval of the final pay-ratio rules.