

SEC and Staff Issue Welcome Guidance Introducing Flexibility and Practicality to Pay Ratio Rules

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On September 21, 2017, the U.S. Securities and Exchange Commission (SEC) issued an interpretive release on the pay ratio disclosure requirements in Item 402(u) of Regulation S-K, and the staff of the Division of Corporation Finance (staff) issued separate guidance regarding the use of statistical sampling in conducting the pay ratio analysis. The pay ratio rules require companies to provide pay ratio disclosure for their first full fiscal year beginning on or after January 1, 2017, which means many companies will be including pay ratio disclosures in annual meeting proxy statements filed in 2018.

This new guidance is a welcome development and affirms that the SEC and its staff intend to provide companies with a wide range of flexibility in complying with the pay ratio rules.

The SEC's interpretive release provides the following guidance regarding the pay ratio rules:

- The pay ratio rules provide significant flexibility to companies in identifying their median employee and calculating the median employee's total annual compensation. In order to ease concerns that this flexibility could expose companies to liability, the release provides that as long as a company uses reasonable estimates, assumptions and methodologies, the pay ratio calculation and related disclosure will not provide the basis for an SEC enforcement action, unless the company lacked a reasonable basis for the disclosure or it was not made in good faith.
- The explicit exclusion in the pay ratio rules of certain workers (*e.g.*, independent contractors and leased workers who are employed by, and whose compensation is determined by, an unaffiliated third party) does not represent the sole basis for excluding those individuals from coverage under the pay ratio rules. The release provides that in determining whether its workers are employees for purposes of the pay ratio rules, a company also may apply a widely recognized test under another area of law, such as employment or tax law, that it otherwise generally uses.
- A company may use existing internal records that reasonably reflect employees' annual compensation to identify its median employee, even if those records do not include every element of compensation, such as equity awards widely distributed to employees.
- A company may use existing internal records in determining whether it can disregard its non-U.S. employees under the "de-minimis" rule that permits companies to disregard non-U.S. employees who account for 5 percent or less of the company's total employees.

The separate guidance issued by the staff sets forth hypothetical examples to assist companies in determining how to use statistical sampling methodologies and other reasonable methods that may be appropriate for their specific circumstances. For instance, the staff identified various sampling techniques (*e.g.*, simple random sampling, stratified sampling, cluster sampling and systematic sampling) as well as potential situations under the pay ratio rules in which companies may use reasonable estimates, which may be appropriate depending on a company's particular circumstances.

The SEC's interpretive release is available [here](#), and the separate guidance from the staff can be found [here](#). A copy of the adopting release, including the final rules, are available [here](#). For additional information about the final rules, please see our previous client alerts from [October 2016](#) and [August 2015](#).

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