

CLIENT ALERT

SEC Issues New Guidance on Pay Ratio Rule

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On September 21, 2017, the Securities and Exchange Commission (the “SEC”) issued new interpretive guidance¹ to assist issuers in their compliance with the pay ratio disclosure rule (the “Pay Ratio Rule”). The Pay Ratio Rule, adopted by the SEC in 2015 to implement Section 953(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, requires the disclosure of the ratio of the annual compensation of an issuer’s median employee to the annual compensation of its chief executive officer. The release of this new guidance comes as the Pay Ratio Rule is about to go into effect for most U.S. public companies starting with the 2018 proxy season.

The Interpretive Release sets forth the SEC’s view that, because pay ratio computations involve a degree of imprecision, the use of reasonable estimates, assumptions and statistical methodologies permitted by the Pay Ratio Rule to identify the median employee and in calculating the annual compensation or any elements of annual compensation for employees and the related disclosure that results from such use will not provide the basis for an SEC enforcement action, unless the disclosure is made or reaffirmed without a reasonable basis or provided other than in good faith. The Interpretive Release also clarifies that an issuer may use appropriate existing internal records that reasonably reflect annual compensation, such as tax or payroll records, in identifying the median employee (including in determinations about whether an employee may be excluded in reliance upon the Pay Ratio Rule’s five percent *de minimis* exemption for non-U.S. employees), even if those records do not include every element of compensation (such as equity awards widely distributed to employees). Finally, the Interpretive Release confirms the SEC’s view that an issuer may use widely

¹ SEC Release, Commission Guidance on Pay Ratio Disclosure, Release No. 33-10415; 34-81673; File No. S7-07-13, September 21, 2017, available [here](#) (the “Interpretive Release”).

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recognized tests under other areas of the law (e.g., employment or tax law) to determine whether its workers are employees or independent contractors for purposes of the Pay Ratio Rule.

Separately, the SEC's Division of Corporation Finance issued its own guidance² regarding the use of statistical sampling in determining an issuer's median employee for purposes of the Pay Ratio Rule. In particular, the Corp. Fin. Guidance underscores the flexibility afforded under the Pay Ratio Rule to combine the use of reasonable estimates with the use of statistical sampling and other reasonable methodologies. The Corp. Fin. Guidance validates the use of simple random sampling, stratified sampling, cluster sampling and systematic sampling and includes examples illustrating how reasonable estimates and statistical methodologies may be used, including analyzing the composition of an issuer's workforce, evaluating the likelihood of significant changes in employee compensation from year to year and identifying the median employee. The Corp. Fin. Guidance also sets forth several examples showing the use of reasonable estimates, statistical sampling and other reasonable methodologies as applied to a hypothetical issuer with a large multinational workforce.

Finally, in connection with the publication of the Interpretive Release, the SEC updated previously issued Compliance and Disclosure Interpretations ("C&DIs") relating to the Pay Ratio Rule. A new C&DI was added (Question 128C.06), which permits an issuer to refer to the pay ratio as a reasonable estimate in its proxy disclosure. The SEC also withdrew a previously issued C&DI (Question 128C.05) relating to the identification and treatment of independent contractors and leased workers under the Pay Ratio Rule. Finally, the SEC modified C&DI Question 128C.01 to conform to the views set forth in the Interpretive Release relating to the use of existing internal records.

We will keep you apprised of any further developments regarding the Pay Ratio Rule.

If you have any questions regarding this client alert, please contact any of the following attorneys or the attorney with whom you regularly work.

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² Division of Corporation Finance Guidance on Calculation of Pay Ratio Disclosure, September 21, 2017, available [here](#) (the "Corp. Fin. Guidance").

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