

SEC Issues New Pay Ratio Guidance

September 26, 2017

On September 21, 2017, the Securities and Exchange Commission (“SEC”) issued helpful guidance to assist companies in complying with the CEO/median employee pay ratio disclosure requirement (the “Rule”) under Section 953(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act and Item 402(u) of Regulation S-K. The guidance also addresses the issue of SEC enforcement action in respect of pay ratio disclosure.

The new guidance was issued in the form of an interpretive release, SEC staff guidance and revised Compliance and Disclosure Interpretations (“C&DIs”).¹

— **Interpretive Release.** The SEC’s interpretive release clarified the following:

- A company may use certain existing internal records, such as tax or payroll records, in determining whether the 5% de minimis exclusion for non-U.S. employees is available and for purposes of identifying the median employee, even if such records do not include every element of compensation (e.g., equity awards widely distributed to employees).
- A company may apply any widely recognized test under another area of law that the company otherwise uses to determine whether its workers are “employees” (e.g., IRS guidance on independent contractors).

The SEC also stated its view that, so long as a company’s pay ratio disclosure is based on reasonable estimates, assumptions and methodologies, it would have no basis for an enforcement action unless the disclosure was made or reaffirmed without a reasonable basis or was provided other than in good faith.

If you have any questions concerning this memorandum, please reach out to your regular firm contacts in the [Executive Compensation and ERISA](#) group.

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¹ The interpretive release is available at <https://www.sec.gov/rules/interp/2017/33-10415.pdf>, the SEC staff guidance is available at <https://www.sec.gov/corpfin/announcement/guidance-calculation-pay-ratio-disclosure> and the revised C&DIs are available at <https://www.sec.gov/divisions/corpfin/guidance/regs-kinterp.htm#128c.01>.



- **Staff Guidance.** The SEC staff guidance makes clear that in complying with the Rule companies may combine the use of reasonable estimates with statistical sampling or other reasonable methodologies in order to tailor their approach to their particular facts and circumstances. The guidance includes several hypothetical examples, in question and answer format, of how statistical sampling, reasonable estimates and other reasonable methods may be used in determining the median employee, including the use of different methodologies for different employee populations within the company.
- **Revised C&DIs.** One pay ratio C&DI was updated to include a reference to the new interpretive release and a new C&DI was added clarifying that the SEC would not object if a company stated that the pay ratio was a “reasonable estimate”. Perhaps the most welcomed development was the withdrawal of an existing C&DI which would have broadened the definition of “employee” to encompass individuals not considered employees for tax or employment law purposes. Based on the withdrawal and the guidance provided under the interpretative release, companies are not required to develop a newly defined employee population solely for purposes of compliance with the Rule.

The Rule remains in effect and requires most companies to provide pay ratio disclosure for the first fiscal year beginning on or after January 1, 2017, with the result that most companies will begin making disclosures in early 2018. While companies should continue to prepare for compliance with the Rule, companies should take some comfort in the flexibility the new guidance provides.

If you have any questions or would like to discuss this further, please do not hesitate to contact your regular contacts in the [Executive Compensation and ERISA](#) group.

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