Skadden

SEC Reporting & Compliance Alert

Four Times Square
New York, NY 10036
212.735.3000

SEC Staff Issues Interpretive Guidance on Pay Ratio Rules

On October 18, 2016, the staff of the Division of Corporation Finance (Staff) of the U.S. Securities and Exchange Commission (SEC) issued interpretive guidance on the pay ratio disclosure requirements in Item 402(u) of Regulation S-K. The SEC adopted the pay ratio disclosure requirements in August 2015, and the disclosures, if required, will need to be made in 2018. This new guidance is available here, as part of the Staff's "Compliance and Disclosure Interpretations" (Questions 128C.01 to 128C.05).

The Staff's guidance discusses the following points regarding the pay ratio rules:

- In order to identify the median employee, the rules allow a company to use a "consistently applied compensation measure" (CACM), instead of annual total compensation. The Staff's guidance notes that any measure of compensation that reasonably reflects the annual compensation of employees could serve as a CACM, depending on the company's facts and circumstances.
- The Staff's guidance notes that a company may not exclusively use hourly or annual rates of pay as its CACM.
- The rules require that a company identify its median employee from its employee population as of a date within the last three months of its fiscal year. However, to identify the median employee, a company is not required to use a full annual period or a period that includes the date on which the employee population is determined. A CACM may also consist of annual total compensation from the company's prior fiscal year, provided that there is no change in the company's employee population or compensation arrangements that would result in a significant change of its pay distribution to its workforce.
- Because the rules do not address furloughed workers, the Staff's guidance notes that companies would need to analyze the facts and circumstances to determine whether such workers should be included as employees and, if so, whether they should be included as full-time, part-time, temporary or seasonal employees.
- The rules permit the exclusion of independent contractors or leased workers, only if an unaffiliated third party determines their compensation. Although the Staff's guidance notes that a company should include workers whose compensation it determines, regardless of their "employee" status under other laws, an independent contractor who determines his or her own compensation may be considered an unaffiliated third party and therefore not considered an employee for purposes of the pay ratio rules.

This new guidance should be helpful in designing the methodologies that companies use to calculate their pay ratio. Although the pay ratio rules will not impact the 2017 reporting season for companies that will be required to make disclosures, we recommend that companies begin preparing for their implementation now. With 2017 compensation as the basis for the new disclosures required in registration statements, annual reports and proxy statements in 2018, companies are advised to begin developing a plan to comply with the pay ratio disclosure requirements.

* * *

A copy of the adopting release, including the final rules, is available here. For additional information about the final rules, please see our previous client alert here.

Contacts

Brian V. Breheny
Washington, D.C.
202.371.7180
brian.breheny@skadden.com

Neil M. Leff
New York
212.735.3269
neil.leff@skadden.com

Regina Olshan
New York
212.735.3963
regina.olshan@skadden.com

Erica Schohn
New York
212.735.2823
erica.schohn@skadden.com

Joseph M. Yaffe
Palo Alto
650.470.4650
joseph.yaffe@skadden.com

Andrew J. Brady
Washington, D.C.
202.371.7513
andrew.brady@skadden.com

Hagen J. Ganem
Washington, D.C.
202.371.7503
hagen.ganem@skadden.com

Josh LaGrange
Palo Alto
650.470.4575
josh.lagrange@skadden.com

Caroline S. Kim
Washington, D.C.
202.371.7555
caroline.kim@skadden.com

Audrey J. Murga
Wilmington
302.651.3117
audrey.murga@skadden.com

Emily M. Prezioso
Washington, D.C.
202.371.7709
emily.prezioso@skadden.com