



An International
Joint Venture
Law Firm

ZAG-S&W CORPORATE CLIENT ADVISORY

New SEC Rule to Require Disclosure of Ratio of CEO Compensation to Median Worker Compensation

The SEC has adopted a final rule under the Dodd-Frank Act requiring that public companies present the ratio of their chief executive officer's total annual compensation to their median worker's compensation. This rule comes nearly two years after being proposed, in a divided vote on an issue that has also divided public opinion.

COMPANIES SUBJECT TO, AND EXCLUDED FROM, THE PAY RATIO REQUIREMENT

The pay ratio disclosure requirement applies to all companies required to provide executive compensation disclosure under Item 402(c)(2)(x) of Regulation S-K. Smaller reporting companies, emerging growth companies, foreign private issuers, MJDS filers, and registered investment companies are not subject to this requirement.

WHERE AND WHEN DISCLOSURE WILL BE REQUIRED

The pay ratio must be included in any annual report, proxy or information statement, or registration statement that requires executive compensation disclosure pursuant to Item 402 of Regulation S-K.

Companies subject to the pay ratio disclosure requirement must comply for the first fiscal year beginning on or after January 1, 2017. A company that was not previously a reporting company is required to report the pay ratio disclosure for the first fiscal year (starting on or after January 1, 2017) following the year in which it becomes subject to SEC reporting requirements.

CALCULATION OF PAY RATIO

Companies must disclose the median of the annual total compensation to its employees (excluding the CEO), the annual total compensation of its CEO, and the ratio of those two amounts.

IF YOU WOULD LIKE ADDITIONAL INFORMATION, PLEASE CONTACT:

Howard E. Berkenblit
617 338 2979
hberkenblit@zag-sw.com

Natalie S. Lederman
212 660 3039
nlederman@zag-sw.com

BOSTON

ZAG-S&W
One Post Office Square
Boston, MA 02109

NEW YORK

ZAG-S&W
1633 Broadway
New York, NY 10019

WASHINGTON, DC

ZAG-S&W
1666 K Street, NW
Washington, DC 20006

ISRAEL

Zysman, Aharoni, Gayer and Sullivan &
Worcester LLP
41-45 Rothschild Blvd., Beit Zion
Tel Aviv, 65784 Israel

The SEC purports to address concerns about the costs of compliance by providing companies flexibility in meeting the rule's requirements, particularly with respect to identifying the median employee and the employee population, and in determining total compensation, as follows:

The Median Employee

- To identify the median employee, a company can apply a methodology suited to its own facts and circumstances, such as using its total employee population, or a statistical sampling of its population, which could mitigate the compliance costs associated with this rule. A company can also identify the median of its population or sample using annual total compensation as determined under existing executive compensation rules, or another consistently-applied compensation measure from compensation amounts reported in its tax and/or payroll records.
- Depending on the principal residence of its CEO, if there exists a disparity in the cost of living between the jurisdiction of residence of its CEO and the locations of its other employees, a company can apply cost-of-living adjustments in identifying the median employee. But even if such an adjustment is applied, the company must still disclose the median employee's annual total compensation and pay ratio before any cost-of-living adjustments.
- A company can use the median employee whose compensation will be used for the total annual compensation calculation for up to three fiscal years, unless there has been a change in its employee population or compensation arrangements that would result in a significant change to the company's pay ratio disclosure. If, within those three years, the median employee's compensation changes, the company can use another employee with substantially similar compensation to its previously-identified median employee.

Employee Population

A company can select a date within the last three months of its last completed fiscal year on which to determine the employee population for purposes of identifying the median employee.

All employees of the company and its consolidated subsidiaries must be included in the calculation, including domestic and international, full- and part-time, temporary and seasonal, employed by the company or its consolidated subsidiaries, without adjusting for factors such as full-time equivalent status.

However, the following non-U.S. employees can be excluded from the calculation:

- All non-U.S. employees working in a jurisdiction in which collection and transmission of compensation and personal data would violate applicable foreign data privacy and security laws (in such an instance, the company must file a legal opinion from counsel on the company's inability to obtain or process the information necessary for compliance); and
- Less than 5% of the Company's non-U.S. workforce, including those excluded under the aforementioned data privacy exemption, as a *de minimis* exemption.

A company otherwise subject to this reporting requirement can omit from its calculation any employees added as a result of a business combination or acquisition for the fiscal year in which the transaction is effective; in such cases, the company is required to identify the acquired business and disclose the estimated number of employees it is omitting from the calculation.

Total Compensation

A company must calculate the annual total compensation for its median employee using the same rules that apply to the CEO's compensation; "annual total compensation" means total compensation for the last completed fiscal year, applying the definition of "total compensation" in Item 402(c)(2)(x) of Regulation S-K.

RATIONALIZATION FOR, AND CONCERNS WITH RESPECT TO, THE RULE'S ADOPTION

The SEC claims that it has adopted this rule to provide shareholders with an additional metric to consider in voting on executive compensation matters, including say-on-pay votes. The ratio is also intended to serve as an indicator of long-term growth and effectiveness of corporate governance.

The new rule gives companies more flexibility than what was originally proposed in respect of calculating their median employee's pay, as an effort to ease the burden of this reporting requirement. Even so, the pay ratio disclosure requires significant effort to be expended to ensure compliance; as a result, it is unclear whether shareholders will embrace companies' reliance on the flexibility, or how much significance this ratio will ultimately bear to shareholders. On the other hand, rumors are abounding as to whether litigation or legislation will be pursued to challenge this new rule.

* * *

FOR MORE INFORMATION

To obtain further information about the pay ratio, its calculation, and its impact on reporting requirements, please consult the lawyer at ZAG-S&W with whom you regularly consult, or either of the lawyers listed above.