

# SEC ISSUES SOME GUIDANCE ON PAY RATIO DISCLOSURE

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**Practices & Industries**

Employee Benefits

Provisions of the Dodd Frank Act require most public companies to disclose the amount of and the ratio between the annual total compensation of the chief executive officer and the median compensation of all employees other than the chief executive officer. The disclosure is required for the first fiscal year beginning on or after January 1, 2017. Companies with a calendar fiscal year will need to provide the pay ratio with the 2018 proxy statement based on 2017 compensation information. The disclosure requirement does not apply to emerging growth companies, smaller reporting companies, foreign private issuers, and registered investment companies.

As companies have begun to prepare for this disclosure, there have been some recurring issues that arise under several areas of the regulations. The Securities and Exchange Commission has issued guidance which provide guidance to some common questions.

A common question addressed by the guidance is whether a worker who is an independent contractor or leased employee must be included in determining the median compensation of all employees. The guidance states that in determining whether a worker is an employee for this purpose does not depend on tax or employment law purposes but is based on the company's overall employment and compensation practices. If the company determines the compensation of that worker, the worker should be treated as an employee. A company will not be determining the compensation if it only determines the minimum compensation level for the worker hired through a third party or as an independent contractor. While this guidance is helpful, it does not provide a decisive answer in many situations.

The pay ratio regulation also provides that a company may use compensation measures that consistently and reasonably reflect the annual compensation of employees. The guidance indicates that this is a facts and circumstances determination. The guidance provides some examples where a compensation measure does not reasonably reflect the annual compensation of an employee. Under the pay ratio regulations a company may determine the annual compensation of the median employee by selecting a date within the last three months of the company's last completed fiscal year. The guidance provides further guidance in determining



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annual compensation if the determination date is other than the last day of the fiscal year.

Companies subject to this new pay ratio reporting requirement should have already begun the process of collecting data and setting up systems for making the determination. These companies should review this new guidance and determine whether changes to the systems need to be made or if the process may be simplified. (SEC Compliance & Disclosure Interpretations of Regulation S-K, Section 128C - Item 402(u) Pay Ratio Disclosure)

