

September 22, 2017

SEC Provides Additional Pay Ratio Interpretive Guidance

The Securities and Exchange Commission (SEC) yesterday issued interpretive guidance on the CEO pay ratio rule. Separately, the SEC's Division of Corporation Finance issued guidance on calculation of the pay ratio. These moves suggest that the SEC is not expected to defer the effectiveness of the rule and that it will be in place for the 2018 proxy season.

The SEC interpretive guidance makes the following points:

- The use of estimates, assumptions, adjustments and statistical sampling to calculate the pay ratio will not result in an SEC enforcement action unless the disclosure is made without a reasonable basis or not in good faith.
- Companies may use their internal records to determine the 5% of the workforce used to apply the *de minimis* exception for foreign employees. They may also use internal records for the consistently applied compensation measure used to identify the median employee, even if those records do not include every element of compensation, such as equity awards. If the annual total compensation calculated in accordance with Item 402 of Regulation S-K for the identified median employee results in anomalous characteristics, companies can choose another employee with substantially similar compensation based on the compensation measure used, rather than using a new measure.
- For determining whether independent contractors are "employees" for purposes of calculating the pay ratio disclosure, a company may use widely recognized tests under other areas of law (e.g., the IRS determination) to determine whether an individual is an independent contractor or an employee. This interpretation reverses a position the staff had taken in an earlier Compliance and Disclosure Interpretation (C&DI).

The Corporation Finance guidance provides examples of how companies can use both statistical sampling and estimates, alone or in combination, to identify the median employee and determine his or her annual total compensation. The guidance will be most helpful for large, multinational companies that of necessity must use some sort of sampling methodologies. Although at times the guidance is quite technical, the takeaway for companies should be that as long as you proceed reasonably, the SEC will not be second guessing your disclosure.

A separate new C&DI states that companies are permitted to call the pay ratio disclosure an estimate in any required disclosure.

The SEC interpretive release can be found [here](#).

The Corporation Finance guidance on calculating the pay ratio can be found [here](#).

The new C&DI (Question 128C.06) can be found [here](#).

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