



August 24, 2015

SEC Adopts CEO Pay Ratio Rule

On August 5, 2015, the U.S. Securities and Exchange Commission (SEC) adopted a final rule to amend Item 402 of Regulation S-K under the *Securities Act of 1933* to require most SEC-registered U.S. companies to disclose the ratio of the compensation of their chief executive officer (or any equivalent position) to the median compensation of their other employees. The long-awaited rule, mandated by the *Dodd-Frank Wall Street Reform and Consumer Protection Act* to highlight CEO pay, does not resolve criticisms of the proposed rule regarding the lack of conformity or comparability of pay ratios across companies. In its adopting release, the SEC states that "the final pay ratio rule should be designed to allow shareholders to better understand and assess a particular registrant's compensation practices and pay ratio disclosures rather than to facilitate a comparison of this information from one registrant to another."

Foreign private issuers, Canadian multijurisdictional disclosure system filers, smaller reporting companies and emerging growth companies are exempt from providing pay ratio disclosure. All other registrants, in addition to disclosing the annual total compensation of the chief executive officer (CEO Compensation), are required to disclose the following under the final rule:

- the median of the annual total compensation of all other employees (the Median Compensation); and
- the ratio of the CEO Compensation to the Median Compensation expressed either as a ratio in which the Median Compensation equals one or, narratively, as the multiple that the CEO Compensation bears to the Median Compensation.

Pay ratio disclosure is required in annual reports on Form 10-K, registration statements (other than registration statements on Form S-1 or Form S-11 for an initial public offering and registration statements on Form 10) and proxy and information statements. A registrant must provide pay ratio disclosure for a completed fiscal year upon the filing of an annual report on Form 10-K for that fiscal year or the filing of a definitive proxy or information statement for the next annual shareholders' meeting, whichever is later. In any event, however, the pay ratio disclosure must be provided within 120 days of the end of that fiscal year. Registrants must commence providing pay ratio disclosure for their first fiscal year beginning on or after January 1, 2017.¹

¹ A new registrant's first pay ratio disclosure must be provided for the first fiscal year beginning after the registrant (a) has been subject to the requirements of Sections 13(a) and 15(d) of the *Securities Exchange Act of 1934*, as amended (the Exchange Act) for a period of at least 12 calendar months commencing on or after January 1, 2017, and (b) has filed at least one annual report under Section 13(a) or 15(d) of the Exchange Act that does not contain the pay ratio disclosure.

How Is the Median Compensation Calculated?

The Median Compensation is calculated by identifying a registrant's "median employee." The final rule does not specify any required methodology for identifying the median employee or the compensation of its employees. Registrants may choose a method based on their own facts and circumstances, including statistical sampling. However, registrants must disclose the method they use in identifying the median employee, as well as any material assumptions, adjustments and estimates used.

A registrant may continue to use the same median employee selected for calculating the Median Compensation for up to three fiscal years, unless there has been a change in its employee population or employee compensation arrangements that it reasonably believes would result in a significant change in the pay ratio disclosure. Once a registrant selects a median employee, it must calculate the Median Compensation in the same manner that it calculates the CEO Compensation.

Which Employees Are Covered in the Calculation of the Median Compensation?

Subject to the exemptions discussed below, all employees of a registrant and its consolidated subsidiaries worldwide must be taken into account in calculating the Median Compensation, including part-time, seasonal and temporary employees. An "employee of a registrant" is defined as an individual employed by a registrant or any of its consolidated subsidiaries on any date that the registrant chooses within the last three months of its last completed fiscal year. Persons who are employed, and whose compensation is determined, by an unaffiliated third party but who provide services to the registrant or its consolidated subsidiaries as independent contractors or "leased" workers are excluded from the definition. Registrants must disclose the date chosen for determining the Median Compensation.

Can Certain Employees Be Excluded from the Calculation of the Median Compensation?

There are two exemptions from the requirement to include all employees in the calculation of the Median Compensation.

The Foreign Data Privacy Law Exemption

Employees in foreign jurisdictions in which the laws or regulations governing data privacy prohibit compiling and/or disclosing such compensation information may be excluded from the calculation of the Median Compensation. Registrants must use "reasonable efforts to obtain or process" the information required to calculate the Median Compensation, including seeking an exemption or other relief under the applicable jurisdiction's governing data privacy laws or regulations. If an employee in a particular foreign jurisdiction is excluded, all other employees in that jurisdiction must be excluded.

Registrants that rely on the data privacy exemption must do the following:

- list the excluded jurisdictions;
- identify the specific data privacy law or regulation;
- explain how complying with the final rule violates such law or regulation, including efforts made by the registrant to use or seek an exemption or other relief under such law or regulation;
- disclose the approximate number of employees excluded from each jurisdiction; and

- obtain (and file with the SEC as an exhibit to the filing in which the pay ratio is disclosed) a legal opinion on the inability to obtain or process the information required to comply with the final rule without violating that jurisdiction's laws or regulations governing data privacy, including the inability to obtain an exemption or other relief under applicable laws or regulations.

The *De Minimis* Exemption

Under this exemption, a registrant may exclude all employees outside the United States when calculating the Median Compensation, so long as the total number of excluded non-U.S. employees, including those excluded under the data privacy exemption, does not exceed 5% of the total number of employees worldwide. If an employee in a particular foreign jurisdiction is excluded, all other employees in that jurisdiction must be excluded. All non-U.S. employees that qualify to be excluded under the data privacy exemption may be excluded even if the number of excluded employees exceeds the 5% threshold; but in that case, the *de minimis* exemption is not available to exclude any additional non-U.S. employees.

Registrants that rely on the *de minimis* exemption must disclose the following:

- the jurisdictions from which employees are being excluded;
- the approximate number of employees excluded from each jurisdiction;
- the total number of employees worldwide; and
- the total number of employees used for the *de minimis* calculation.

If you have any questions regarding the foregoing, please contact [Jeff Nadler](#) (212.588.5505), [Scott Fisher](#) (212.588.5596) or [Nir Servatka](#) (212.588.5579) in our New York office; [Patricia Olasker](#) (416.863.5551) or [Jessica Bullock](#) (416.863.5503) in our Toronto office; or [Neil Kravitz](#) (514.841.6522) in our Montréal office.

The information and comments herein are for the general information of the reader and are not intended as advice or opinions to be relied upon in relation to any particular circumstance. For particular applications of the law to specific situations, the reader should seek professional advice.