

Meridian Client Update

SEC Issues Final Rule on CEO Pay Ratio

Nearly two years after issuing a proposed rule on the CEO Pay Ratio, the Securities and Exchange Commission (SEC) today approved (by a 3 to 2 vote) a final rule (“Final Rule”) that would require public companies to disclose the relationship between CEO compensation and the median employee’s compensation (“Pay Ratio”).

WHEN EFFECTIVE: The Final Rule provides that a public company’s **first reporting period** for the Pay Ratio disclosure is its first full fiscal year beginning on or after January 1, 2017. For a calendar year company, this means that the initial Pay Ratio would relate to calendar year 2017 compensation and would be disclosed in the company’s **2018 proxy**.

At today’s hearing, the SEC staff summarized the Final Rule’s key terms, which appear to be substantially similar to the Proposed Rule (see Meridian Client Update dated September 25, 2013 for a summary of the Proposed Rule). The Final Rule requires every public company (subject to certain exceptions) to disclose the ratio of CEO proxy-disclosed total compensation to the median employee’s total compensation. The determination of median employee must take into account a public company’s worldwide workforce, subject to certain narrow exceptions. However, the Final Rule permits a public company to use any reasonable method to identify the median employee, such as statistical sampling techniques.

The Final Rule differs from the Proposed Rule in a number of important respects, including the following:

- A company may determine who is the “median employee” **once every three years**, subject to certain exceptions. However, that employee’s total compensation would need to be recalculated each year. The Proposed Rule would have required an annual determination of the median employee.
- The identification of the median employee may be made as of any date that occurs within a company’s last fiscal quarter. The Proposed Rule would have required the identification of the median employee as of the last day of a company’s fiscal year.
- A company may exclude the following employees from the determination of the median employee:
 - Non-U.S. employees that are employed in a foreign jurisdiction with data privacy laws that make the company unable to comply with the Final Rule without violating those laws,
 - A company may exclude non-U.S. employees up to 5% of its worldwide workforce (subject to certain limitations).

A summary of the key terms of the Final Rule follows.

We will have more to say on this topic after the SEC has published the text of the Final Rule.

Summary of Final Rule on CEO Pay Ratio Disclosure

Provision of Proposed Rule	Requirement
Disclosures	
<ul style="list-style-type: none"> Principal Disclosures 	<ul style="list-style-type: none"> Pay Ratio The median employee's total compensation The CEO's total compensation
<ul style="list-style-type: none"> Other Required Disclosures 	<ul style="list-style-type: none"> High level disclosure of the use of any statistical assumptions, estimates and consistently applied compensation measures used to determine median employee and total compensation
<ul style="list-style-type: none"> Supplemental Disclosure Required 	<ul style="list-style-type: none"> The Final Rule imposes no requirement on companies to explain or provide context to the required disclosures However, companies are permitted, but not required, to supplement the required disclosure with a narrative discussion or additional ratios
<ul style="list-style-type: none"> Placement of Disclosure 	<ul style="list-style-type: none"> A company would have the discretion to determine the placement of the Pay Ratio and related disclosures within its proxy or annual report
Determination of Pay Ratio	
<ul style="list-style-type: none"> Pay Ratio 	<ul style="list-style-type: none"> Pay Ratio must be equal to either: <ul style="list-style-type: none"> A multiple of CEO total compensation to "median employee" pay (e.g., 200 to 1), or Median employee pay to CEO total compensation where median pay is expressed as one (e.g., 1 to 200)
<ul style="list-style-type: none"> CEO Total Compensation 	<ul style="list-style-type: none"> CEO total compensation is equal to the CEO's proxy-reported total compensation
Determination of Median Employee	
<ul style="list-style-type: none"> Frequency of Determination of the Median Employee 	<ul style="list-style-type: none"> The median employee may be determined once every three years, unless there has been a change in: <ul style="list-style-type: none"> Employee population, or Employee compensation arrangements that a company reasonably believes would result in a significant change to its Pay Ratio disclosure <ul style="list-style-type: none"> Note: However, the median employee's total compensation must be recalculated each fiscal year

Provision of Proposed Rule	Requirement
<ul style="list-style-type: none"> Employees that Must Be Considered in the Determination of Median Employee Pay (“Covered Employee”) 	<ul style="list-style-type: none"> Any employee who is a full-time, part-time, seasonal or temporary worker on company selected date that occurs at any time during the company’s fourth fiscal quarter (includes employees of subsidiary entities except for non-consolidated U.S. subsidiary) The determination as to who is a Covered Employee is made on a worldwide basis, except that the following employees may be excluded: <ul style="list-style-type: none"> Non-U.S. employees that are employed in a foreign jurisdiction with data privacy laws that make the company unable to comply with the Final Rule without violating those laws, provided that the company obtains a legal opinion on the basis for such exclusion Non-U.S. employees up to 5% of its worldwide workforce <ul style="list-style-type: none"> However, if a company excludes any non-U.S. employees in a particular jurisdiction, it must exclude all non-U.S. employees in that jurisdiction If more than 5% of a company’s employees are located in any one non-U.S. jurisdiction, the company may not exclude any employees in that jurisdiction
<ul style="list-style-type: none"> Identification of Median Employee 	<ul style="list-style-type: none"> A company is not required to calculate the proxy-equivalent total compensation for each Covered Employee to identify the Median Employee Rather, a company may identify the Median Employee using any reasonable methodology, such as statistical sampling <ul style="list-style-type: none"> A company-selected compensation measure (e.g., base salary) that is consistently applied to all Covered Employees or to a statistically derived sample of Covered Employees may be used to identify the Median Employee Reasonable estimates may be used to determine any element of compensation or annual total compensation for Covered Employees
<p>Determination of Median Employee’s Total Compensation</p>	<ul style="list-style-type: none"> After the Median Employee is identified, a company will be required to determine the Median Employee’s “total compensation” Generally, total compensation must be calculated in accordance with the proxy rules for calculating named executive officer compensation <ul style="list-style-type: none"> However, companies would have the discretion to include or exclude personal benefits of less than \$10,000 when calculating total compensation In addition, companies would have the discretion to include the value of non-discriminatory benefit plans when calculating total compensation (if such value is added to the Median Employee’s compensation it must also be added to the CEO’s total compensation)
<p>First Year Pay Ratio is Disclosed</p>	<ul style="list-style-type: none"> The initial Pay Ratio will relate to the first reporting period (i.e., fiscal year) beginning on or after January 1, 2017 For a calendar year company, this means that the initial Pay Ratio would relate to calendar year 2017 compensation and would be disclosed in the company’s 2018 proxy
<p>Status as Filed not Furnished</p>	<ul style="list-style-type: none"> The CEO pay ratio disclosure would be deemed “filed” and not “furnished.” This means that a company’s CEO and CFO would be required to “certify” the material accuracy and completeness of the pay ratio disclosure

* * * * *

The *Client Update* is prepared by Meridian Compensation Partners' Technical Team led by Donald Kalfen. Questions regarding this Client Update or executive compensation technical issues may be directed to Donald Kalfen at 847-235-3605 or dkalfen@meridiancp.com.

This report is a publication of Meridian Compensation Partners, LLC, provides general information for reference purposes only, and should not be construed as legal or accounting advice or a legal or accounting opinion on any specific fact or circumstances. The information provided herein should be reviewed with appropriate advisers concerning your own situation and issues.

www.meridiancp.com