"(A) that is listed on a national se
or by a national securities association; and
"(B) that holds an election for the
of the issuer in which more than 50 per
power is held by an individual, a group, o

(b) STUDY AND REPORT.—

(1) STUDY.—The Securities and Exchange
conduct a study and review of the use of com
ants and the effects of such use.

(2) REPORT.—Not later than 2 years afte
enactment of this Act, the Commission shal
to Congress on the results of the study and
by this subsection.

SEC. 953. EXECUTIVE COMPENSATION DISCLOSURE

(a) DISCLOSURE OF PAY VERSUS PERFORMA
of the Securities Exchange Act of 1934 (15 U.S.C
by this title, is amended by adding at the end the f

"(i) DISCLOSURE OF PAY VERSUS PERFORMAN
sion shall, by rule, require each issuer to dis
or consent solicitation material for an annual mee
holders of the issuer a clear description of
required to be disclosed by the issuer under
title 17, Code of Federal Regulations for any s
including information that shows the relationship
compensation actually paid and the financial p
issuer, taking into account any change in the va
of stock and dividends of the issuer and any

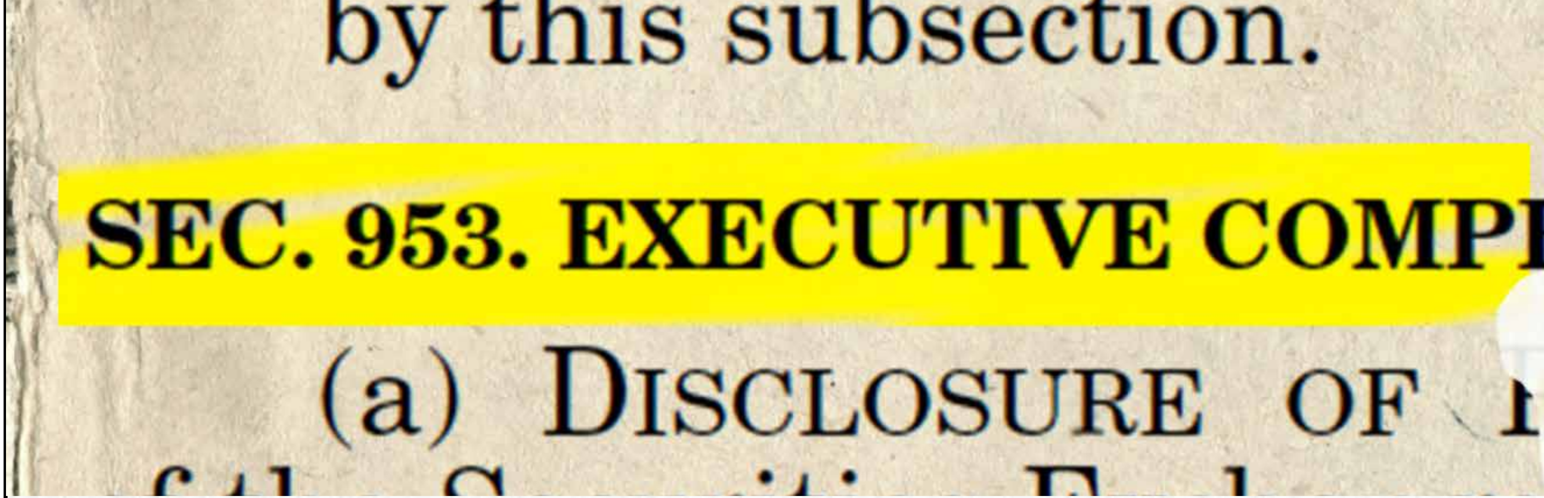
BY WILLIAM M. GEREK & ANDREW SHAPIRO

Part Two

What The Dodd-Frank Pay Ratio Means Now

In the second of this two-part series on what public US companies can expect to face as a result of recent rulemaking under the 2010 Dodd-Frank legislation (Dodd-Frank), we focus on the controversial pay ratio determination and disclosure, commonly referred to as the "CEO pay ratio" rules.

KEEP READING


by this subsection.

SEC. 953. EXECUTIVE COMP

(a) DISCLOSURE OF

Pay ratio disclosure

In August 2015 the SEC adopted final rules on the CEO pay ratio disclosure to comply with Dodd-Frank section 953(b), requiring most reporting companies to annually disclose:

(i) **the median of the annual total compensation of all of its employees (excluding its CEO),**

(ii) **the annual total compensation of its CEO, and**

(iii) **the ratio of those two amounts.**

Pay ratio disclosure will be required in registration statements, proxy and information statements, and annual reports.

Determining the employee population

To calculate pay ratio, your company must consider the total compensation of all employees (excluding the CEO), including all full-time, part-time, temporary and seasonal workers employed by the company and its consolidated subsidiaries worldwide. The rules allow the employee population to be measured at a particular date, selected by the company, within the last three months of its most recently completed fiscal year. Your company may also exclude employees who become employed as a result of a business combination for the fiscal year when the transaction becomes effective.

Non-US employees

The final rule provides two limited exemptions regarding non-US employees:

- **A non-US employee may be excluded if the applicable country's data privacy laws would prohibit your company from accessing or utilizing the relevant compensation information. If any employee is excluded under this exemption, all employees in the jurisdiction must be excluded. A legal opinion that states the information could not be obtained or processed under the relevant country's laws must be included as an exhibit to the filing.**

- **Another exemption permits the exclusion of non-US employees if the number of non-US employees accounts for 5% or less of the company's employees. If a company excludes non-US employees in a jurisdiction under this exemption, all employees in that jurisdiction must be excluded. Any employee excluded under the data privacy exemption counts toward the 5% limit.**

Identifying the median employee and calculating pay ratio

The final rules give companies some flexibility in calculating pay for identifying the median employee. Your company may use the total employee population, a statistical sampling or any other reasonable method. In determining annual total compensation to identify the median employees, companies may use consistently applied measures, such as information derived from tax and/or payroll records. The final rule also permits reporting companies to make cost-of-living adjustments to the compensation of employees in jurisdictions other than where the CEO resides.

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Although the pay ratio must be disclosed each year, a company only need identify the median employee once every three years unless it reasonably believes that developments would result in a significant change in the pay ratio disclosure.

Once the median employee is identified, their annual total compensation must be determined, but companies may use reasonable estimates to calculate the annual total compensation, or any elements thereof, for the median employee.

When this rule becomes effective

Pay ratio disclosure will be required with respect to a company's first fiscal year commencing on or after January 1, 2017. This means that the first required disclosures will be in 2018.

What should you be doing now?

With almost two years before any CEO pay ratio information must be disclosed, there is some breathing room. The first step is to understand what may be required, given your company's particular facts and circumstances. We suggest developing a working timeline with action steps (including needed decisions), responsible parties and target completion dates. You may wish to consider the potential consequences of ratio disclosure among various stakeholder groups, and also cost implications.

Identifying your company's median employee is critical to any analysis, but there are a variety of approaches. Questions to consider include:

- **To what extent is the workforce part-time or seasonal, and should this inform the testing date?**
- **Will statistical sampling be helpful (from cost and presentation perspectives)? How large should the sample be?**
- **What reasonable assumptions should be considered?**
- **If virtually all of the workforce is in the US, could the 5% de minimis exemption apply?**
- **If non-US employees comprise a significant portion of the workforce, are there any countries where data privacy laws may apply?**
- **Is the ability to use cost-of-living adjustments for those living in a different jurisdiction from the CEO worth the additional complexity?**
- **What adjustments to payroll and other systems will be needed to implement the relevant determinations, calculations and disclosures?**

In addition, the new rules are likely to have indirect (and often unintended) consequences. For example, when the disclosures are made, half of the employee population will learn that they are paid below the median employee; human resources should be prepared to address potential questions. Similarly, some CEOs may argue that their own low pay ratios demonstrate that they are underpaid.

The compensation committee and the human resources team, in particular, need to understand the potential implications of the new rules. And from a compliance perspective, responsibilities and due dates will have to be determined, allowing for timely analyses, discussions and decisions. As your company's ratio can be affected by any of the permitted choices, it's critical to understand the interrelationships of the alternatives on this "decision tree."