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17 CFR Parts 229 and 249

Pay Ratio Disclosure; Proposed Rule

## SECURITIES AND EXCHANGE COMMISSION

### 17 CFR Parts 229 and 249

[Release Nos. 33-9452; 34-70443; File No. S7-07-13]

RIN 3235-AL47

### Pay Ratio Disclosure

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Proposed rule.

**SUMMARY:** We are proposing amendments to Item 402 of Regulation S-K to implement Section 953(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Section 953(b) directs the Commission to amend Item 402 of Regulation S-K to require disclosure of the median of the annual total compensation of all employees of an issuer (excluding the chief executive officer), the annual total compensation of that issuer's chief executive officer and the ratio of the median of the annual total compensation of all employees to the annual total compensation of the chief executive officer. The proposed disclosure would be required in any annual report, proxy or information statement or registration statement that requires executive compensation disclosure pursuant to Item 402 of Regulation S-K. The proposed disclosure requirements would not apply to emerging growth companies, smaller reporting companies or foreign private issuers.

**DATES:** Comments should be received on or before December 2, 2013.

**ADDRESSES:** Comments may be submitted by any of the following methods:

#### Electronic Comments

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/proposed.shtml>);
- Send an email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number S7-07-13 on the subject line; or
- Use the Federal Rulemaking ePortal (<http://www.regulations.gov>). Follow the instructions for submitting comments.

#### Paper Comments

- Send paper comments to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549-1090.

All submissions should refer to File Number S7-07-13. This file number should be included on the subject line if email is used. To help us process and review your comments more efficiently, please use only one method. The

Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/proposed.shtml>). Comments are also available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street NE., Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

**FOR FURTHER INFORMATION CONTACT:** Christina L. Padden, Attorney Fellow in the Office of Rulemaking, at (202) 551-3430, in the Division of Corporation Finance; 100 F Street NE., Washington, DC 20549.

**SUPPLEMENTARY INFORMATION:** We are proposing amendments to Item 402<sup>1</sup> of Regulation S-K<sup>2</sup> and a conforming amendment to Form 8-K<sup>3</sup> under the Securities Exchange Act of 1934 (the "Exchange Act").<sup>4</sup>

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<sup>1</sup> 17 CFR 229.303.

<sup>2</sup> 17 CFR 229.10 *et seq.*

<sup>3</sup> 17 CFR 249.220f.

<sup>4</sup> 15 U.S.C. 78a *et seq.*

## I. Background

### A. Section 953(b) of the Dodd-Frank Act

Section 953(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act")<sup>5</sup> directs the Commission to amend section 229.402 of title 17, Code of Federal Regulations, to require each issuer, other than an emerging growth company, as that term is defined in Section 3(a) of the Securities Exchange Act of 1934, to disclose in any filing of the issuer described in section 229.10(a) of title 17, Code of Federal Regulations (or any successor thereto)—the median of the annual total compensation of all employees of the issuer, except the chief executive officer (or any equivalent position) of the issuer; the annual total compensation of the chief executive officer (or any equivalent position) of the issuer; and the ratio of the median of the total compensation of all employees of the issuer to the annual total compensation of the chief executive officer of the issuer. Section 953(b) also requires that the total compensation of an employee of an issuer shall be determined in accordance with section 229.402(c)(2)(x) of title 17, Code of Federal Regulations, as in effect on the day before the date of enactment of the Dodd-Frank Act.<sup>6</sup>

We are proposing amendments to implement Section 953(b). We refer to this disclosure of the median of the annual total compensation of all employees of the issuer, the annual total compensation of the chief executive officer of the issuer and the ratio of the two amounts as "pay ratio" disclosure.

Section 953(b) of the Dodd-Frank Act does not amend the Securities Act of 1933 ("Securities Act")<sup>7</sup> or the Exchange Act. Instead, Section 953(b) directs the Commission to amend Item 402 of Regulation S-K ("Item 402") to add the pay ratio disclosure requirements mandated by the Dodd-Frank Act. Although Section 953(b) defines some terms used in the provision, commenters have raised questions about the scope of the

<sup>5</sup> Public Law 111-203, 124 Stat. 1376 (2010), as amended by Public Law 112-106, 126 Stat. 306 (2012).

<sup>6</sup> Public Law 111-203, sec. 953(b), 124 Stat. 1376, 1904 (2010), as amended by Public Law 112-106, sec. 102(a)(3), 126 Stat. 306, 309 (2012). Section 102(a)(3) of the Jumpstart Our Business Startups Act (the "JOBS Act") amended Section 953(b) of the Dodd-Frank Act to provide an exemption for registrants that are emerging growth companies as that term is defined in Section 3(a) of the Exchange Act.

<sup>7</sup> 15 U.S.C. 77a *et seq.*

statutory requirements and the need for additional interpretive guidance.<sup>8</sup>

### B. Comments Received

In connection with rulemakings implementing the Dodd-Frank Act, we have sought comment from the public before the issuance of a proposing release. With respect to Section 953(b) of the Dodd-Frank Act, as of September 15, 2013, we have received approximately 22,860 comment letters and a petition with approximately 84,700 signatories.<sup>9</sup> We have considered these comments in proposing the rules described in this release.

Commenters were divided in their recommended approaches to Section 953(b) and the implementation issues it raises. Comments from industry groups, issuers, law firms and executive compensation professionals generally raised concerns about the complexity of the Section 953(b) requirements, the significant compliance costs that could be involved and the potential inability for many companies to verify the accuracy of their disclosure.<sup>10</sup> These commenters generally asserted that this type of disclosure would not be material to investors or useful to an investment or voting decision, and they disputed the potential benefits cited by commenters who supported the provision.<sup>11</sup> Comments from individual and institutional investors and some

public policy organizations generally outlined what they expected to be the benefits of the mandated information and urged the Commission to implement the provision in a way that would preserve those benefits.<sup>12</sup> Notwithstanding these differing viewpoints, several commenters supported a flexible approach to implementation that would retain the potential benefits of the mandated disclosure, while avoiding the additional compliance costs that a less flexible approach could impose.<sup>13</sup>

We discuss the concerns and recommendations from the commenters in more detail throughout this release. We agree with commenters that, depending on how Section 953(b) is implemented, the cost of compliance with these new disclosure requirements could be, at least for some registrants, substantial. The rules we are proposing are intended to address commenters' concerns and are designed to lower the cost of compliance while remaining consistent with Section 953(b).

## II. Discussion of the Proposed Amendments

### A. Introduction

Section 953(b) imposes a new requirement on registrants to disclose the median of the annual total compensation of all employees (excluding the chief executive officer), the annual total compensation of the chief executive officer and the ratio of the median disclosed to the annual total compensation of the chief executive officer. Section 953(b)(2) specifies that, for purposes of Section 953(b), the total compensation of an employee of an issuer shall be determined in accordance with Item 402(c)(2)(x) of Regulation S-K. The Commission's rules for compensation disclosure have traditionally focused on the compensation of executive officers and directors.<sup>14</sup> Although registrants subject

to Item 402 are required to provide extensive information about the compensation of the principal executive officer ("PEO") and other named executive officers identified pursuant to Item 402(a), current disclosure rules generally do not require registrants to disclose detailed compensation information for other employees in their filings with the Commission.<sup>15</sup> Commenters have observed that, because of the complexity of the requirements of Item 402(c)(2)(x), registrants typically compile information required by Item 402(c) manually for the named executive officers, which they have stated takes significant time and resources.<sup>16</sup> We do not expect that many registrants, if any, currently disclose or track total compensation as determined pursuant to Item 402 for their workforce.<sup>17</sup>

Exchange Act registration statements. In 1938, the Commission promulgated its first executive and director compensation disclosure rules for proxy statements. *See* Amended Proxy Rules, Release No. 34-1823 (Aug. 11, 1938) [3 FR 1991].

From time to time thereafter, the Commission has amended its executive and director compensation disclosure requirements in light of changing trends in executive compensation and other issues, and, more recently, to comply with the mandates of the Dodd-Frank Act. *See, e.g.*, Solicitation of Proxies Under the Act, Release No. 34-3347 (Dec. 18, 1942) [7 FR 10655]; Solicitation of Proxies, Release No. 34-4775 (Dec. 11, 1952) [17 FR 11431]; Uniform and Integrated Reporting Requirements: Management Remuneration, Release No. 33-6003 (Dec. 4, 1978) [43 FR 58181]; Disclosure of Executive Compensation, Release No. 33-6486 (Sept. 23, 1983) [48 FR 44467]; Executive Compensation Disclosure, Release No. 33-6962 (Oct. 16, 1992) [57 FR 48126]; Executive Compensation Disclosure; Securityholder Lists and Mailing Requests, Release No. 33-7032 (Nov. 22, 1993) [58 FR 63010]; Executive Compensation and Related Person Disclosure, Release No. 33-8732A (Aug. 29, 2006) [71 FR 53158] ("2006 Adopting Release"); Proxy Disclosure Enhancements, Release No. 33-9089A (Dec. 16, 2009) [74 FR 68334]; and Shareholder Approval of Executive Compensation and Golden Parachute Compensation, Release No. 33-9178 (Jan. 25, 2011) [76 FR 6010].

<sup>15</sup> Although the group of covered individuals for whom disclosure is required has changed over time, the rules generally have sought to require compensation disclosure for "persons who, in fact, function as key, policy-making members of management." Uniform and Integrated Reporting Requirements: Management Remuneration, Release No. 33-5950 (July 28, 1978) [43 FR 34415], at 34416.

<sup>16</sup> *See* letter from Davis Polk. *See also* letter from R. Morrison.

<sup>17</sup> *See* letter from Protective Life (noting that "very few employers routinely determine certain items of compensation for individual 'rank and file' employees, notably the values of stock and stock option awards and the aggregate change in the actuarial present value of defined benefit pension plan accruals. For most employers, determining these amounts will require, for the first time, calculations for all (or a large subset) of their employees"). *See also* COEC I ("No public company currently calculates each employee's total compensation as it calculates total pay on the Summary Compensation Table for the named

<sup>8</sup> Comments submitted to the Commission in connection with Section 953(b) are discussed generally in Section I.B. and throughout this release as they relate to specific aspects of the proposals.

<sup>9</sup> Comments related to the executive compensation provisions of the Dodd-Frank Act, including Section 953(b), are available at <http://www.sec.gov/comments/df-title-ix/executive-compensation/executive-compensation.shtml>. In connection with Section 953(b), the Commission received approximately 260 unique comment letters and approximately 22,600 form letters (posted on the Web site as Letter Type A) as of September 15, 2013. The Commission also received a petition (posted on the Web site as Letter Type B) with approximately 84,700 signatories. In this release, references to comment letters identify the commenter by the name of the organization or individual submitting the letter. Letters by commenters who submitted multiple letters are identified by date.

<sup>10</sup> *See, e.g.*, letters from American Bar Association ("ABA"); Center on Executive Compensation dated September 10, 2010 ("COEC I"); Center on Executive Compensation dated November 11, 2011 ("COEC II"); Davis Polk & Wardwell LLP ("Davis Polk"); Business Roundtable *et al.*, ("Group of Trade Associations"); Society of Corporate Secretaries and Governance Professionals ("SCSGP"); Greta E. Cowart, Haynes & Boone LLP *et al.* ("Group of Exec. Comp. Lawyers"); Protective Life Corporation; Towers Watson; Brian Foley & Co.; and Pay Governance LLC. We discuss these costs in detail in Section IV of this release.

<sup>11</sup> *See, e.g.*, COEC I and letters from Brian Foley & Co.; Group of Trade Associations; Meridian Compensation Partners, LLC; National Association of Corporate Directors ("NACD"); and Retail Industry Leaders Association ("RILA").

<sup>12</sup> *See, e.g.*, letters from AFL-CIO dated December 13, 2010 ("AFL-CIO I") and AFL-CIO dated August 11, 2011 ("AFL-CIO II"); Americans for Financial Reform; Batirente *et al.* ("Group of International Investors"); J. Brown; K. Burgoyne; Calvert Investment Management; Community Action Commission; CtW Investment Group; Drucker Institute; Institute for Policy Studies; R. Landgraf; D. Miron; Social Investment Forum; S. Towns; Trillium Asset Management; UAW Retiree Medical Benefits Trust; and Walden Asset Management. *See also* Letter Type A. We discuss these benefits in detail in Section IV of this release.

<sup>13</sup> *See, e.g.*, AFL-CIO II and letters from ABA; American Benefits Council; COEC II; Protective Life Corporation; and Davis Polk.

<sup>14</sup> Initially, disclosure requirements for executive and director compensation were set forth in Schedule A to the Securities Act and Section 12(b) of the Exchange Act, which list the type of information to be included in Securities Act and

Registrants are required to present various elements of employee compensation, on an aggregate basis, in the relevant line items of their financial statements and related footnotes (such as accrued payroll and benefits amounts recorded in current liabilities on the balance sheet, or salary and bonus amounts included in selling and administrative expenses or cost of goods sold on the income statement).<sup>18</sup> These amounts are calculated and presented in accordance with the comprehensive set of accounting principles that the registrant uses to prepare its primary financial statements. For example, under United States generally accepted accounting principles (“U.S. GAAP”), there are several accounting standards that relate to compensation,<sup>19</sup> and these standards are distinct from the Commission’s executive compensation disclosure rules. In addition, the Commission’s executive compensation disclosure rules differ from tax accounting and reporting standards.<sup>20</sup> Therefore, Section 953(b) requires registrants to disclose specific information about non-executive employee compensation that is not

executive officers, because disclosure of executive pay has a different purpose than internal accounting.”); and letter from R. Morrison (“Collecting, organizing, and analyzing this kind of data for all employees in order to develop a median comp figure would be extremely complex, time-consuming, and burdensome, assuming this is even possible.”).

<sup>18</sup> “Total compensation” as determined pursuant to Item 402 is not an amount that is reported or calculated in connection with a registrant’s financial statements.

<sup>19</sup> See, e.g., FASB ASC 710, *Compensation—General*; ASC 715, *Retirement Benefits Compensation*; ASC 960, *Defined Benefit Pension Plans*; ASC 962, *Defined Contribution Pension Plans*; ASC 965, *Health and Welfare Benefit Plans*; and ASC 718, *Compensation—Stock Compensation*.

<sup>20</sup> For example, registrants that are subject to the United States Internal Revenue Code [26 U.S.C. 1 *et seq.*] are required to report certain compensation information for each employee to the Internal Revenue Service, typically on Form W–2. The elements of compensation that are required to be calculated and reported on Form W–2 are not the same as those covered by Item 402 requirements, and the reported amounts relate to the relevant calendar year for tax purposes, rather than the registrant’s fiscal year.

Additionally, the compensation required to be disclosed under Item 402 reflects the compensation that was awarded to, earned by or paid to the executive officer during the fiscal year in contrast to compensation reported on Form W–2, which reflects only compensation that was includible in income for income tax purposes during the calendar year regardless of when that compensation was earned. For example, under Item 402, the value of stock options, deferred salary and bonuses would be included in compensation in the period they were awarded or earned. In contrast, for purposes of Form W–2, income from stock options is generally included in income at the time of exercise, and income relating to deferred salary and bonuses is included only when those amounts are actually paid, which could be in a future year.

currently required for disclosure, accounting or tax purposes.

Many commenters raised concerns about the significant compliance costs that could result from requiring the use of “total compensation” as defined in Item 402(c)(2)(x) to calculate employee pay and requiring registrants to identify the median instead of the average.<sup>21</sup> According to these commenters, the primary driver of the significant compliance costs is that many registrants, whether large multinationals or companies of modest revenue size and market capitalization, maintain multiple and complex payroll, benefits and pension systems (including systems maintained by third party administrators) that are not structured to easily accumulate and analyze all the types of data that would be required to calculate the annual total compensation for all employees in accordance with Item 402(c)(2)(x). Thus, in order to compile such disclosure, registrants would either need to integrate these data systems or consolidate the data manually, which, in both cases, would be, according to these commenters, highly costly and time consuming.<sup>22</sup>

The proposed rules to implement Section 953(b) are designed to comply with the statutory mandate and to address commenters’ concerns regarding the potential costs of complying with the disclosure requirement. Where we have exercised discretion in implementing the statutory requirements, we are proposing alternatives that we believe will reduce costs and burdens, while preserving what we believe to be the potential

<sup>21</sup> See, e.g., letters from Davis Polk (noting that compliance will be “highly costly and burdensome, with tremendous uncertainty as to accuracy. Companies are justifiably concerned about the costs and burdens to accomplish the formidable data collection and calculation tasks for employees worldwide between the end of the year and the first required filing.”); Frederick W. Cook & Co., Inc. (stating, “the calculation of median total pay for all employees other than the CEO is problematic, burdensome and perhaps impossible for many issuers”) and Protective Life Corporation (“It is difficult to overemphasize how burdensome this requirement could be for large employers. Calculating annual total compensation is much more complicated than simply adding up numbers that companies already have available. . . . Since many large companies use outside accounting, actuarial and compensation and pension administration firms to perform these calculations, the costs of disclosure will increase accordingly.”). See also letters from ABA; COEC I; Group of Exec. Comp. Lawyers; Group of Trade Associations; Meridian Compensation Partners, LLC; NACD; and R. Morrison.

<sup>22</sup> See, e.g., letter from Group of Trade Associations (“There is a widespread misconception that this information is readily available at the touch of a button.”) See also COEC II and letters from Group of Exec. Comp. Lawyers; Meridian Compensation Partners, LLC; and R. Morrison.

benefits, as articulated by commenters, of the disclosure requirement mandated by the Dodd-Frank Act. We note, however, that neither the statute nor the related legislative history directly states the objectives or intended benefits of the provision.<sup>23</sup> Commenters supporting Section 953(b) have emphasized that potential benefits could arise from adding pay ratio-type information to the total mix of executive compensation information.<sup>24</sup> We have considered the statutory mandate of Section 953(b) in the context of other executive compensation disclosure under Item 402, and, where practicable, we have sought to make the mandated disclosure of Section 953(b) work with the existing executive compensation disclosure regime.

<sup>23</sup> The requirements imposed by Section 953(b) originated in the Senate. A provision identical to Section 953(b) was first included in S. 3049, the “Corporate Executive Accountability Act of 2010,” which was sponsored by Senator Menendez and introduced on February 26, 2010. In that bill, the provision accompanied a say-on-pay provision. A provision identical to Section 953(b) next appeared in S. 3217, the “Restoring American Financial Stability Act of 2010” sponsored by Senator Dodd and introduced on April 15, 2010, which served as the basis for the Senate’s amendments to H.R. 4173. The legislative record includes only a few brief references to the pay ratio disclosure requirements, each opposing the provision. See 156 Cong. Rec. S3121 (daily ed. May 5, 2010) (statement of Sen. Gregg) and 156 Cong. Rec. S4075 (daily ed. May 20, 2010) (statement of Sen. Shelby). The April 30, 2010 report issued by the Senate Committee on Banking, Housing and Urban Affairs does not mention the pay ratio requirements other than a short statement by the minority. See Report of the Senate Committee on Banking, Housing and Urban Affairs to Accompany S. 3217 (“the Senate Report”), S. Rep. No. 111–176, at 245.

The requirements of Section 953(b) were not discussed during the conference committee’s deliberations on the legislation. Similarly, the Joint Explanatory Statement of the Committee of Conference does not mention the pay ratio requirements in its summary of Title IX, Subtitle E. See Conference Report on H.R. 4173, H. Rep. No. 111–517, at 872.

<sup>24</sup> See, e.g., letters from Americans for Financial Reform (“Existing requirements mandate disclosure of top executive compensation only, encouraging companies to focus unduly on peer to peer comparisons when setting CEO pay. . . . Disclosure of CEO-to-worker pay ratios will encourage Boards of Directors to also consider vertical pay equity within firms.”); Calvert Investment Management (“The disclosure required by Section 953(b) will help investors understand how issuers are distributing compensation dollars throughout the firm in ways that may help improve employee morale and productivity.”); C&W Investment Group (“The new disclosure offers an insight into compensation within the entire organization, and provides a different way for boards and shareholders to evaluate the relative worth of a CEO.”); and UAW Retiree Medical Benefits Trust (“[W]e view Section 953(b) as an essential tool that will increase corporate board accountability to investors. . . . a comparison between CEO and employee pay may help shareholders identify the board’s strengths and weaknesses, and may provide insight into [the board’s] relationship with the CEO.”).

In light of the significant potential costs articulated by commenters,<sup>25</sup> we believe that it is appropriate for the proposed rules to allow registrants flexibility in developing the disclosure required by the statute. The proposal seeks to implement Section 953(b) without imposing additional prescriptive requirements that are not mandated by the Dodd-Frank Act and reflects our consideration of the relative costs and benefits of this approach as opposed to a more prescriptive one. For example, registrants would be able to choose from several options in order to provide the disclosure. Registrants may choose to identify the median using their full employee population or by using statistical sampling or another reasonable method. In doing so, the proposed requirements would allow registrants to choose a statistical method to identify the median that is appropriate to the size and structure of their own businesses and the way in which they compensate employees, rather than prescribing a particular methodology or specific computation parameters. Registrants may calculate the annual total compensation for each employee included in the calculation (whether the entire population or a statistical sample) and the PEO using Item 402(c)(2)(x) and to identify the median using this method. As an alternative, registrants may identify the median employee based on any consistently applied compensation measure and then calculate the annual total compensation for that median employee in accordance with Item 402(c)(2)(x). The proposed requirements also would permit registrants to use reasonable estimates in calculating the annual total compensation for employees other than the PEO, including when disclosing the annual total compensation of the median employee identified using a consistently applied compensation measure. We believe that this flexible approach is consistent with Section 953(b) and could ease commenters' concerns about the potential burdens of complying with the disclosure requirement. We do not believe that a one-size-fits-all approach would be prudent, given the wide range of registrants and the disparate burdens on registrants based on factors such as their type of business and the complexity of their payroll systems. We seek comment on whether the proposed rules address sufficiently the practical

<sup>25</sup> The potential costs arising from the requirements of Section 953(b), as well as the potential costs relating to the proposed rules, are discussed in detail below in Section IV of this release.

difficulties of data collection and whether there are other alternative approaches consistent with Section 953(b) that could provide the potential benefits of pay ratio information at a lower cost. We also seek comment on whether the flexible approach proposed in this release appropriately implements Section 953(b).

The details of the proposal are set forth in the sections below. First, we interpret the scope of Section 953(b) with respect to the filings and the registrants that are subject to the proposed requirements. Next, we set forth the proposed new pay ratio disclosure requirement in Item 402, to be designated paragraph (u), and provide details on a variety of technical and interpretive issues, including:

- The employees that are to be included in the identification of the median;
- identifying the median;
- determining “total compensation;”
- disclosure of the methodology, assumptions and estimates used;
- the meaning of “annual” in the context of “annual total compensation;”
- various timing matters that arise in connection with the proposed requirements; and
- the status of the disclosure as “filed” rather than “furnished.”

Finally, we address transition matters, including the proposed compliance date for registrants that would be subject to the rules, and proposed transition provisions for new registrants.

#### *B. Scope of Section 953(b) of the Dodd-Frank Act*

##### 1. Filings Subject to the Proposed Disclosure Requirements

In accordance with Section 953(b) of the Dodd-Frank Act, we are proposing to require registrants to include pay ratio disclosure in any filing described in Item 10(a) of Regulation S–K that requires executive compensation disclosure under Item 402 of Regulation S–K. Therefore, the proposed pay ratio disclosure would be required in annual reports on Form 10–K,<sup>26</sup> registration statements under the Securities Act and Exchange Act, and proxy and information statements, to the same extent that the requirements of these forms require compliance with Item 402.<sup>27</sup> We are not proposing changes to

<sup>26</sup> 17 CFR 249.310.

<sup>27</sup> Registrants would follow the instructions in each form to determine whether Item 402 information is required, including any instructions that allow for the omission of Item 402 information in certain circumstances, such as General Instructions I(2)(c) and J(1)(m) to Form 10–K containing special provisions for the omission of

the requirements of these forms relating to Item 402. Section 953(b) does not direct the Commission to amend any of its forms to add the pay ratio disclosure requirements to filings that do not already require disclosure of Item 402 information, and we are not proposing to do so.

Although some commenters suggested that Section 953(b)(1) requires pay ratio disclosure in every Commission filing,<sup>28</sup> other commenters suggested that the statute, by referring to filings described in Item 10(a) of Regulation S–K, is intended to apply only to those filings for which the applicable form requires Item 402 disclosure.<sup>29</sup> We agree with the latter reading of Section 953(b). We believe that reading Section 953(b) to require pay ratio disclosure in filings that do not contain other executive compensation information would not present this information in a meaningful context. Because some commenters have asserted that the pay ratio disclosure would provide another metric to evaluate executive compensation disclosure,<sup>30</sup> we believe that the proposed pay ratio disclosure should be placed in context with other executive compensation disclosure, such as the summary compensation table required by Item 402(c) and the compensation discussion and analysis required by Item 402(b), rather than provided on a stand-alone basis. Therefore, we believe it is appropriate to read Section 953(b) as requiring pay ratio disclosure in only those filings that are required to include other Item 402 information.

#### Request for Comment

1. Should we require the pay ratio disclosure only in filings in which Item 402 disclosure is required, as proposed? Should we require the pay ratio disclosure in Commission forms that do

Item 402 information by wholly-owned subsidiaries and asset-backed issuers.

As described below in Section I.I.C.7., the proposed requirements do not require a registrant to update its pay ratio disclosure for the most recently completed fiscal year until it files its annual report on Form 10–K, or, if later, its proxy or information statement for its next annual meeting of shareholders (or written consents in lieu of such a meeting).

In addition, we are proposing a transition period for compliance by new registrants that are subject to Section 953(b), so that the pay ratio requirement is not required in a registration statement on Form S–1 [17 CFR 239.11] or Form S–11 [17 CFR 239.18] for an initial public offering or registration statement on Form 10 [17 CFR 249.210]. See Section II.D.2. of this release.

<sup>28</sup> See, e.g., COEC I and letters from American Benefits Council; Compensia, Inc.; Davis Polk; SCSSGP; and Towers Watson.

<sup>29</sup> See, e.g., letters from ABA and RILA.

<sup>30</sup> See, e.g., AFL–CIO I, House Letter and Senate Letter; and letters from CFW Investment Group and UAW Retiree Medical Benefits Trust.

not currently require Item 402 disclosure? If so, which forms, and why? Would disclosure be meaningful to investors where no other executive compensation disclosures are required?

2. Do registrants need any additional guidance about which filings would require the proposed pay ratio disclosure? Are there circumstances where the requirements of a particular form call for Item 402 information in certain circumstances, but the applicability of the proposed pay ratio disclosure requirements may not be clear? If so, please provide details about what should be clarified and what guidance is recommended.

## 2. Registrants Subject to the Proposed Disclosure Requirements

The proposed pay ratio disclosure requirements would apply to only those registrants that are required to provide summary compensation table disclosure pursuant to Item 402(c). We recognize that the reference to “each issuer” in Section 953(b) could be read to apply to all issuers that are not emerging growth companies, including smaller reporting companies and foreign private issuers. As a result of the specific reference in Section 953(b) to the definition of total compensation contained in Item 402(c)(2)(x), and the absence of direction to apply this requirement to companies not previously subject to Item 402(c) requirements, we propose to limit the pay ratio disclosure requirement to registrants that are subject to Item 402(c) requirements, as described in more detail below.

### a. Emerging Growth Companies Are Not Covered

Under JOBS Act Section 102(a)(3), registrants that qualify as emerging growth companies, as that term is defined in Section 3(a) of the Exchange Act,<sup>31</sup> are not subject to Section 953(b). To give effect to the statutory exemption, we are proposing an instruction to Item 402(u) that provides that a registrant that is an emerging growth company is not required to comply with Item 402(u).<sup>32</sup>

### b. Smaller Reporting Companies Are Not Covered

Section 953(b) requires total compensation to be calculated in accordance with Item 402(c)(2)(x). Smaller reporting companies (as defined in Item 10(f)(1) of Regulation S-K)<sup>33</sup> are permitted to follow the scaled disclosure requirements set forth in

Items 402(m)–(r) instead of complying with the disclosure requirements set forth in Items 402(a)–(k) and (s),<sup>34</sup> and therefore are not required to calculate compensation in accordance with Item 402(c)(2)(x). The requirement set forth in Item 402(n) for disclosure of summary compensation table information, which includes disclosure of “total compensation,” does not require smaller reporting companies to include all of the same types of compensation required to be included in total compensation for other registrants under Item 402(c)(2).<sup>35</sup> We believe that by requiring the use of Item 402(c)(2)(x) to calculate total compensation (without mention of Item 402(n)(2)(x)), Congress intended to exclude smaller reporting companies from the scope of Section 953(b). In addition, requiring smaller reporting companies to provide the pay ratio disclosure consistent with the requirement for other registrants would require smaller reporting companies to collect data and calculate compensation for the PEO in a manner they otherwise would not be required to calculate compensation. Thus, we do not believe this is the intent of the provision.

Therefore, as proposed, the pay ratio disclosure requirements would not apply to smaller reporting companies. To make this clear, we are proposing a technical amendment to paragraph (I) of Item 402, to add proposed paragraph (u) to the list of items that are not required for smaller reporting companies.

### c. Foreign Private Issuers and MJDS Filers Are Not Covered

Foreign private issuers that file annual reports and registration statements on Form 20-F and MJDS filers that file annual reports and registration statements on Form 40-F would not be required to provide the proposed pay ratio disclosure, because those forms do not require Item 402 disclosure.<sup>36</sup> We do not read Section

<sup>34</sup> See Item 402(I). Smaller reporting companies are permitted to choose compliance with either the scaled disclosure requirements or the larger company disclosure requirements on an “a la carte” basis. As discussed in the scaled disclosure adopting release, the staff evaluates compliance by smaller reporting companies with only the Regulation S-K requirements applicable to smaller reporting companies, even if the company chooses to comply with the larger company requirements. See Smaller Reporting Company Regulatory Relief and Simplification, Release No. 33-8876 (Dec. 19, 2007) [73 FR 934], at 941.

<sup>35</sup> Specifically, under Item 402(n)(2)(viii), smaller reporting companies are not required to include the aggregate change in the actuarial present value of pension benefits that is required for companies subject to Item 402(c)(2)(viii).

<sup>36</sup> The term “MJDS filers” refers to registrants that file reports and registration statements with the

953(b) as requiring the Commission to expand the scope of Item 402 to apply to companies that are not currently subject to the executive compensation disclosure requirements set forth in Item 402. Accordingly, we are not proposing to amend Form 20-F or Form 40-F, and the proposed pay ratio disclosure requirements would not be applicable to foreign private issuers or MJDS filers. In addition, we are not proposing any changes to existing Item 402(a)(1), which provides for the treatment of foreign private issuers. Accordingly, foreign private issuers that file annual reports on Form 10-K will continue to be able to satisfy Item 402 requirements by following the requirements of Items 6.B and 6.E.2 of Form 20-F and would not be required to make the pay ratio disclosure mandated by Section 953(b). In addition, requiring foreign private issuers and MJDS filers to provide the pay ratio disclosure consistent with the requirement for other registrants would require these registrants to collect data and calculate compensation for the PEO in a manner they otherwise would not be required to calculate compensation. Thus, we do not believe this is the intent of the provision.

### Request for Comment

3. Should the pay ratio disclosure requirements, as proposed, apply only to those registrants that are required to provide summary compensation table disclosure pursuant to Item 402(c)? If not, to which registrants should pay ratio disclosure requirements apply?

4. Should we revise the proposal so that smaller reporting companies would be subject to the proposed pay ratio disclosure requirements? If so, why? If so, also discuss how smaller reporting companies should calculate total compensation for employees and the PEO. For example, should they be required to calculate total compensation in accordance with Item 402(c)(2)(x) instead of the scaled disclosure requirements? In the alternative, should smaller reporting companies be required to provide a modified version of the pay ratio disclosure? If so, why, and what should that modified version entail?

Commission in accordance with the requirements of the U.S.- Canadian Multijurisdictional Disclosure System (the “MJDS”). The definition for “foreign private issuer” is contained in Exchange Act Rule 3b-4(c) [17 CFR 240.3b-4(c)]. A foreign private issuer is any foreign issuer other than a foreign government, except for an issuer that, as of the last business day of its most recent fiscal year, has more than 50% of its outstanding voting securities held of record by United States residents and any of the following: A majority of its officers and directors are citizens or residents of the United States, more than 50% of its assets are located in the United States, or its business is principally administered in the United States.

<sup>31</sup> 15 U.S.C. 78c(a).

<sup>32</sup> See proposed Instruction 6 to Item 402(u).

<sup>33</sup> 17 CFR 229.10(f)(1).

Should it be based on the compensation amounts required under the scaled disclosure requirements applicable to smaller reporting companies, such as a ratio where the PEO compensation and other employee compensation are calculated in accordance with Item 402(n)(2)(x)? Please provide information as to particular concerns that smaller reporting companies may have. Please discuss whether the disclosure would be useful to investors in smaller reporting companies.

5. Should we amend either Form 20-F or Form 40-F to include disclosure that is similar to the proposed pay ratio disclosure requirements? If so, why? Assuming we would not otherwise subject foreign private issuers to the executive compensation disclosure rules, what modifications would be needed to address the different reporting requirements that foreign private issuers and MJDS filers have for executive compensation disclosure in order to require pay ratio disclosure? In particular, how should these registrants calculate total compensation (for the PEO and for employees) for purposes of such a requirement? Please provide information as to particular concerns that foreign private issuers or MJDS filers may have if they were required to comply with such a requirement. Please discuss whether the disclosure would be useful to investors, particularly in the absence of the executive compensation disclosure that would accompany disclosure of the ratio for registrants subject to Item 402 disclosure.

### C. Proposed Requirements for Pay Ratio Disclosure

#### 1. New Paragraph (u) of Item 402 (Pay Ratio Disclosure)

We are proposing new paragraph (u) of Item 402 that would require disclosure of:

(A) The median of the annual total compensation of all employees of the registrant, except the principal executive officer of the registrant;

(B) the annual total compensation of the principal executive officer of the registrant; and

(C) the ratio of the amount in (A) to the amount in (B), presented as a ratio in which the amount in (A) equals one or, alternatively, expressed narratively in terms of the multiple that the amount in (B) bears to the amount in (A).

For consistency with existing Item 402 requirements, the proposed requirements would use the defined term “PEO” (principal executive officer), instead of the term “chief executive officer” used in Section

953(b).<sup>37</sup> PEO is defined in Item 402(a)(3) as an “individual serving as the registrant’s principal executive officer or acting in a similar capacity during the last completed fiscal year.” We believe that this consistency would simplify compliance for registrants and would clarify how the pay ratio disclosure relates to the PEO’s total compensation figure disclosed in the summary compensation table. We also believe that this change in terminology is consistent with Section 953(b).

Section 953(b) specifies that registrants must disclose the ratio of the median of the annual total compensation of all employees to the PEO’s annual total compensation. We note that three commenters raised concerns about the presentation of the pay ratio in the order set forth in Section 953(b).<sup>38</sup> These commenters noted that the customary manner of presenting similar types of ratios would include the PEO’s annual total compensation in the numerator and the median of the annual total compensation of all employees in the denominator and would typically be expressed in terms of the multiple that the PEO amount bears to the median amount (such as “PEO pay is X times the median employee pay”). These commenters recommended that we allow registrants to present the ratio in this more customary manner.

Although Section 953(b) calls for a ratio showing the median of the annual total compensation of all employees to the PEO’s annual total compensation, it does not specify how the ratio should be expressed. In order to promote consistent presentation and address the potential for confusion, the proposed pay ratio disclosure requirements specify that the ratio must be expressed as a ratio in which the median of the annual total compensation of all employees is equal to one, or, alternatively, expressed narratively in terms of the multiple that the PEO total

<sup>37</sup> The term chief executive officer in the executive compensation rules was replaced by the term “principal executive officer” as part of the 2006 amendments to Item 402 of Regulation S-K in order to maintain consistency with the nomenclature used in Item 5.02 of Form 8-K. See 2006 Adopting Release, *supra* note 14, at n. 326.

<sup>38</sup> See letters from Compensia, Inc. (“For example, if the annual total compensation of a company’s chief executive officer was \$3,750,000 and the median of the annual total compensation of all employees was \$75,000, then as currently formulated, the required disclosure would be 0.02 to 1, rather than the commonly understood calculation of 50 to 1.”); Frederick W. Cook & Co., Inc.; and Group of Exec. Comp. Lawyers (“For example, if CEO pay were 2 million and the median annual compensation of all employees were \$25,000, the statute literally requires a disclosure that the median annual compensation of all employees is 1/80 of the CEO’s pay.”).

compensation amount bears to the median of the annual total compensation amount. For example, if the median of the annual total compensation of all employees of a registrant is \$45,790,<sup>39</sup> and the annual total compensation of a registrant’s PEO is \$12,260,000,<sup>40</sup> then the pay ratio disclosed would be “1 to 268” (which could also be expressed narratively as “the PEO’s annual total compensation is 268 times that of the median of the annual total compensation of all employees”).

We believe that the proposed requirements for the expression of the ratio would help to address the concerns of commenters and are consistent with the statute. It does not appear that the order of the ratio specified in Section 953(b) would impact investor understanding or the usefulness, as expressed by some commenters,<sup>41</sup> to investors of the proposed pay ratio disclosure.

#### Request for Comment

6. Are there any other presentation issues that companies need guidance on or that should be clarified in the pay ratio disclosure requirements? If so, please provide details about such issues and any recommended guidance that should be provided.

#### 2. Employees Included in the Identification of the Median

##### a. All Employees

Section 953(b) expressly requires disclosure of the median of the annual total compensation of “all employees.” Consistent with that mandate, the proposed requirements state that “employee” or “employee of the registrant” includes any full-time, part-time, seasonal or temporary worker employed by the registrant or any of its subsidiaries<sup>42</sup> (including officers other

<sup>39</sup> Average salary for all occupations, U.S. Bureau of Labor Statistics, May 2012 National Occupational Employment and Wage Estimates United States, available at [http://www.bls.gov/oes/current/oes\\_nat.htm#00-0000](http://www.bls.gov/oes/current/oes_nat.htm#00-0000).

<sup>40</sup> Derived from 2012 Average CEO at S&P 500 Index Companies, AFL-CIO, *Trends in CEO Pay*, available at <http://www.aflcio.org/Corporate-Watch/CEO-Pay-and-the-99/Trends-in-CEO-Pay>.

<sup>41</sup> The commenters asserting that Section 953(b) disclosure would be useful to investors did not raise the order of the ratio components as a factor that would diminish the meaningfulness of the information. These commenters are listed at notes 155 through 165, *infra*.

<sup>42</sup> By directing the Commission to amend Item 402, we believe that Section 953(b) is intended to cover employees on an enterprise-wide basis, including both the registrant and its subsidiaries, which is the same approach as that taken for other Item 402 information. See Item 402(a)(2) and Instruction 2 to Item 402(a)(3). Because this issue

than the PEO).<sup>43</sup> Therefore, under the proposed requirements, “all employees” covers all such individuals. In contrast, workers who are not employed by the registrant or its subsidiaries, such as independent contractors or “leased” workers or other temporary workers who are employed by a third party, would not be covered.<sup>44</sup>

We note that commenters were split in their support for a rule that would include all employees of the issuer,<sup>45</sup> rather than only covering full-time U.S. workers.<sup>46</sup> Many commenters raised concerns that the inclusion of workers located outside the United States, as well as employees that are not permanent, full-time employees, would render the comparison to the PEO less meaningful, while at the same time imposing significant costs on registrants that have global operations.<sup>47</sup> According to these commenters, the international variation in compensation arrangements and benefits, in addition to cost-of-living differences and currency fluctuations, could distort the comparability of employee compensation to that of a PEO based in the United States.<sup>48</sup> In addition, these commenters noted that the types of

was not addressed by commenters, we specifically request comment below on this approach.

In the context of Item 402 disclosure, a subsidiary of a registrant is an affiliate controlled by the registrant directly or indirectly through one or more intermediaries, as set forth in the definition of “subsidiary” under both Securities Act Rule 405 and Exchange Act Rule 12b-2. Therefore, for purposes of the proposed pay ratio disclosure, an employee would be covered by the disclosure requirements if he or she is employed by the registrant or a subsidiary of the registrant as defined in Rule 405 and Rule 12b-2.

<sup>43</sup> Rule 405 under the Securities Act states that the term “employee” does not include a director, trustee or officer. The parenthetical “(including officers other than the PEO)” in Item 402(u)(3) of the proposed rules is intended to clarify that officers, as that term is defined under Rule 405, are not excluded from the definition of employee for purposes of the proposed pay ratio disclosure requirements.

<sup>44</sup> For example, if a registrant pays a fee to another company (such as a management company or an employee leasing agency) that supplies workers to the registrant, and those workers receive compensation from that other company, those workers would not be counted as employees of the registrant for purposes of the proposed rules.

<sup>45</sup> See AFL-CIO I and letters from Americans for Financial Reform; CtW Investment Group; Group of International Investors; Senator Menendez; Social Investment Forum; Trillium Asset Management; UAW Medical Benefits Trust; and Walden Asset Management.

<sup>46</sup> See COEC I and letters from ABA; American Benefits Council; Brian Foley & Co.; Group of Exec. Comp. Lawyers; NACD; Protective Life Corporation; RILA; SCSGP; and Towers Watson.

<sup>47</sup> See COEC I and letters from ABA; American Benefits Council; Brian Foley & Co.; Group of Exec. Comp. Lawyers; NACD; Protective Life Corporation; RILA; SCSGP; and Towers Watson.

<sup>48</sup> See, e.g., letter from Group of Exec. Comp. Lawyers.

compensation that are recorded in payroll and benefits systems outside the United States may vary from those recorded as compensation in the United States due to local accounting standards and tax regulations. Because of these variations, they further suggest that requiring registrants to recompute or adjust the output of payroll systems to include non-payroll items that would be reportable as compensation under Item 402 has the potential to impose significant compliance costs.<sup>49</sup>

In contrast, one commenter asserted that the provision was intended to cover all employees of the issuer, including full-time, part-time, U.S. and non-U.S. employees.<sup>50</sup> Some commenters asserted that the exclusion of non-U.S. and non-full-time employees would diminish the meaningfulness of the pay ratio disclosure to investors.<sup>51</sup> Some of these commenters suggested allowing companies to present separate pay ratios covering U.S. and non-U.S. employees, which they believed could mitigate concerns that the comparison of the PEO to workers located outside of the United States could distort the disclosure.<sup>52</sup>

We acknowledge the concerns of commenters that the inclusion of non-U.S. employees raises compliance costs for multinational companies, introduces cross-border compliance issues, and could raise concerns about the impact of non-U.S. pay structures on the comparability of the data to companies without off-shore operations. We also recognize that differences in relative compliance costs may have an adverse impact on competition. We have weighed these considerations and are

<sup>49</sup> *Id.*

<sup>50</sup> See letter from Senator Menendez, the sponsor of Section 953(b) (“Specifically, I want to clarify that when I wrote ‘all’ employees of the issuer, I really did mean all employees of the issuer. I intended that to mean both full-time and part-time employees, not just full-time employees. I also intended that to mean all foreign employees of the company, not just U.S. employees.”).

<sup>51</sup> See AFL-CIO I and letters from Americans for Financial Reform; CtW Investment Group; Group of International Investors; Institute for Policy Studies; and UAW Medical Benefits Trust. *But see* letter from Social Investment Forum (“[W]e acknowledge that a comparison of a U.S. CEO’s pay to the median for U.S. employees is the most useful comparison as a factor for the compensation committee in establishing executive pay packages.”) and letter from Walden Asset Management (“[F]or the purposes of analyzing trends in executive pay for U.S. executives, statistics comparing compensation of NEOs to the median U.S. employee [are] most useful.”).

<sup>52</sup> See AFL-CIO I and letters from Americans for Financial Reform; Walden Asset Management; and Social Investment Forum (“We recommend that the SEC require two statistics, one on pay disparity with only U.S. workers and another for non-U.S. workers so that investors can better study pay disparity trends and inherent risks.”).

proposing that the requirement cover all employees without carve-outs for specific categories of employees. Although we believe that the inclusion of non-U.S. employees in the calculation of the median is consistent with the statute, we have considered ways to address the costs of compliance that commenters attribute to the provision’s coverage of a registrant’s global workforce.

In particular, we are cognizant that data privacy laws in various jurisdictions could have an impact on gathering and verifying the data needed to identify the median of the annual total compensation of all employees. Commenters have asserted that, in some cases, data privacy laws could prohibit a registrant’s collection and transfer of personally identifiable compensation data that would be needed to identify the median.<sup>53</sup> We also understand that in many cases, the collection or transfer of the underlying data is made burdensome by local data privacy laws, but is not prohibited.

For example, we acknowledge that multinational companies based in the United States may need to ensure compliance with data privacy regulations in transmitting personally identifiable human resources data (“personal data”) of European Union (“EU”) persons onto global human resource information system networks in the United States, sending personal data in hard copy from the European Union to the United States, as well as personal data “onward transfers” to third-party payroll, pension and benefits processors outside of the European Union.<sup>54</sup> In some EU Member States, employee consent is required, while in others, consent may not be sufficient.<sup>55</sup> Commenters also have asserted that other jurisdictions, such as Peru, Argentina, Canada and Japan also have data privacy laws that could be implicated by the gathering of data for purposes of the proposed pay ratio disclosure.<sup>56</sup>

Although we are not proposing any additional accommodation to address this concern, we believe that the flexibility afforded to all registrants under the proposed rules could permit registrants to manage any potential costs

<sup>53</sup> See COEC II and letters from Davis Polk; Group of Exec. Comp. Lawyers; and SCSGP.

<sup>54</sup> The EU Directive 95/46/EC, 1995 O.J. L 281 (European Union Directive on the Protection of Individuals with Regard to the Processing of Personal Data and on the Free Movement of Such Data) sets forth the regulatory framework governing the transfer of personal data from an EU Member State to a non-EU country.

<sup>55</sup> See letter from Group of Exec. Comp. Lawyers.

<sup>56</sup> *Id.*



arising from applicable data privacy laws. For example, consistent with the proposed requirements, registrants in this situation would be permitted to estimate the compensation of affected employees. We request comment below on whether the proposed flexibility afforded to registrants in selecting a method to identify the median, such as the use of statistical sampling or other reasonable estimation techniques and the use of consistently applied compensation measures to identify the median employee, could enable registrants to better manage any potential costs and burdens arising from local data privacy regulations or if there are other alternatives that would be consistent with Section 953(b). Commenters did not provide us with information about applicable data privacy laws sufficient to analyze how the flexibility allowed to all registrants under the proposed requirements could impact the potential costs arising from such laws, and we request information about the specific impact these matters would have on collecting or transferring data needed to comply with the proposed requirements.

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7. Are there alternative ways to fulfill the statutory mandate of covering “all employees” that could reduce the compliance costs and cross-border issues raised by commenters? For example, would it be consistent with the statute to permit registrants to exclude non-U.S. employees from the calculation of the median? Would it be consistent with the statute to permit registrants to exclude non-full-time employees from the calculation of the median? If not, could these alternatives be implemented in a way that would be consistent with the statute?

8. Should registrants be allowed to disclose two separate pay ratios covering U.S. employees and non-U.S. employees in lieu of the pay ratio covering all U.S. and non-U.S. employees? Why or why not? Should we require registrants to provide two separate pay ratios, as requested by some commenters?<sup>57</sup> What should the separate ratios cover (e.g., should there be one for U.S. employees and one for non-U.S. employees, or should there be one for U.S. employees and one covering all employees)? If separate ratios are required, should this be in addition to, or in lieu of, the pay ratio covering all U.S. and non-U.S. employees? Would such a requirement

increase costs for registrants? Would it increase the usefulness to investors of the disclosure?

9. Please identify the applicable data privacy laws or regulations that could impact the collection or transfer of the data needed to comply with the proposed pay ratio requirement. Please also identify whether there are exclusions, exemptions or safe harbors that could be used to collect or transfer such data. Please quantify, to the extent practicable, the impact of such laws on registrants subject to Section 953(b), such as an estimate of the number of registrants affected or the average percentage of employees affected. How would the proposed flexibility afforded to all registrants (i.e., selecting a method to identify the median, the use of statistical sampling or other reasonable estimation techniques and the use of consistently applied compensation measures to identify the median employee) impact any potential costs and burdens arising from local data privacy laws? In particular, would a registrant be able to make a reasonable estimation of the total compensation for affected employees? Would a registrant be able to select a consistent compensation measure that is not subject to local data privacy laws? If not, are there alternative ways to meet the statutory mandate of Section 953(b) that would reduce the costs and burdens arising from local data privacy laws?

10. Are there applicable local data privacy laws that would prohibit the collection or transfer of data necessary to calculate the annual total compensation of an employee or group of employees or the identification of a median employee using a consistent compensation measure? In that situation, would a registrant be able to reasonably estimate compensation? If not, are there alternatives to the proposed rule that would address such a situation while still being consistent with Section 953(b)? Should any such alternatives be permitted? If an alternative should be permitted, what limitations or conditions should be imposed on using the alternative? For example, should registrants be required to disclose the approximate number of employees affected and identify the law that prohibits the collection or transfer of data? Please discuss whether any such alternatives would significantly impact the pay ratio disclosure.

11. Should the rule cover employees of a registrant’s subsidiaries as defined in Rule 405 and Rule 12b–2, as proposed? Are there any situations where an entity meets the subsidiary definition but its employees should not be included for purposes of the

proposed requirement? For example, should the rule be limited to subsidiaries that consolidate their financial statements with those of the registrant? Should the rule not apply to subsidiaries of certain types of registrants, such as the portfolio companies of business development companies? Please provide details of any recommended limitations.

12. Alternatively, should the requirements be limited to employees that are employed directly by the registrant (i.e., excluding employees of its subsidiaries)? Would such a limitation be consistent with Section 953(b)? How would such a limitation affect the potential benefits of the disclosure? Would such a limitation have other impacts, such as incentivizing registrants to alter their corporate structure, and, if so, are there alternative ways that the rule could address those impacts?

13. Should Section 953(b) be read to apply to “leased” workers or other temporary workers employed by a third party? Does the proposed approach to such workers raise costs or other compliance issues for registrants, or impact potential benefits to investors, that we have not identified? Do registrants need guidance or instructions for determining how to treat employees of partially-owned subsidiaries or joint ventures? If so, what should such guidance or instructions entail?

14. Is it likely that registrants would alter their corporate structure or employment arrangements to reduce the number of employees covered by the proposed requirements? How should we tailor the proposed requirements to address such an impact?

15. Does the proposed inclusion of all employees raise competition concerns? If so, are there some industries or types of registrants that would be more affected than others? How should we tailor the proposed requirements to address such concerns?

#### b. Calculation Date for Determining Who Is An Employee

The proposed requirement defines “employee” as an individual employed as of the last day of the registrant’s last completed fiscal year.<sup>58</sup> This calculation date for determining who is an employee would be consistent with the one used for the determination of the three most highly compensated executive officers under Item

<sup>57</sup> See AFL–CIO I and letters from Americans for Financial Reform; Walden Asset Management; and Social Investment Forum.

<sup>58</sup> Proposed Item 402(u)(3).

402(a)(3)(iii). Two commenters expressly supported this approach.<sup>59</sup>

Additionally, two commenters suggested that only employees that have been employed for the entire annual period (and as of the last day of the fiscal year) should be covered.<sup>60</sup> The composition of a company's workforce typically changes throughout the fiscal year, and in some industries and businesses, it can change constantly. Although Section 953(b) requires the median calculation to cover all employees, it does not prescribe a particular calculation date for the determination of who should be treated as an employee for that purpose. We believe that a bright line calculation date for determining who is an employee would ease compliance for registrants by eliminating the need to monitor changing workforce composition during the year, while still providing a recent snapshot of the entire workforce.<sup>61</sup> We agree with the commenters who suggest that the most appropriate calculation date is one that is consistent with the calculation date for determining the named executive officers under current Item 402 requirements.

In proposing this approach, we have assumed that the potential benefits of the disclosure mandated by Section 953(b) would not be significantly diminished by covering only individuals employed on a specific date at year-end, rather than covering every individual who was employed at any time during the year. Although we believe that this approach could help contain compliance costs for registrants, we acknowledge that it could have other costs. For example, this approach would not capture seasonal or temporary employees that are not employed at year-end. This would enable a registrant with a significant amount of such workers to calculate a median that does not fully reflect the workforce that is required to run its business. It could

<sup>59</sup> See letters from RILA ("For consistency with the requirements of Item 402, we believe the best option is to determine the median total annual salary of the issuer's employees as of the close of the most recently completed fiscal year.") and Towers Watson ("[I]t will be necessary to fix the employee group as of a particular date... The last day of the prior year would seem an obvious choice.").

<sup>60</sup> See letters from ABA and RILA. One of these commenters suggested that the use of the word "annual" in Section 953(b) could be interpreted as limiting the scope of the provision to only those employees that have been employed for the full fiscal year. See letter from ABA.

<sup>61</sup> We note that a requirement to track which employees have been continuously employed for the entire annual period could increase costs for registrants, although, as discussed below, we are permitting registrants to annualize the compensation of certain employees.

also cause the proposed requirements to be costlier for, and thereby have an anti-competitive impact on, registrants whose temporary or seasonal workers are employed at year-end as opposed to other times during the year. Finally, it is possible, although commenters have asserted that it is remote, that registrants could try to structure their employment arrangements to reduce the number of workers employed on the calculation date.<sup>62</sup>

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16. Is the proposed calculation date workable for registrants? If not, what date should be used (e.g., the last day of the registrant's second (or third) fiscal quarter) and why?

17. In the alternative, should registrants be permitted the flexibility to choose a calculation date for this purpose? Why or why not? If so, should we require the registrant to disclose why a particular date was chosen? Should such flexibility be limited to certain circumstances? If so, what principles should apply in identifying those circumstances?

18. Is it appropriate to limit the scope of covered employees to those who were employed on the last day of the registrant's fiscal year, as proposed? Why or why not? Is consistency with other Item 402 disclosure important in this context? Would this approach ease compliance costs for registrants? What impact would this calculation date have on registrants that employ seasonal workers and would the exclusion of seasonal workers not employed on the calculation date likely have an impact on the median or the ratio? Please provide data, such as an estimate of the number of registrants that employ seasonal workers and the average percentage of seasonal employees that would likely be excluded. Is it likely that registrants might structure their employment arrangements to reduce the number of workers employed on the calculation date? Are there other costs that would be incurred using this approach that we should consider? Would the proposed calculation date have a meaningful impact on the potential usefulness of the disclosure for investors? Are there other ways to deal with defining the scope of covered employees that are more effective at reducing costs and providing meaningful disclosure?

19. Should registrants be required to include any individual who was

<sup>62</sup> See AFL-CIO I ("The disclosure of compensation data under Section 953(b) will not have unintended consequences on public company employment decisions.").

employed at any time during the year, or for some minimum amount of time (and if so, what amount of time) during the year?

20. Should the rule only apply to employees employed for the full fiscal year? Why or why not?

#### c. Adjustments for Certain Employees

Some commenters raised questions about how to treat employees who were not employed during the entire fiscal year and recommended that companies be permitted to annualize the compensation for these employees in order to more accurately reflect the employment relationship.<sup>63</sup> We agree that in instances where the employment relationship is permanent, and not temporary or seasonal, registrants should be permitted to annualize the total compensation for an employee who did not work for the entire year, such as a new hire or an employee who took an unpaid leave of absence during the period.<sup>64</sup>

Accordingly, the proposed requirements include an instruction that states that total compensation may be annualized for all permanent employees (other than those in temporary or seasonal positions) who were employed for less than the full fiscal year.<sup>65</sup> We are not proposing to require registrants to perform this type of adjustment, however, because we do not believe that the costs of requiring companies to make an extra calculation would be justified.

The proposed instruction is limited to permanent employees. In addition, as proposed, the instruction would not permit a registrant to annualize some eligible employees and not others. As discussed below, this instruction also would not permit adjustments that would cause the ratio to not reflect the actual composition of the workforce, such as annualizing the compensation of seasonal or temporary workers. Depending on the facts and circumstances, it could be appropriate for a registrant to annualize the compensation for a permanent part-time worker who has only worked a portion of the year (such as an employee who is permanently employed for three days a week and who took an unpaid leave

<sup>63</sup> See, e.g., letters from Davis Polk; Frederick W. Cook & Co.; Social Investment Forum; RILA, Walden Asset Management; and Trillium Asset Management.

<sup>64</sup> RILA noted employees on leave under the Family and Medical Leave Act of 1993 [29 U.S.C. 2601 *et seq.*] and employees called for active military duty as common examples.

<sup>65</sup> By use of the term "employee," this proposed instruction would apply to individuals who were employed on the last day of the fiscal year (the calculation date).

of absence under the Family and Medical Leave Act). In such a case, the adjustment should reflect compensation for the employee's part-time schedule over the entire year, but should not adjust the part-time schedule to a full-time equivalent schedule.

In proposing this approach, we have assumed that this annualizing adjustment would not significantly diminish the potential usefulness of the disclosure mandated by Section 953(b). For example, we would not expect that annualizing the salary of a permanent new hire would impact the potential ability of an investor to use the pay ratio disclosure as an indicator of employee morale or to gain an understanding of a registrant's investment in human capital, which some commenters have identified as potential benefits of the disclosure under Section 953(b).<sup>66</sup> We also note that some of the commenters that support Section 953(b) disclosure were also supportive of allowing annualizing adjustments for employees employed for less than the full year.<sup>67</sup>

By permitting but not requiring registrants to annualize compensation for these employees, the comparability of disclosure across companies could be reduced. As discussed elsewhere in this release,<sup>68</sup> we do not believe that precise comparability or conformity of disclosure from registrant to registrant is necessarily achievable due to the variety of factors that could cause the ratio to differ, and, accordingly, we do not believe that the costs associated with attempting to promote precise comparability in this respect would be justified.

Although we are proposing to permit the annualizing adjustments described above, we believe that some of the assumptions or adjustments suggested by commenters for calculating the annual total compensation of employees might present a distorted picture of the actual composition of a registrant's workforce or compensation practices. We believe that certain adjustments or assumptions, such as full-time equivalent adjustments for part-time workers, annualizing adjustments for temporary or seasonal employees, and cost-of-living adjustments for non-U.S. workers, would cause the median to not be reasonably representative of the

registrant's actual employment and compensation arrangements for its workforce during the period and could, therefore, diminish the potential usefulness of the disclosure. Therefore, the proposed disclosure requirements would not permit such adjustments.

For example, under the proposed rules, a retailer that hires a seasonal worker at minimum wage for three months during the holiday season would need to calculate annual total compensation for that employee as three months at \$7.25/hour (\$3,480) and could not "annualize" the wages as if the seasonal worker was paid for a full 12 months of work (\$13,920). In this example, if the seasonal worker was not still employed by the registrant on the last day of the registrant's fiscal year, the registrant would exclude that worker from the calculation of the median.<sup>69</sup>

We understand that some commenters believe that these types of adjustments could allow for a more meaningful comparison between the compensation of the PEO and that of the registrant's employees, especially where those employees are not full-time, U.S. employees.<sup>70</sup> We are concerned, however, that adjusting for these variables could distort an understanding of the registrant's compensation practices. For example, if a registrant with a workforce primarily located in jurisdictions with a lower cost of living than the United States adjusted the annual total compensation of those employees using purchasing power parity statistics, the median of the annual total compensation of all its employees would likely increase. Likewise, if a registrant with a workforce that is primarily part-time or seasonal adjusted the annual total compensation of those employees using full-time equivalent adjustments, the median of the annual total compensation of all its employees would likely increase. In these scenarios, the registrant's pay ratio would show less of a disparity in compensation levels, while its labor costs would appear to be higher than they actually were. We believe that, rather than making the disclosure more meaningful, such a result could diminish the potential usefulness of the disclosure because the ratio would show a less accurate reflection of actual workforce compensation and could permit a registrant to alter the reported

ratio to achieve a particular objective with the ratio disclosure.

#### Request for Comment

21. Is it appropriate to allow registrants to annualize the compensation for non-seasonal, non-temporary employees that have only worked part of the year, as proposed? Why or why not? Would allowing annualizing the compensation for these employees likely impact the median or the pay ratio?

22. In the alternative, should registrants be required to annualize the compensation for these employees? Why or why not?

23. Should we require all registrants that rely on the proposed instruction to annualize compensation for these employees to disclose that they have done so (or only when the adjustment is material, as would be required under the proposed instruction for disclosure of material assumptions, adjustments and estimates)? Why or why not? If so, what should the disclosure entail? For example, should the registrant only be required to state that it has relied on the instruction, or should it also be required to discuss the number or percentage of employees for which compensation was annualized?

24. Should we allow full-time equivalent adjustments for part-time employees and temporary or seasonal employees, as recommended by some commenters?<sup>71</sup> Should we allow cost-of-living adjustments for non-U.S. employees as recommended by some commenters?<sup>72</sup> If so in either case, please explain why. In particular, please address the potential concern that these kinds of adjustments could cause the ratio to be a less accurate reflection of actual workforce compensation. Is there an alternative way to mitigate this concern?

### 3. Identifying the Median

Commenters have suggested that a potential purpose of the pay ratio disclosure is to allow investors to evaluate the annual total compensation of the PEO within the context of the registrant's internal compensation practices.<sup>73</sup> We note that Congress

<sup>66</sup> See letters from Americans for Financial Reform; Frederick W. Cook & Co., Inc.; and RILA.

<sup>67</sup> See generally letter from CtW Investment Group.

<sup>68</sup> See letter from Senator Menendez ("I wrote this provision so that investors and the general public know whether public companies' pay practices are fair to their average employees, especially compared to their highly compensated CEOs.").

See also Representative Keith Ellison, *et al.* ("House Letter") and Senator Robert Menendez *et al.* ("Senate Letter") (noting that Section 953(b)

<sup>66</sup> See AFL-CIO I and letters from; Calvert Investment Management; CtW Investment Group; Group of International Investors; Americans for Financial Reform; Drucker Institute; Institute for Policy Studies; Social Investment Forum; Trillium Asset Management; and UAW Retiree Medical Benefits Trust.

<sup>67</sup> See letters from Social Investment Forum and Trillium Asset Management.

<sup>68</sup> See Section IV of this release.

<sup>69</sup> See proposed Item 402(u)(3).

<sup>70</sup> See letters from American Benefits Council; Americans for Financial Reform; Davis Polk; Frederick W. Cook & Co., Inc.; RILA; Social Investment Forum; Trillium Asset Management; and Walden Asset Management.

specifically chose “median” as the point of comparison for Section 953(b), rather than the average,<sup>74</sup> and, therefore, the proposed pay ratio requirements also require the median to be used.

Section 953(b) does not expressly set forth a methodology that must be used to identify the median, nor does it mandate that the Commission must do so in its rules. In order to allow the greatest degree of flexibility while remaining consistent with the statutory provision, the proposed requirements do not specify any required calculation methodologies for identifying the median. Instead, we are providing instructions and guidance designed to allow registrants to choose from several alternative methods to identify the median, so that they may use the method that works best for their own facts and circumstances. As discussed in detail below, we believe that even a registrant with a large number of employees should be able to provide the proposed disclosure in a relatively cost-efficient manner based on statistical sampling, estimates and the use of any consistently applied compensation measure to identify the median. For instance, an employer with a large number of employees could take a random sample of employees (as discussed further below, the size of the sample needed would typically depend on the overall distribution of compensation across employees) and determine the annual cash compensation, or any other consistently applied compensation measure, for those employees. Identifying the median employee would not necessarily require a determination of exact compensation amounts for each employee in the sample. The registrant could exclude the employees in the sample that have extremely low or extremely high pay because they would fall on either end of the spectrum of pay and, therefore, not be the median employee. Once the registrant identifies the median employee based on the selected compensation measure applied to each remaining employee in the sample, the registrant would calculate that employee’s annual total compensation in accordance with Item 402(c)(2)(x) and

disclose that amount as part of the pay ratio disclosure.

We believe that allowing a registrant to choose a method that works best for its particular facts and circumstances should help registrants to comply with the disclosure requirements in a relatively cost-efficient manner while still achieving the purpose of Section 953(b). As such, the proposed requirements permit registrants to identify the median by using a number of different methods, such as calculating total compensation for each employee using Item 402(c)(2)(x), using reasonable estimates, and/or statistical sampling.<sup>75</sup> We are not prescribing what a reasonable estimate would entail because we believe that would necessarily depend on the registrant’s particular facts and circumstances. In addition, the proposed rules do not prescribe specific estimation techniques or confidence levels for an estimated median because we believe that companies would be in the best position to determine what is reasonable in light of their own employee population and access to compensation data. As discussed in Section II.C.5. below, we are proposing to require that the methodology and any material assumptions, adjustments or estimates used to identify the median be briefly disclosed and consistently used, and any estimated amounts be clearly identified as such. We are proposing this approach because we believe that the appropriate and most cost effective methodology would necessarily depend on a registrant’s particular facts and circumstances, including, among others, such variables as:

- The size and nature of the workforce;
- the complexity of the organization;
- the stratification of pay levels across the workforce;
- the types of compensation the employees receive;
- the extent that different currencies are involved;
- the number of tax and accounting regimes involved;
- the number of payroll systems the registrant has and the degree of difficulty involved in integrating payroll systems to readily compile total compensation information for all employees.

We believe that these likely are the same factors that would cause substantial variation in the costs of compliance. By not prescribing specific methodologies that must be used, the proposed

requirements would allow registrants to choose a method for identifying the median that is appropriate to the size, structure and compensation practices of their own businesses, including identifying the median employee based on any consistently applied compensation measure. In addition, this flexibility could enable registrants to manage compliance costs more effectively. We also believe that, by allowing registrants to better manage costs, a flexible approach could mitigate, to some extent, any potential negative effects on competition arising from the mandated requirements.<sup>76</sup> We recognize, however, that a flexible approach could increase uncertainty for registrants that prefer more specificity on how to comply with the proposed rules, particularly for those registrants that do not use statistical analysis in the ordinary course of managing their businesses.

We acknowledge that commenters provided a variety of recommendations for identifying the median aimed at reducing compliance costs or providing a roadmap for registrants to use to ensure compliance. For example, one commenter suggested that the Commission should establish safe harbor methodologies that authorize registrants to identify the median using a sampling method that is reasonably representative of its workforce, that could be certified by an independent expert or that exceeds a minimum number or percentage of the issuer’s total employees.<sup>77</sup> Another commenter suggested that the Commission prescribe a “menu of alternatives” from which a registrant may select the calculation method that works best in its situation to facilitate disclosure that is meaningful while minimizing data collection costs; registrants would then be required to explain the method and assumptions used.<sup>78</sup> Several commenters recommended that registrants be permitted to use reasonable estimation techniques to identify median compensation for all employees and to determine all forms of compensation, including annual changes in pension value.<sup>79</sup> In considering these alternatives, we favored the recommendations that did not call for prescriptive requirements in order to avoid the additional costs that a less flexible approach could impose. In particular, we believe that the use of reasonable estimates could afford

<sup>74</sup>requires disclosure by public companies of the ratio between the compensation of their CEO and the typical worker at that company . . . and while comprehensive data will not be available until this provision takes effect, there is no question that CEO pay is soaring compared to that of average workers.”)

<sup>74</sup> Some commenters raised the possibility of using an average rather than a median, which they believed would reduce the costs of compliance. See, e.g., letters from American Benefits Council and Brian Foley & Co.

<sup>75</sup> We discuss the specific recommendations of commenters regarding the use of statistical sampling techniques below in this section.

<sup>76</sup> See the discussion in Section IV of this release.

<sup>77</sup> See American Benefits Council.

<sup>78</sup> See letter from Group of Exec. Comp. Lawyers.

<sup>79</sup> See COEC I and letters from Meridian Compensation Partners, LLC and SCSGP.

registrants flexibility without imposing prescriptive requirements that may not be workable for all types of registrants. In addition, we highlight below two alternatives recommended by commenters that would be permitted under the proposal.

*Use of Statistical Sampling.* Two commenters suggested that companies should be permitted to identify the median through a sampling technique or other statistically reasonable method.<sup>80</sup> Two other commenters also provided views on statistical sampling. One commenter, based on a survey of 95 registrants, disagreed that statistical sampling methodology would reduce the compliance burden for companies because of the wide variability in pay practices and recordkeeping and asserted that requiring statistical sampling would introduce further complexity.<sup>81</sup> Another commenter supported the use of statistical sampling and described a random sampling technique that could yield an accurate and unbiased estimate of a registrant's actual median compensation using a relatively small sample size.<sup>82</sup> This commenter asserted that more complicated procedures, such as stratified sampling, would be unnecessary, regardless of company size, how many countries it operates in or how many subsidiaries it has.<sup>83</sup>

As we discuss in more detail in the economic analysis section of this release, the variance of underlying

compensation distributions (that is, how widely employee compensation is spread out or distributed around the mean) can materially affect the sample size needed for reasonable statistical sampling.<sup>84</sup> Variation in the types of employees at a registrant across business units and geographical regions can also add complexity to the sampling procedure. While we generally agree that a relatively small sample size would be appropriate in certain situations, a reasonable determination of sample size would ultimately depend on the underlying distribution of compensation data.<sup>85</sup> As a result, compliance costs would vary across registrants according to the characteristics of their compensation distributions. Nevertheless, we believe that permitting registrants to use statistical sampling may lead to a reduction in compliance costs as compared to other methods of identifying the median.

We note that the identification of a median employee does not necessarily require a determination of exact compensation amounts for every single employee included in the sample. A registrant could, rather than calculating exact compensation, identify the employees in the sample that have extremely low or extremely high pay and that would therefore fall on either end of the spectrum of pay. Since identifying the median involves finding the employee in the middle, it may not be necessary to determine the exact compensation amounts for every employee paid more or less than that employee in the middle. Instead, just noting that the employees are above or below the median would be sufficient

for finding the employee in the middle of the pay spectrum.

*Use of a Consistently Applied Compensation Measure.* Several commenters raised concerns about expected compliance costs arising from the complexity of the "total compensation" calculation under Item 402(c)(2)(x) and, in particular, the determination of total compensation in accordance with Item 402(c)(2)(x) for employees when identifying the median.<sup>86</sup> To address these concerns, several commenters recommended allowing companies to use total direct compensation (such as annual salary, hourly wages and any other performance-based pay) or cash compensation to first identify a median employee and then calculate that median employee's annual total compensation in accordance with Item 402(c)(2)(x).<sup>87</sup> We agree that this approach would provide a workable identification of the median for many registrants, and we expect that the costs of compliance would be reduced if registrants were permitted to identify the median using a less complex, more readily available figure, such as salary and wages, rather than total compensation as determined in accordance with Item 402(c)(2)(x). This approach could also help reduce costs for registrants that are not able to reduce costs using statistical sampling techniques.<sup>88</sup> Because some commenters have indicated that using cash compensation could be just as burdensome to calculate for registrants with multiple payroll systems in various countries,<sup>89</sup> we are not proposing to require companies to use a specific compensation measure, like cash compensation or total direct compensation, when they are identifying the median employee. Instead, we believe that registrants would be in the best position to select a compensation measure that is appropriate to their own facts and

<sup>80</sup> See AFL-CIO II ("The SEC can minimize issuer compliance costs by permitting the use of random statistical sampling to calculate the median. . . . Because the median is a statistical term that is frequently used to describe a set of observations randomly drawn from a larger population, it is reasonable for the SEC to permit issuers to sample their employee populations to calculate the median.") and letter from Davis Polk ("We recommend that the Commission permit companies to identify a single employee, via a sampling technique or other statistically reasonable method, among its employee base as the representative for median compensation.").

<sup>81</sup> See COEC II (noting that sampling "would introduce additional complexity by requiring the development of a methodology to determine the appropriate stratification of the sample population, develop and assess the appropriate confidence intervals to enhance the reliability of the data collected and ensure that comparable forms of compensation are included across the varying pay practices that are common in different regions of the world.").

<sup>82</sup> See letter from M. Ohlrogge.

<sup>83</sup> The commenter assumed that any compensation distribution is lognormal and that the variance of compensation distribution within a company is given as a constant number. We believe, however, that this may not be a practical assumption because, as described in detail in Section IV of this release, each registrant would have a company-specific compensation variance, which is impossible to be generally assumed. In addition, registrants that have multiple business or geographical segments may not necessarily have lognormal distribution of wages.

<sup>84</sup> Our analysis, further discussed in Section IV of this release, uses mean and median wage estimates from the Bureau of Labor Statistics (BLS) at the 4-digit NAICS industry level (290 industries) and assumes a lognormal wage distribution, a 95% confidence interval with 0.5% margin of error. The analysis focuses on the registrants that have a single business or geographical unit. The analysis also assumes that when the sampling is implemented, the sampling method would be a true random sampling, *i.e.*, it would not be biased by region, occupation, rank, or other factor. In our analysis, the appropriate sample size for the registrants with a single business or geographical unit varies between 81 and 1,065 across industries, with the average estimated sample size close to 560.

<sup>85</sup> We believe that reasonable estimates of the median for registrants with multiple business lines or geographical units could be arrived at through more than one statistical sampling approach. All approaches, however, require drawing observations from each business or geographical unit with a reasonable assumption on each unit's compensation distribution and inferring the registrant's overall median based on the observations drawn. Certain cases may not easily generate confidence intervals around the estimates or prescribe the appropriate minimum sample size. See Section IV of this release for further discussion.

<sup>86</sup> See, *e.g.*, COEC I and II and letters from American Benefits Council; Brian Foley & Co.; Group of Exec. Comp. Lawyers; Group of Trade Associations; Protective Life Corporation; SCSGP; and Towers Watson.

<sup>87</sup> See AFL-CIO II and letters from ABA; American Benefits Council; Americans for Financial Reform; CtW Investment Group; Protective Life Corporation; RILA; and SCSGP.

<sup>88</sup> Registrants would be permitted to use a consistently-applied compensation measure to identify the median employee regardless of whether they use statistical sampling.

<sup>89</sup> See COEC II (asserting that cash compensation is not an appropriate substitute since non-cash remuneration makes up a substantial part of compensation in certain parts of the world, and cash compensation would still need to be gathered manually for many registrants due to variances in payroll systems and tax regimes).

circumstances and that a consistently applied compensation measure would result in a reasonable estimate of a median employee at a substantially reduced cost. Therefore, the proposed instructions would permit a registrant to identify a median employee based on any consistently applied compensation measure, such as compensation amounts reported in its payroll or tax records, as long as the registrant briefly discloses the measure that it used (e.g. "We found the median using salary, wages and tips as reported to the U.S. Internal Revenue Service on Form W-2 and the equivalent for our non-U.S. employees." ).<sup>90</sup>

We also understand from commenters that the annual period used for payroll or tax recordkeeping can sometimes differ from the registrant's fiscal year, and, therefore, for purposes of determining the annual compensation amounts when using a consistently applied compensation measure, the proposed instructions also permit the registrant to use the same annual period that is used in the payroll or tax records from which the compensation amounts are derived. We are not proposing to define or limit what would qualify as payroll or tax records. We note, however, that this proposed accommodation is intended to be construed broadly enough to allow registrants to use information that they already track and compile for payroll or tax purposes. We are persuaded by commenters who asserted that permitting companies to use compensation information in the form that it is maintained in their own books and records would reduce compliance costs without appreciably affecting the quality of the disclosure.

Two commenters suggested that registrants should be permitted to calculate the ratio using employee earnings estimates available through the U.S. Department of Labor's Bureau of Labor Statistics ("BLS"), which they believed would reduce costs for registrants and promote comparability across companies.<sup>91</sup> Although we agree

<sup>90</sup> As discussed in Section II.C.4 below, a registrant using a consistently applied compensation measure for purposes of identifying the median would be required to calculate and disclose the annual total compensation for that median employee using the definition of total compensation in Item 402(c)(2)(x).

<sup>91</sup> See COEC II and letter from Group of Exec. Comp. Lawyers. One of these commenters asserts that using BLS statistics would likely result in ratio with a higher disparity than comparing PEO compensation to median employee compensation, and, "if a company decides to avoid the cost and other burdens of an actual median computation by publishing a statistic that shows a higher disparity, it should be allowed to do so." See letter from Group of Exec. Comp. Lawyers.

that such an approach would greatly reduce the compliance burden for registrants, we do not believe it would be consistent with Section 953(b). In addition, we do not believe it would be useful for the Commission to require registrants to compile and disclose information that investors are already able to calculate using publicly available information.

Although the proposed flexible approach could reduce the comparability of disclosure across registrants, we do not believe that precise conformity or comparability of the ratio across companies is necessary. Some commenters believe that a primary benefit of the pay ratio disclosure would be providing a company-specific metric that investors could use to evaluate the PEO's compensation within the context of his or her own company,<sup>92</sup> rather than a benchmark for compensation arrangements across companies. Accordingly, we do not believe that improving the comparability of the disclosure across companies by mandating a specific method for identifying the median would be justified in light of the costs that would be imposed on registrants by a more prescriptive rule. We do not believe that mandating a particular methodology would necessarily improve the comparability across companies because of the numerous other factors that could also cause the ratios to be less meaningful for company-to-company comparison.<sup>93</sup> We believe that greater comparability across companies could increase the likelihood that a registrant's competitors could infer proprietary or sensitive information about the registrant's business,<sup>94</sup> which could increase the costs to registrants of the proposed requirements.

Finally, we recognize that allowing registrants to select a methodology for identifying the median, including identifying the median employee based

<sup>92</sup> See, e.g., Senate Letter; House Letter; and AFL-CIO I; and letters from CitW Investment Group and UAW Retiree Medical Benefits Trust.

<sup>93</sup> These factors could include, among others, variations in the way companies organize their workforces to accomplish similar tasks; variations in pay between companies for identical tasks; differences in the geographical distribution of employees (domestic or international, as well as in high- or low-cost areas); degree of vertical integration; reliance on contract and outsourced workers; ownership structure; and differences in industry and business type.

<sup>94</sup> Where pay ratio information is more "precisely" comparable between companies in the same industry, information about median pay could allow inferences about the business, such as how a company and its workforce is structured, what its compensation practices are, its labor costs and use of outsourcing.

on any consistently applied compensation measure and allowing the use of reasonable estimates, rather than prescribing a methodology or set of methodologies, could permit a registrant to alter the reported ratio to achieve a particular objective with the ratio disclosure, thereby potentially reducing the usefulness of the information. We believe that requiring the use of a consistently applied compensation measure should lessen this concern. We request comment on whether the flexibility of the proposed requirements would allow a registrant to distort its pay ratio in material respects.

#### Request for Comment

25. Should registrants be permitted, as proposed, to choose a method to identify the median that is workable for the company based on its particular facts and circumstances? Will registrants be able to use the proposed approach to identify the median? Do registrants need additional guidance or instructions to be able to use the proposed approach to identify the median? If so, what additional guidance is needed?

26. Do registrants need further guidance on the permitted use of reasonable estimates in identifying the median? If so, what should that guidance be? In the alternative, should the proposed requirement expressly disallow the use of reasonable estimates? Please explain how the usefulness of the pay ratio disclosure would be affected by the use of reasonable estimates. Should the rule specify requirements for statistical sampling or any other estimation methods, such as appropriate sample sizes for reasonable estimates or requiring the results to meet specified confidence levels? Why or why not? If so, what should the requirements be? For example, should the estimate have at least a 90% (or 85%, or some other percentage) confidence level?

27. Are registrants likely to use statistical sampling to identify the median? How would registrants conduct the sampling? Would it be outsourced or conducted by internal personnel? How much would statistical sampling cost? Would the use of statistical sampling address costs relating to the inclusion of non-U.S. employees in the calculation?

28. Should registrants be permitted, as proposed, to identify the median employee using a consistently applied compensation measure? Why or why not? How would this impact compliance costs? Would this address costs arising from having employees in multiple jurisdictions and payroll systems? Should there be any limitations on the

types of compensation measures that can be used? What compensation measure would registrants likely use for this purpose? How would that measure compare to total compensation calculated under Item 402(c)(2)(x)? How would the use of that measure affect the median (e.g. would it likely generate a median that is a reasonable approximation of the median of Item 402(c)(2)(x) total compensation)? What impact, if any, would the use of a consistently applied compensation measure have on the usefulness of the pay ratio disclosure? How could the proposed rules be changed to address any such impact? Are there any circumstances where it would be inappropriate to permit a registrant to use a consistently applied compensation measure to identify the median employee?

29. Should we, as proposed, permit registrants to use the time period that is used for payroll or tax recordkeeping when identifying the median employee based on consistently applied compensation measures, whether or not the time periods correspond with the last completed fiscal year or the tax year? Why or why not? Are there any parameters that should be set, such as requiring the period to end within a designated amount of time before the filing of the proxy or information statement relating to the annual meeting of shareholders or written consents in lieu of such meeting or annual report, as applicable, in which updated pay ratio information is required (such as 3 months, 6 months, 9 months or 12 months) or, alternatively, a period ending no more than 9 months (or 12 months or another amount of time) following the last annual meeting of shareholders? Should such flexibility only be permitted where the registrant's fiscal year-end is different from calendar year-end? Are we correct that this accommodation would decrease costs for registrants? Would the use of different time periods for different employees have an adverse impact on the disclosure? Would such flexibility meaningfully reduce the comparability of the median of the annual total compensation of all employees to the annual total compensation of the PEO, or otherwise impair the potential usefulness to investors of the pay ratio disclosure?

30. Could the flexibility of the proposed requirements allow a registrant to distort its pay ratio in material respects? If so, explain how.

31. Is our belief correct that allowing flexibility in identifying the median could minimize the potential anti-competitive impact of the costs of

compliance? Would the proposed flexibility address other impacts on competition that could arise from the proposed requirements? Could a registrant's competitors infer proprietary or sensitive information about a company's business operations, strategy or labor cost-structure from the disclosure of the median of the annual total compensation of all employees? If so, how can this impact be addressed?

32. Are there alternative ways to satisfy the statutory mandate? Please be specific.

#### 4. Determination of Total Compensation

As mandated by Section 953(b), the proposed requirements would define "total compensation" by reference to Item 402(c)(2)(x). We note that Section 953(b) refers to Item 402(c)(2)(x) as in effect on the day before the date of enactment of the Dodd-Frank Act, or July 20, 2010. No substantive amendments have been made to Item 402(c) since that date.<sup>95</sup> Therefore, the proposed requirements would refer to Item 402(c)(2)(x), without reference to the rules in effect on July 20, 2010. We expect to address the impact on the proposed rules of any future amendments to Item 402(c)(2)(x) if and when such future amendments are considered.

Commenters have observed that, because of the complexity of the requirements of Item 402(c)(2)(x), registrants typically compile information required by Item 402(c) manually for the named executive officers, which they have stated takes significant time and resources.<sup>96</sup> To address this issue, some of these commenters made various recommendations to simplify the total compensation definition, such as including only cash compensation, only cash compensation and equity-based compensation, or only compensation that is reported to the U.S. Internal Revenue Service on Form W-2.<sup>97</sup> As discussed above, we are proposing to allow registrants to identify the median in a variety of ways, including by identifying the median employee using any consistently applied compensation

<sup>95</sup> There have been technical amendments since that date. In August 2011, certain references to U.S. GAAP requirements in the instructions to Item 402 were updated to reflect the FASB's Accounting Standards Codification. See *Technical Amendments to Commission Rules and Forms Related to the FASB's Accounting Standards Codification*, Release No. 33-9250 (Aug. 8, 2011) [76 FR 50117].

<sup>96</sup> See letter from Davis Polk. See also letter from R. Morrison.

<sup>97</sup> See COEC I and letters from American Benefits Council; Brian Foley; Group of Exec. Comp. Lawyers; Protective Life Corporation; SCSGP; and Towers Watson.

measure and then determining and disclosing the Item 402(c)(2)(x) total compensation for that median employee. As proposed, a registrant would be permitted to calculate total compensation for all employees in accordance with Item 402(c)(2)(x), but would only be required to calculate and disclose such information for the median employee.<sup>98</sup> Because the total compensation calculation using Item 402(c)(2)(x) would only be required for one additional employee (the median employee), we are not proposing to simplify the total compensation definition that is required to be used to disclose the median employee compensation and the ratio.

Some commenters have recommended that registrants be permitted to use reasonable estimates to determine the value of the various elements of total compensation for employees in accordance with Item 402(c)(2)(x).<sup>99</sup> We believe that the use of reasonable estimates would not diminish the potential usefulness of the pay ratio disclosure as a general point of comparison of PEO pay to employee pay within a company, and we believe that the use of reasonable estimates would be consistent with Section 953(b). Furthermore, we expect that requirements that allow registrants to use reasonable estimates in these calculations would impose lower compliance costs than requirements that prohibit the use of estimates. Accordingly, the proposed pay ratio requirements permit the use of reasonable estimates in determining any elements of total compensation of employees other than the PEO under Item 402(c)(2)(x), including when disclosing the annual total compensation of the median employee identified using a consistently applied compensation measure. If a registrant uses estimates, instructions to the proposed rule require that the resulting disclosure would need to be clearly identified as an estimated amount and include a brief description of the estimation methods used by the registrant.<sup>100</sup> In using an estimate for annual total compensation (or for a particular element of total compensation), a registrant should have a reasonable basis to conclude that the estimate approximates the actual amount of compensation under Item

<sup>98</sup> Given the specificity of the definition used in Section 953(b), the proposed requirements incorporate the Item 402(c)(2)(x) definition of total compensation as it is set forth in Section 953(b) for purposes of disclosing the median of the annual total compensation of employees and the pay ratio.

<sup>99</sup> See COEC I and letters from ABA and SCSGP.

<sup>100</sup> See proposed Instruction 2 to Item 402(u).

402(c)(2)(x) (or for a particular element of compensation under Item 402(c)(2)(iv)–(ix)) awarded to or paid to those employees. We are not prescribing what a reasonable basis would entail because we believe that would necessarily depend on the registrant's particular facts and circumstances.

Because the requirements of Item 402(c)(2)(x) were promulgated to address executive officer compensation, rather than compensation for all employees, we have considered the difficulties that registrants could face in applying the requirements of Item 402(c)(2)(x) to employees that are not executive officers.<sup>101</sup> First, to assist registrants in applying the definition of "total compensation" to an employee that is not an executive officer, the proposed requirements state that, in determining the total compensation of employees in accordance with Item 402(c)(2)(x), references to "named executive officer" in Item 402 and the related instructions may be deemed to refer instead, as applicable, to "employee." Also, the proposed requirements clarify that, for non-salaried employees, references to "base salary" and "salary" in Item 402 may be deemed to refer instead, as applicable, to "wages plus overtime."<sup>102</sup>

In addition, we understand that certain elements of total compensation may raise particular valuation issues that do not typically arise in the context of compensation for named executive officers. For example, in the case of pension benefits provided to union members in connection with a multi-employer defined benefit pension plan,<sup>103</sup> commenters have noted that the

<sup>101</sup> See letter from RILA ("From a practical perspective, Item 402 raises a host of complexities when applied to an issuer's overall employee population for purposes of calculating the [pay ratio].").

One commenter drew an analogy to the U.S. Treasury regulations [31 CFR Part 30] that required TARP recipients to identify their 100 most highly compensated employees using the definition of total compensation under Item 402; however, the Treasury regulations notably permitted the exclusion of actuarial increases in pension plans and above market earnings on deferred compensation. See letter from ABA ("In our experience, TARP companies found that calculating 'total compensation' to identify their 100 highest paid employees required weeks of work, and presented numerous interpretive issues that do not typically arise when calculating total compensation of executive officers.").

<sup>102</sup> Letter from RILA (noting "'salary' and 'bonus' presumably would translate into total hourly wages plus overtime for non-salaried employees").

<sup>103</sup> See letter from RILA (noting "in cases involving multi-employer plans for union employees, the availability of the required information may be a significant issue when the plan is not required to provide such data on each beneficiary"). See also, J. Goldstein, *Cost Benefit*

participating employers typically do not have access to information (or do not have access in the timeframe needed to compile pay ratio disclosure) from the plan administrator that would be needed to calculate the aggregate change in actuarial present value of the accumulated benefit of a particular individual under the plan.<sup>104</sup> In such circumstances, we believe it would be appropriate for a registrant to use reasonable estimates as described above in determining an amount that reasonably approximates the aggregate change in actuarial present value of an employee's defined pension benefit for purposes of Item 402(c)(2)(viii).

Commenters have also mentioned that interpretive questions will likely arise for registrants with non-U.S. employees in terms of how to value certain unique types of employee compensation given only in certain countries,<sup>105</sup> including personal benefits such as housing. Because we understand that compensation arrangements vary significantly both in the United States and globally, we do not believe it would be practicable for purposes of the proposed requirements to provide detailed, prescriptive rules on valuing particular types of employee compensation. We note, however, that the instructions to Item 402(c)(2)(ix) would permit the exclusion of personal benefits as long as the total value for the employee is less than \$10,000 and that personal benefits should be valued on the basis of the aggregate incremental cost to the registrant.<sup>106</sup> In calculating any such amounts for purposes of determining the total compensation of

*Analysis of Pay Disparity Disclosure*, Oct. 16, 2010, available at <http://blogs.law.harvard.edu/corpgov/2010/10/16/cost-benefit-analysis-of-pay-disparity-disclosure/>.

<sup>104</sup> Section 101(k) and related regulations under the Employee Retirement Income Security Act of 1974, as amended [21 U.S.C. 1021(k)], govern the requirements for plan administrators to provide actuarial reports relating to the plan. Under the rules, a plan administrator has thirty days to respond to a request for an actuarial report, and it is not required to provide access to any reports that have not been its possession for more than thirty days. In addition, the rules prohibit the disclosure of reports that include information that the plan administrator reasonably determines to be "personally identifiable information regarding a plan participant, beneficiary . . . or contributing employer." See 29 CFR 2520.101–6.

<sup>105</sup> See letters from SCSGP and Group of Exec. Comp. Lawyers. We discuss comments relating to non-U.S. employees in more detail in Section II.C.2 of this release.

<sup>106</sup> See Instruction 4 to Item 402(c)(2)(ix). This instruction applies to perquisites and personal benefits. Accordingly, perquisites provided to executive officers who are included in the identification of the median should be treated as set forth in Instruction 4. For this purpose, however, benefits that are provided to all employees or all salaried employees would not be considered "perquisites."

employees other than the PEO, we are proposing that a registrant could use reasonable estimates in the manner described above.

In addition, questions have been raised involving the valuation of government-mandated pension plans,<sup>107</sup> and at least one commenter has noted that the valuation of these plans can be difficult.<sup>108</sup> Another commenter has noted that cross-border differences in government-mandated pension plans raise additional complexity for registrants calculating total compensation for employees located outside the United States.<sup>109</sup> In light of these comments, we acknowledge that some registrants may need clarity as to how to treat government-mandated pension plans for purposes of calculating an employee's total compensation and, specifically, for purposes of determining the aggregate change in actuarial present value of defined pension benefits under Item 402(c)(2)(viii).

In most cases, amounts relating to a government-mandated pension plan would not be included in an employee's total compensation, just as these amounts would not be included under current rules applicable to named executive officers. We note, in particular, that Item 402(c)(2)(viii) applies to a defined benefit plan, which, as explained in the 2006 Adopting Release, is a retirement plan in which the company pays the executive specified amounts at retirement that are not tied to the investment performance of the contributions that fund the plan.<sup>110</sup> The 2006 Adopting Release states that the disclosure required by Item 402(c)(2)(viii) is intended to permit a full understanding of the company's compensation obligations to named executive officers, given that defined

<sup>107</sup> See J. Goldstein, *supra* note 103.

<sup>108</sup> See letter from Group of Exec. Comp. Lawyers. This commenter raised the issue in the context of a discussion of cross-border differences in the availability of government-mandated retirement benefits, which this commenter believed would cause comparisons of employees across jurisdictions to be distorted. This commenter further suggested that the difficulty in valuing government-mandated pension benefits for individual employees would make it difficult for registrants to adjust the ratio for these differences. As described above in Section II.C.3., we believe that such an adjustment would not comply with the proposed requirements.

<sup>109</sup> See letter from Davis Polk ("The information for non-U.S. employees is complicated by local severance benefits and pension rights and related accounting outside the U.S.").

<sup>110</sup> See 2006 Adopting Release, *supra* note 14, at 53175. This definition serves to distinguish defined benefit pension plans from defined contribution plans, in which the amount payable at retirement is tied to the performance of the contributions that fund the plan.



benefit plans guarantee what can be a lifetime stream of payments and allocate risk of investment performance to the company and its shareholders.<sup>111</sup> In contrast, under many government-mandated pension plans, the employee ultimately receives the pension benefit payment from the government, not the employer, and the purpose of the mandated pension benefit is not to provide compensation to the employee from the employer.<sup>112</sup> Notwithstanding any amounts that an employer may be obligated to pay (typically as a tax) to the government in respect of an employee or amounts the employee may be obligated to have withheld from wages and paid to the government,<sup>113</sup> where the pension benefit is being provided to the employee from the government and not by the registrant, a government-mandated defined benefit pension plan would not be considered a “defined benefit plan” for purposes of Item 402(c)(2)(viii) and any accrued pension benefit under such a plan would not be considered compensation for purposes of Item 402(c)(2)(x).

Finally, we acknowledge the concern from some commenters that the application of the definition of total compensation under Item 402(c)(2)(x) to employees that are not executive officers could understate the overall compensation paid to such employees.<sup>114</sup> One of these commenters explains that “[b]y design, Item 402 captures all of the various compensation components received by a named executive officer, excluding certain limited items like benefits under non-discriminatory plans (e.g., healthcare) and perquisites and personal benefits that aggregate less than \$10,000. . . . Applied to an average worker, however, these rules will work in the opposite direction. By excluding certain benefit plans and perquisites (e.g., employee discounts, transportation/parking benefits, education assistance) that do

not exceed the \$10,000 threshold, the rules understate the average employee’s real total compensation. Relative to wages, benefits like healthcare and employee discounts both add significant economic value for an employee and are a prime motivator for the average employee when applying for and maintaining employment.”<sup>115</sup> From this perspective, the omission of these components from the annual total compensation of employees, could render the ratio less meaningful, particularly for the purpose, suggested by some commenters, of evaluating employee morale. We note, however, that these exclusions are permissive, rather than mandatory.<sup>116</sup> Therefore, registrants would be permitted, at their discretion, to include personal benefits (and perquisites in the case of employees that are executive officers) that aggregate less than \$10,000 and compensation under non-discriminatory benefit plans in calculating the annual total compensation of employees. In order to be consistent, the PEO total compensation used in the related pay ratio disclosure would also need to reflect the same approach to these items as is used for employees, and the registrant should explain any difference between the PEO total compensation used in the pay ratio disclosure and the total compensation amounts reflected in the summary compensation table.

#### Request for Comment

33. Are there other alternatives to calculating total compensation in accordance with Item 402(c)(2)(x) that would be consistent with Section 953(b)?

34. Should the requirements provide instructions or should we provide additional guidance about how to apply the definition of total compensation under Item 402(c)(2)(x) (or any particular elements of total compensation under Item 402(c)(2)) to employees that are not executive officers? If so, what specific instructions or guidance would be useful to registrants? Please also address whether specific instructions or guidance would limit flexibility and thereby raise costs for registrants.

35. Do registrants need further guidance on the permitted use of reasonable estimates in determining total compensation (or specific elements of total compensation) for employees other than the PEO in accordance with Item 402(c)(2)(x)? If so, what should that

guidance entail? Would the use of reasonable estimates ever be inappropriate? Please also address whether specific instructions or guidance would limit flexibility and thereby raise costs for registrants.

36. Instead of allowing the use of reasonable estimates in determining total compensation (or any elements of total compensation) as described in this proposal, should the rules prohibit the use of reasonable estimates for that purpose? If so, why? Please include an explanation of how the potential usefulness of the pay ratio disclosure would be affected by a registrant’s use of reasonable estimates in this context. Are there alternative ways to address this impact, such as requiring an explanation describing the use of estimates, rather than prohibiting the use of estimates?

37. Is it likely that the proposed requirements would affect the types of compensation that registrants provide to employees, and if so, what would that impact be? For example, one commenter suggested that registrants could decide to discontinue pension and incentive plans for employees or eliminate 401(k) plan matching contributions in order to facilitate their calculation of the pay ratio.<sup>117</sup> If so, how should the proposed requirements address that impact?

#### 5. Disclosure of Methodology, Assumptions and Estimates

We are proposing instructions for the disclosure of the methodology and material assumptions, adjustments and estimates used in the calculation of the median or the annual total compensation of employees.<sup>118</sup> The proposed instruction provides that registrants must briefly disclose and consistently apply any methodology used to identify the median and any material assumptions, adjustments or estimates used to identify the median or to determine total compensation or any elements of total compensation, and registrants must clearly identify any estimated amount as such. Registrants’ disclosure of the methodology and material assumptions, adjustments and estimates used should provide sufficient information for a reader to be able to evaluate the appropriateness of the estimates. For example, when statistical sampling is used, registrants should

<sup>111</sup> *Id.*

<sup>112</sup> Although Item 402(a)(2) includes in compensation transactions between a registrant and a third party where the purpose of the transaction is to furnish compensation to the employee, we generally would not consider a government-mandated pension plan to be such a transaction.

<sup>113</sup> As under current rules, amounts an employer pays to the government in respect of an employee are obligations of the registrant to that government and would not be “compensation” for purposes of Item 402(c)(2)(x).

Note, however, pursuant to Item 402(c)(2)(ix), tax gross-ups are included in total compensation. Therefore, if a registrant pays an employee’s required contribution to the government (*i.e.*, the registrant satisfies the employee’s obligation to the government), the amount of the employee’s contribution that is paid by the registrant would be includable in total compensation as a tax gross-up.

<sup>114</sup> See letters from RILA and Protective Life Corporation.

<sup>115</sup> See letter from RILA; however, as discussed above, by definition, benefits provided on a non-discriminatory basis to all employees would not be considered perquisites.

<sup>116</sup> See Item 402(c)(ix)(A) and Item 402(a)(6)(ii).

<sup>117</sup> See letter from RILA.

<sup>118</sup> We note that other Commission rules require such disclosures, particularly where registrants are given the flexibility to choose a methodology. See, e.g., Instructions to Item 402(h)(2), requiring registrants to disclose the valuation method and all material assumptions applied in quantifying the present value of accrued pension benefits for purposes of the Pension Benefit Table.

disclose the size of both the sample and the estimated whole population, any material assumptions used in determining the sample size, which sampling method (or methods) is used, and, if applicable, how the sampling method deals with separate payrolls such as geographically separated employee populations or other issues arising from multiple business or geographic segments. In order to promote comparability from year to year, the instruction also provides that, if a registrant changes methodology or material assumptions, adjustments or estimates from those used in the previous period, and if the effects of any such change are material, the registrant must briefly describe the change, the reasons for the change, and must provide an estimate of the impact of the change on the median and the ratio.

Because we are concerned that disclosure about methodology, assumptions, adjustments and estimates could become dense and overly technical, the instruction asks for a brief overview and makes clear that it is not necessary to provide technical analyses or formulas. In addition, we do not believe that a detailed, technical discussion (such as statistical formulas, confidence levels or the steps used in data analysis) would enhance the potential usefulness, as suggested by some commenters,<sup>119</sup> of the ratio as a metric to evaluate the level of PEO compensation. We expect that a succinct description of the methodology and material assumptions, adjustments or estimates would not be overly burdensome for registrants and would be more informative for investors. We expect that the costs of the additional disclosure on registrants would be marginal, as these additional disclosures are intended to simply describe what has already been done or assumed in the calculations and, therefore, will not require additional actions for registrants. It is likely that some costs may be incurred in developing and reviewing the appropriate language to describe the approach taken.

The instruction also provides that the methodology and any material assumptions, adjustments and estimates should be consistently applied by the registrant in identifying the median. Likewise, where a registrant uses estimates in calculating the annual total compensation (or elements thereof) of employees, the methodology and any material assumptions, adjustments and estimates used in the calculation (such

<sup>119</sup> See, e.g., Senate Letter; House Letter; and AFL-CIO I; and letters from CtW Investment Group and UAW Retiree Medical Benefits Trust.

as currency translations<sup>120</sup> or annualizing newly hired, non-temporary employees) should be used consistently by a registrant. Similarly, when using a compensation measure to identify the median employee, that compensation measure should be consistently applied to each employee included in the calculation. We believe that requiring consistent use of methodology, and particularly material assumptions, adjustments and estimates, could reduce incentives for registrants to use methodology to affect the outcome of the identification of the median or the ratio.

Several commenters recommended that registrants be required to describe the methodology, assumptions and estimates used in identifying the median.<sup>121</sup> Some commenters further suggested that a narrative discussion of the ratio and its components (including methodology and assumptions used), together with supplemental information about employee compensation structures and policies, be required, in order to provide additional context for the ratio.<sup>122</sup> Other than the brief description of methodology described above, the proposed requirements do not include a specific requirement for narrative discussion of the ratio, the median or any supplemental information. Section 953(b) requires disclosure of the pay ratio, but it does not require any additional information to provide context for or to explain the ratio or its components, therefore, we are not proposing to require additional information. We are sensitive to the costs of the mandated disclosure, and we believe that additional narrative disclosure about the ratio would not, for many registrants, provide useful information for investors that would justify the costs associated with

<sup>120</sup> Some commenters requested guidance on converting wages to U.S. dollars for purposes of pay ratio disclosure. Instruction 2 to Item 402(c) requires registrants to identify by footnote the currency, exchange rate and conversion methodology used in connection with compensation that is paid to or received by an executive officer in a different currency than U.S. dollars. In connection with the proposed requirements, registrants generally would not be required to disclose the currencies, exchange rates and conversion methodologies used in determining the annual total compensation of employees, but, where applicable, the rates and conversion methodologies used should be consistent with those used for the named executive officers in the summary compensation table.

<sup>121</sup> See AFL-CIO II and COEC I; and letters from ABA; Group of Exec. Comp. Lawyers; Meridian Compensation Partners, LLC; and SCSGP.

<sup>122</sup> See AFL-CIO I (recommending a required discussion and analysis "including their use of outsourcing and off-shoring strategies, use of part-time and temporary employees, and use of efficiency wages to boost productivity") and letter from Americans for Financial Reform.

providing that additional disclosure. The types of additional information that may be relevant to further understanding the ratio in a particular period would necessarily vary from company to company and could also vary from time to time as a registrant's business evolves or due to external factors, such as changes in the global economic environment or the labor marketplace. While some investors and other market participants could find supplemental information about a registrant's employment practices, the composition of its workforce and similar topics (such as employment policies, use of part-time workers, use of seasonal workers, outsourcing and off-shoring strategies) useful or informative, we do not believe that the cost of prescribing additional disclosure would be justified. Therefore, we are not proposing requirements for a narrative discussion beyond the proposed brief description of the calculation methodology where estimation techniques have been used.

Finally, one commenter suggested that the rule expressly permit additional disclosure to accompany the pay ratio.<sup>123</sup> Although we do not believe that it is necessary to include instructions in the proposed requirements for this purpose, we emphasize that, as with other mandated disclosure under our rules, registrants would be permitted to supplement the required disclosure with a narrative discussion if they choose to do so. Likewise, we note that registrants may, at their discretion, present additional ratios to supplement the required ratio. As with other disclosure under our rules, however, any additional ratios should be clearly identified and not misleading, and should not be presented with greater prominence than the required ratio.<sup>124</sup>

#### Request for Comment

38. Should we require registrants to disclose information about the methodology and material assumptions, adjustments or estimates used in identifying the median or calculating annual total compensation for employees, as proposed? Why or why not? Would this information assist investors in understanding the pay ratio? Are there changes we could make to the requirement to avoid boilerplate disclosure? Should we require a more technical discussion, such as requiring the disclosure of statistical formulas,

<sup>123</sup> See letter from Towers Watson.

<sup>124</sup> See, e.g., Exchange Act Rule 12b-20; and Commission's Guidance Regarding Management's Discussion and Analysis or Financial Condition and Results of Operations, Release No. 33-8350 (Dec. 19, 2003) [68 FR 75056], at 75060.

confidence levels or the steps used in the data analysis?

39. Should we require disclosure when a registrant changes its methodology (or material assumptions, adjustments or estimates) from previous periods, where such change has a material effect, as proposed? Should registrants be required to describe the reasons for the change, as proposed? Should registrants be required to provide an estimate of the impact of the change on the median and the ratio, as proposed? Is the proposed information useful? Is there other information that should be required?

40. Should we require registrants to disclose additional narrative information about the pay ratio or its components, or factors that give context for the median, such as employment policies, use of part-time workers, use of seasonal workers, outsourcing and off-shoring strategies? If so, what additional information should be required? Please be specific as to how this information would assist investors in understanding the pay ratio or in using the pay ratio disclosure. Please also be specific about the costs of providing such disclosure. How could such a requirement be designed to avoid boilerplate disclosure? Would such a requirement raise competition concerns?

41. Should we require registrants to disclose additional metrics about the total compensation of all employees (or of the statistical sample if one is used), such as the mean and the standard deviation, as a supplement to the required disclosure? Would additional metrics be useful to investors? We assume that these metrics could be provided without additional cost or at a low cost once the median has been identified. Is this assumption correct? If not, please identify the costs and benefits of such additional disclosure. Would such a requirement raise competition concerns?

## 6. Clarification of the Meaning of "Annual"

In order to provide clarity, the proposed requirement defines "annual total compensation" to mean total compensation for the last completed fiscal year, consistent with the time period used for the other Item 402 disclosure requirements. This clarification is intended to address questions from commenters about the need to update the pay ratio disclosure throughout the year and make clear that the disclosure does not need to be updated more than once a year.<sup>125</sup> One

<sup>125</sup> See, e.g., letters from American Benefits Council and ABA.

commenter expressly supported this approach.<sup>126</sup>

Two commenters suggested other possible alternatives for the calculation of "annual" total compensation. One of these commenters recommended that registrants should have flexibility to select a time period for calculating the annual total compensation of employees, noting that registrants without a calendar year fiscal year-end might benefit from the flexibility to use the calendar year period since that would be consistent with the registrant's tax reporting obligations.<sup>127</sup> Another commenter suggested two timing rules that would grant registrants further flexibility to use the 12-month time periods that their payroll systems use.<sup>128</sup> We understand that these suggestions are intended to reduce compliance costs for registrants by giving registrants the ability to use information in the form that it is currently compiled for other purposes, such as tax and payroll recordkeeping. We believe, however, that it is appropriate for the time period for the pay ratio disclosure to be the same as the time period used for the registrant's other executive compensation disclosures, and, therefore, a registrant would be required to calculate the total compensation for the median employee for the last completed fiscal year. As discussed above, for purposes of estimating the median employee, we propose to allow a registrant to use compensation amounts derived from its payroll or tax records for the same annual period that is used in the payroll or tax records. We believe that permitting companies to identify the median employee using compensation information in the form that it is maintained in their own books and records would reduce compliance costs and that the proposed flexibility in estimating the median employee could address the concerns raised by these commenters. Registrants using payroll

<sup>126</sup> See letter from RILA (noting "we recommend that the Compensation Ratio be based on the issuer's last completed fiscal year, which would make it consistent with the executive compensation disclosure under Item 402 and reduce the compliance costs and burdens at least in so far as the information required for the Summary Compensation Table could be used for purposes of the Compensation Ratio as well.").

<sup>127</sup> See letter from American Benefits Council.

<sup>128</sup> See letter from Group of Exec. Comp. Lawyers (recommending: "Rule One—the registrant can select any date as of which to calculate median compensation, provided the date is within 12 months of the proxy filing, and is the most recent practicable date, and Rule Two—if different payroll systems are involved, the 12-month period for computing compensation data for each payroll system's data will be acceptable so long as the period ends within 12 months of the date chosen under Rule One.").

or tax records to identify the median employee would be required to calculate the Item 402(c)(2)(x) total compensation for that median employee for the last completed fiscal year, rather than the annual period used in the payroll or tax records.

## Request for Comment

42. For purposes of the disclosure of the median of the annual total compensation of employees and the pay ratio, should we, as proposed, require total compensation to be calculated for the last completed fiscal year, rather than some other annual period? Why or why not? How does this impact the ability of a registrant to compile the disclosure in time to include it in a proxy or information statement relating to an annual meeting of shareholders (or written consents in lieu of such meeting)?

## 7. Timing of Disclosure

### a. Updating Pay Ratio Disclosure for the Last Completed Fiscal Year

We are proposing instructions to clarify the timing for updating pay ratio disclosure after the end of a registrant's fiscal year.<sup>129</sup> As discussed above, proposed Item 402(u) would require annual total compensation amounts used in the ratio to be calculated for the registrant's last completed fiscal year. In addition, pay ratio disclosure would be required in any filing by the registrant that requires Item 402 disclosure. Accordingly, without the proposed instructions, a registrant could be required to include pay ratio disclosure in an annual report or registration statement filed after the end of the fiscal year, but before it has compiled the executive compensation information for that fiscal year for inclusion in its proxy statement relating to its annual meeting of shareholders,<sup>130</sup> which could raise additional incremental costs for registrants that elect to provide executive compensation disclosure in their annual proxy statement rather than their annual report and for registrants that are conducting registered offerings at the beginning of their fiscal year.

To address this issue, some commenters recommended that pay ratio disclosure not be required to be

<sup>129</sup> See letter from ABA (noting "the Commission should clarify when information for the most recently completed fiscal year is required to first be disclosed").

<sup>130</sup> Many registrants typically satisfy their disclosure obligations under Part III of Form 10-K (which includes Item 402 requirements) by incorporating the required information by reference from their proxy or information statement that is filed after their annual report on Form 10-K. See General Instruction G(3). We discuss the mechanics of General Instruction G(3) in more detail below.

updated for the most recently completed fiscal year until the registrant files its proxy statement for its annual meeting of shareholders.<sup>131</sup> We agree with this suggested approach, and we believe that such an approach would not diminish the potential usefulness of the disclosure. At least one commenter who supported Section 953(b) disclosure also recommended a similar approach.<sup>132</sup> We also believe that this approach could hold down additional costs for registrants in connection with filings made or required to be made before the filing of the proxy or information statement for the annual meeting of shareholders (or written consents in lieu of such a meeting) that would typically contain the registrant's other Item 402 disclosure covering the most recently completed fiscal year. For example, under the proposed approach, updating the pay ratio disclosure would not be an additional hurdle for a registrant that requests effectiveness of a registration statement after the end of its fiscal year and before the filing of the proxy statement for its annual meeting of shareholders. We believe that the proposed instruction would provide certainty to registrants as to when the updated information is required and would allow sufficient time after the end of the fiscal year to identify the median.

Although we agree with the recommendation of commenters to not require updated annual pay ratio disclosure until a registrant files its annual proxy or information statement, we note that not all registrants that would be subject to the proposed pay ratio disclosure file proxy or information statements in connection with annual meetings of shareholders. For example, reporting companies that do not have securities registered under Section 12 of the Exchange Act are not required to file proxy or information statements for their annual meeting of shareholders and therefore typically provide Item 402 information updated for the most recently completed fiscal year in their annual report on Form 10-K. In addition, some registrants are not required to file annual proxy or information statements because they are not required to hold annual meetings (such as registrants that are organized as master limited partnerships) or because the securities that are registered under Section 12 of the Exchange Act have limited voting rights (such as common

units representing limited liability company interests). Accordingly, we are proposing a modified version of the recommendation of commenters in order to provide a similar accommodation for registrants that do not file annual proxy statements and to align the proposed requirement to the timing rules for providing Item 402 disclosure in annual reports and proxy and information statements.

As noted above, registrants typically disclose Item 402 information for the most recently completed fiscal year in their proxy or information statement relating to their annual meeting of shareholders, in reliance on General Instruction G(3) of Form 10-K. This instruction allows the information required by Part III of Form 10-K (including Item 402 information) to be incorporated by reference from the registrant's definitive proxy statement (filed or required to be filed pursuant to Regulation 14A) or definitive information statement (filed or required to be filed pursuant to Regulation 14C) if that statement involves the election of directors and is filed not later than 120 days after the end of the fiscal year covered by the annual report. If a definitive proxy statement or information statement is not filed in the 120-day period (or is not required to be filed by virtue of Rule 3a12-3(b) under the Exchange Act), the Part III information must be filed as part of the Form 10-K, or as an amendment to the Form 10-K, not later than the end of the 120-day period.

In order to align with this timeframe, the proposed instruction would state that a registrant is not required to include pay ratio disclosure with respect to its last completed fiscal year until the filing of its annual report for that last completed fiscal year or the filing of a definitive proxy or information statement relating to an annual meeting of shareholders (or written consents in lieu of such a meeting), provided that updated pay ratio information must, in any event, be filed as provided in General Instruction G(3) of Form 10-K not later than 120 days after the end of such fiscal year. As an example, a registrant would not be required to disclose pay ratio information relating to compensation for fiscal year 2014 until its definitive proxy or information statement for its 2015 annual meeting of shareholders.<sup>133</sup>

<sup>133</sup> Consistent with the proposed instructions, we note that a registration statement that incorporates by reference a Form 10-K (or amended Form 10-K) containing all Part III information *other than* updated pay ratio information could be declared effective before the registrant's definitive proxy or information statement containing updated pay ratio

Consistent with the treatment of other information required by Part III of Form 10-K, if that registrant does not file its definitive proxy or information statement within 120 days of the end of 2014 (*i.e.*, April 30, 2015), it would need to file updated pay ratio disclosure in its Form 10-K for 2014 or an amendment to that Form 10-K. In contrast, a registrant that is not subject to the proxy rules or does not file a proxy or information statement in connection with an annual meeting of shareholders would be required to update its pay ratio disclosure for fiscal year 2014 in its annual report on Form 10-K for that year.

In order to provide guidance to registrants in connection with filings made before the annual update is triggered, the proposed instruction would also state that, in any filing made by a registrant after the end of its last completed fiscal year and before the filing of such Form 10-K or proxy or information statement, as applicable, a registrant must include or incorporate by reference its pay ratio disclosure (if such disclosure had been required) for the fiscal year prior to the last completed fiscal year.

Although the annual update is not required to be disclosed until the filing of an annual report for the last completed fiscal year, or if later, the filing of a definitive proxy statement or information statement relating to the registrant's annual meeting of shareholders, this updating provision does not alter the requirements for Item 402 disclosure under Item 8 of Schedule 14A in other proxy or information statement filings. For example, if a registrant files a proxy statement (other than the definitive proxy statement for its annual meeting) that requires Item 402 information pursuant to Item 8 of Schedule 14A, the registrant would be required to include or incorporate by reference pay ratio disclosure for the most recent period that had been filed in its Form 10-K or definitive proxy statement for its annual meeting.

#### Request for Comment

43. Should we, as proposed, require the pay ratio disclosure to be updated no earlier than the filing of a registrant's annual report on Form 10-K or, if later, the filing of a proxy or information statement for the registrant's annual meeting of shareholders (or written consents in lieu of such a meeting), and in any event not later than 120 days after the end of its fiscal year? Are we correct that the proposed timing rule

information is filed in accordance with General Instruction G(3).

<sup>131</sup> See letters from ABA and Compensia, Inc.

<sup>132</sup> See AFL-CIO II (asserting that pay ratio disclosure will be useful to investors and recommending that the disclosure be limited to annual proxy statements).

would not affect the potential usefulness of the pay ratio disclosure for investors? If not, how should the requirements be changed to address that impact? Are we correct that the proposed timing rule would help to keep costs down for registrants by providing certainty as to the timing for annual updates and by allowing registrants to compile the disclosure at the same time as other executive compensation disclosure under Item 402? Are we correct that the proposed timing rule would help keep down costs for registrants that request effectiveness of registration statements after the end of the last fiscal year but before the filing of their annual proxy statement?

44. Is the proposed timing workable for registrants? Does it provide enough time after the end of the fiscal year for companies to identify the median of the total compensation of all employees for that year? We note that one commenter asserted that it could take registrants three months or more each year to calculate pay ratio disclosure, and, accordingly, that the disclosure would not be available in time to be included in the annual proxy statement or annual report.<sup>134</sup> Would the ability to use reasonable estimates, consistently applied compensation measures, or statistical sampling be sufficient to alleviate this issue? For example, if a registrant is unable to calculate its employees' incentive compensation before such time, would it be able to reasonably estimate such compensation? Instead, should the proposed rules provide an accommodation for a company that cannot compile compensation information in time to be included in its proxy statement for the annual meeting of shareholders or Form 10-K, as applicable? For example, should registrants be permitted to delay the pay ratio disclosure until it is calculable and then file the disclosure under Item 5.02(f) of Form 8-K?<sup>135</sup> If so, under what circumstances should registrants be permitted to do so? Or, if we were to allow for such a delay, should we specify when the disclosure should be required to be made? If so, what deadline should we impose? Would such a delay impact the usefulness to investors of the disclosure, particularly if the disclosure would not be available in time for inclusion in

proxy or information statements for the annual meeting of shareholders?

b. Proposed Instruction for Pay Ratio Disclosure When the Registrant Omits Salary or Bonus Information for the PEO in Reliance on Instruction 1 to Item 402(c)(2)(iii) and (iv), and Proposed Technical Amendment to Item 5.02(f) of Form 8-K

In accordance with Instruction 1 to Items 402(c)(2)(iii) and (iv) of Regulation S-K, a registrant is permitted to omit disclosure in the summary compensation table of the salary or bonus of a named executive officer if it is not calculable as of the latest practicable date. In that circumstance, a registrant must include a footnote disclosing that fact and providing the date that the amount is expected to be determined, and the amount must be disclosed at that time by filing a Form 8-K. Item 5.02(f) of Form 8-K sets forth the requirements for the filing of information that was omitted from Item 402 disclosure in accordance with Instruction 1 to Items 402(c)(2)(iii) and (iv), including the requirement to include a new total compensation figure for the named executive officer.

In cases where a registrant is relying on this instruction because the salary or bonus of the PEO is not calculable until a later date, we believe that it is also appropriate for a registrant to omit pay ratio disclosure until those elements of the PEO's total compensation are determined and provide its pay ratio disclosure in the same filing under Item 5.02(f) of Form 8-K in which the PEO's salary or bonus is disclosed. Accordingly, the proposed rule would include an instruction that provides that a registrant relying on Instruction 1 to Items 402(c)(2)(iii) and (iv) with respect to the salary or bonus of the PEO would be required to disclose that the pay ratio disclosure is being omitted because the PEO's total compensation is not available and to disclose the expected date that the total compensation for the PEO will be determined.<sup>136</sup> The instruction would then require the registrant to include its pay ratio disclosure in the filing on Form 8-K that includes the omitted salary or bonus information as contemplated by Instruction 1 to Items 402(c)(2)(iii) and (iv). We are also proposing a conforming amendment to Item 5.02(f) of Form 8-K to reflect the addition of this pay ratio disclosure requirement. In addition, although a filing is triggered under Item 5.02(f) when the omitted salary or bonus becomes calculable in whole or in part, under the proposed amendments to

Form 8-K, the pay ratio information would be required only when the salary or bonus becomes calculable in whole, which would avoid the need for multiple updates to the pay ratio disclosure until the final total compensation amount for the PEO is known.

In proposing this instruction, we have assumed that the potential benefits of the disclosure could be diminished if the pay ratio were to be calculated using less than the entire amount of the PEO's total compensation for the period and that these potential benefits could justify the potential costs to investors of a delay in the timing of the disclosure. For example, in some cases, the amount of compensation that is omitted under Instruction 1 to Items 402(c)(2)(iii) and (iv) could be significant, and, therefore, the pay ratio would be lower if it were presented using that incomplete compensation amount. Based on the number of registrants that have historically relied on Instruction 1 to Items 402(c)(2)(iii) and (iv),<sup>137</sup> we do not expect that the proposed instruction would impact a significant number of registrants each year.

#### Request for Comment

45. Is the proposed instruction appropriate in instances where registrants are relying on Instruction 1 to Items 402(c)(2)(iii) and (iv) with respect to the salary or bonus of the PEO?

46. Instead of the proposed approach, should these registrants be required to calculate pay ratio disclosure using only the amounts of total compensation of the PEO that are available at the time of the filing, or in the alternative, make a reasonable estimate of the omitted total compensation amounts? Would such disclosure be useful or meaningful? In that case, should the registrant be required to update (by Form 8-K or otherwise) its pay ratio disclosure to reflect the PEO's recalculated total compensation?

47. Is the proposed instruction clear? If not, what changes should be made to clarify it?

48. Should we require any additional or supplemental disclosure when a registrant relies on the proposed instruction? If so, what would that disclosure entail? For example, should the proposed instruction require registrants to report the median annual total compensation of employees, even if the PEO total compensation and pay

<sup>134</sup> See COEC II.

<sup>135</sup> Item 5.02(f) of Form 8-K sets forth the requirements for the filing of information that was omitted from Item 402 disclosure in accordance with Instruction 1 to Items 402(c)(2)(iii) and (iv). These are described in more detail in the next subsection of this release.

<sup>136</sup> See Proposed Instruction 4 to Item 402(u).

<sup>137</sup> For example, based on a review of EDGAR filings in 2012, only 22 registrants relied on Instruction 1 to Items 402(c)(2)(iii) and (iv) in connection with the total compensation of their PEO.

ratio are not available? Should registrants relying on the proposed instruction be required to disclose the pay ratio for the prior year in the Form 10-K or proxy or information statement?

49. Would the proposed instruction cause registrants to change their compensation practices? Alternatively, would the proposed instruction have an adverse impact on the usefulness to investors of the proposed pay ratio disclosure? How should we change the proposed requirements to address such impacts?

#### 8. Status as “Filed” Not “Furnished”

Some commenters suggested that pay ratio information be deemed “furnished” and not “filed” for purposes of the Securities Act and Exchange Act.<sup>138</sup> We note that Section 953(b) refers to the pay ratio information being disclosed in the registrant’s “filings” with the Commission. We believe that the use of the word “filing” in Section 953(b) is consistent with the disclosure being filed and not furnished. Accordingly, we are not proposing to permit the pay ratio information to be deemed “furnished.” Like other Item 402 information, the pay ratio disclosure would be considered “filed” for purposes of the Securities Act and Exchange Act and, accordingly, would be subject to potential liabilities thereunder.

We note that one of the reasons that commenters recommended treating the information as furnished and not filed is because of the difficulty that some companies may have in determining and verifying the information, which must be covered by the certifications required for Exchange Act filings under the Sarbanes-Oxley Act of 2002.<sup>139</sup> We also recognize that some registrants could have more difficulty in gathering and verifying the information than others. Nevertheless, we believe that the flexibility afforded to registrants in connection with identifying the median could reduce some of the difficulties of compiling the required information, because registrants would be able to tailor the methodology to reflect their own facts and circumstances. The ability to use reasonable estimates in connection with the calculation of annual total compensation for employees other than the PEO could also alleviate some of these concerns. In addition, we believe that the proposed transition periods discussed below, which are designed to give registrants

sufficient time to develop and implement compliance procedures, could mitigate some concerns about compiling and verifying the information.

#### Request for Comment

50. Should the Section 953(b) information be filed rather than furnished? What weight should we give to the use of the word “filing” in the statute?

51. Are there other ways to address commenters’ concerns about the ability to compile and verify the pay ratio information that still fulfills the statutory mandate?

#### D. Transition Matters

##### 1. Proposed Compliance Date

Section 953(b) does not specify a date when registrants must begin to comply with the requirements that we implement. We are proposing to require that a registrant must begin to comply with proposed Item 402(u) with respect to compensation for the registrant’s first fiscal year commencing on or after the effective date of the rule, and, as proposed, a registrant would be permitted to omit this initial pay ratio disclosure from its filings until the filing of its annual report on Form 10-K for that fiscal year or, if later, the filing of a proxy or information statement for its next annual meeting of shareholders (or written consents in lieu of a meeting) following the end of such year. Similar to the proposed instructions for updating pay ratio disclosure, this initial pay ratio disclosure would be required, in any event, to be filed as provided in connection with General Instruction G(3) of Form 10-K not later than 120 days after the end of such fiscal year. Thus, if the final requirements were to become effective in 2014, a registrant with a fiscal year ending on December 31 would be first required to include pay ratio information relating to compensation for fiscal year 2015 in its proxy or information statement for its 2016 annual meeting of shareholders (or written consents in lieu of such a meeting). Consistent with the treatment of other information required by Part III of Form 10-K, if that registrant does not file its proxy or information statement within 120 days of the end of 2015 (*i.e.*, April 30, 2016), it would need to file its initial pay ratio disclosure in its Form 10-K for 2015 or an amendment to that Form 10-K. Similarly, a registrant with a fiscal year ending on December 31 that is not subject to the proxy rules or does not file a proxy or information statement in connection with an annual meeting of

shareholders would be required to include pay ratio information relating to compensation for fiscal year 2015 in its Form 10-K covering fiscal year 2015, which would be due in the first quarter of 2016. Registrants would be permitted to begin compliance earlier on a voluntary basis.

Several commenters noted that companies will need a long transition period before they can implement systems to compile the disclosure and verify its accuracy.<sup>140</sup> We understand that this time would likely be needed by large, multinational registrants and any registrants that currently do not have a centralized, consolidated payroll, benefits and pension system that captures the information necessary to identify the median.<sup>141</sup> We expect that it will take registrants one full reporting cycle to implement and test any necessary systems,<sup>142</sup> and we believe that the proposal provides that time for transition and implementation.

We believe it is appropriate to allow a registrant to omit its initial pay ratio disclosure from filings that would otherwise require Item 402 information for its first fiscal year commencing on or after the effective date of the final rule until the filing of its annual report on Form 10-K or, if later, a proxy or information statement relating to its next annual meeting of shareholders (and in any event not later than 120 days after the end of such fiscal year), for the same reasons described in Section II.C.7.a. above.

#### Request for Comment

52. Should the proposed requirements have a transition period, as proposed? Is the period too long? Too short? If so, how long should the transition period be and why? Please be specific (for example, instead of the proposed period, should compliance be delayed until the first fiscal year beginning on or after six months following the effective date of the final rules?).

53. In the alternative, should the transition periods be different for different types of registrants? If so, what transition periods should apply to which registrants? For example, should registrants with a workforce below a certain size (*e.g.*, fewer than 1,000 employees) have a shorter phase-in

<sup>140</sup> See letters from ABA; American Benefits Council; Brian Foley & Co.; Group of Exec. Comp. Lawyers; Davis Polk; NACD; SCSGP; RILA; and Towers Watson.

<sup>141</sup> See letters from ABA; American Benefits Council; Brian Foley & Co.; Group of Exec. Comp. Lawyers; Davis Polk; NACD; SCSGP; RILA; and Towers Watson.

<sup>142</sup> See, *e.g.*, letters from American Benefits Council and Group of Exec. Comp. Lawyers.

<sup>138</sup> See COEC I and letters from ABA; Protective Life Corporation; and RILA. In contrast, no commenters have asserted that the disclosure should be filed.

<sup>139</sup> See, *e.g.*, COEC I.

period than others? Should there be a longer phase-in for multinational registrants? Please provide specific information about how to define the categories of registrants that should be subject to any recommended phase-in.

54. Are there any other accommodations that we should consider for particular types of companies or circumstances (other than the proposed transition period for new registrants described below in this release)?

- Should we provide a transition period for business combinations? If so, what should the transition be? For example, should a registrant be permitted to omit the employees of a newly acquired entity until a period of time (e.g., six months, 12 months) has passed following the closing of the business combination transaction? Instead of a specific transition period, would guidance about when the employees of a newly acquired entity need to be covered in the pay ratio provide sufficient direction for registrants? What should that guidance entail?

- Should we permit a registrant that is not subject to the proxy rules to amend its Form 10-K no later than 120 days after the end of the fiscal year covered by the report to provide the pay ratio disclosure? Should we permit such a registrant to provide the disclosure by filing a Form 8-K instead of an amendment to Form 10-K?

- Should we provide a transition period for registrants that cease to be smaller reporting companies? If so, what should the transition be?

- Does the fact that Title I of the JOBS Act provides transition periods for provisions other than Section 953(b) for registrants that cease to be emerging growth companies suggest that we should not provide a transition period for such registrants? Should we provide a transition for registrants that cease to be emerging growth companies? If so, what should the transition be? If not, would these registrants have the information available to compile the disclosure in time for their first proxy statement or annual report, as applicable, following the date they exit emerging growth company status? Should a transition period depend on the disqualifying event that occurs, on the basis that the registrant may have more advance notice of the occurrence for some types of events?<sup>143</sup> For

<sup>143</sup> The definition of emerging growth company provides that an issuer continues to be deemed an emerging growth company until the earliest of: (1) The last day of the fiscal year during which it had total annual gross revenues of \$1 billion; (2) the last day of the fiscal year following the fifth anniversary

example, should a company that exits emerging growth company status because it reaches the fifth anniversary of its first sale of common equity be required to first disclose pay ratio information relating to the fiscal year in which its fifth anniversary occurred? Alternatively, should the amount of transition time provided depend on how long a company has enjoyed emerging growth company status, such as a longer transition for registrants that lose that status after one year or less?

## 2. Proposed Transition for New Registrants

New registrants that do not qualify as emerging growth companies are not exempted from the application of Section 953(b). The proposed requirements include instructions that would permit new registrants to delay compliance, so that pay ratio disclosure would not be required in a registration statement on Form S-1 or S-11 for an initial public offering or a registration statement on Form 10.<sup>144</sup> Instead, such a registrant would be required to first comply with proposed Item 402(u) with respect to compensation for the first fiscal year commencing on or after the date the registrant becomes subject to the requirements of Section 13(a) or Section 15(d) of the Exchange Act, and, as proposed, the registrant would be permitted to omit this initial pay ratio disclosure from its filings until the filing of its Form 10-K for such fiscal year or, if later, the filing of a proxy or information statement for its next annual meeting of shareholders (or written consents in lieu of a meeting) following the end of such fiscal year. Similar to the proposed instructions for updating pay ratio disclosure, these proposed instructions also require that this initial pay ratio disclosure must, in any event, be filed as provided in connection with General Instruction G(3) of Form 10-K not later than 120 days after the end of such fiscal year.

For example, assuming the proposed requirements become effective in 2014, a company with a fiscal year ending on December 31 that completes its initial public offering in October 2016 would not be required to include any pay ratio information in its registration statement on Form S-1. The company would then not be required to include pay ratio disclosure in any filing until it files its

of the first sale of its common equity securities; (3) the date on which it has issued more than \$1 billion in non-convertible debt during the previous three years; or (4) the date on which it is deemed a large accelerated filer. See Exchange Act Section 3(a)(80) [15 U.S.C. 78c(a)(80)] and Securities Act Section 2(a)(19) [15 U.S.C. 77b(a)(19)].

<sup>144</sup> See proposed Instruction 5 to paragraph (u).

definitive proxy or information statement for its 2018 annual meeting of shareholders (or written consents in lieu of such a meeting), which would include pay ratio disclosure relating to 2017 compensation amounts. Consistent with the treatment of other information required by Part III of Form 10-K, if the company does not file its definitive proxy or information statement within 120 days of the end of its fiscal year (i.e., April 30, 2018), it would need to file its initial pay ratio disclosure in its Form 10-K for 2017 or an amendment to that Form 10-K. If that company were not required to file a proxy statement relating to its annual meeting of shareholders, the first filing that would be required to include pay ratio disclosure would be its Form 10-K covering fiscal year 2017, which would include pay ratio disclosure relating to 2017 compensation amounts.

Commenters did not address the impact of pay ratio disclosure requirements on newly public companies. Although investors might benefit from pay ratio information in connection with an initial public offering or Exchange Act registration, we believe it is appropriate to give companies time to develop any needed systems to compile the disclosure and verify its accuracy. The transition period for new registrants is similar to the proposed time frame provided for other registrants to comply with pay ratio disclosure requirements following the effective date of the final rules. The proposed approach is also similar to the current phase-in for newly public companies in connection with Item 308 of Regulation S-K, for management's report on the registrant's internal control over financial reporting.<sup>145</sup>

We are sensitive to the impact that the proposed rules could have on capital formation. We note that the requirements of Section 953(b), as amended by the JOBS Act, distinguish between certain newly public companies and all other issuers by providing an exemption for emerging growth companies. We note that the incremental time needed to compile pay ratio disclosure could cause companies that are not emerging growth companies to delay an initial public offering, which could have a negative impact on capital formation. In this regard, we assume that, in order to be disqualified for emerging growth company status, these companies are likely to be businesses with more extensive operations or a greater number of employees than many emerging growth companies, which

<sup>145</sup> See Instruction 1 to Item 308 of Regulation S-K.

could increase the initial efforts needed to comply with the proposed requirements. We believe that providing a transition period for these newly public companies could mitigate this potential impact on capital formation.

#### Request for Comment

55. Instead of the proposed transition period, should we require new registrants that are not emerging growth companies to comply with pay ratio disclosure requirements in registration statements on Form S-1, Form S-11 or Form 10? Are we correct that the incremental time needed to compile pay ratio disclosure could cause companies that are not emerging growth companies to delay an initial public offering? What costs would be imposed on these companies if we did not provide the transition? Does the potential importance of the information to investors justify the burden on these companies of complying with the requirements in their Form S-1, Form S-11 or Form 10?

56. Does the proposed transition period for compliance by new registrants provide sufficient time (or, alternatively, too much time) for these companies to be able to comply? Why or why not?

57. Are there any alternatives to the proposed transition period that we should consider? For example, should we permit new registrants to omit pay ratio disclosure from Form S-1 and Form 10 (as proposed), but require them to comply with the proposed pay ratio disclosure requirements in their first proxy statement or annual report, as applicable?

58. Are there other accommodations we should consider for new registrants?

### III. General Request for Comment

We request and encourage any interested person to submit comments on any aspect of the proposals, other matters that might have an impact on the amendments and any suggestions for additional changes. With respect to any comments, we note that they are of greatest assistance to our rulemaking initiative if accompanied by supporting data and analysis of the issues addressed in those comments, particularly quantitative information as to the costs and benefits, and by alternatives to the proposals where appropriate. Where alternatives to the proposals are suggested, please include information as to the costs and benefits of those alternatives.

59. Have we struck the appropriate balance between prescribing rules to satisfy the mandate of Section 953(b) and allowing a registrant flexibility to

identify the median in a manner that is appropriate to its own facts and circumstances?

60. Are there alternatives to the proposals we should consider that would satisfy the requirements of Section 953(b) of the Dodd-Frank Act?

### IV. Economic Analysis

#### A. Background

As discussed in detail above, Section 953(b) directs the Commission to amend Item 402 of Regulation S-K to add the pay ratio disclosure requirements prescribed by the Dodd-Frank Act. Section 953(b) imposes a new requirement on registrants to disclose the median of the annual total compensation of all employees and the ratio of that median to the annual total compensation of the chief executive officer. In doing so, Section 953(b) requires registrants to determine total compensation in accordance with Item 402(c)(2)(x). The Commission's rules for compensation disclosure have traditionally focused on compensation matters that relate to executive officers and directors. Although registrants subject to Item 402 are required to provide extensive information about the compensation of the principal executive officer and other named executive officers identified pursuant to Item 402(a), current disclosure rules generally do not require registrants to disclose detailed compensation information for other employees in their filings with the Commission. In addition, the Commission's executive compensation disclosure rules differ from tax accounting and reporting standards.<sup>146</sup> Therefore, Section 953(b) requires registrants to disclose specific information about non-executive employee compensation that is not currently required for disclosure, accounting or tax purposes. We do not expect that many registrants, if any, currently disclose or track total compensation as determined pursuant to Item 402 for their workforce.<sup>147</sup>

We are proposing these amendments to Item 402 in order to satisfy the statutory mandate of Section 953(b). We note that neither the statute nor the related legislative history directly states the objectives or intended benefits of the provision or a specific market failure, if

<sup>146</sup> "Total compensation" as determined pursuant to Item 402 is not an amount that is reported or calculated in connection with a registrant's financial statements. The elements of compensation that are required to be calculated and reported for U.S. tax purposes are not the same as those covered by Item 402 requirements, and the reported amounts relate to the relevant calendar year for tax purposes, rather than the registrant's fiscal year.

<sup>147</sup> See *supra* note 17.

any, that is intended to be remedied;<sup>148</sup> however, commenters supporting Section 953(b) have emphasized that potential benefits could arise from adding pay ratio-type information to the total mix of executive compensation information.<sup>149</sup>

As discussed throughout this release, in proposing amendments to implement Section 953(b), we have considered the statutory language and exercised our discretion to develop rules designed to lower the cost of compliance while remaining consistent with Section 953(b). In doing so, we have considered a variety of issues, including, among others, the specificity of the statute, whether the rules should specify a methodology for determining the median, the use of estimates and assumptions, whether and how to define certain terminology used in the statute, the form of the disclosure, how often the disclosure should be updated in the required filings, and compliance and transition matters.

We are sensitive to the costs and benefits imposed by the statutory requirements and the proposed pay ratio disclosure requirements, and our analysis of these costs and benefits is discussed below. Some of the costs and benefits stem directly from the statutory mandate in Section 953(b), while others are affected by the discretion we exercise in implementing that mandate. Our economic analysis of the proposed pay ratio disclosure requirements addresses both the costs and benefits that stem directly from Section 953(b) and those arising from the policy choices under the Commission's discretion, recognizing that it may be difficult to separate the discretionary aspects of the rules from those elements required by statute. The economic analysis that follows focuses first on the benefits and costs arising from the new mandatory disclosure requirements prescribed by the Dodd-Frank Act and then focuses on those that arise from the choices we have made in exercising our discretion.

We request comment throughout this release on alternative means of meeting the statutory mandate of Section 953(b) and on all aspects of the costs and benefits of the proposals and possible alternatives. We also request comment on any effect the proposed pay ratio disclosure requirements may have on efficiency, competition and capital formation.<sup>150</sup> We particularly appreciate

<sup>148</sup> See *supra* note 23.

<sup>149</sup> See *supra* note 24.

<sup>150</sup> Section 2(b) of the Securities Act [15 U.S.C. 77b(b)] and Section 3(f) of the Exchange Act [15 U.S.C. 78c(f)] require us, when engaging in



comments that distinguish between costs and benefits that are attributed to the statute and costs and benefits that are a result of policy choices made by the Commission in implementing the statutory requirements, as well as comments that include both qualitative information and data quantifying the costs and the benefits identified.

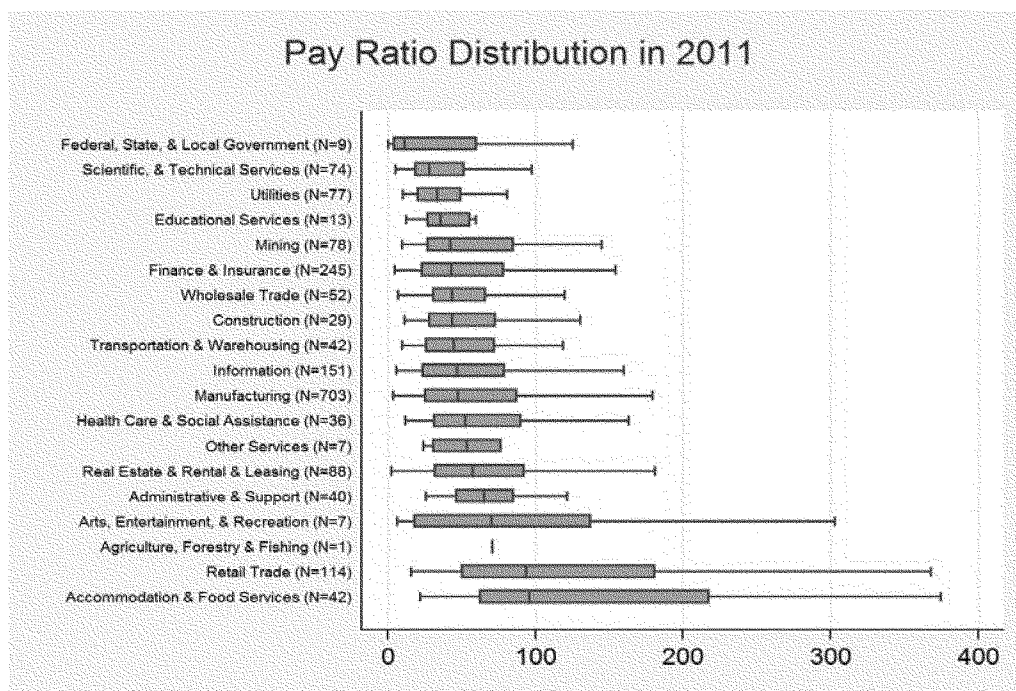
### B. Baseline

To assess the economic impact of the proposed rules, we are using as our baseline the current state of the market without a requirement for registrants to disclose pay ratio information. At present, the registrants subject to Item 402(c)(2)(x) already provide disclosure of their executive officer compensation

as Section 953(b) requires. Other registrants, such as emerging growth companies, smaller reporting companies and foreign private issuers, are not required to comply with to Item 402(c)(2)(x) and provide disclosure of executive compensation different from Item 402(c)(2)(x). We do not expect that many registrants, if any, currently maintain payroll and information systems that track total compensation as determined pursuant to Item 402 for their employees, or make that information publicly available. Therefore, investors cannot calculate registrant-specific median employee compensation because there are no existing or publicly available sources for this data. Correspondingly, they cannot

currently calculate the annual pay ratio in accordance with Section 953(b). Statistics on the earnings of U.S. workers in various “industries” are publicly available from the Bureau of Labor Statistics. Therefore, investors may be able to approximate the ratio using the industry median employee compensation and the information about PEO compensation for the registrants subject to Item 402(c). For example, the distribution of the ratios of PEO to industry median employee compensation for a sample of large reporting companies is reported by North American Industry Classification System (“NAICS”) industry sectors in the figure below for fiscal year 2011.<sup>151</sup>

Figure 1. Pay ratio distribution using industry median compensation.



The pay ratio compiled with currently available information as in the above example is different from the ratio that Section 953(b) requires issuers to disclose; the above example uses the median wage information of U.S. workers within the same 3-digit NAICS industries, while Section 953(b)

mandates registrants to use company-specific information about median employee compensation for “all employees” which would include employees in workplaces outside the United States. Also, the example is based on only wages and does not consider other forms of compensation

for employees other than PEOs because the Bureau of Labor Statistics does not report those components. In contrast, Section 953(b) requires registrants to present the ratio using total compensation including all forms of compensation in Item 402(c)(2)(x).

rulemaking under those Acts where we are required to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition and capital formation.

Section 23(a)(2) of the Exchange Act [15 U.S.C. 78w(a)(2)] requires us, when adopting rules under the Exchange Act, to consider the impact that any new rule would have on competition. In addition,

Section 23(a)(2) prohibits us from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.

<sup>151</sup> The ratios in the figure are calculated for each registrant with executive total compensation data from the Standard and Poor's Compustat Executive Compensation database which tracks compensation for the companies currently or previously in the S&P 1500 index and industry median employee

wage information at each 3-digit NAICS level from the U.S. Department of Labor's Bureau of Labor Statistics (available at <http://www.bls.gov/bls/wages.htm>). The distribution of the registrant-level ratios within each NAICS industry sector (2-digit) is represented using horizontal box plots that show the minimum and maximum, and 25th, 50th (median) and 75th percentiles.

Although the ratio described in the above example does not represent the ratio mandated by Section 953(b), it shows that there is considerable disparity in the compensation differentials between industries. It is not clear how the distribution of ratios by industry would change if company-specific median employee wage and other compensation components for employees were used. In the example above, the variation in ratios within the same industry group at the 3-digit NAICS level is determined only by the variation in PEO pay between companies. The Section 953(b) disclosure of median pay at the company level would introduce an additional factor for the variation,

which is the company-specific median employee compensation. This could widen or narrow the distribution of ratios depending on how median pay corresponds to PEO pay at each company.

To assess the effects of the proposed rule, we consider the impact of the rule on investors, registrants subject to the pay ratio disclosure and all their employees including executive officers. The proposed disclosure requirement would apply to all registrants that are not emerging growth companies, smaller reporting companies and foreign private issuers, which we estimate to be approximately 3,830 registrants.<sup>152</sup> We estimate that there are approximately 900 emerging growth companies,

approximately 3,750 smaller reporting companies, approximately 750 foreign private issuers filing on Form 20-F and approximately 144 MJDS filers.<sup>153</sup>

An important factor to consider when analyzing the competitive effects of the proposed pay ratio disclosure requirements on the affected registrants is the difference in size and nature of the workforce, complexity of the organization and the degree of integration of payroll systems that are likely to exist among these registrants. The average number of business and geographical segments and employees of each segment disclosed by some of the potentially affected registrants in the calendar year 2011 are reported in the table below.<sup>154</sup>

TABLE 1—REGISTRANTS WITH MULTIPLE BUSINESS OR GEOGRAPHICAL SEGMENTS

	Average	Min	Median	Max	Number of registrants
No. of Geographic Segments .....	2.92	1	2	28	2,691
No. of Business Segments .....	2.36	1	1	11	2,947
Total Assets (\$ millions) .....	10,472	0	1,287	3,211,484	2,691
Geographic Segment Assets (\$ millions) .....	8,833	0	905	3,211,484	1,411
No. of Employees per Registrant .....	12,681	0	2,300	2,100,000	2,652
No. of Employees per Geographic Segment .....	7,096	0	1,155	338,000	1,433

The above table shows that the average number of segments among potentially affected registrants was about three in 2011. Also, the approximate number of average employees per registrant and per geographic segment was 13,000 and 7,000 respectively. Although we do not have information on how the registrants maintained their payroll systems across the multiple segments, the number of segments for the registrants serves as one indication of the potential complexity of trying to comply with the proposed rules (whether by sampling at each segment and aggregating the samples across the segments, or aggregating the payroll observations and sampling from the aggregated pool).

Another important factor in analyzing the competitive effects of the proposed disclosure requirement is the current

level of competition in the labor market for PEOs. Unfortunately, we do not have data that would allow us to assess the degree of competitiveness of the current market for PEOs.

*C. Discussion of Benefits and Costs Arising From the Mandated Disclosure Requirements*

1. Benefits

We have considered the impact that the requirements prescribed by Section 953(b) could have on the efficiency of the U.S. capital markets, particularly the informational efficiency. The following discussions of potential informational benefits are mainly intended to address benefits of the mandated disclosure to investors and shareholders and the employees (other than executive officers) of the registrants that are subject to Section 953(b).

As noted above, there is limited legislative history to inform our understanding of the legislative intent behind Section 953(b) or the specific benefits the provision is intended to secure. In particular, the lack of a specific market failure identified as motivating the enactment of this provision poses significant challenges in quantifying potential economic benefits, if any, from the pay ratio disclosure. Some commenters have noted that there is an information gap between registrants and investors with regard to internal pay parity at companies.<sup>155</sup> Although investors are able to compare compensation arrangements for the PEO across companies, registrants are not required to provide, and investors may not have access to, information that would allow them to assess the level of a PEO's compensation as it compares to

<sup>152</sup> Based on a review of EDGAR filings in 2011, we estimate that of the approximately 8,870 annual reports on Form 10-K filed in that year, approximately 3,750 annual reports were filed by smaller reporting companies, approximately 290 were filed by ABS issuers and approximately 100 were filed by wholly-owned subsidiaries of other registrants. We have also reduced the total number affected registrants by 900 to reflect the approximate number of emerging growth companies that have identified themselves as such in their EDGAR filings as of May 2013.

<sup>153</sup> We estimate that approximately 900 SEC registrants have identified themselves as emerging growth companies in their EDGAR filings as of May 2013. The estimates for smaller reporting

companies and foreign private issuers including MJDS filers are based on a review of EDGAR filings for calendar year 2011. Based on a review of EDGAR filings in 2012, there approximately 8,154 registrants filing on Form 10-K, approximately 3,640 smaller reporting companies, approximately 715 foreign private issuers filing on Form 20-F and approximately 152 MJDS filers. Registrants can fall into multiple categories among emerging growth companies, smaller reporting companies and foreign private issuers.

<sup>154</sup> The corporate segments data used in the table come from the Standard and Poor's Compustat Segment database and the information is self-reported by the companies. As such, it is not based on standardized definitions of lines-of-business and

geographic areas. Segment information of approximately 65% of the potentially affected registrants is available from the database.

<sup>155</sup> See letter from Social Investment Forum (noting "a number of investors, including several of our members, have been active in submitting shareholder resolutions in recent years supporting corporate disclosure of similar pay disparity data."). See generally House Letter and Senate Letter; and letters from Americans for Financial Reform; Group of International Investors; Calvert Investment Management; K. Burgoyne; Institute for Policy Studies; and Trillium Asset Management. See also Form Letter A.

that of employees at the same company.<sup>156</sup> Some investors have suggested that this type of comparison would assist in their ability to evaluate the PEO's compensation in the context of the company's overall business,<sup>157</sup> and could provide insight into the effectiveness of board oversight.<sup>158</sup> Other commenters have suggested that a comparison of PEO compensation to employee compensation could be used by investors to approximate employee morale and productivity,<sup>159</sup> or analyzed as a measure of a particular company's investment in human capital.<sup>160</sup>

These commenters did not quantify the magnitude or value of these potential benefits. Statistics on the average earnings of U.S. workers in various industries are already publicly available to investors.<sup>161</sup> Company-specific information about median employee pay would be new information generated pursuant to the Section 953(b) requirements, and thus the potential incremental benefits identified by commenters primarily derive from this company-specific information. Commenters have not specified whether this type of company-specific information would be equally useful in connection with all types of companies or whether the potential benefits are more relevant to certain types of businesses, industries, business structure or size of registrant. One commenter asserted that the impact of pay disparity on employee performance

and morale is "particularly strong in industries based on technology, creativity and innovation,"<sup>162</sup> which suggests that a measure of employee morale could be more potentially useful in evaluating those businesses or that this pay ratio may be a more sensitive indicator of that effect in those industries.

Furthermore, commenters have not specified what an optimal pay ratio is or what a proper benchmark should be. They also have not specified what effect a pay ratio has on employee morale and productivity relative to other environment-specific and company-specific factors. To the extent that factors exist that could cause the ratios to differ, precise comparability across companies may not be relevant and could generate potentially misleading interpretations or conclusions. In particular, the ratio may significantly depend on how a company structures its business. For example, one company might outsource the labor-related (manufacturing) aspects of its business to a third-party to focus on product innovation, while another company competing in the same industry might choose to retain the labor aspect of its business. To the extent that product innovation requires higher pay than manufacturing, the outsourcing company will have a lower pay ratio for the same PEO pay. If pay ratio parity between these two companies were pursued, and a lower ratio sought, this could create incentive for the manufacturing company to outsource jobs. Therefore, the potential value of this disclosure for assessing issues related to employee morale, productivity and investment in human capital may be diminished by the indirect costs of creating incentives for registrants to change their business structure.

Some commenters have asserted that the intended purpose of the provision is to address a broader public policy concern relating to income inequality, which they suggest is exacerbated by increasingly high levels of PEO compensation relative to other workers.<sup>163</sup> More specifically, some of

these commenters have suggested that the mandated disclosure requirement will encourage the boards of public companies to consider the relationship between the PEO's compensation and the compensation of other employees, which, these commenters suggest could, in turn, curb excessive PEO compensation.<sup>164</sup> It has also been suggested that shareholders of public companies could use pay ratio information, together with pay-for-performance disclosure, to help inform their say-on-pay votes, which could also serve to limit PEO compensation.<sup>165</sup>

Commenters have also suggested<sup>166</sup> that comparing PEO pay to the compensation of the median worker may help offset an upward bias in executive pay resulting from the practice of benchmarking PEO compensation solely against the compensation of other PEOs.<sup>167</sup> To the extent that pay ratio disclosure diminishes the focus of benchmarking executive compensation exclusively to the level of peer-PEO pay, the mandate of Section 953(b) may provide indirect economic benefits to registrants and their shareholders by reducing the frequency of pay increases that are tied to a benchmarking process that is not based on performance. It is also possible, however, that pay ratio disclosure could exacerbate any upward bias in executive pay by providing another benchmark that could be used in certain situations to increase PEO compensation (*i.e.*, for a PEO whose company's pay ratio is lower than its peers' pay ratios). In addition to these possibilities, there is also evidence that setting executive compensation through benchmarking practices is practical and efficient,<sup>168</sup> particularly when the

pay. Section 953(b) was intended to shine a light on figures like this at every company.'").

<sup>164</sup> See, *e.g.*, AFL-CIO I and letters from Americans for Financial Reform; Group of International Investors; Institute for Policy Studies. In contrast, the National Association of Corporate Directors asserted that pay ratio information would not be useful for this purpose. See letter from NACD.

<sup>165</sup> See letters from CtW Investment Group and S. Towns.

<sup>166</sup> See AFL-CIO II and letter from Americans for Financial Reform.

<sup>167</sup> See, *e.g.*, M. Faulkender and J. Yang, *Inside the Black box: the Role and Composition of Compensation Peer Groups*, J. of Financial Economics. 96, 257-270 (2010); C. Elson and C. Ferrere, *Executive Superstars, Peer Groups and Overcompensation: Cause, Effect and Solution*, J. of Corporation Law. Forthcoming (2013) for one view that benchmarking is inefficient because it can lead to increases in executive compensation not tied to firm performance.

<sup>168</sup> See, *e.g.* J. Bizjak, M. Lemmon, and L. Naveen, *Does the use of peer groups contribute to higher pay and less efficient compensation?* J. of Financial

<sup>156</sup> See, *e.g.*, Senate Letter; House Letter; and AFL-CIO I (noting "few companies provide meaningful disclosure of how employee compensation is allocated over their workforce").

<sup>157</sup> See, *e.g.*, letter from UAW Retiree Medical Benefits Trust ("Disclosure of internal pay equity, whether the ratio between median employee wages and those of the CEO or the ratio between compensation awarded to the CEO and to other top executives, will ultimately help investors evaluate executive pay practices by better contextualizing the information provided to the shareholders through the proxy statement and other corporate filings.") and letter from CtW Investment Group ("The new [pay ratio] disclosure offers an insight into compensation within the entire organization, and provides a different way for boards and shareholders to evaluate the relative worth of a CEO.").

<sup>158</sup> See letter from CtW Investment Group (noting that "compensation disclosure is important, not only in its own right, but the ability it offers shareholders to evaluate and hold accountable board members"); and letter from UAW Retiree Medical Benefits Trust (noting "we view Section 953(b) as an essential tool that will increase corporate board accountability to investors").

<sup>159</sup> See AFL-CIO I and letters from Americans for Financial Reform; Calvert Investment Management; Drucker Institute; and Institute for Policy Studies. See also Form Letter A.

<sup>160</sup> See AFL-CIO I and letter from CtW Investment Group.

<sup>161</sup> See U.S. Department of Labor's Bureau of Labor Statistics, available at <http://www.bls.gov/bls/wages.htm>.

<sup>162</sup> See AFL-CIO II ("These sectors . . . depend significantly on the ability of employees to collaborate, share ideas, and function effectively as teams, all of which are damaged by extreme differentials in compensation amongst employees.").

<sup>163</sup> See Letter from Americans for Financial Reform ("[T]his information clearly bears directly on the important public policy issues of pay equity and income inequality"). See also House Letter and Senate Letter (each stating "income inequality is a growing concern among many Americans . . . by 2010 large company CEO pay had skyrocketed to \$10.8 million, or 319 times the median worker's

market can observe the method used.<sup>169</sup> To the extent that current benchmarking practices and disclosure requirements are efficient, additional pay ratio disclosure would not provide additional benefits.

Similar benefits to the potential benefits cited by commenters may be achieved using the currently available information on PEO compensation and the industry median or average wages of U.S. workers, although currently available data do not provide company-specific information. Also, these commenters did not provide details about the causes of compensation disparity within particular companies or industries and did not address whether there are alternative means to effect an overall reduction in PEO compensation, or, alternatively, an overall improvement in the wages and benefits for workers. The evidence that the current PEO compensation practice is not efficient or that the benchmarking process causes the upward bias in executive compensation is not sufficiently clear to establish that the purpose of the provision is a remedy for a specific market failure in the current compensation practice.<sup>170</sup>

In contrast, other commenters believe that the disclosure mandated by Section 953(b) would not have any benefit, or, at most, would not have benefits sufficient to justify the compliance costs, which many of such commentators anticipate would be substantial.<sup>171</sup> Some of these

commenters questioned the materiality of pay ratio information to an investment decision and specifically questioned the meaningfulness of the information in the form expressly required by Section 953(b).<sup>172</sup> This view was also asserted by the minority in the Senate Report accompanying the legislation.<sup>173</sup> In light of these comments, we are particularly interested in receiving information relating to material, direct economic benefits to investors or shareholders of the affected registrants derived from the pay ratio disclosure.

We note that some commenters asserted that certain investors incorporate social and governance issues, like pay equity, as part of their investment decisions.<sup>174</sup> These investors may realize non-economic benefits associated with their investment decisions based on this type of information. These commenters, however, did not quantify the extent to which investors would value pay ratio information or would incorporate the disclosure required by Section 953(b) into their investment or voting decision, if at all.<sup>175</sup> We also note that many

months and thousands of hours to come up with a completely useless number”).

<sup>172</sup> See, e.g., letters from Group of Exec. Comp. Lawyers (“We are unaware of any evidence correlating corporate performance to the ratio of CEO pay to median employee pay.”) and Group of Trade Associations (“While it may be of general interest to some investors for different purposes, it is unclear how the pay ratio disclosure will be material for the reasonable investor when making investment decisions.”). See also, letter from RILA (noting “current Item 402 requirements if applied to the overall employee population of an issuer will only serve to distort the already questionable meaning of the Compensation Ratio”).

<sup>173</sup> See Senate Report, *supra* note 23 (“Although provisions like this appeal to popular notions that chief executive officer salaries are too high, they do not provide material information to investors who are trying to make a reasoned assessment of how executive compensation levels are set. Existing SEC disclosures already do this.”).

<sup>174</sup> See letters from Americans for Financial Reform; Group of International Investors; and Social Investment Forum.

<sup>175</sup> We are not aware of any empirical studies that address the value of pay disparity disclosure specifically. We are aware of research that has studied whether there is a correlation between information about employee satisfaction and long-term equity returns in an effort to understand how the market values a public company’s intangible assets. This research was based on the equity prices of companies that were identified on Fortune Magazine’s list of the “100 Best Companies to Work For in America.” See A. Edmans, *Does the stock market fully value intangibles? Employee satisfaction and equity prices*, J. of Financial Economics 101, 621–640 (2011) (finding evidence implying that the market fails to incorporate intangible assets, like employee satisfaction, fully into stock valuations until the intangible subsequently manifests in tangibles, such as earnings, that are valued by the market; and finding evidence suggesting that the non-incorporation of intangibles into stock prices is not simply due to the lack of salient information about them).

commenters disagreed with the assertion that this type of disclosure is material to investors or would be useful to an investment or voting decision, particularly in the form required by the Dodd-Frank Act.<sup>176</sup> As mentioned above, currently it is not possible to quantify the usefulness to investors of company-specific pay ratio information as required by Section 953(b) as compared to the usefulness of publicly available statistics on average salaries, or the usefulness of any other company-specific metric of employee compensation or satisfaction. We understand from some commenters that the proposed pay ratio disclosure could be used by some investors in allocating capital and from that perspective would be perceived by such investors as a benefit, although not necessarily an economic benefit measured by a financial return. It is uncertain whether the investment decisions by these investors would impact the overall efficiency of U.S. capital markets, or if there would be an impact, whether the impact would be net positive or negative.

Nevertheless, as discussed above, in designing the proposed requirements, we have sought to preserve what we believe to be the potential benefits, as articulated by commenters, of the mandated requirement. To the extent that some investors and other stakeholders may seek the disclosure of pay ratio information, both those investors and the registrants who have already disclosed similar information voluntarily may benefit from mandated, rather than voluntary, disclosure of pay ratio information. Given that some registrants have already disclosed information similar to the pay ratio voluntarily,<sup>177</sup> those registrants may benefit from the mandated disclosure requirement to the extent that standardized pay ratio information may decrease uncertainty around, or increase the relevance of, the voluntarily disclosed information.<sup>178</sup> To the extent that the voluntarily disclosed information and the manner in which it

<sup>176</sup> See, e.g., COEC I and letters from Brian Foley & Co.; Group of Trade Associations; Meridian Compensation Partners, LLC; NACD; and RILA.

<sup>177</sup> We are not aware of any registrants that currently provide pay ratio disclosure in the form contemplated by the proposed rules in their filings with the Commission. However, several registrants provide (or in the past have provided) voluntary disclosures that provide a comparison of CEO compensation with worker pay.

<sup>178</sup> See, e.g., B. Bushee and C. Leuz, *Economic consequences of SEC disclosure regulation: evidence from the OTC bulletin board*, J. of Accounting and Economics 39, 233–264 (2005); R. Lambert, C. Leuz, and R. Verrecchia, *Accounting Information, Disclosure, and the Cost of Capital*, J. of Accounting Research 45, 385–420 (2007).

Economics 90, 152–168 (2008). This study shows that benchmarking is a practical and efficient mechanism used to gauge the market wage necessary to retain valuable human capital.

<sup>169</sup> See, e.g., J. Bizjak, M. Lemmon, and T. Nguyen, *Are all CEOs Above Average? An Empirical analysis of compensation Peer Groups and Pay Design*, J. of Financial Economics 100, 538–555 (2011). This study finds that disclosure of peer groups mandated in the 2006 Adopting Release has reduced the bias in peer group choice.

<sup>170</sup> See, e.g., J. Core, W. Guay, and R. Thomas, *Is U.S. CEO Compensation Broken?* J. of Applied Corporate Finance 12, 97–104 (2005); C. Fryman and D. Jenter, *CEO Compensation*, Annual Review of Financial Economics 2, 75–102 (2010).

<sup>171</sup> See, e.g., letter from Meridian Compensation Partners LLC (stating that “disclosure of the CEO pay ratio will provide investors with little or no meaningful information about an issuer’s executive or employee pay practices. We further believe that what value this information may have to investors is far outweighed by the administrative burden and associated costs borne by issuers in accumulating the compensation data necessary to make the CEO pay ratio disclosure.”); COEC I (opposing Section 953(b) because it “does not believe that [the ratio] will provide any meaningful or material information that will be used by investors.”); Brian Foley & Co. (asserting that Section 953(b) disclosure “realistically provides little serious added analytical value, and presents, in its current form, a variety of practical issues and potentially significant calculation costs.”); letter from NACD (stating that “it would take global companies

is calculated differs from the disclosure that would be required under the proposed rules, those companies may incur costs. We request comment throughout this release about the potential benefits of the disclosure mandated by the Dodd-Frank Act and the proposed rules and any alternative ways of achieving these benefits in a manner consistent with the Dodd-Frank Act. We seek further comment on the impact of the proposed requirements on the efficiency of the U.S. capital markets.

## 2. Costs

The following discussions are mainly intended to address costs to registrants that are subject to the pay ratio disclosure, investors who invest their capital in those registrants and employees of the registrants who invest their human capital in those registrants. As noted above, the provision does not identify a specific objective and therefore, the appropriateness of the costs in relation to the statutory objective is not readily assessable. Therefore, the following analysis on costs focuses on direct compliance costs on registrants and possible second-order effects on efficiencies and competition. We expect that the effects of the pay ratio disclosure requirement on capital formation would be minimal.

Many commenters raised concerns about the significant compliance costs that would arise from requiring the use of “total compensation” as defined in Item 402(c)(2)(x) to calculate employee pay and requiring registrants to identify the median instead of the average.<sup>179</sup> According to these commenters, the primary driver of the significant compliance costs is that many registrants, whether large multinationals or companies of modest revenue size and market capitalization, maintain

multiple and complex payroll, benefits and pension systems (including systems maintained by third party administrators) that are not structured to easily accumulate and analyze all the types of data that would be required to calculate the annual total compensation for all employees in accordance with Item 402(c)(2)(x). Thus, in order to compile such disclosure, registrants would either need to integrate these data systems or consolidate the data manually, which, in both cases, these commenters have stated would be highly costly and time consuming.<sup>180</sup>

In addition, several commenters raised concerns about expected compliance costs arising from the complexity of the “total compensation” calculation under Item 402(c)(2)(x).<sup>181</sup> These commenters made various recommendations to simplify the total compensation definition, such as including only cash compensation, including only cash compensation and equity-based compensation, including only compensation that is reported to the U.S. Internal Revenue Service on Form W-2 or other relevant tax authority, or including only compensation that is required to be recorded in the payroll system of a particular jurisdiction and its overseas equivalents.<sup>182</sup>

As discussed elsewhere in this release, registrants would be able to choose from several options in order to identify the median and provide the required disclosure. Registrants may choose to calculate the annual total compensation for each employee and the PEO using Item 402(c)(2)(x) and to identify the median using this method. In addition, the proposed requirements would allow registrants to choose a statistical method to identify the median that is appropriate to the size and

structure of their own businesses and the way in which they compensate employees, rather than prescribing a particular methodology or specific computation parameters. The proposed rules also would permit registrants to use a consistently applied compensation measure to identify the median employee and calculate and disclose that median employee’s total compensation in accordance with Item 402(c)(2)(x). The proposed requirements also would permit registrants to use reasonable estimates in calculating the annual total compensation for employees other than the PEO, including when disclosing the annual total compensation of the median employee identified using a consistently applied compensation measure. We believe that this flexible approach is consistent with Section 953(b) and could ease commenters’ concerns about the potential burdens of complying with the disclosure requirement. Also, allowing these specific alternatives could reduce the potential uncertainty for registrants as to how to comply with the proposed rules.

Although some commenters have estimated the cost of compliance for certain registrants,<sup>183</sup> the estimates we have received vary significantly. The estimates provided by commenters are also based on the commenters’ initial reading and interpretation of the statute and not the proposed means of implementation. One commenter reported that a registrant estimated that compliance would cost approximately \$7.6 million and take approximately 26 weeks,<sup>184</sup> while another registrant estimated approximately \$2.0 million annually solely for computing the actuarial change in accrued pension benefit.<sup>185</sup> We have also received cost information from discussions with registrants and industry groups, including the following estimates:

- Approximately 201 to 500 hours per year, plus significant costs;
- \$3 to \$6.5 million for a multinational manufacturing company with 90 separate payrolls;
- \$4.725 million for a multinational consumer products company (including an estimated 50 hours per country for employees located in 80 countries);
- \$100 million dollars for a multinational company; and

<sup>179</sup> See, e.g., letters from Davis Polk (noting that compliance will be “highly costly and burdensome, with tremendous uncertainty as to accuracy. Companies are justifiably concerned about the costs and burdens to accomplish the formidable data collection and calculation tasks for employees worldwide between the end of the year and the first required filing.”); Frederick W. Cook & Co., Inc. (stating “the calculation of median total pay for all employees other than the CEO is problematic, burdensome and perhaps impossible for many issuers”) and Protective Life Corporation (“It is difficult to overemphasize how burdensome this requirement could be for large employers. Calculating annual total compensation is much more complicated than simply adding up numbers that companies already have available. . . . Since many large companies use outside accounting, actuarial and compensation and pension administration firms to perform these calculations, the costs of disclosure will increase accordingly.”) See also COEC I and letters from ABA; Group of Exec. Comp. Lawyers; Group of Trade Associations; Meridian Compensation Partners, LLC; NACD; and R. Morrison.

<sup>180</sup> See, e.g., COEC II and letters from Meridian Compensation Partners, LLC; R. Morrison; and Group of Trade Associations (“There is a widespread misconception that this information is readily available at the touch of a button.”).

For example, one commenter submitted a survey demonstrating that, of the 95 companies surveyed, 10.9% maintained a centralized payroll computer system that could be used to calculate cash compensation of each employee (or a sample of employees); 28.3% had payroll systems in each location or regionally that could be used to aggregate the data; 47.8% expected to compile the data manually and 13% expected to be able to use some combination of information technology and manual data gathering. See COEC II.

<sup>181</sup> See, e.g., COEC I and II; and letters from American Benefits Council; Brian Foley & Co.; Group of Exec. Comp. Lawyers; Group of Trade Associations; Protective Life Corporation; SCSGP; and Towers Watson.

<sup>182</sup> See COEC I and letters from American Benefits Council; Brian Foley & Co.; Group of Exec. Comp. Lawyers; Group of Trade Associations; Protective Life Corporation; SCSGP; and Towers Watson.

<sup>183</sup> See COEC II and letter from Group of Trade Associations.

<sup>184</sup> See letter from Group of Trade Associations (the commenter does not clarify whether these estimates reflect a one-time or ongoing annual burden).

<sup>185</sup> See letter from Group of Trade Associations.

• \$350,000 to implement plus \$100,000 a year for ongoing compliance for a global technology company. We are, however, unable to quantify with any precision the compliance costs at this time.<sup>186</sup> Although these estimates are a useful starting point for our analysis, we do not believe the aggregate of these estimates necessarily represents an accurate indication of the expected compliance costs because they do not take into account the flexibility allowed under the proposed requirements.<sup>187</sup> Also, these estimates, although providing potentially useful data points, do not reflect costs incurred across the breadth of the registrant population subject to the requirement. Commenters did not provide sufficient information on the factors used to produce these estimates to enable us to evaluate these cost estimates, such as, among others, how separate payrolls are maintained within a company across divisions or subsidiaries, how the compensation components that the current payroll systems record compare to the “total compensation” as defined in Item 402(c)(2)(x), whether the estimated costs reflect internal personnel costs, technology costs or the costs of third-party service providers and outside professionals, and any assumptions used in deriving the estimates. Accordingly, we could not quantify differential costs from these estimates when the flexibility allowed under the proposed requirements is applied to each of those inputs. Also, these estimates do not precisely distinguish between initial and ongoing costs, while we expect that, for many registrants, the overall compliance burden will diminish after systems are in place to gather and verify the underlying data. We request comment throughout this release for additional information about the costs of compliance, including, where applicable, estimates or data that differentiate between categories of registrants facing relatively harder or easier burdens that could better inform our understanding of the direct and indirect costs of the proposed rules.

<sup>186</sup> In light of the limitations of these estimates, we were not able to use these estimates to inform the hour and cost burden estimates that are required by the Paperwork Reduction Act of 1995 (the “PRA”). See Section V of this release. Our discussion and analysis in that section describes the assumptions we made for purposes of deriving our PRA estimates. We request comment on our PRA estimates in Section V. We expect to review and revise those PRA estimates in light of any further information we receive on estimated costs.

<sup>187</sup> We expect that the flexibility allowed under the proposed requirements could, at least for some registrants, substantially reduce the overall compliance burden, and we request estimates or data that quantifies this impact.

We are particularly sensitive to the competitive effects that could impact registrants subject to the requirements of Section 953(b). In this regard, we have assumed that these registrants would incur direct costs to compile the information and may incur indirect costs arising from revealing information about the cost structure of their workforce that registrants not covered by Section 953(b) would not have to reveal. Such costs are potentially significant, although as described elsewhere in this release we have sought to exercise our discretion to reduce such costs. Any material costs resulting from Section 953(b), however, could result in differential pressures from and treatment by market participants for companies competing in the same industry that are similar except for whether they are covered by Section 953(b). Accordingly, registrants covered by Section 953(b) could be at a competitive disadvantage to registrants (including private companies, foreign private issuers, smaller reporting companies and emerging growth companies) that are outside the scope of Section 953(b). This disadvantage could be greater for registrants that have already completed an initial public offering but that would otherwise have qualified for emerging growth company status.<sup>188</sup> In addition, we understand from commenters that some registrants covered by Section 953(b) would likely incur higher costs of compliance based on size, business type and level of integration of payroll and benefits systems—such as large, multinational companies that do not maintain integrated employee compensation information on a global basis. Therefore, the competitive impact of compliance with the disclosure requirements prescribed by Section 953(b) could disproportionately fall on U.S. companies with large workforces and global operations, although the incremental impact of the fixed cost components of compliance will be proportionally smaller for large, multinational companies compared to smaller companies.

We also acknowledge that there could be competitive impacts that result from indirect costs of disclosure. Registrants subject to Section 953(b) could be subject to competitive harm if their

<sup>188</sup> Registrants that completed their first sale of common equity in a registered offering before December 8, 2011 do not qualify as emerging growth companies, regardless of the level of their annual total revenues or public float. See Section 101(d) of the JOBS Act. These registrants could be at a competitive disadvantage to companies with similar levels of revenue and public float that do qualify as emerging growth companies.

competitors are able to infer proprietary or sensitive information from the disclosure of the median of the annual total compensation of all employees. For example, it could be possible for a competitor to infer sensitive information about a registrant’s cost structure based on information about median levels of employee compensation. This could also have an impact on labor markets if competitors use the disclosure to target and hire away a registrant’s employees. We have sought to use our discretion to reduce the potential for such indirect costs, by permitting flexibility in the manner in which issuers may determine median compensation. We request comment on whether the flexibility provided by the proposed rule would make it more difficult for competitors to infer a registrant’s cost structure from such disclosure. Alternatively, a registrant subject to Section 953(b) could be at a competitive disadvantage when hiring or retaining a PEO if there is pressure to limit PEO wages based on the pay ratio disclosure while non-covered registrants are not subject to the same pressure.

Finally, a registrant subject to Section 953(b) could face pressure from its PEO or from employees to increase compensation in light of the pay ratio disclosure of the registrant’s competitors. Alternatively, there could be incentives to alter the median employee compensation either by increasing all employee compensation or by reducing the number of lowest wage employees or groups of employees, such as a specific office or division of a company. One method of doing this, as previously mentioned, is through outsourcing operations to third parties, including through the use of independent contractors, “leased” workers or other temporary employees. In some instances this might not harm and could even improve the profit margin of the registrant, but it could also result in changes to the business structure that are inefficient. Pressure for a registrant to maintain a low pay ratio could also curtail the expansion of business operations into lower cost geographies. This could adversely affect states and municipalities in lower wage geographies seeking to generate jobs for their communities. We do not have data that can be used to analyze the likelihood or potential magnitude of these impacts. We request comment on these and any other potential uses of the disclosure that could result in costs for registrants or that could impact competition.

*D. Discussion of Benefits and Costs Arising From the Exercise of Our Discretion*

1. General

In addition to the statutory benefits and costs described above, we believe that the use of our discretion in implementing the statutory requirements could result in benefits and costs to registrants and users of the pay ratio disclosure. We discuss below the choices we made in implementing the statute and the associated benefits and costs. We are unable, in most cases, to provide quantified estimates of these benefits and costs because we lack particularized data on the potential effects of these policy choices. Specifically, we expect that most registrants do not currently track total compensation as determined pursuant to Item 402 for their employees, thus we would not be able to acquire sufficiently analogous data.

In general, the proposed rules implementing Section 953(b) are designed to comply with the statutory mandate. Because commenters supporting Section 953(b) have emphasized the potential benefits that could arise from adding pay ratio information to the total mix of executive compensation information,<sup>189</sup> we have sought to make the mandated disclosure of Section 953(b) work with the existing executive compensation disclosure regime. In light of the significant potential costs that commenters attribute to the requirements of Section 953(b),<sup>190</sup> we believe that it is appropriate for the proposed rules to allow registrants flexibility, which we believe should help lower the costs of compliance generally. The proposal seeks to implement Section 953(b) without imposing additional requirements that are not mandated by the Dodd-Frank Act. In this respect, the proposed requirements reflect our consideration of the relative costs and benefits of a more flexible approach as opposed to a more prescriptive approach.

In weighing alternatives, we considered the potential costs and benefits of comparability of disclosure across registrants. Although a flexible approach could reduce the comparability of disclosure across

registrants, we do not believe that precise conformity or comparability of the ratio across companies is necessarily achievable, due to the variety of factors that could influence the ratio,<sup>191</sup> or justifiable, in light of the substantial additional costs that such an approach would impose on registrants. In addition, we believe that a flexible approach would not significantly diminish the potential benefits of the mandated disclosure. In this respect, we note that some commenters suggest that the expected benefits of pay ratio disclosure derive from its ability to offer an internal comparison, by providing a metric by which a PEO's compensation can be evaluated within the context of his or her own company.<sup>192</sup> We also acknowledge that some commenters that support Section 953(b) disclosures suggest that the mandated disclosure could be used to compare compensation practices between companies and registrants,<sup>193</sup> and our flexible approach could impose costs on investors seeking to use the pay ratio disclosure to compare registrants. We note, however, that using the ratios to compare compensation practices between registrants without taking into account inherent differences in business models, which may not be readily available information, could possibly lead to potentially misleading conclusions and to unintended consequences.

2. Implementation Choices and Alternatives

a. Filings Subject to the Proposed Disclosure Requirements

Although some commenters raised questions as to whether Section 953(b)(1) could be read to require pay ratio disclosure in every Commission

<sup>191</sup> We note that some commenters raised the issue of comparability in their letters. For example, Towers Watson noted, "Among other issues, there's no way (without significantly more information) to reliably compare ratios between companies. For example, companies in different industries will pay their employees at different levels. And even within the same industry, companies located in different geographical areas will pay their employees at different levels. As a result, this disclosure does not provide much meaningful information regarding differences in executive to employee pay ratios from company to company." See letter from Towers Watson. See also letter from RILA (noting that pay ratio disclosure "is more likely to result in confusion and erroneous comparisons between companies because of inherent differences in business models, staffing and compensation practices . . . these disparate results are only magnified if the ratio is used to compare publicly traded companies across industry sectors.").

<sup>192</sup> See letters from CtW Investment Group; and letter from Senator Menendez.

<sup>193</sup> See, e.g., AFL-CIO I and letter from Americans for Financial Reform.

filing,<sup>194</sup> other commenters suggested that the statute, by referring to filings described in Item 10(a) of Regulation S-K, is better read as applying only to those filings for which the applicable form requires Item 402 disclosure.<sup>195</sup> The proposed requirements follow the latter approach. We believe that requiring pay ratio disclosure in filings that do not contain other executive compensation information would not present this information in a meaningful context. Because some commenters have asserted that the pay ratio disclosure would provide another metric to evaluate executive compensation disclosure,<sup>196</sup> we believe that the proposed pay ratio disclosure would be less useful for this purpose if it were provided on a stand-alone basis, unaccompanied by other Item 402 information, such as the summary compensation table required by Item 402(c) and the compensation discussion and analysis required by Item 402(b). Therefore, we believe it is appropriate to read Section 953(b) as requiring pay ratio disclosure in only those filings that are required to include other Item 402 information. We seek information from commenters regarding how to quantify the costs or the benefits of this approach.

b. Registrants Subject to the Proposed Pay Ratio Disclosure Requirements

The proposed requirements would apply to only those registrants that are required to provide summary compensation table disclosure pursuant to Item 402(c). We recognize that the reference to "each issuer" in Section 953(b) could be read to apply to all issuers that are not emerging growth companies, including smaller reporting companies and foreign private issuers. As a result of the specific reference in Section 953(b) to the definition of total compensation contained in Item 402(c)(2)(x), and the absence of Congressional direction to apply this requirement to companies not previously subject to Item 402(c) requirements, the proposals would not apply to registrants that are not subject to Item 402(c) requirements.

As discussed in detail above in Section II.B.2.a., we considered whether a broader reading of the statute was warranted in the context of smaller reporting companies. Requiring smaller reporting companies to provide the pay

<sup>194</sup> See, e.g., COEC I and letters from American Benefits Council; Davis Polk; Compensia, Inc.; SCSGP; and Towers Watson.

<sup>195</sup> See, e.g., letters from ABA and RILA.

<sup>196</sup> See, e.g., Senate Letter; House Letter; and AFL-CIO I; and letters from CtW Investment Group and UAW Retiree Medical Benefits Trust.

<sup>189</sup> See, e.g., letters from Americans for Financial Reform; Group of International Investors; Calvert Investment Management; CtW Investment Group; K. Burgoyne; House Letter; Institute for Policy Studies; Senate Letter; Social Investment Forum; Trillium Asset Management; UAW Retiree Medical Benefits Trust; and S. Towns.

<sup>190</sup> See, e.g., letter from Group of Trade Associations.

ratio disclosure consistent with the requirement for other registrants would require smaller reporting companies to collect data and calculate compensation for the PEO in a manner they otherwise would not be required to calculate compensation. Although quantifying the costs to smaller reporting companies of calculating PEO compensation under Item 402(c)(2)(x) instead of under Item 402(n)(2)(x), or of complying with the requirements prescribed by Section 953(b), is not currently feasible, we assume that such costs could be significant. Based on a review of EDGAR filings for calendar year 2011, we estimate that there are approximately 3,750 smaller reporting companies that would benefit by not being required to comply with the proposed requirements.

We also considered whether to expand the coverage of the proposed requirements to registrants, such as foreign private issuers and MJDS filers, that are not currently required to provide Item 402 disclosure. Foreign private issuers, for example, provide a modified version of executive compensation disclosure under Form 20-F, while MJDS filers follow the executive compensation requirements arising under Canadian law. Although quantifying the costs to these registrants of calculating PEO compensation under Item 402(c)(2)(x) or of complying with the requirements prescribed by Section 953(b) is not currently possible, we assume that such costs could be significant. Based on a review of EDGAR filings for calendar year 2011, we estimate that there are approximately 750 foreign private issuers filing on Form 20-F and 144 MJDS filers that would benefit from the exclusion from the proposed requirements.

#### c. Employees Included in the Identification of the Median

Section 953(b) expressly requires disclosure of the median of the annual total compensation of “all employees.” Consistent with that mandate, the proposed requirements state that “employee” or “employee of the registrant” includes any full-time, part-time, seasonal or temporary worker employed by the registrant or any of its subsidiaries (including officers other than the PEO).<sup>197</sup> Therefore, under the proposed requirements, “all employees” covers all such individuals. In contrast,

workers who are not employed by the registrant or its subsidiaries, such as independent contractors or “leased” workers or other temporary workers who are employed by a third party, would not be covered.

We considered whether Section 953(b) is intended to cover employees of the registrant alone, or also cover employees of the registrant’s subsidiaries. By directing the Commission to amend Item 402, we believe that Section 953(b) is intended to cover employees on an enterprise-wide basis, including both the registrant and its subsidiaries, which is the same approach as that taken for other Item 402 information. This interpretation could raise compliance costs for registrants that are holding companies that have a significant portion of their workers employed by operating subsidiaries rather than by the holding company. We also note that allowing a holding company registrant to exclude employees from the identification of the median solely on the basis of its corporate structure could affect the potential meaningfulness of the disclosure. Further, allowing holding company registrants to exclude employees could provide a potential competitive advantage over non-holding company registrants due to lower compliance costs associated with having fewer workers covered by the rule.

Because Section 953(b) directs the Commission to amend Item 402, we believe it is appropriate to apply the same definition of subsidiary that is used for other disclosure under Item 402. We acknowledge that compliance costs for some registrants potentially could be further reduced if we limited the application of the proposed rules to employees of wholly-owned subsidiaries, or some other definition of subsidiary. We request comment on whether using a different definition of subsidiary would reduce costs for registrants, or whether it would raise costs by causing registrants to make a new, separate determination of which entities are subsidiaries for purposes of pay ratio requirements. Comment is also requested on whether a different definition of subsidiary would affect any benefits expected to be derived from the proposed rule. Because registrants already make the determination of which entities are subsidiaries for purposes of Rule 405 and Rule 12b-2 in connection with other required disclosure, we believe that using the same set of entities for purposes of the proposed requirements would simplify compliance for most registrants and make the information easier for users of the information to understand.

We recognize that it is possible that a registrant could alter its corporate structure or its employment arrangements in order to reduce the number of employees covered by the rule, and, therefore, reduce its costs of compliance or to alter the reported ratio to achieve a particular objective with the ratio disclosure. For example, a registrant could choose to use only independent contractors or “leased” workers instead of hiring its own employees. Or a registrant could choose to outsource or franchise some aspects of its business, either to lower compliance costs by having fewer employees subject to the proposed pay ratio requirements or in an effort to “improve” its pay ratio. One commenter has questioned the likelihood of this behavior.<sup>198</sup> To the extent that there is an incentive for companies to change their business model to adjust their pay ratio, such an incentive would arise wherever a prescriptive standard is used. Therefore, we have sought to avoid adding prescriptive standards that are not mandated by the Dodd-Frank Act.

As discussed in Section II.C.2.a., we acknowledge the concerns of commenters that the inclusion of non-U.S. employees raises compliance costs for multinational companies and introduces cross-border compliance issues. We also recognize that these companies could suffer competitively if they compete with companies that have lower costs of compliance, due to, for example, fewer employees, fewer global locations, or data systems that are more centralized. We have weighed these considerations and are proposing that the requirement cover all employees without carve-outs for specific categories of employees.

Although we believe that the inclusion of non-U.S. employees in the calculation of the median is consistent with the statute, we considered ways to address the costs of compliance that commenters attribute to the provision’s coverage of a registrant’s global workforce. In particular, we considered the concerns of commenters that data privacy regulations in various jurisdictions could impact the ability of registrants to gather and verify the data needed to identify the median. We believe that the proposed flexibility

<sup>197</sup> Rule 405 under the Securities Act states that the term “employee” does not include a director, trustee or officer. This parenthetical in the proposed rules is intended to clarify that officers, as that term is defined under Rule 405, are not excluded from the definition of employee for purposes of the proposed pay ratio disclosure requirements.

<sup>198</sup> See AFL-CIO I (“It is simply not credible to suggest that companies will dramatically restructure their operations to manipulate this [pay ratio] data. Moreover, such a business decision would be improper under state corporate laws that require boards of directors to put the interests of shareholders before the interests of company CEOs who may be potentially embarrassed by their companies’ Section 953(b) disclosures.”).



afforded to registrants in selecting a methodology to identify the median, such as statistical sampling, the use of a consistently applied compensation measure to identify a median employee, as well as the ability of registrants to use reasonable estimates in the calculation of total compensation of employees other than the PEO and the identification of the median, could enable registrants to better manage the costs and burdens arising from local data privacy regulations. We specifically requested comment on these issues in order to gain more information about appropriate ways to address these potential issues in a way that is consistent with Section 953(b) and the costs and benefits of any alternatives.

Section 953(b) does not prescribe a particular calculation date for the determination of who should be treated as an employee for purposes of the rule. We believe that a bright line calculation date for determining who is an employee would ease compliance for registrants by eliminating the need to monitor changing workforce composition during the year, while still providing a recent snapshot of the entire workforce. Accordingly, the proposed requirement includes a calculation date for determining who is an employee for purposes of identifying the median by defining "employee" as an individual employed as of the last day of the registrant's last completed fiscal year.<sup>199</sup> This calculation date would be consistent with the one used for determining the named executive officers under current Item 402 requirements.

We believe that the potential benefits of the disclosure mandated by Section 953(b) would not be significantly diminished by covering only individuals employed at year-end, rather than covering every individual employed during the year. Although we believe that this approach could help contain compliance costs for registrants, by not requiring registrants to monitor the composition of the workforce during the year, we note that it could have other economic effects. For example, this approach would not capture seasonal or temporary employees that are not employed at year-end. In the case of a registrant with a significant amount of such workers, the exclusion of such workers from the median calculation could reduce the potential benefits of the rule, as a median so calculated may not fully reflect the workforce required to run the registrant's business. It could also cause the proposed requirements to be costlier

for, and thereby have an anti-competitive impact on, registrants whose temporary or seasonal workers are employed at year-end as opposed to at other times during the year. Finally, it is possible that registrants could try to structure their employment arrangements to reduce the number of workers employed on the calculation date or to alter the reported ratio to achieve a particular objective with the ratio disclosure, although it is not known whether registrants will do so. Currently, it is not possible to quantify whether any such restructuring of employee arrangements would have a material impact on a registrant's reported median annual total compensation. Comment is requested on this issue.

The proposed requirements also include an instruction that permits a registrant to annualize the compensation for all permanent employees (other than those in temporary or seasonal positions) who were employed for less than the full fiscal year. We did not propose to require registrants to perform this type of adjustment, however, because we do not believe that the costs of requiring companies to make an extra calculation would be justified.

We believe that this annualizing adjustment would not significantly diminish the potential usefulness of the disclosure mandated by Section 953(b), particularly because the ratio uses median employee compensation, not average employee compensation. For example, we would not expect that annualizing the salary of a permanent new hire would impact the potential ability of an investor to use the pay ratio disclosure as an indicator of employee morale or to gain an understanding of a registrant's investment in human capital, which some commenters have identified as a benefit of the disclosure under Section 953(b).<sup>200</sup> For annualizing adjustments to have any significant impact on the reported pay ratio, both the fraction of permanent new hires to all employees of the registrant and their annualized compensation would have to be relatively large. We do not believe those factors are typical of employment arrangements of many registrants. We also note that some of the commenters that support Section 953(b) disclosure

were also supportive of allowing annualizing adjustments.<sup>201</sup>

By permitting, but not requiring, registrants to annualize compensation for these employees, the comparability of disclosure across companies could be reduced. We do not believe that precise comparability or conformity of disclosure from registrant to registrant is necessarily achievable due to the variety of factors that could cause the ratio to differ, and, accordingly, we do not believe that the costs associated with promoting precise comparability would be justified. We assume that comparability of disclosure would be promoted at a lower cost to registrants by proscribing all annualizing adjustments, rather than by prescribing rules for making such adjustments for employees who were employed for less than the full year.

#### d. Identifying the Median

Section 953(b) does not expressly set forth a methodology that must be used to identify the median, nor does it mandate that the Commission must do so in its rules. In order to allow the greatest degree of flexibility while maintaining consistency with the statutory provision, the proposed requirements do not specify any required calculation methodologies for identifying the median.<sup>202</sup>

Several commenters recommended allowing companies to use total direct compensation (such as annual salary, hourly wages and any other performance-based pay) or cash compensation to first identify a median employee.<sup>203</sup> We agree that the costs of compliance could be reduced if registrants were permitted to identify the median of a less complex, more readily available figure, such as salary and wages, rather than total compensation as determined in

<sup>201</sup> See AFL-CIO II and letters from Social Investment Forum and Trillium Asset Management.

<sup>202</sup> One of the difficulties in identifying a median arises from the situation that a registrant with multiple business units, geographical operations, or subsidiaries maintains payroll data at each business unit or subsidiary. Calculating the average for the consolidated entity only requires each subsidiary or business unit to convey information on the total (or average) compensation and the number of its employees to its parent entity, whereas identifying the median requires transferring the entire set of compensation data from each subsidiary to the parent entity. We recognized that registrants with multiple operations are likely to maintain payroll data at the business unit or subsidiary level, and thus allowing them to use the average employee compensation could reduce their compliance costs. Nevertheless, we believe that Section 953(b) is clear in requiring the median rather than the average.

<sup>203</sup> See AFL-CIO II and letters from ABA; American Benefits Council; Americans for Financial Reform; CtW Investment Group; Protective Life Corporation; RILA; and SCSSG.

<sup>200</sup> See AFL-CIO I and letters from Calvert Investment Management; CtW Investment Group; Group of International Investors; Americans for Financial Reform; Drucker Institute; Institute for Policy Studies; Social Investment Forum; Trillium Asset Management; and UAW Retiree Medical Benefits Trust.

<sup>199</sup> Proposed Item 402(u)(4).

accordance with Item 402(c)(2)(x). This approach could also help reduce costs for registrants that are not able to reduce costs using statistical sampling techniques. We are proposing to permit registrants to use any consistently applied compensation measure to identify the median employee and then calculate that median employee's annual total compensation in accordance with Item 402(c)(2)(x). For purposes of estimating the median employee, registrants may use the same annual period that is used in the payroll or tax records from which the compensation amounts are derived. We believe that registrants would be in the best position to select a compensation measure that is appropriate to their own facts and circumstances and that a consistently applied compensation measure would result in a reasonable estimate of a median employee. After identifying the median employee, registrants would be required to calculate that employee's annual total compensation in accordance with Item 402(c)(2)(x) for the last completed fiscal year, which would provide comparability with the calculation of the PEO's total compensation without imposing significant costs.

Allowing registrants to choose this alternative approach is likely to reduce registrants' compliance costs significantly, compared to requiring registrants to calculate total compensation in accordance with Item 402(c)(2)(x) for all employees and then identify the median. Registrants that choose this alternative approach would be able to identify a median employee from employee compensation data that they may already track or record or that may be less expensive for them to acquire than acquiring and computing all of the Item 402(c)(2)(x) compensation information for each employee. We acknowledge, however, that some registrants would still incur costs if they have to combine or sample from separately maintained payroll systems across segments and/or geographic locations. In addition, the proposal specifically permits registrants, in identifying a median employee, to use compensation amounts reported in

payroll or tax records. This approach would reduce uncertainty for registrants and may also be less costly to them, compared to other alternatives that may use various sources of compensation data to generate reasonable estimates of total compensation in accordance with Item 402(c)(2)(x).

We are proposing this flexible approach because we believe that the appropriate and most cost effective methodology would necessarily depend on a registrant's particular facts and circumstances, including, among others, such variables as size and nature of the workforce, complexity of the organization, the stratification of pay levels across the workforce, the types of compensation the employees receive, the extent that different currencies are involved, the number of tax and accounting regimes involved, the number of payroll systems the registrant has and the degree of difficulty involved in integrating payroll systems to readily compile total compensation information for all employees. We believe that these are likely the same factors that would cause substantial variation in the costs of compliance. By not prescribing specific methodologies that must be used, the proposed requirements would allow registrants to choose a method to identify the median that is appropriate to the size, structure and compensation practices of their own businesses, including permitting a registrant to identify the median employee using any consistently applied compensation measure. In addition, this flexibility could enable registrants to manage compliance costs more effectively than a more prescriptive approach would allow. We also believe that, by allowing registrants to minimize direct compliance costs, a flexible approach could mitigate, to some extent, any potential negative effects of the mandated requirements on competition. We recognize, however, that a flexible approach could increase uncertainty for registrants that prefer more specificity on how to comply with the proposed rules, particularly for registrants that do not use statistical analysis in the ordinary course of managing their businesses. In light of this potential

uncertainty, we have provided clarity to registrants that the use of statistical sampling or other reasonable estimates in identifying the median would be permitted, as well as identifying the median employee based on any consistently applied compensation measure.

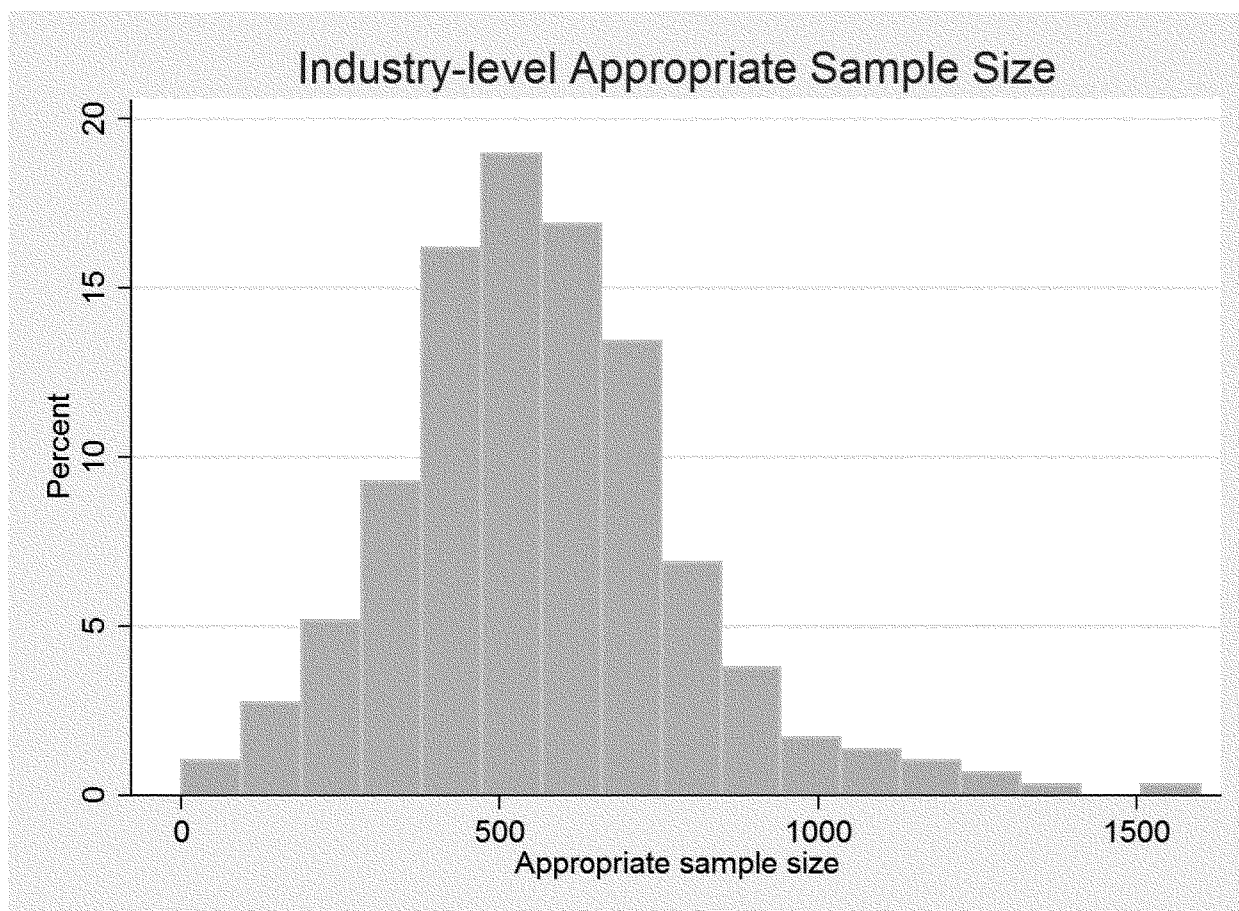
The reduction in compliance costs by using statistical sampling or other reasonable estimates in determining median would ultimately depend on a registrant's particular facts and circumstances. For example, in the following figure and tables, we show that the variance of underlying wage distributions can materially affect the appropriate sample size for statistical sampling.<sup>204</sup> Industries characterized by the Bureau of Labor Statistics as having low wage variances, such as *Motor Vehicle Manufacturing, Electric Power Generation, Coal Mining*, have estimated minimum appropriate sample sizes for an accurate median estimate of less than one hundred. In contrast, industries characterized by the high wage variances, such as *Offices of Physicians, Spectator Sports, and Motion Picture and Video* industries, have estimated minimum appropriate sample sizes of more than 1,000 employees. Figure 2 shows the distribution of estimated minimum appropriate sample sizes for each of the 290 4-digit NAICS industries tracked by the BLS.

<sup>204</sup> The analysis uses mean and median wage estimates from the Bureau of Labor Statistics (BLS) at the 4-digit NAICS industry level (290 industries) and assumes a lognormal wage distribution, a 95% confidence interval with 0.5% margin of error in the estimate of the median of the logarithm of wage. The lognormal wage distribution assumption is supported by the following studies: F. Clementi, and M. Gallegati, *Pareto's law of income distribution: evidence for Germany, the United Kingdom, and the United States*. *Econophysics of Wealth Distributions*, New Economic Window. 3–14 (2005), and J. López and L. Servén, *A Normal Relationship? Poverty, Growth and Inequality*. World Bank Policy Research Working Paper 3814 (2006). Also, see M. Pinkovskiy and X. Sala-i-Martin, *Parametric Estimations of the World Distribution of Income*, NBER Working Paper 15433, (2009). This analysis also assumes that when the sampling is implemented, the sampling method would be a true random sampling, *i.e.*, it would not be biased by region, occupation, rank, or other factor.

TABLE 2—THE INDUSTRIES WITH THE LARGEST AND SMALLEST APPROPRIATE SAMPLE SIZES

Industry	Mean wage (\$)	Median wage (\$)	Appropriate sample size
<i>10 industries with smallest variance in wage distribution:</i>			
Electric Power Generation, Transmission and Distribution .....	67,950	65,790	81
Motor Vehicle Manufacturing .....	56,160	54,430	81
Coal Mining .....	53,560	51,610	97
Support Activities for Water Transportation .....	57,220	55,080	99
Other Pipeline Transportation .....	67,240	64,180	117
Metal Ore Mining .....	56,540	53,900	124
Natural Gas Distribution .....	68,630	64,930	139
Wired Telecommunications Carriers .....	62,540	59,050	147
Software Publishers .....	91,050	85,290	156
Rail Transportation .....	56,020	52,560	166
<i>10 industries with largest variance in wage distribution:</i>			
Offices of Physicians .....	69,710	38,960	1,601
Spectator Sports .....	40,550	25,720	1,357
Motion Picture and Video Industries .....	61,280	38,580	1,276
Health and Personal Care Stores .....	40,860	26,790	1,248
Home Health Care Services .....	36,650	24,600	1,199
Cut and Sew Apparel Manufacturing .....	34,530	23,280	1,199
Independent Artists, Writers, and Performers .....	63,560	41,550	1,156
Agents and Managers for Artists, Athletes, Entertainers, and Other Public Figures .....	67,660	44,820	1,104
Other Professional, Scientific, and Technical Services .....	45,860	31,470	1,079
Electronic Shopping and Mail-Order Houses .....	43,710	30,230	1,065

Figure 2. The distribution of appropriate sample size for median estimates for different industries.



Because these estimated minimum appropriate sample sizes are based on

wage distributions measured by the BLS in standardized industries, they may not

correspond to the appropriate minimum sample size at registrants with an

employee base that does not correspond precisely to one of these industries. Even for registrants whose operations are wholly within one of these standardized industries, their appropriate sample size may also be different to the extent that their distribution of employee wages is different than that of the industry. In these instances, a registrant's

appropriate sample size could be higher or lower than that estimated for its industry.

Of the nearly 4,000 registrants that we believe will be subject to the rule, we estimate that approximately 50% have an organizational structure characterized by a compensation distribution that falls into a tractable statistical distribution category, which

would allow the registrant use a simple random sampling method.<sup>205</sup> Of these registrants for which we have industry classifications that match the BLS data, Table 3 shows estimated minimum appropriate sample sizes assuming that each registrant's wage distribution is similar to the BLS-measured industry distribution.

TABLE 3—NUMBER OF REGISTRANTS ACCORDING TO SAMPLE SIZE RANGES

Sample size (n) ranges	Number of registrants	Mean wage (\$)	Median wage (\$)
n < 100	77	62,281	60,245
100 ≤ n < 250	149	50,269	46,298
250 ≤ n < 500	441	45,154	39,232
500 ≤ n < 750	682	41,736	33,410
750 ≤ n < 1000	119	46,997	34,897
n ≥ 1000	29	61,221	37,906
Total	1,497		

For the remaining 50% of the potentially affected registrants that have multiple business segments, and thus are likely to maintain their payroll systems separately for each segment, statistical sampling could involve more steps and other assumptions. This may be particularly true for approximately 25% of the potentially affected registrants that self-report that they have both multiple business segments and geographical segments.

While we believe that there is more than one statistical sampling approach that could result in reasonable estimates of the median for these registrants, all would be more complicated than simple random sampling. The alternative approaches would require drawing observations from each business or geographical segment with a unique distribution of compensation and statistically inferring the registrant's overall median based on the observations drawn. For example, the statistical inference may involve a weighted sample median using a stratified cluster sampling,<sup>206</sup> or a numerically solved median estimate based on their knowledge or assumptions on the size and distribution for each segment and pre-estimated mean and variance of each business or geographical segment. Some methods, however, may not easily generate confidence intervals around the estimates or prescribe a minimum

sample size. As a result, generating reasonable estimates through statistical sampling could result in a disproportionately higher cost to registrants with more complicated payroll systems or organization structures. Nevertheless, we believe that permitting registrants to use statistical sampling may lead to a reduction in compliance costs as compared to other methods of identifying the median.

We believe that a flexible approach would not significantly diminish the potential benefits of the disclosure mandated by Section 953(b). Although the proposed flexible approach could reduce the comparability of disclosure across registrants, we do not believe that precise conformity or comparability of the ratio across companies is necessary. As noted earlier in this release, some commenters believe that a primary benefit of the pay ratio disclosure would be providing a company-specific metric that investors could use to evaluate the PEO's compensation within the context of his or her own company, rather than a benchmark for compensation arrangements across companies. Accordingly, we do not believe that improving the comparability of the disclosure across companies by mandating a specific method for identifying the median would be justified in light of the costs that would be imposed on registrants by a more prescriptive rule. We do not believe that

mandating a particular methodology would necessarily improve the comparability across companies because of the numerous other factors that could also cause the ratios to be less meaningful for company-to-company comparison. We also believe that greater comparability across companies could increase the likelihood that a registrant's competitors could infer proprietary or sensitive information about the registrant's business. This in turn could increase the indirect costs to registrants of the proposed requirements, such as competitive harms in labor markets discussed in the previous section or general costs arising from the mandated disclosure requirement.

Finally, we recognize that allowing registrants to select a methodology to identify the median, including identifying the median employee using and allowing the use of reasonable estimates, rather than prescribing a methodology or set of methodologies, could reduce benefits for investors if that flexibility enables a registrant to make its pay ratio appear more "favorable" and thus results in a pay ratio that does not reflect a more precisely and consistently calculated ratio. We are not able to determine, however, the extent to which the flexibility allowed by the proposed requirements could actually enable a registrant to adjust its pay ratio in any material respects.

<sup>205</sup> This estimate is based on data from Standard and Poor's Compustat Segment database. Segment information is available for approximately 65% of the potentially affected registrants. Among these, 50% report having multiple business segments and 60% report having multiple geographical segments. Also, 25% of the potentially affected registrants

self-report that they have both multiple business segments and geographical segments. Because the segment information is self-reported by the companies, it not based on standardized definitions of geographic areas such as states, countries or regions. Multiple geographical segments could represent different geographies with similar

operations and thus similar wage distributions, for examples, different states within the United States.

<sup>206</sup> See, e.g., S. Gross. Median estimation in sample surveys. In Proceedings of the Section on Survey Research Methods. American Statistical Association, 181–184. (1980).

e. Determination of Total Compensation

As mandated by Section 953(b), the proposed requirements would define “total compensation” by reference to Item 402(c)(2)(x) as in effect on the day before the date of enactment of the Dodd-Frank Act, or July 20, 2010. We note that several commenters raised concerns about the potential compliance costs that could arise from the complexity of the “total compensation” calculation under Item 402(c)(2)(x).<sup>207</sup> Commenters have observed that, because of this complexity, registrants typically compile information required by Item 402(c) manually for the named executive officers, which they have stated takes significant time and resources.<sup>208</sup> We also note that commenters have raised concerns about the ability of companies to compile and verify the data needed to calculate total compensation in accordance with Item 402(c)(2)(x) for every employee and have asserted that the costs of doing so would be significant and unwarranted in light of the potential benefits of the disclosure, which such commenters anticipate to be minimal.<sup>209</sup> To address these concerns, some commenters recommended that registrants be permitted to use reasonable estimates to determine the value of the various elements of total compensation of employees in accordance with Item 402(c)(2)(x).<sup>210</sup> We generally support this recommendation and we provided guidance about the use of estimates in this context.

We do not believe that the use of reasonable estimates would diminish the potential usefulness of the pay ratio disclosure as a general point of comparison of PEO pay to employee pay within a company, and we do not believe that the use of reasonable estimates would be inconsistent with Section 953(b). Furthermore, we believe that requirements that allow registrants to use reasonable estimates in these calculations would impose lower compliance costs than requirements that prohibit the use of estimates. We acknowledge that, however, to the extent that the use of estimates causes the ratio to be an inaccurate reflection of the registrant’s median compensation, it could diminish the potential usefulness of the disclosure.

<sup>207</sup> See, e.g., COEC I and II; and letters from American Benefits Council; Brian Foley & Co.; Group of Exec. Comp. Lawyers; Group of Trade Associations; Protective Life Corporation; SCSGP; and Towers Watson.

<sup>208</sup> See letter from Davis Polk.

<sup>209</sup> See, e.g., COEC I and II; and letters from ABA; American Benefits Council; Protective Life Corporation; and R. Morrison.

<sup>210</sup> See COEC I and letters from ABA and SCSGP.

As discussed above, the proposal allows registrants to identify the median employee using any consistently applied compensation measure and then determine and disclose the Item 402(c)(2)(x) total compensation for that median employee. A registrant would be permitted to calculate compensation for all employees in accordance with Item 402(c)(2)(x), but would only be required to calculate and disclose such information for the median employee. The proposed rules also permit registrants to use reasonable estimates in the calculation of annual total compensation for the median employee that must be disclosed and used in the pay ratio.

f. Disclosure of Methodology, Assumptions and Estimates; Additional Disclosure

We are proposing instructions for the disclosure of the methodology and material assumptions, adjustments and estimates used in the identification of the median or the calculation of the annual total compensation (or any elements of total compensation) of employees. The proposed instruction provides that registrants must briefly disclose and consistently apply any methodology used to identify the median and any material assumptions, adjustments or estimates used to identify the median or to determine total compensation or any elements of total compensation, and registrants must clearly identify any estimated amount as such. Registrants’ disclosure of the methodology and material assumptions, adjustments and estimates used should be designed to provide information for a reader to be able to evaluate the appropriateness of the estimates. For example, when statistical sampling is used, registrants should disclose the size of both the sample and the estimated whole population, any material assumptions used in determining the sample size, which sampling method (or methods) is used, and, if applicable, how the sampling method deals with separate payrolls such as geographically separated employee populations or other issues arising from multiple business or geographic segments. In order to promote comparability from year to year, the instruction also provides that, if a registrant changes methodology or material assumptions, adjustments or estimates from those used in the previous period, and if the effects of any such change are material, the registrant must briefly describe the change, the reasons for the change and an estimate of the impact of the change on the median and the ratio. This approach is

consistent with other Commission rules that allow registrants flexibility to choose a methodology, such as the valuation method for determining the present value of accrued pension benefits in Item 402(h)(2) or the description of models, assumptions and parameters in Item 305 of Regulation S-K (quantitative and qualitative disclosures about market risk). Five commenters recommended requiring this information in cases where the rules allowed registrants to use estimation techniques.<sup>211</sup>

Because we are concerned that disclosure about methodology, assumptions, adjustments and estimates could become dense and overly technical, which we believe would limit its usefulness, the instruction asks for a brief overview and makes clear that it is not necessary to provide technical analyses or formulas. We do not believe that a detailed, technical discussion (such as statistical formulas, confidence levels or the steps used in data analysis) would enhance the potential usefulness of the pay ratio, as suggested by some commenters,<sup>212</sup> as a metric to evaluate the level of PEO compensation. We expect that a succinct description of the methodology and material assumptions, adjustments and estimates used would not be overly burdensome for registrants and would be more informative for investors. We expect that the costs of the additional disclosure on registrants would be marginal, as these additional disclosures are intended to simply describe what has already been done or assumed in the calculations, and therefore will not require additional actions for registrants. It is likely that some costs may be incurred in developing and reviewing the appropriate language to describe the approach taken.

We considered the recommendations of commenters relating to requirements for additional narrative discussion of the ratio and supplemental information about a registrant’s employee compensation structures and policies.<sup>213</sup> Section 953(b) does not mandate a narrative discussion to accompany the pay ratio disclosure, and the proposed requirements do not include a specific requirement for narrative discussion of the ratio, its components or any supplemental information that could provide context

<sup>211</sup> See AFL-CIO II and COEC I; and letters from Group of Exec. Comp. Lawyers, Meridian Compensation Partners, LLC; and SCSGP.

<sup>212</sup> See, e.g., Senate Letter; House Letter; and AFL-CIO I; and letters from CtW Investment Group and UAW Retiree Medical Benefits Trust.

<sup>213</sup> See AFL-CIO I and letter from Americans for Financial Reform.

for or explain the ratio. We believe that additional narrative disclosure about the ratio would not, for many registrants, provide useful information for investors that would justify the costs associated with providing that additional narrative disclosure. While some investors could find supplemental information about a registrant's employment practices, the composition of its workforce and similar topics (such as employment policies, use of part-time workers, use of seasonal workers, outsourcing and off-shoring strategies) useful or informative, we note that Section 953(b) does not call for that level of detail. We note too, that, as with other mandated disclosure under our rules, registrants would be permitted to supplement the required disclosure with a narrative discussion if they choose to do so.

g. Defining "Annual"

In order to provide clarity, the proposed requirement defines "annual total compensation" to mean total compensation for the last completed fiscal year, consistent with the time period used for the other Item 402 disclosure requirements. This clarification is intended to address questions from commenters about the need to update the pay ratio disclosure throughout the year and make clear that the disclosure does not need to be updated more than once a year.

Two commenters suggested other possible alternatives for the calculation of "annual" total compensation. One of these commenters recommended that registrants should have flexibility to select a time period for calculating the annual total compensation of employees, noting that registrants without a calendar year fiscal year-end might benefit from the flexibility to use the calendar year period since that would be consistent with the registrant's tax reporting obligations.<sup>214</sup> Another commenter suggested two timing rules that would grant registrants further flexibility to use the 12-month time periods that their payroll systems use.<sup>215</sup> We understand that these suggestions are intended to reduce compliance costs for registrants by giving registrants the ability to use information in the form that it is

currently compiled for other purposes, such as tax and payroll recordkeeping. We believe, however, that it is appropriate for the time period for the pay ratio disclosure to be the same as the time period used for the registrant's other executive compensation disclosures, although the proposed flexibility in identifying the median employee could address the concerns raised by these commenters.

As discussed above, we propose to allow a registrant that is identifying the median employee by reference to compensation amounts derived from its payroll or tax records to use the same annual period that is used in the payroll or tax records from which the compensation amounts are derived. We also did not propose to define or limit what would qualify as payroll or tax records so that registrants would be able to use information that they already track and report for tax purposes. We believe that permitting companies to identify the median employee using compensation information in the form that it is maintained in their own books and records would reduce compliance costs, yet still yield a reasonable estimate of the median employee. Registrants using that approach to identify the median employee would be required to calculate the Item 402(c)(2)(x) total compensation for that median employee for the last completed fiscal year, in order to maintain consistency with other Item 402 information.

h. Updating the Pay Ratio Disclosure for the Last Completed Fiscal Year

The proposed requirements include instructions to clarify the timing for updating pay ratio disclosure after the end of a registrant's fiscal year. Without the proposed instructions, a registrant could be required to include pay ratio disclosure in an annual report or registration statement filed after the end of the fiscal year, but before it has compiled the executive compensation information for that fiscal year for inclusion in its proxy statement relating to its annual meeting of shareholders, which could raise additional incremental costs for registrants that elect to provide executive compensation disclosure in their annual proxy statement rather than their annual report and for registrants that are conducting registered offerings at the beginning of their fiscal year.

To address this, we considered the recommendation of commenters that pay ratio disclosure not be required to be updated for the most recently completed fiscal year until the registrant files its proxy statement for its annual

meeting of shareholders. The proposed requirements generally follow this approach, but the proposed instructions provide a similar accommodation for registrants that do not file annual proxy statements<sup>216</sup> and align the proposed requirement to the timing rules for providing Item 402 disclosure in annual reports and proxy and information statements. We believe that the proposed instruction would provide certainty to registrants as to when the updated information is required and would allow sufficient time after the end of the fiscal year to identify the median. We believe that such an approach would not diminish the potential usefulness of the disclosure.

We also believe that this approach could reduce additional costs for registrants in connection with filings made or required to be made before the filing of the proxy or information statement for the annual meeting of shareholders (or written consents in lieu of such a meeting) that would typically contain the registrant's other Item 402 disclosure covering the most recently completed fiscal year. In addition, under the proposed approach, updating the pay ratio disclosure would not be an additional hurdle for a registrant that requests effectiveness of a registration statement after the end of its fiscal year and before the filing of the proxy statement for its annual meeting of shareholders. In this regard, the proposed approach could alleviate some of the potential impact on capital formation from Section 953(b).

i. Instructions for Registrants Relying on Instruction 1 to Items 402(c)(2)(iii) and (iv)

We have also proposed instructions to provide consistency with current executive compensation disclosure rules in cases where a registrant cannot compute the total compensation of the PEO because the salary or bonus of the PEO is not calculable until a later date. Similar to existing requirements for the disclosure of PEO total compensation under those circumstances, the proposed requirements permit the registrant to omit pay ratio disclosure until those elements of the PEO's total compensation are determined and to provide the pay ratio disclosure in the same filing under Item 5.02(f) of Form

<sup>216</sup> Based on a review of EDGAR filings in calendar year 2012, approximately 250 registrants that would be subject to the proposed requirements do not file proxy or information statements in connection with annual meetings of shareholders, including 15D filers (other than smaller reporting companies and ABS issuers) and registrants that are not corporate entities required to hold annual meetings of shareholders.

<sup>214</sup> See letter from American Benefits Council.

<sup>215</sup> See letter from Group of Exec. Comp. Lawyers (recommending: "Rule One—the registrant can select any date as of which to calculate median compensation, provided the date is within 12 months of the proxy filing, and is the most recent practicable date, and Rule Two—if different payroll systems are involved, the 12-month period for computing compensation data for each payroll system's data will be acceptable so long as the period ends within 12 months of the date chosen under Rule One.").

8-K in which the PEO's salary or bonus is disclosed. In taking the proposed approach, we have assumed that the potential benefits of the disclosure could be diminished if the pay ratio were to be calculated using less than the entire amount of the PEO's total compensation for the period, because the ratio would be lower than if it reflected the full PEO total compensation, and that this could justify the potential costs to investors of a delay in the timing of the disclosure.

Instead of this approach, we considered whether to require registrants to report pay ratio disclosure using a reasonable estimate of the elements of PEO compensation that are not calculable. We also considered whether registrants should be permitted to use an incomplete amount, comprising only the elements of total compensation that are calculable at the time.

In some cases, the amount of compensation that is omitted under the Instruction 1 to Items 402(c)(2)(iii) and (iv) could be significant. Therefore, the pay ratio could be lower if it were presented using an amount of PEO total compensation that fails to adequately account for the amounts of salary or bonus ultimately included in the PEO's actual total compensation, including the alternative approach of using estimated PEO compensation, and such an approach could incentivize registrants to give their PEOs more of these types of compensation in order to achieve a more favorable ratio at the time of the proxy statement or annual report. We believe that the potential incentive to change compensation practices could be exacerbated by an alternative approach that permitted or required calculation using incomplete total compensation amounts.

Based on the number of registrants that have historically relied on Instruction 1 to Items 402(c)(2)(iii) and (iv),<sup>217</sup> we do not expect that the proposed instruction would impact a significant number of registrants each year.

#### j. Status of Disclosure as Filed Not Furnished

Some commenters suggested that pay ratio information be deemed "furnished" and not "filed" for purposes of the Securities Act and the Exchange Act.<sup>218</sup> We note that Section

<sup>217</sup> For example, based on a review of EDGAR filings in 2012, only 22 registrants relied on Instruction 1 to Items 402(c)(2)(iii) and (iv) in connection with the total compensation of their PEO.

<sup>218</sup> See COEC I and letters from ABA; Protective Life Corporation; and RILA.

953(b) states that the pay ratio information be disclosed in the registrant's "filings" with the Commission. We further note that one of the reasons that commenters recommended treating the information as furnished and not filed is because of the difficulty that some companies may have in determining and verifying the information, which must be covered by the certifications required for Exchange Act filings under the Sarbanes-Oxley Act of 2002. We also recognize that some registrants could have more difficulty in gathering and verifying the information than others. Nevertheless, we believe that the flexibility afforded to registrants in connection with identifying the median could reduce some of the difficulties of compiling the required information, because registrants would be able to tailor the methodology to reflect their own facts and circumstances. The ability to use reasonable estimates in connection with the calculation of annual total compensation for employees other than the PEO could also alleviate some of these concerns. In addition, we believe that the proposed transition periods discussed below, which are designed to give registrants sufficient time to develop and implement compliance procedures, could mitigate some concerns about compiling and verifying the information.

#### k. Proposed Compliance Date

Section 953(b) does not specify a date when registrants must begin to comply with the requirements that we implement under the provision. We are proposing to require that a registrant must begin to comply with proposed Item 402(u) with respect to compensation for the registrant's first fiscal year commencing on or after the effective date of the rule, and, as proposed, a registrant would be permitted to omit this initial pay ratio disclosure from its filings until the filing of its annual report on Form 10-K for that fiscal year or, if later, the filing of a proxy or information statement for its next annual meeting of shareholders (or written consents in lieu of a meeting) following the end of such year. Similar to the proposed instructions for updating pay ratio disclosure, the proposed transition instructions also require that this initial pay ratio disclosure must, in any event, be filed as provided in connection with General Instruction G(3) of Form 10-K not later than 120 days after the end of such fiscal year.

Several commenters noted that companies will need a long transition period to enable them to implement

systems to compile the disclosure and verify its accuracy.<sup>219</sup> We understand that this time would likely be needed by large, multinational registrants and any registrants that currently do not have a centralized, consolidated payroll, benefits and pension system that captures the information necessary to identify the median of the annual total compensation of all employees,<sup>220</sup> however, we seek comment on whether the flexibility in the proposed rules would reduce the need for a lengthy transition period. We expect that it will take registrants one full reporting cycle to implement and test any necessary systems,<sup>221</sup> and we have designed the initial transition period to provide that time for transition and implementation.

#### l. Proposed Transition Periods

The proposed requirements also include a transition period for new registrants because we are sensitive to the impact that the proposed rules could have on capital formation. We note that the requirements of Section 953(b), as amended by the JOBS Act, distinguish between certain newly public companies and all other issuers by providing an exemption for emerging growth companies. We also note that the incremental time needed to compile pay ratio disclosure could cause companies that are not emerging growth companies to delay an initial public offering, which could have a negative impact on capital formation. In this regard, we expect that, in order to be disqualified for emerging growth company status, these companies are likely to be businesses with more extensive operations or a greater number of employees than many emerging growth companies, which could increase the initial efforts needed to comply with the proposed requirements. We believe that providing a transition period for these newly public companies could mitigate this potential impact on capital formation.

Accordingly, the proposed requirements also include instructions that would permit new registrants to delay compliance, so that pay ratio disclosure would not be required in a registration statement on Form S-1 or S-11 for an initial public offering or a registration statement on Form 10. Instead, such a registrant would be

<sup>219</sup> See letters from ABA; American Benefits Council; Brian Foley & Co.; Group of Exec. Comp. Lawyers; Davis Polk; NACD; SCSGP; RILA; and Towers Watson.

<sup>220</sup> See letters from ABA; American Benefits Council; Brian Foley & Co.; Group of Exec. Comp. Lawyers; Davis Polk; NACD; SCSGP; RILA; and Towers Watson.

<sup>221</sup> See letters from American Benefits Council and Group of Exec. Comp. Lawyers.

required to first comply with proposed Item 402(u) with respect to compensation for the first fiscal year commencing on or after the date the registrant first becomes subject to the requirements of Section 13(a) or Section 15(d) of the Exchange Act.

We note that commenters did not address the impact of pay ratio disclosure requirements on newly public companies. Although investors might benefit from pay ratio information in connection with an initial public offering or Exchange Act registration, we believe it is appropriate to give companies time to develop any needed systems to compile the disclosure and verify its accuracy. The transition period for new registrants is similar to the proposed time frame provided for other registrants to comply with pay ratio disclosure requirements following the effective date of the final rules. The proposed approach is also similar to the current phase-in for newly public companies in connection with Item 308 of Regulation S-K, for management's report on the registrant's internal control over financial reporting. We seek comment in this release on whether these timing and transition rules are sufficient to address the burdens on capital formation that could arise due to the mandated pay ratio disclosure requirements.

We have not proposed a separate transition period for companies that cease to qualify as emerging growth companies. We acknowledge that companies exiting emerging growth status could need additional time to implement systems to compile and verify their pay ratio disclosure, particularly because registrants may not be able to predict in advance, depending on which of the four conditions occurs, when they will cease to be an emerging growth company. By exempting emerging growth companies from the scope of Section 953(b), the JOBS Act essentially provides a transition period for companies for as long as they qualify for emerging growth company status. In connection with other executive compensation provisions, the JOBS Act includes specific transition periods for companies exiting emerging growth company status.<sup>222</sup> It does not, however, include a similar transition provision in the case of Section 953(b). Therefore, we are not proposing any additional transition period for compliance after a company ceases to qualify as an emerging growth company. We seek comment in this release on whether

additional transition periods are needed for these companies.

#### *E. Request for Comment*

Throughout this release, we have discussed the anticipated costs and benefits of the proposed rules. We request data to quantify the costs and the value of the benefits described throughout this release. We seek estimates of these costs and benefits, as well as any costs and benefits not described, that may result from the adoption of these proposed amendments. We also request comments on the qualitative benefits and costs we have identified and any benefits and costs we may have overlooked.

61. We request comment on all aspects of the costs and benefits of the proposed rules, including identification and assessment of any costs and benefits not already discussed. We seek comment and data on the magnitude and the value of the benefits identified. We also welcome comments on the accuracy of the cost estimates and request that commenters provide data that may be relevant to these cost estimates. In addition, we seek estimates and views regarding these costs and benefits for particular covered registrants, including small registrants, and, where relevant, for particular categories of covered registrants, as well as any other costs or benefits that may result from the adoption of these proposed amendments.

62. What are the characteristics of employee compensation data that current payroll systems (or other management information systems) maintain? Would it be necessary for registrants to change such systems or other employee compensation records in order to track the information needed to comply with the proposed pay ratio rules? What would the transition costs be to make any such changes? How generally are payroll systems maintained across business or geographic segments and how would the separate payroll information across segments be aggregated to comply with the proposed rules? What are the initial and ongoing costs to comply and what activities incur those costs, such as burden hours/wages of company personnel, development and maintenance of computer systems, use of third-party service providers and other professionals? How would the use of reasonable estimates or statistical sampling affect these costs generally, including the need to change current payroll systems? Please also describe benefits, if any, to the registrant, beyond compliance with the proposed rules, from implementing changes to current

payroll systems or management information systems.

63. How would allowing registrants to choose an approach for determining the median influence potential costs? How would allowing registrants to choose an approach that permits registrants to use any consistently applied measure of compensation and/or statistical sampling to identify the median employee and then calculate that employee's total compensation in accordance with Item 402(c)(2)(x) affect compliance costs, particularly as compared to requiring registrants to calculate total compensation in accordance with Item 402(c)(2)(x) for all employees to identify the median? Comparisons of the costs of each approach would be particularly helpful. Would allowing for alternative approaches retain the benefits of Section 953(b)? If not, please provide specific information or data on what benefits would not be achieved under the proposed rules.

64. What are the transition costs that will be imposed on registrants as a result of the proposals, if adopted? Please be detailed and provide quantitative data or support, as practicable. Where applicable, please also distinguish between costs that are initial, non-recurring implementation costs and the costs of ongoing compliance.

65. What impact would the proposed rules have on the incentives of boards, senior executives and shareholders? Would the proposed rules be likely to change the behavior of registrants, investors or other market participants? Should we alter the proposed requirements to address that impact? If so, describe any changes that would address that impact and discuss any related costs and benefits that would arise from such a change.

66. What impact would the proposed rules have on competition? Would the expected compliance costs put registrants subject to the rule at a competitive disadvantage? Are there particular industries or types of registrants that would be more likely to be impacted? If so, what changes to the proposed requirements could mitigate the impact?

67. What impact would the proposed rules have on market efficiency? Are there any positive or negative effects of the proposed rules on efficiency that we may have overlooked? How could the rules be changed to promote any positive effect or to mitigate any negative effect on efficiency, while still satisfying the mandate of Section 953(b)?

<sup>222</sup> See, e.g., Section 102(a)(1)(B) (providing such a transition for say-on-pay compliance).



68. Could a registrant's competitors infer proprietary or sensitive information about the registrant's business operations, strategy or labor cost-structure from the proposed pay ratio disclosure? If so, please tell us what type of information could be inferred and how that could be determined. Please also tell us what changes to the proposed requirements could mitigate that concern?

69. What impact would the proposed rules have on capital formation? How could the rules be changed to promote capital formation or to mitigate any negative effect on capital formation resulting from the rules, while still satisfying the mandate of Section 953(b)?

## V. Paperwork Reduction Act

### A. Background

Certain provisions of the proposed amendments contain "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 (the "PRA").<sup>223</sup> We are submitting the proposed amendments to the Office of Management and Budget ("OMB") for review in accordance with the PRA.<sup>224</sup> The titles for the collection of information are:

- "Regulation S-K" (OMB Control No. 3235-0071);<sup>225</sup>
- "Form 10-K" (OMB Control No. 3235-0063);
- "Regulation 14A and Schedule 14A" (OMB Control No. 3235-0059);<sup>226</sup>
- "Regulation 14C and Schedule 14C" (OMB Control No. 3235-0057);<sup>227</sup>
- "Form 8-K" (OMB Control No. 3235-0060);

<sup>223</sup> 44 U.S.C. 3501 *et seq.*

<sup>224</sup> 44 U.S.C. 3507(d) and 5 CFR 1320.11.

<sup>225</sup> The paperwork burden from Regulation S-K is imposed through the forms that are subject to the disclosures in Regulation S-K and is reflected in the analysis of those forms. To avoid a Paperwork Reduction Act inventory reflecting duplicative burdens, for administrative convenience, we estimate the burdens imposed by Regulation S-K to be a total of one hour.

<sup>226</sup> As described below, our estimates for Form 10-K take into account the burden that would be incurred by including the proposed disclosure in the annual report directly or incorporating by reference from a proxy or information statement. To avoid a Paperwork Reduction Act inventory reflecting duplicative burdens, we estimate that the proposed disclosure would not impose an incremental burden for proxy statements on Schedule 14A.

<sup>227</sup> As described below, our estimates for Form 10-K take into account the burden that would be incurred by including the proposed disclosure in the annual report directly or incorporating by reference from a proxy or information statement. To avoid a Paperwork Reduction Act inventory reflecting duplicative burdens, we estimate that the proposed disclosure would not impose an incremental burden for information statements on 14C.

- "Form S-1" (OMB Control No. 3235-0065);<sup>228</sup>
- "Form S-4" (OMB Control No. 3235-0324)<sup>229</sup>
- "Form S-11" (OMB Control No. 3235-0067);<sup>230</sup>
- "Form 10" (OMB Control No. 3235-0064);<sup>231</sup> and
- "Form N-2" (OMB Control No. 3235-0026).<sup>232</sup>

These regulations, schedules and forms were adopted under the Securities Act and the Exchange Act, and in the case of Form N-2,<sup>233</sup> the Investment Company Act of 1940.<sup>234</sup> They set forth the disclosure requirements for periodic and current reports, registration statements and proxy and information statements filed by companies to help investors make informed investment and voting decisions. The hours and

<sup>228</sup> As described below, we have assumed that the burden relating to the proposed disclosure requirements would be associated primarily with Form 10-K rather than Forms S-1, S-4, S-11 or N-2 as applicable (because registrants would incorporate the disclosure from Form 10-K). To avoid a Paperwork Reduction Act inventory reflecting duplicative burdens, we estimate that the proposed disclosure would not impose an incremental burden for registration statements on Form S-1.

<sup>229</sup> As described below, we have assumed that the burden relating to the proposed disclosure requirements would be associated primarily with Form 10-K rather than Forms S-1, S-4, S-11 or N-2 as applicable (because registrants would incorporate the disclosure from Form 10-K). To avoid a Paperwork Reduction Act inventory reflecting duplicative burdens, we estimate that the proposed disclosure would not impose an incremental burden for registration statements on Form S-4.

<sup>230</sup> As described below, we have assumed that the burden relating to the proposed disclosure requirements would be associated primarily with Form 10-K rather than Forms S-1, S-11 or N-2 as applicable (because registrants would incorporate the disclosure from Form 10-K). To avoid a Paperwork Reduction Act inventory reflecting duplicative burdens, we estimate that the proposed disclosure would not impose an incremental burden for registration statements on Form S-11.

<sup>231</sup> As described below, because we have assumed that all new registrants would take advantage of the transition period afforded to them under the proposed requirements, we estimate no annual incremental increase in the paperwork burden associated with Form 10 as a result of the proposed requirements.

<sup>232</sup> Only Forms N-2 filed by business development companies would be subject to the proposed disclosure requirements, because Form N-2 requires business development companies, and not other investment companies, to provide Item 402 disclosure. As described below, we have assumed that the burden relating to the proposed disclosure requirements would be associated primarily with Form 10-K rather than Forms S-1, S-11 or N-2 as applicable (because registrants would incorporate the disclosure from Form 10-K). To avoid a Paperwork Reduction Act inventory reflecting duplicative burdens, we estimate that the proposed disclosure would not impose an incremental burden for registration statements on Form N-2.

<sup>233</sup> 17 CFR 239.14 and 274.11a-1.

<sup>234</sup> 15 U.S.C. 80a-1 *et seq.*

costs associated with preparing, filing and sending each form or schedule constitute reporting and cost burdens imposed by each collection of information. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number.

The proposals discussed in this release are intended to satisfy the requirements of Section 953(b) of the Dodd-Frank Act, which directs the Commission to amend Item 402 of Regulation S-K to add the pay ratio disclosure requirements specified by that provision. Compliance with the proposed requirements will be mandatory for affected registrants. Responses to the information collections will not be kept confidential, and there will be no mandatory retention period for the information disclosed.

### B. Summary of Collection of Information Requirements

In order to satisfy the legislative mandate in Section 953(b), we are proposing to add new paragraph (u) to Item 402 of Regulation S-K. This new paragraph (u) would require registrants to disclose:

- The median of the annual total compensation of all employees of the registrant (excluding the principal executive officer),
- the annual total compensation of the registrant's principal executive officer, and
- the ratio between these two amounts.

For this purpose, Section 953(b) specifies that total compensation is to be determined in accordance with Item 402(c)(2)(x). Item 402 already requires registrants to disclose the annual total compensation of the principal executive officer in accordance with Item 402(c)(2)(x).<sup>235</sup> The median of the annual total compensation of all employees and the ratio would be new, incremental disclosure burdens and would require affected registrants to collect compensation information for employees that is not currently required to be disclosed.

Investors and other market participants interested in executive compensation disclosure have indicated that the proposed disclosure would be

<sup>235</sup> As of the date of this proposal, the requirements for the calculation of total compensation under Item 402(c)(2)(x) are the same as those in effect on July 20, 2010. Therefore, for purposes of this PRA analysis, we have assumed that registrants would not need to recalculate the annual total compensation for the principal executive officer in connection with the proposed pay ratio disclosure.

useful in informing investment and voting decisions, particularly for say-on-pay votes and in director elections.<sup>236</sup> In this regard, pay ratio information could be used by shareholders for purposes of evaluating the actions of the board of directors in fulfilling its responsibilities to the company and its shareholders.<sup>237</sup> Pay ratio information could also be used to enhance an investor's understanding of a registrant's compensation practices applicable to non-executive employees relative to the named executive officers.<sup>238</sup>

The proposed disclosure under new paragraph (u) of Item 402 would be required in registration statements and annual reports that require executive compensation information under Item 402 of Regulation S-K and in proxy and information statements relating to an annual meeting of shareholders or written consents in lieu of such a meeting.<sup>239</sup> In addition, the proposed requirements would allow certain new registrants to omit the disclosure otherwise required by Item 402(u) from filings made during a specified transition period.

Finally, in order to conform the proposed requirements to current rules for the disclosure of PEO compensation when certain elements are not yet known, the proposals include a conforming amendment to Item 5.02 of Form 8-K. This proposed amendment would require registrants that are disclosing PEO total compensation in accordance with Item 5.02 of Form 8-K to also provide in that filing the updated pay ratio disclosure required by Item 402(u). Because Item 5.02 of Form 8-K provides a delayed method of filing information that would otherwise be required in the registrant's proxy or information statement or annual report, the PRA analysis assumes that the burden and cost of compliance with proposed Item 402(u) would be associated primarily with those forms and schedules rather than Form 8-K.

<sup>236</sup> See, e.g., letters from CtW Investment Group and S. Towns.

<sup>237</sup> See, e.g., letters from CtW Investment Group and UAW Retiree Medical Benefits Trust.

<sup>238</sup> See, e.g., letters from CtW Investment Group and UAW Retiree Medical Benefits Trust.

<sup>239</sup> Consistent with the scope of Section 953(b), the proposed requirements would not apply to the annual reports and proxy and information statements of emerging growth companies, smaller reporting companies or foreign private issuers. In addition, consistent with the instructions J and I of Form 10-K, the proposed requirements would not apply to the annual reports of issuers of asset-backed securities or to wholly-owned subsidiary registrants.

### C. Burden and Cost Estimates Related to the Proposed Amendments

We anticipate that the proposed amendments, if adopted, would increase the burdens and costs for registrants that are subject to the proposed disclosure requirements. For purposes of the PRA, we estimate that the total annual increase in the paperwork burden for all affected registrants to comply with the proposed collection of information requirements to be approximately 545,792 hours of company personnel time and total costs of approximately \$72,772,200 for the services of outside professionals.<sup>240</sup> These estimates include the time and the cost of implementing data gathering systems and disclosure controls and procedures, compiling necessary data, preparing and reviewing disclosure, filing documents and retaining records.

In deriving these estimates, we have assumed that:

- Registrants subject to the proposed requirements would satisfy the proposed requirements by either including the information directly in annual reports on Form 10-K or incorporating the information by reference from a proxy statement on Schedule 14A or information statement on Schedule 14C. Our estimates assume that substantially all of the burden relating to the proposed disclosure requirements would be associated with Form 10-K;
- For registrants that would be permitted to provide their pay ratio disclosure in a filing made in accordance with Item 5.02 of Form 8-K, rather than in Form 10-K, the burden relating to the proposed disclosure requirements would be associated primarily with Form 10-K rather than Form 8-K;<sup>241</sup>
- 100% of new registrants would use the proposed transition provisions allowing them to omit the proposed disclosure from their filings and, for follow-on offerings by these registrants, the burden relating to the proposed disclosure requirements would be associated primarily with Form 10-K rather than Forms S-1, S-11 or N-2 as applicable (because registrants would incorporate the disclosure from Form 10-K); and

<sup>240</sup> We describe how we derived the three-year average hour and cost burdens per response below. For administrative convenience, the presentation of the totals related to the paperwork burden hours have been rounded to the nearest whole number and the cost totals have been rounded to the nearest hundred.

<sup>241</sup> Our PRA estimates for Form 8-K include an estimated one hour burden to account for the inclusion of the proposed pay ratio disclosure.

- For Form 10-K and Form 8-K, 75% of the burden would be carried by the company internally and that 25% of the burden would be carried by outside professionals retained by the company at an average cost of \$400 per hour.<sup>242</sup>

As discussed above in this release, we understand from commenters that the costs of compliance will likely vary among individual companies based on a number of factors, including the size and complexity of their organizations, the nature of their operations, the nature of their workforce, the location of their operations, and, significantly, the extent that their existing payroll systems collect the information necessary to identify the median of the annual total compensation of their employees (including whether a single, centralized computer system covers all employees of the registrant and whether the company's benefits and cash compensation records reside in the same system). Because the proposed requirements would allow registrants some flexibility in identifying the median and the annual total compensation of employees, the actual burden could be lower if the methodology used is able to reduce the effort needed to collect the data or if the registrant is able to use information that it uses for other purposes.<sup>243</sup> We believe that the actual burdens will likely vary significantly among individual companies based on these factors.<sup>244</sup> Our estimates reflect average burdens, and, therefore, some companies may experience costs in excess of our estimates and some companies may experience costs that are lower than our estimates.<sup>245</sup>

<sup>242</sup> The portion of the burden carried by outside professionals is reflected as a cost, while the portion of the burden carried by the company internally is reflected in hours. We recognize that the costs of retaining outside professionals may vary depending on the nature of the professional services, but for purposes of this PRA analysis we estimate that such costs would be an average of \$400 per hour. This is the rate we typically estimate for outside legal services used in connection with public company reporting.

<sup>243</sup> See Section II of this release for a discussion of the proposed requirements.

<sup>244</sup> We also note that companies could address these factors in a variety of ways. For example, some companies might perform the data collection and consolidation manually, while others may incur the cost of implementing an information technology solution for collecting the data. In addition, some companies might outsource some of the burden hours to consultants or third party payroll management providers, which could increase the costs to the registrant while decreasing the burden hours of company personnel.

<sup>245</sup> Although we received some information from commenters and stakeholders regarding the time and costs to comply with Section 953(b), in light of the limitations of that information described above in Section IV of this release, we did not that information as the basis for our PRA estimates. We

We have derived our burden estimates by estimating the average number of hours it would take a registrant to prepare and submit the required data. In determining these estimates, we considered the burden estimates for similar disclosure requirements. We believe the burden hours associated with the preparation of the proposed pay ratio disclosure may be comparable to a registrant's preparation of the summary compensation table and other executive compensation disclosures required by the 2006 amendments to Item 402.<sup>246</sup> We recognize that, in this proposal, the burden reflects the compilation of data covering the entire workforce rather than only the named executive officers. We note that the proposal allows for a broad use of any consistently applied compensation measure and statistical sampling and the use of other reasonable estimates to identify the median. As noted above, the actual burden will vary depending on factors including the size of the company, the number of employees and how many are located outside of the United States. For a company with a medium-sized workforce, located primarily in the United States, that is able to identify a median employee from a sample of its employee population using a consistently applied compensation measure, the burden hours could be less than the estimated burden hours for the 2006 amendments to Item 402.<sup>247</sup> In contrast, for a large, multi-national registrant with hundreds of thousands of employees, the burden hours could be more than the estimated burden hours for the 2006 amendments to Item 402.<sup>248</sup> We believe, therefore,

received various hours estimates, including estimates of approximately 201 to 500 hours, and another estimate of 4,000 hours (based on 50 hours per country where employees are located). We received four cost estimates, including \$7.6 million, \$6.5 million, \$4.725 million and \$350,000 per registrant. We note that all of these estimates are estimates based on the commenter's initial reading and interpretation of the statute and do not reflect the discretionary choices we have made in the proposed rule implementing the statute. For instance these estimates do not take into account the ability to use statistical sampling. We also note that the estimates do not represent the full breadth of the registrant population. As noted in our economic analysis section, we anticipate that the PRA estimates will be revised in light of further information we receive on estimated costs.

<sup>246</sup> See 2006 Adopting Release, *supra* note 14, at 53215 (which we estimated to be a three-year average of 95 hours, based on 170 hours in year one, 80 hours in year two and 35 hours in year three and thereafter).

<sup>247</sup> We expect that such a company would be determining total compensation under Item 402(c)(2)(x) for only one additional employee.

<sup>248</sup> For these companies, we considered the estimated burden of other international reporting regimes, such as the Commission's rules implementing Section 1502 of the Dodd-Frank Act.

that it is reasonable to assume that the burden hours will be a multiple of the average burden hours associated with the 2006 amendments to Item 402. We also expect that, similar to the 2006 amendments, the proposed rules' burden would be greatest during the first year of their effectiveness and diminish in subsequent years. Accordingly, to derive our estimates, we multiplied the average burden estimate for the 2006 amendments by two, yielding an estimated burden of 340 hours in year one, 160 hours in year two and 70 hours in year three and thereafter, for a three-year average burden of 190 hours.

We used this three-year average hour burden to estimate the cost and hour burden for each collection of information as follows:

#### 1. Regulation S-K

While the proposed amendments would make revisions to Regulation S-K, the collection of information requirements for that regulation are reflected in the burden hours estimated for the forms and schedules listed below. The rules in Regulation S-K do not impose any separate burden. Consistent with historical practice, we are proposing to retain an estimate of one burden hour to Regulation S-K for administrative convenience.

#### 2. Form 10-K

Only Forms 10-K that are filed by registrants that are not smaller reporting companies or emerging growth companies would be required to include the proposed disclosure. For purposes of our PRA estimates, we have assumed that 100% of asset-backed securities issuers would omit Item 402 disclosure from Form 10-K pursuant to Instruction J of Form 10-K and 100% of wholly-owned subsidiary registrants would omit Item 402 disclosure from Form 10-K pursuant to Instruction I of Form 10-K, and, accordingly, these registrants would also not be subject to the proposed disclosure requirements. Based on a review of EDGAR filings in calendar year 2011, we estimate that of the approximately 8,870 annual reports filed in that year, approximately 3,830 annual reports are filed by registrants that would be subject to the proposed disclosure requirements.<sup>249</sup> We estimate

See Conflict Minerals, Release No. 34-67716 (Aug. 22, 2012) [77 FR 56273] (which we estimated to be a three year average of 495 hours). In that regard, we assume this proposal would be less burdensome because the underlying information would be under the control of the registrant rather than data that must be gathered from unrelated third parties in the registrant's supply chain.

<sup>249</sup> Based on a review of EDGAR filings in 2011, approximately 3,750 annual reports were filed by

that the proposed disclosure requirements would add an average of 190 burden hours to the total burden hours required to produce each Form 10-K that is subject to the proposed requirements (143 hours in-house personnel time and a cost of approximately \$19,000 for outside professionals).

We estimate that the preparation of annual reports currently results in a total annual compliance burden of 21,430,988 hours and an annual cost of outside professionals of \$2,857,465,000. If the proposals were adopted, we estimate that the incremental cost of outside professionals for annual reports would be approximately \$72,770,000 per year and the incremental company burden would be approximately 545,775 hours per year.

#### 3. Form 8-K

As described in this release, we are proposing to require a registrant that is filing its PEO total compensation on a delayed basis due to the unavailability of certain components of compensation on Form 8-K (in accordance with Instruction 1 to Items 402(c)(2)(iii) and (iv) of Regulation S-K and Item 5.02(f) of Form 8-K) to provide the proposed pay ratio disclosure at the same time. We have proposed a conforming amendment to Item 5.02 of Form 8-K that would require a registrant to include updated pay ratio disclosure in the Form 8-K that it files to disclose its PEO total compensation information.<sup>250</sup> We estimate that the burden for adding the pay ratio disclosure to that Form 8-K filing would be one hour per registrant.<sup>251</sup> We also estimate that the proposed Form 8-K amendment would not result in additional Form 8-K filings because registrants who omit disclosure in reliance on Instruction 1 to Items 402(c)(2)(iii) and (iv) are already required to file a Form 8-K. The proposed amendments would, however, add pay ratio disclosure requirements to that Form 8-K filing.

Based on a review of EDGAR filings for calendar years 2011 and 2012, we estimate that approximately 29 Forms

smaller reporting companies, approximately 290 were filed by ABS issuers and approximately 100 were filed by wholly-owned subsidiaries of other registrants. We have also reduced the total number of Form 10-K filings by 900 to reflect the approximate number of emerging growth companies that have identified themselves as such in their EDGAR filings as of May 2013.

<sup>250</sup> See Section II.C.7.b. above.

<sup>251</sup> As noted above, we have assumed that the burden relating to the proposed pay ratio requirements would remain associated with the registrant's proxy or information statement or annual report, and, therefore, our PRA estimates for those forms reflect that burden.

8–K are filed pursuant to Item 5.02(f) annually and approximately 75% of these relate to disclosure of PEO compensation. As a result, we estimate that 22 of the Forms 8–K filed in a given year would spend 1 additional hour preparing the disclosure required by the amendments (0.75 hours of internal personnel time and a cost of approximately \$100 for professional services), in addition to the total burden hours required to produce each Form 8–K. We estimate that the preparation of current reports on Form 8–K currently results in a total annual compliance burden of 507,665 hours and an annual cost of outside professionals of \$67,688,700. If the proposals were adopted, we estimate that the incremental company burden would be approximately 16.5 hours per year and approximately \$2,200 in the incremental cost of outside professionals for current reports on Form 8–K.

#### 4. Proxy Statements on Schedule 14A

Only proxy statements on Schedule 14A that are required to include Item 402 information, and that are not filed by smaller reporting companies or emerging growth companies, would be required to include the proposed pay ratio disclosure. For purposes of our PRA estimates, consistent with past amendments to Item 402,<sup>252</sup> we have assumed that all of the burden relating to the proposed disclosure requirements would be associated with Form 10–K, even if registrants include the proposed disclosure required in Form 10–K by incorporating that disclosure by reference from a proxy statement on Schedule 14A.

#### 5. Information Statements on Schedule 14C

Only information statements on Schedule 14C that are required to include Item 402 information, and that are not filed by smaller reporting companies or emerging growth companies, would be required to include the proposed pay ratio disclosure. For purposes of our PRA estimates, consistent with past amendments to Item 402, we have assumed that all of the burden relating to the proposed disclosure requirements would be associated with Form 10–K, even if registrants include the proposed disclosure required in Form 10–K by incorporating that disclosure by

<sup>252</sup> We took a similar approach in connection with the rules for Summary Compensation Table disclosure required by the 2006 amendments to Item 402. See 2006 Adopting Release, *supra* note 14.

reference from an information statement on Schedule 14C.

#### 6. Form S–1

Because we have assumed that all new registrants would take advantage of the transition period afforded to them under the proposed requirements, we estimate that approximately 70 registration statements on Form S–1 would be required to include the proposed disclosure.<sup>253</sup> In addition, because we assume that all of these Forms S–1 will incorporate by reference the registrant's disclosure from its annual report, we have assumed that all of the burden relating to the proposed disclosure requirements would be associated with Form 10–K.

#### 7. Form S–4

We have assumed that registrants filing on Form S–4 for whom executive compensation information under Item 402 is required pursuant to Items 18 or 19 of Form S–4 will incorporate by reference the pay ratio disclosure contained in the registrant's annual report. Thus, we have assumed that all of the burden relating to the proposed disclosure requirements would be associated with Form 10–K.

#### 8. Form S–11

Because we have assumed that all new registrants would take advantage of the transition period afforded to them under the proposed requirements, we have assumed that five registration statements on Form S–11 would be required to include the proposed disclosure.<sup>254</sup> In addition, because we assume that these Forms S–11 will incorporate by reference the registrant's pay ratio disclosure contained in its annual report, we have assumed that all of the burden relating to the proposed disclosure requirements would be associated with Form 10–K.

#### 9. Form N–2

Only Forms N–2 filed by business development companies would be subject to the proposed disclosure requirements. Based on a review of EDGAR filings for calendar year 2011, our best estimate of the total number of business development companies is 41 and that 28 of these have no

<sup>253</sup> Based on a review of EDGAR filings for calendar year 2012, we estimate that approximately 70 Forms S–1 would be filed in connection with follow-on offerings (rather than initial public offerings) by companies that are not emerging growth companies or smaller reporting companies.

<sup>254</sup> Based on a review of EDGAR filings for calendar year 2012, we estimate that approximately five Forms S–11 would be filed in connection with follow-on offerings by registrants that are not emerging growth companies.

employees.<sup>255</sup> Therefore, of the 205 Forms N–2 that are filed annually, we estimate that approximately 41 are filed by business development companies and approximately 13 of these business development companies have employees. In addition, because we assume that all of these Forms N–2 will incorporate by reference the registrant's disclosure in its annual report, we have assumed that all of the burden relating to the proposed disclosure requirements would be associated with Form 10–K.

#### 10. Form 10

Because we have assumed that all new registrants would take advantage of the transition period afforded to them under the proposed requirements, we estimate no annual incremental increase in the paperwork burden associated with Form 10 as a result of the proposed requirements.

#### *D. Summary of Proposed Changes to Annual Compliance Burden in Collection of Information*

Tables 1 and 2 below illustrate the total annual compliance burden of the collection of information in hours and in cost under the proposed amendments for annual reports on Form 10–K and current reports on Form 8–K under the Exchange Act. The burden estimates were calculated by multiplying the estimated number of annual responses by the estimated average number of hours it would take a company to prepare and review the proposed disclosure. We recognize that some registrants may need to include the pay ratio disclosure in more than one filing covering the same period, accordingly actual numbers may be lower than our estimates.

As discussed above, there is no change to the estimated burden of the collection of information under Forms S–1, S–4, S–11 or N–2 or under Schedule 14A and 14C because we have assumed that the burden relating to the proposed disclosure requirements would be associated primarily with Form 10–K. In addition, there is no change to the estimated burden of the collection of information under Form 10, because we have assumed that all new registrants would take advantage of the proposed transition period. There is no change to the estimated burden of the collection of information under Regulation S–K because the burdens that Regulation S–K imposes are

<sup>255</sup> As discussed in this release, the proposed requirements for identifying the median apply to workers who are employees of the registrant. Business development companies are often externally managed rather than having their own employees.

reflected in our revised estimates for the forms.

TABLE 1—CALCULATION OF INCREASES IN BURDEN ESTIMATES DUE TO THE RULE PROPOSAL

	Estimated annual responses subject to proposed requirements (A)	Estimated hour burden per response (B)	Estimated aggregate incremental hour burden (C) = (A) * (B)	75% Company (hours) (D) = (C) * 0.75	25% Outside professional (hours) (E) = C * 0.25	Estimated aggregate cost of outside professions in connection with proposed requirements (F) = (E) * \$400
Form 10-K .....	3,830	190	898,700	545,775	181,925	\$72,770,000
Form 8-K .....	22	1	22	16.5	5.5	2,200
Total .....	3,852	191	898,722	545,792	181,931	72,772,200

TABLE 2—CALCULATION OF TOTAL PRA BURDEN ESTIMATES

	Current annual responses (A)	Proposed annual responses (B)	Current burden hours (C)	Increase in burden hours (D) <sup>256</sup>	Proposed burden hours (E) = C + D	Current professional costs (F)	Increase in professional costs (G)	Proposed professional costs = F + G
Form 10-K ...	14,296	14,296	21,430,988	545,775	22,105,013	\$2,857,465,000	\$72,770,000	\$2,930,235,000
Form 8-K .....	118,387	118,387	507,665	16.5	507,681.5	67,688,700	2,200	67,690,900
Total .....	132,683	132,683	21,938,653	545,792	22,612,694	2,925,153,700	72,772,200	2,997,925,900

### E. Request for Comment

Pursuant to 44 U.S.C. 3506(c)(2)(B), we request comment in order to:

- Evaluate whether the proposed collections of information are necessary for the proper performance of the functions of the Commission, including whether the information would have practical utility;
- Evaluate the accuracy of our estimates of the burden of the proposed collections of information;
- Determine whether there are ways to enhance the quality, utility and clarity of the information to be collected;
- Evaluate whether there are ways to minimize the burden of the collections of information on those who respond, including through the use of automated collection techniques or other forms of information technology; and
- Evaluate whether the proposed amendments would have any effects on any other collections of information not previously identified in this section.

Any member of the public may direct to us any comments concerning the

<sup>256</sup> The increase in burden hours reflected in the table is based on the aggregate incremental burden hours per form multiplied by the annual responses that would be required to include additional disclosure under our rules as proposed. As explained in the discussion above, for purposes of determining the total increase in burden hours, we have reduced the current number of annual responses to reflect that the proposed disclosure requirements will not apply to all forms filed. See Table 1 for estimates per response.

accuracy of these burden estimates and any suggestions for reducing the burdens. Persons who desire to submit comments on the collection of information requirements should direct their comments to the OMB, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Room 10102, New Executive Office Building, Washington, DC 20503, and send a copy of the comments to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549-1090, with reference to File No. S7-07-13. Requests for materials submitted to the OMB by us with regard to these collections of information should be in writing, refer to File No. S7-07-13 and be submitted to the Securities and Exchange Commission, Office of FOIA Services, 100 F Street NE., Washington, DC 20549-2736. Because the OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication, your comments are best assured of having their full effect if the OMB receives them within 30 days of publication.

### VI. Small Business Regulatory Enforcement Fairness Act

For purposes of the Small Business Regulatory Enforcement Fairness Act of

1996 (“SBREFA”),<sup>257</sup> we solicit data to determine whether the proposed amendments constitute a “major” rule. Under SBREFA, a rule is considered “major” where, if adopted, it results or is likely to result in:

- An annual effect on the economy of \$100 million or more (either in the form of an increase or a decrease);
- A major increase in costs or prices for consumers or individual industries;
- or
- Significant adverse effects on competition, investment or innovation.

Commenters should provide comment and empirical data on (a) the potential annual effect on the U.S. economy; (b) any increase in costs or prices for consumers or individual industries; and (c) any potential effect on competition, investment or innovation.

### VII. Regulatory Flexibility Act Certification

The Commission hereby certifies, pursuant to 5 U.S.C. 605(b), that the amendments contained in this release, if adopted, would not have a significant economic impact on a substantial number of small entities. The proposed amendments would provide that a registrant (other than a smaller reporting company or an emerging growth company) would be required to disclose a pay ratio (showing the median of the

<sup>257</sup> Public Law 104-121, tit. II, 110 Stat. 857 (1996).

annual total compensation of all employees of the registrant and its subsidiaries to the annual total compensation of the principal executive officer of the registrant) in filings that are required to include executive compensation information pursuant to Item 402 of Regulation S-K. Section 953(b) does not apply to smaller reporting companies and does not apply to emerging growth companies, and, consistent with Section 953(b), the proposed requirements would not apply to smaller reporting companies or emerging growth companies. Because smaller reporting companies are not subject to the proposed requirements, we believe the proposed rules would not have a significant economic impact on a substantial number of small entities.

### VIII. Statutory Authority and Text of Amendments

The amendments contained herein are being proposed pursuant to Sections 7, 10 and 19(a) of the Securities Act, Sections 3(b), 12, 13, 14, 15(d) and 23(a) of the Exchange Act, Section 953(b) of the Dodd-Frank Act, as amended, and Section 102(a)(3) of the JOBS Act.

#### List of Subjects

##### 17 CFR Part 229

Reporting and recordkeeping requirements, Securities.

##### 17 CFR Part 249

Brokers, Reporting and recordkeeping requirements, Securities.

#### Text of Proposed Amendments

In accordance with the foregoing, title 17, chapter II of the Code of Federal Regulations, is proposed to be amended as follows:

### PART 229—STANDARD INSTRUCTIONS FOR FILING FORMS UNDER SECURITIES ACT OF 1933 AND SECURITIES EXCHANGE ACT OF 1934—REGULATION S-K

■ 1. The general authority citation for part 229 is revised to read as follows:

**Authority:** 15 U.S.C. 77e, 77f, 77g, 77h, 77j, 77k, 77s, 77z-2, 77z-3, 77aa(25), 77aa(26), 77ddd, 77eee, 77ggg, 77hhh, 77iii, 77jjj, 77nnn, 77sss, 78c, 78i, 78j, 78l, 78m, 78n, 78o, 78u-5, 78w, 78ll, 78 mm, 80a-8, 80a-9, 80a-20, 80a-29, 80a-30, 80a-31(c), 80a-37, 80a-38(a), 80a-39, 80b-11 and 7201 *et seq.*; 18 U.S.C. 1350; Sec. 953(b) Pub. L. 111-203, 124 Stat. 1904; and Sec. 102(a)(3) Pub. L. 112-106, 126 Stat. 309, unless otherwise noted.

■ 2. Amend § 229.402 by:

■ a. In paragraph (l) removing “(k) and (s)” and adding in its place “(k), (s) and (u)”;

■ b. Adding paragraph (u) directly after the Instructions to Item 402(t).

The addition reads as follows:

#### § 229.402 (Item 402) Executive Compensation.

\* \* \* \* \*

(u) *Pay ratio disclosure.* (1) Disclose:

(i) The median of the annual total compensation of all employees of the registrant, except the PEO of the registrant;

(ii) The annual total compensation of the PEO of the registrant; and

(iii) The ratio of the amount in paragraph (u)(1)(i) of this Item to the amount in paragraph (u)(1)(ii) of this Item. For purposes of the ratio required by this paragraph (u)(1)(iii), the amount in paragraph (u)(1)(i) of this Item shall equal one, or, alternatively, the ratio may be expressed narratively as the multiple that the amount in paragraph (u)(1)(ii) of this Item bears to the amount in paragraph (u)(1)(i) of this Item.

(2) (i) For purposes of this paragraph (u), the *total compensation* of employees of the registrant (including the PEO of the registrant) shall be determined in accordance with paragraph (c)(2)(x) of this Item 402. In determining the total compensation, all references to “named executive officer” in this Item 402 and the instructions thereto may be deemed to refer instead, as applicable, to “employee” and, for non-salaried employees, references to “base salary” and “salary” in this Item 402 and the instructions thereto may be deemed to refer instead, as applicable, to “wages plus overtime.”

(ii) For purposes of this paragraph (u), *annual total compensation* means total compensation for the registrant’s last completed fiscal year.

(3) For purposes of this paragraph (u), *employee* or *employee of the registrant* means an individual employed by the registrant or any of its subsidiaries as of the last day of the registrant’s last completed fiscal year. This includes any full-time, part-time, seasonal or temporary worker employed by the registrant or any of its subsidiaries on that day (including officers other than the PEO).

*Instruction 1 to Item 402(u)—Updating for the last completed fiscal year.* Pay ratio information (*i.e.*, the disclosure called for by paragraph (u)(1) of this Item) with respect to the registrant’s last completed fiscal year is not required to be disclosed until the filing of its annual report on Form 10-K for that last completed fiscal year or, if later, the filing of a definitive proxy

or information statement relating to its next annual meeting of shareholders (or written consents in lieu of such a meeting) following the end of such fiscal year; *provided that*, the required pay ratio information must, in any event, be filed as provided in General Instruction G(3) of Form 10-K (17 CFR 249.310) not later than 120 days after the end of such fiscal year. In any filing made by a registrant after the end of its last completed fiscal year and before the filing of such Form 10-K or proxy or information statement, as applicable, a registrant that was subject to the requirements of paragraph (u) of this Item for the fiscal year prior to the last completed fiscal year shall include or incorporate by reference the information required by paragraph (u) of this Item for that prior fiscal year.

*Instruction 2 to Item 402(u)—Methodology and use of estimates.* (i) Registrants may use (A) a methodology that uses reasonable estimates to identify the median and (B) reasonable estimates to calculate the annual total compensation or any elements of total compensation for employees other than the PEO.

(ii) In determining the employees from which the median is identified, a registrant may use (A) its employee population or (B) statistical sampling or other reasonable methods.

(iii) A registrant may identify the median employee using (A) annual total compensation or (B) any other compensation measure that is consistently applied to all employees included in the calculation, such as amounts derived from the registrant’s payroll or tax records. In using a compensation measure other than annual total compensation to identify the median employee, if that measure is recorded on a basis other than the registrant’s fiscal year (such as payroll or tax information), the registrant may use the same annual period that is used to derive those amounts. Where a compensation measure other than annual total compensation is used to identify the median employee, the registrant must (A) disclose the compensation measure used and (B) calculate and disclose the annual total compensation for that median employee.

(iv) Registrants must briefly disclose and consistently apply any methodology used to identify the median and any material assumptions, adjustments or estimates used to identify the median or to determine total compensation or any elements of total compensation, and registrants must clearly identify any estimated amount. This disclosure should be a brief overview; it is not

necessary to provide technical analyses or formulas. If a registrant changes methodology or material assumptions, adjustments or estimates from those used in its pay ratio disclosure for the prior fiscal year, and if the effects of any such change are material, the registrant shall briefly describe the change and the reasons for the change, and shall provide an estimate of the impact of the change on the median and the ratio.

*Instruction 3 to Item 402(u)—Permitted annualizing adjustments.* A registrant may annualize the total compensation for all permanent employees (other than those in temporary or seasonal positions) that were employed by the registrant for less than the full fiscal year (such as newly hired employees or permanent employees on an unpaid leave of absence during the period).

*Instruction 4 to Item 402(u)—PEO compensation not available.* A registrant that is relying on Instruction 1 to Item 402(c)(2)(iii) and (iv) in connection with the salary or bonus of the PEO for the last completed fiscal year, shall disclose that the pay ratio required by paragraph (u) of this Item is not calculable until the PEO salary or bonus, as applicable, is determined and shall disclose the date that the PEO's actual total compensation is expected to be determined. The disclosure required by paragraph (u) of this Item must then be disclosed in the filing under Item 5.02(f) of Form 8-K (17 CFR 249.308) that discloses the PEO's salary or bonus in accordance with Instruction 1 to Item 402(c)(2)(iii) and (iv).

*Instruction 5 to Item 402(u)—Transition period.* A registrant must comply with paragraph (u) of this Item with respect to compensation for the first fiscal year commencing on or after the date the registrant first becomes subject to the requirements of Section 13(a) or 15(d) of the Exchange Act (15 U.S.C. 78m or 78o(d)), and may omit such pay ratio disclosure from any filing until it the filing of its annual report on Form 10-K for such fiscal year or, if later, the filing of a proxy or information statement relating to its next annual meeting of shareholders (or written consents in lieu of such a meeting) following the end of such year, *provided that*, such pay ratio disclosure must, in any event, be filed as provided in General Instruction G(3) of Form 10-K (17 CFR 249.310) not later than 120 days after the end of such fiscal year.

*Instruction 6 to Item 402(u)—Emerging growth companies.* A registrant is not required to comply with paragraph (u) of this Item if it is an emerging growth company as defined in Section 3(a) of the Exchange Act (15 U.S.C. 78c(a)).

#### **PART 249—FORMS, SECURITIES EXCHANGE ACT OF 1934**

■ 3. The general authority citation for part 249 is revised to read as follows:

**Authority:** 15 U.S.C. 78a *et seq.* and 7201 *et seq.*; 12 U.S.C. 5461 *et seq.*; 18 U.S.C. 1350; Sec. 953(b) Pub. L. 111-203, 124 Stat. 1904; and Sec. 102(a)(3) Pub. L. 112-106, 126 Stat. 309, unless otherwise noted.

\* \* \* \* \*

■ 4. Form 8-K (referenced in § 249.308) is amended by revising paragraph (f) of Item 5.02, designating paragraph (f) as (f)(1) and adding paragraph (2).

The revisions and additions read as follows:

**Note:** The text of Form 8-K does not, and this amendment will not, appear in the Code of Federal Regulations.

Form 8-K

\* \* \* \* \*

#### **Item 5.02 Departure of Directors or Certain Officers; Election of Directors; Appointment of Certain Officers; Compensatory Arrangements of Certain Officers.**

\* \* \* \* \*

(f)(1) \* \* \*

(2) As specified in Instruction 4 to Item 402(u) of Regulation S-K (17 CFR 229.402(u)), disclosure under this Item 5.02(f) with respect to the salary or bonus of a principal executive officer shall include pay ratio disclosure pursuant to Item 402(u) of Regulation S-K calculated using the new total compensation figure for the principal executive officer. Pay ratio disclosure is not required under this Item 5.02(f) until the omitted salary or bonus amounts for such principal executive officer become calculable in whole.

\* \* \* \* \*

Dated: September 18, 2013.

By the Commission.

**Elizabeth M. Murphy,**  
*Secretary.*

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