Section 128C — Item 402(u) Pay Ratio Disclosure

Question 128C.01

Question: If a registrant does not use annual total compensation calculated using Item 402(c)(2)(x) of Regulation S-K ("annual total compensation") to identify the median employee, how should a registrant select another consistently applied compensation measure ("CACM") to identify the median employee?

Answer: Item 402(u) requires registrants to identify the median employee using annual total compensation or another CACM, such as information derived from the registrant's tax and/or payroll records. Because of concerns about the expected compliance costs if registrants had been required to calculate annual total compensation for all employees, the Commission permitted registrants to use a CACM other than annual total compensation as a reasonable alternative to identifying the median employee. Any measure that reasonably reflects the annual compensation of employees could serve as a CACM. The appropriateness of any measure will depend on the registrant's particular facts and circumstances. ~~For example, total cash compensation could be a CACM unless the registrant also distributed annual equity awards widely among its employees. Social Security taxes withheld would likely not be a CACM unless all employees earned less than the Social Security wage base. The registrant must also briefly disclose the compensation measure used. Although the CACM must~~ As the Commission stated in the interpretive release, "a registrant may use internal records that reasonably reflect annual compensation~~, it is not expected that the CACM would necessarily~~ to identify the ~~same~~ median employee ~~as if the registrant were to use annual total~~, even if those records do not include every element of compensation~~.~~, such as equity awards widely distributed to employees." [October 18, 2016; updated September 21, 2017]

Question 128C.02

Question: May a registrant exclusively use hourly or annual *rates* of pay as its CACM?

Answer: No. Although an hourly or annual pay rate may be a component used to determine an employee's overall compensation, the use of the pay rate alone generally is not an appropriate CACM to identify the median employee. Using an hourly rate without taking into account the number of hours actually worked would be similar to making a full-time equivalent adjustment for part-time employees, which is not permitted. Similarly, using an annual *rate* only, without regard to whether the employees worked the entire year and were actually paid that amount during the year, would be similar to annualizing pay, which the rule only permits in limited circumstances. [October 18, 2016]

Question 128C.03

Question: When a registrant uses a CACM to identify the median employee, what time period may it use? Must the period include the date on which the employee population is determined? Must it always be for an annual period? May it use the prior fiscal year?

Answer: To calculate the required pay ratio, a registrant must first select a date, which must be within three months of the end of its fiscal year, to determine the population of its employees from which to identify the median. Once the employee population is determined, the registrant must then identify the median employee from that population using either annual total compensation or another CACM. In applying the CACM to identify the median employee, a registrant is not required to use a period that includes the date on which the employee population is determined nor is it required to use a full annual period. A CACM may also consist of annual total compensation from the registrant's prior fiscal year so long as there has not been a change in the registrant's employee population or employee compensation arrangements that would result in a significant change of its pay distribution to its workforce. [October 18, 2016]

Question 128C.04

Question: When someone is furloughed on the date that the registrant uses to determine the population of its employees from which it is required to identify the median, must the registrant include the furloughed person in the employee population used to identify the median employee, and, if included in the population, how should the furloughed employee's compensation be calculated?

Answer: Item 402(u) does not define or even address furloughed employees. Because a furlough could have different meanings for different employers, registrants will need to determine whether furloughed workers should be included as employees based on the facts and circumstances. If the furloughed worker is determined to be an employee of the registrant on the date the employee population is determined, his or her compensation should be determined by the same method as for a non-furloughed employee. Item 402(u)(3) of Regulation S-K identifies four classes of employees: full-time, part-time, temporary and seasonal. The registrant must determine in which class the employee belongs on that date and determine that individual's compensation using annual total compensation or another CACM in accordance with Instruction 5 of Item 402(u). That instruction states that a registrant may annualize the total compensation for all permanent employees (full-time or part-time) that were employed by the registrant for less than the full fiscal year or who were on an unpaid leave of absence during the period. In contrast, a registrant may not annualize the total compensation for employees in temporary or seasonal positions. A registrant may not make a full-time equivalent adjustment for any employee. [October 18, 2016]

Question 128C.05

Question: Under what circumstances is a worker employed and his or her compensation determined by an unaffiliated third party such that the worker is considered an

independent contractor or leased worker under the rule? When is a registrant considered to be determining the compensation of a worker?

Answer: In the release, the Commission noted its belief that the primary benefit of the pay ratio disclosure is to provide shareholders with a company-specific metric that they can use to evaluate the compensation paid to the PEO within the context of their company. Therefore, in determining when a worker is an "employee" of the registrant under the rule, the registrant must consider the composition of its workforce and its overall employment and compensation practices. In furtherance of this, a registrant should include those workers whose compensation it or one of its consolidated subsidiaries determines regardless of whether these workers would be considered "employees" for tax or employment law purposes or under other definitions of that term. Frequently, a registrant will obtain the services of workers by contracting with an unaffiliated third party that employs the workers. When a registrant obtains services in this way, we do not believe it is determining the workers' compensation for purposes of the rule if, for example, the registrant only specifies that those workers receive a minimum level of compensation. Further, an individual who is an independent contractor may be the "unaffiliated third party" who determines his or her own compensation. [October 18, 2016]

[Withdrawn, September 21, 2017]

Question 128C.06

Question: Given the significant flexibility provided to registrants in Item 402(u) to identify the median employee, would the staff object if a registrant describes the pay ratio as an estimate?

Answer: No. As the Commission stated in the interpretive release, due to the use of estimates, assumptions, adjustments, and statistical sampling permitted by the rule, pay ratio disclosures may involve a degree of imprecision. Therefore, the staff would not object if a registrant states in any required disclosure that the pay ratio is a reasonable estimate calculated in a manner consistent with Item 402(u). [September 21, 2017]

Summary report: Litéra® Change-Pro TDC 10.1.0.200 Document comparison done on 9/22/2017 10:15:39 AM	
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Intelligent Table Comparison: Active	
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Modified DMS: iw://DMS/AmericasActive/90090971/2	
Changes:	
Add	9
Delete	7
Move From	0
Move To	0
Table Insert	0
Table Delete	0
Table moves to	0
Table moves from	0
Embedded Graphics (Visio, ChemDraw, Images etc.)	0
Embedded Excel	0
Format changes	0
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