

[Securities Regulation Daily Wrap Up, EXECUTIVE COMPENSATION— New C&DIs explain pay ratio disclosure and benefit plans, restricted securities, \(Oct. 19, 2016\)](#)

Securities Regulation Daily Wrap Up

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By [Mark S. Nelson, J.D.](#)

The SEC's Division of Corporation Finance issued five new Compliance and Disclosure Interpretations in an effort to explain how companies may comply with the pay ratio disclosure requirements. The C&DIs involve the Dodd-Frank-mandated regime the Commission adopted just over a year ago and for which compliance is set for the first fiscal year beginning on or after January 1, 2017. A separate set of updated C&DIs deals with Securities Act rules for compensatory benefit plans and restricted securities.

Pay ratio disclosure. The [final pay ratio rule](#) mandates disclosure of the ratio between the median of the annual total compensation of all employees and the principal executive officer's annual total compensation. The Commission's pay ratio rule is set out in Item 402(u) of Regulation S-K. But the rule text also raises a few perplexing issues that get addressed in the [new C&DIs](#) contained in Section 128C of the Division's Regulation S-K guidance, including the selection of the consistently applied compensation measure (CACM), pay rates, time periods, furloughed workers and independent contractors.

For example, the final rule refers to [Item 402\(c\)\(2\)\(x\)](#) (the SEC provided the text as an adjunct to the new C&DIs) for the calculation of annual total compensation and elsewhere to other CACMs, including information derived from a registrant's tax and/or payroll records. Question 128C.01 confirms that any measure that reasonably reflects employees' annual compensation can work, if the measure is appropriate given the company's particular facts and circumstances. But the C&DI suggests a few limits: total cash compensation is okay unless a certain scenario exists, while Social Security taxes withheld is an unlikely choice absent certain facts.

According to Question 128C.02, rates of pay alone could not be used as a CACM, even though pay rates may be a component of determining an employee's overall compensation. Question 128C.03 clarifies the time period stated in the final rule. Under Question 128C.04, a company must consider its unique circumstances regarding furloughed workers, consistent with Instruction 5 of Item 402(u). Question 128C.05 states that a company should include in its calculations workers for whom the company or its consolidated subsidiary determines compensation. But a company would not be determining compensation if it only specified that workers employed by an unaffiliated third party receive a minimum level of compensation.

Compensatory benefit plans; restricted securities. Shortly after adding the Regulation S-K pay ratio C&DIs, the Division issued another set of revised and new C&DIs covering several topics under the Securities Act rules. For one, the staff updated [Question 271.04](#), which is one of the Securities Act rules C&DIs for general situations, to re-phrase the question and to expand upon the prior answer.

That question involved a non-Exchange Act reporting company that issued options in reliance on Securities Act Rule 701 that is later acquired by an Exchange Act reporting company such that the private company's options become exercisable for shares of the acquirer. Previously, the [question](#) was whether the acquirer could rely on Rule 701(b)(2) to exempt the exercise of the options; the staff said "No." The revised question asks if the acquirer must register the offer and sale of shares issuable upon the exercise of the options; the answer is "No," but the explanation now clarifies the scope of reliance on Rule 701 and states that the acquirer's Exchange Act reports would satisfy any related disclosure requirements.

New [Question 271.24](#) clarifies when an issuer must provide additional information to investors about restricted stock units under Securities Act Rule 701 upon exceeding the \$5 million limit that triggers this informational duty.

Citing Rule 701(e), the staff explained that this information must be delivered to investors within a reasonable time before the sale. A revision to [Question 532.06](#), one of the Securities Act rules C&DIs for particular situations involving Rule 144(d), references a different question in the [SEC release](#) cited in the [prior](#) C&DI.

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