June 25, 2025

Ms. Vanessa Countryman, Secretary
United States Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090
File No. 4-855

Re: Executive Compensation Roundtable; Responses to Potential Questions for Consideration

Dear Ms. Countryman:

This is to respond to the questions raised in the SEC's announcement of a roundtable discussion on the topic of its executive compensation rules, scheduled for Thursday, June 26, 2025.

I am a former staff attorney within the SEC's Division of Corporation Finance. Regulation S-K, Item 402 has represented a significant focus of my practice for the last two decades. During that period, I have found it necessary to rewrite every SEC relevant rule-making since SEC Release Nos. 33-8732A; 34-54302A; IC-27444A; File No. S7-03-06 (November 7, 2006) in an effort to reduce what I perceive to be the gaps and ambiguities in the adopted rules, and clarify the explanations of those rules in the applicable release. On occasion, I have reached out to the Office of the Chief Counsel to raise questions about the then newly-adopted rules. In general, this has proven a fruitless process, with the SEC staffers I have spoken with stating that the SEC does not respond to "hypothetical questions."

For each of the last 10+ years, I have reviewed 50-100 proxy statements for companies' annual meetings of shareholders, typically identifying multiple 'errors' in compliance with Regulation S-K, Item 402 or other related authority in such filings – errors that have gone undiscovered by the companies themselves, their outside advisors, and the SEC staff. Through this process, I have also discovered that companies are not applying the rules in a consistent manner.

Given the above, I welcome any serious interest on the part of the SEC in making fundamental changes to the regulatory requirements in this area, although past experience leaves me less than optimistic that the SEC will ever be in a listening mode. I am also keenly interested in seeing the rule-making process fundamentally change, such that the flaws in the proposed rules can be brought to the fore prior to adoption of the rules.

For the moment, it is my hope that the SEC and its staff are willing to review the existing rules with a sufficient distance, and with open minds.

Without further ado, here are my responses to the SEC's questions, to which, for the sake of clarity, I have made modest revisions for the benefit of the average reader.

I. *Executive Compensation Decisions: Setting Compensation and Making Investment and Voting Decisions*

1. Development of Compensation Packages.

Q1A. What is the process by which companies develop their executive compensation packages?

I suggest that the SEC review and analyze the executive compensation-related disclosure (in particular, the Compensation Discussion and Analysis (**CD&A**)) in 50-100 proxy statements and answer its own question. Having undertaken this exercise myself each year for over 10+ years, my response would be that, in general, an Exchange Act-reporting company:

- relies much more heavily on its compensation consulting firm than the company publicly discloses, with such reliance contributing to the exponential increase in compensation levels over the last decades. In that regard, see the article in the 6-8-2025 edition of the NY Times entitled, "*On One Side of a Vast Gap, It Pays to be the Boss*," citing data from Equilar. The article indicates that the average CEO-to-median employee pay ratio has gone from less than 20-to-1 in the 1970s to 357-to-1 in 2024.

- pays lip service to how much of the compensation the company pays to its executive officers is consistent with the prevailing "pay-for-performance" mantra, while building in so many safeguards to ensure that there is very little risk of a significant drop in compensation levels, no matter how much the company's performance is in decline – for example, by:

    - characterizing equity-based incentive awards with multi-year performance periods as "long-term," but granting such awards on an *annual* basis (in some cases, using the same performance metrics with different performance targets/thresholds);

    - providing that the company's board compensation committee has the discretion to change the manner in which the performance metrics are calculated during or after the performance period, yet failing to then report the compensation over and above that earned on the basis of the original performance metric levels in the unfortunately named "Bonus" column of the Regulation S-K, Item 402(c)/(n) Summary Compensation Table (**SCT**);

    - selecting performance metrics, and attendant performance targets that are *always* considered probable of satisfaction under FASB ASC Topic 718; and

    - including in the company's CD&A lists or tables of "What We Do" and "What We Don't Do" (now an almost universal practice) that appear to serve the primary purpose of obfuscating the reality of how the company's compensation plans work – that is:

        - if the company underperforms its peers, the executive officers are still compensated at a competitive level;

- if the company outperforms its peers, the executive officers get 2X the target level of compensation, thereby raising the market data cited by the compensation consultants for the next year and beyond).

Q1B. What drives the development of and decisions regarding compensation packages?

In economic theory, there is a concept referred to as "opportunity cost": someone should be compensated at a level that reflects the compensation level for his/her next best opportunity. The compensation consulting firms disregard this concept because it is not in their interests. Instead, they instill in their board compensation committee clients an inordinate fear of turnover within the executive officer ranks. Yet hardly a day goes by when the Wall Street Journal reports on a change in CEO (oftentimes with the incoming CEO not having any previous experience in the company's industry), with but a sentence or two dedicated to the $100 million+ in compensation that the outgoing CEO will receive at or following his/her departure.

Q1C. What roles do the company's management, the company's compensation committee (or board of directors), and external advisors (i.e., compensation consulting firms) play in this development?

See my responses to Q1A and Q1B.

Q2. How can the SEC's rules be revised to better inform investors about the material aspects of how executive compensation *decisions* are made?

One would need to begin by revising Regulation S-K, Item 402(b) in an effort to restore the principles-based approach to disclosure of the "big picture" aspects of the company's decision-making processes. This might lead to more individualistic approaches by SEC-reporting companies, compared to the current 'herd mentality' approaches of SEC-reporting companies.

3. Materiality.

Q3A. What *level of detail* regarding executive compensation information is material to investors in making their investment and voting decisions?

My rewrite of Regulation S-K, Item 402, which –

- improves the text and formatting of the SEC's version;
- augments the Instructions to include relevant information from the applicable final rulemaking and the SEC's Reg. S-K Compliance & Disclosure Interpretations (**C&DIs**) (some of which are flawed);
- highlights issues that are a product of the SEC's too hastily written final rulemakings adopting the rule requirements and the staff's unwillingness (to the chagrin of commenters) to provide anything other than simplistic examples of how the rules should be applied; and

- provides, for the benefit of accountants and non-accountants alike, cites to relevant paragraphs of FASB ASC Topic 718 -

is a single-spaced Word document that is 131 pages long. In my view, much of the disclosure dictated by the voluminous relevant authority falls below the materiality standard.

In addition, the rules (including the SEC's interpretive guidance) represent the equivalent of a maize, with which SEC-reporting companies struggle to navigate close to 20 years after SEC Release Nos. 33-8732A; 34-54302A. In this regard, in my annual proxy statement review process, I typically spot at least 2-3 "errors" (i.e., failures to comply with Reg. S-K, Item 402 and/or the SEC's interpretive guidance) in each proxy statement I review – and this is *without* the benefit of access to the underlying data. These errors go undiscovered by the company, the company's outside law firm and the SEC staff. On occasion, I communicate with a company's board compensation committee if an error is particularly egregious. If I get a response, it is typically from an in-house lawyer who states at the outset that the company is not confirming or denying the error. Sound familiar? That's when I know I am right. I then await the company's proxy statement for the following year to see if the error has been corrected. In general, I discover that the company has corrected the error.

Over the years I have created files that reflect the *multiple* ways that SEC-reporting companies present virtually identical compensation awards in one or more of the compensation tables – making the SEC's aspiration of company-to-company comparability (e.g., through the tagging of quantitative data) seem a bit laughable. The distinctions in the reporting are fundamental – for example:

- classifying compensation awards as equity vs. non-equity compensation awards (for which the SEC, by virtue of Regulation S-K, Item 402(a)(6)(iii), has always relied on the thin reed of whether the award is within the scope of FASB ASC Topic 718, for which Paragraph 718-10-15-3 seems to be sole source of authority);

- classifying cash compensation as non-equity incentive plan compensation vs. discretionary (i.e., "Bonus") compensation;

- classifying equity awards as performance-based vs. non-performance based;

- determining the fiscal year in which award compensation is to be reported;

- determining how to treat equity awards for which vesting is not dependent on performance measures, but other factors are (e.g., the exercise price, the conversion ratio, the number of instruments, or the contractual term of the award);

- determining what constitutes an *objective* performance measure, for which someone other than the board compensation committee should be able to calculate the appropriate payout; and

- reporting maximum payout levels under bonus pool plans in the Grants of Plan-Based Awards Table.

Given the challenges that SEC-reporting companies, law firms and the SEC staff have in getting the reporting "right," or at least consistent with other companies, there is no doubt about the overly-detailed nature of Regulation S-K, Item 402 and other relevant authority.

As to what information investors find material, please see my responses to the subsequent questions, which are informed, in part, by the errors I have spotted over the years and the apparent absence of anyone else making an issue of such errors.

Q3B. Is there any information currently required to be disclosed in response to Regulation S-K, Item 402 that is not material to investors?

There are undoubtedly readers of the executive compensation disclosure in companies' annual proxy statements that would take issue with whatever I might cover in response to this question. Out of respect for such readers, I will pass on answering this question – apart from making the general observation that the "spin" engaged in by companies is of very little utility to investors.

Q3C. Is there any information currently required to be disclosed in response to Regulation S-K, Item 402 that could be streamlined to improve the disclosure for investors?

This question warrants a lengthy response.

Since 2006, the SEC has oftentimes cited the following as the objectives underlying Regulation S-K, Item 402:

- to provide investors with clear, concise and meaningful executive compensation disclosure, through presenting a *single total figure* in the Summary Compensation Table (**SCT**) that includes all compensation and is comparable across fiscal years and companies;
- to report the compensatory value of share-based payment awards granted during a fiscal year;
- to illustrate the relationship between pay and performance;
- to facilitate year-to-year comparisons in a cost-effective way; and
- to create greater linkage in the approaches being taken by companies in the CD&A sections of their executive compensation disclosure.

See, for example, SEC Release Nos. 33-905; 34-60280; IC-28817. Let's take a critical look at each of these objectives.

The first objective has resulted in making the SCT the principal compensation table required by Regulation S-K, Item 402, with all the other tables taking on an ancillary role. The SCT is now, and has always been, a misfire – the result of the SEC treating investors as lacking either the brainpower and/or the attention span to digest more meaningful information. The mish-mash of quantitative data relating to disparate types of "compensation" awarded or earned in different fiscal years makes the single "Total Compensation" figure in column (j) of the SCT virtually meaningless. It's no wonder why investors

(perhaps mistakenly) find the Regulation S-K, Item 402(v) metric of "compensation actually paid" more meaningful – if only because of the nomenclature.

The second objective – reflecting the grant-date fair value of share-based payment awards in the SCT – is also a misfire. Having worked within the Division of Corporation Finance (**Corp. Fin.**) in the mid-90s, I learned that there was (and undoubtedly still is) a huge knowledge gap between the staff's lawyers and accountants. If the Corp. Fin. senior accounting staff were to design a fairly simple test to be taken by the Corp. Fin. lawyers to determine their grasp of FASB ASC Topic 718's basic concepts, I would predict that most would fail the test. [Note that the inverse is also true, as is evident by the text of the Corp. Fin. Financial Reporting Manual, prepared by the accounting staff, addressing topics such as smaller reporting companies.] That being the case, the SEC should choose either to:

- insist that companies provide more complete disclosure of FASB ASC Topic 718 concepts, such as a share-based payment award's:
  - classification as an equity award vs. liability award (and the effect of such classification on the measurement objective for each type of award)
  - grant date vs. service inception date
  - requisite service period
  - conditions that affect the award's grant-date fair value (e.g., market conditions; conditions that affect the number of instruments subject to, or the exercise price or contractual term of, an option award), and conditions that do not affect the award's grant-date fair value (e.g., service/performance conditions that affect the vesting of the award's instruments; restrictions stemming from the forfeitability of the award's instruments prior to vesting), and
  - the process by which companies recognize compensation cost associated with their share-based payment awards; or
- abandon reliance on grant-date fair values, given the general lack of comprehension of the concepts in the previous bullet point.

I would suggest opting for the latter and letting the notes to the financial statements deal with the accounting.

The third objective – illustrating the relationship between pay and performance – is a worthy objective, but it has been only recently implemented in a meaningful way through the addition of Regulation S-K, Item 402(v), which I understand has met with a great deal of resistance given the complexity of the calculations required. Compliance with the rules should not introduce any significant incremental burdens on SEC-reporting companies.

The fourth objective – facilitating year-to-year comparisons in a cost-effective way – would seem a worthy goal. But prior to the addition of Regulation S-K, Item 402(v) there was but one compensation table that provided for information beyond the most recently completed fiscal year (i.e., the SCT), which

as previously stated is a misfire. As far as Regulation S-K, Item 402(v), the presentation of the five most recently completed fiscal years (for a company subject to Regulation S-K, Item 402(a) – (l)) is overkill.

The fifth objective – creating greater linkage in the approaches being taken by companies in the CD&A sections of their executive compensation disclosure – would be better achieved by a shortening of the CD&A disclosure and providing more in-depth narrative explanation of a company's compensation plans in the relevant subsections of Item 402 tied to the types and amounts of compensation for which a compensation table is to be provided. In that regard, Regulation S-K, Item 402 should eliminate (and prohibit) the use of footnotes, most of which are formulaic and represent the "fine print." For those readers who are my peers, age-wise, the use of a magnifying glass is really a hassle.

Beyond the above critical commentary with respect to the five objectives, I would suggest the following changes to Regulation S-K, Item 402:

- scrap the SCT (for the reasons stated above);
- scrap (i) the Grants of Plan-Based Awards Table, (ii) the Outstanding Equity Awards at Fiscal Year End Table, and (iii) the Option Exercises and Stock Vested Table, for which the historic intention was to reflect the evolution of a share-based payment award over time until the award is exercised, transferred, expires or is cancelled or rescinded;
- scrap or substantially revise the Pension Benefits Table; and
- scrap or substantially revise the Non-Qualified Defined Contribution and Other Non-Qualified Deferred Compensation Plans Table.

So, what would replace the above tables? Disclosure that is tied to a company's individual *compensation plans* and the *compensation award types under those plans*, incorporating tabular information or graphical presentations, as the company deems appropriate, to highlight the design of the plan and the plan results (including, but not limited to, compensation levels). Separate tabular/graphical presentations for each award type would undoubtedly be more effective by eliminating columns of tables not relevant to the award type. The plan narrative information should be holistic and include topics within the scope of Regulation S-K, Item 402(j) only if relevant (i.e., a named executive officer separates from the company or there is a change-in-control of the company).

Q3D. How does a company's engagement with [mostly institutional] investors drive compensation decisions and compensation disclosure?

Given my practice, I have no insight into this question.

II. *Executive Compensation Disclosure: Past, Present, and Future*

Regulation S-K, Item 402(a) – (r). In 2006, the Commission substantially revised its executive compensation disclosure requirements to provide, among other things, a compensation discussion and analysis (CD&A) of a company's compensation practices and enhanced *tabular* disclosure of compensation amounts. The rules were intended to provide investors with a clearer and more complete picture of the compensation earned by a company's executive officers.

Q4A. Have these disclosure requirements met these objectives?

The short answer is No.

Q4B. Do the required disclosures help investors to make informed investment and voting decisions?

I would like to answer this question with two questions:

- Has the SEC ever sought input from investors – both institutional and individual investors (particularly those in investor groups/clubs) – as to whether companies' compensation levels have any bearing on their investment decisions?

- Has the SEC ever attempted to gather data on the degree to which companies' executive compensation disclosure has an impact on shareholder voting for board compensation committee members relative to other board members?

If the answer to one or both of these questions is negative, then it strikes me that it is possible that the information required to be disclosed under Regulation S-K, Item 402, in its entirety, may not be material.

To me, it is clear that the Exchange Act Section 14A non-binding say-on-pay and say-on-pay frequency votes have had a relatively minor impact on companies' executive compensation practices, other than as a result of the inordinate influence of proxy advisory firms on institutional investors. I have read about how other countries impose similar say-on-pay requirements, in some cases with meaningful consequences in the event votes endorsing the compensation practices fail to reach certain thresholds (e.g., forcing board compensation committees members to step off the board). I don't know whether this would be helpful, given the potential disruption of the group dynamics of the board.

Q4C. Given the complexity and length of these disclosures, are investors able to easily parse through the disclosure to identify the material information they need?

My sense is that very few *individual* investors take the time to read the executive compensation disclosure in a company's proxy statement for its annual meeting of shareholders. Such disclosure typically represents the greatest number of pages in the proxy statement relative to the other topics covered. It would be interesting to conduct a survey of how much time investors, on average, dedicate to reading the executive compensation disclosure. I would guess that it may be as little as ten minutes. I think that explains the misguided rationale behind the 2006 rule changes to introduce the "Total Compensation" column of the SCT.

I recently read an article in The Wall Street Journal reporting that the vast majority of non-professional investors spend less than six minutes studying a company and its stock prior to making a decision as to whether to invest in that company. However, I believe that an investor willing to invest more time trying to make more informed investment decisions should be rewarded for his/her/its efforts.

Q4D. In what ways could disclosure rules be revised to return to a simpler presentation and focus?

In my view, the onus is on the SEC and its staff to better 'engineer' its rules. The key to my ability to spot disclosure errors in proxy statements is the advance work I do in converting the SEC's executive compensation disclosure rules into decision trees. Although this is an oversimplification of the engineering

process, if I find that a branch of the decision tree has no clear resolution, I know there is a problem with the rule. I would suggest that neither the SEC staff, nor the law firms, accounting firms, and other firms that comment on proposed rulemakings, take the often considerable time required to take the steps that I take:

- rewrite the adopting release (and the text and format of the rule(s) adopted) to clean it up, adding bracketed annotations in red font that highlight the first-pass flaws identified;
- prepare a comprehensive explanation of the rule(s);
- sync my rewrite of the rule(s) with my rewrite of the Regulation S-K, Item 402 document, adding information deemed critical to compliance with the rule(s) as shaded annotations in the Regulation S-K, Item 402 document;
- engineer the rule(s) through the creation of decision trees; and
- update the adopting release, my Regulation S-K, Item 402 document, and my decision trees to capture interpretive guidance in the SEC's periodic updates to its Regulation S-K C&DIs.

Let me be clear: I know I don't have a corner on knowledge and that there are bound to be other flaws in the SEC's rules that I have yet to identify.

5. The Dodd-Frank Act added several executive compensation related requirements to the securities laws, including:

- **shareholder *advisory* voting on various aspects of executive compensation, including golden parachute compensation (see Dodd-Fank Section 951 and Exchange Act Section 14A/Exchange Act Rule 14a-21), and**
- **principal executive officer – median employee pay ratio disclosure (see Dodd-Frank Section 953(b)(1) and Regulation S-K, Item 402(u)) .**

Q5A. What types of disclosure do investors find material in making these say-on-pay voting decisions?

This is a topic that I would think the SEC would be best-positioned to answer, perhaps by engaging an academic organization that is already in the executive compensation space.

Q5B. Are companies able to provide say-on-pay disclosure and pay ratio disclosure in a cost-effective manner?

The cost of including the say-on-pay/say-on-pay frequency resolution on a proxy card must be nominal. I have no knowledge of the cost of the lobbying effort (which nominally is characterized as shareholder engagement) to sound out and secure a favorable vote, but suspect it is considerable.

The cost of preparing the CEO-to-median employee pay ratio is an entirely different matter. The SEC Staff noted in SEC Release Nos. 33-9877; 34-75610; File No. S707-13 (August 5, 2015) (the **Pay Ratio**

Adopting Release) that Congress did not expressly state the specific objectives or benefits of Dodd-Frank Act Section 953(b), and the legislative history of the Dodd-Frank Act is similarly unrevealing. However, based on the SEC Staff's analysis of the statute and the comments received on the staff's *proposed* pay ratio rulemaking [SEC Release No. 33-9452 (September 18, 2013)], the staff concluded that Dodd-Frank Act Section 953(b) was intended to provide an SEC-reporting company's shareholders with a ***company-specific*** metric that would assist such shareholders in their evaluation of, and engagement with respect to, the company's executive compensation practices, by, among other things, increasing the transparency of executive compensation. That shareholder engagement would include, for example, the say-on-pay votes required under Dodd-Frank Act Section 951 and the SEC's rules to implement Section 951. With this in mind, the SEC Staff attempted to craft the pay ratio disclosure rule, found in Regulation S-K, Item 402(u), in a manner that would allow a company's shareholders to better understand and assess the company's compensation practices and pay ratio disclosures over time, rather than to facilitate a comparison of the company's pay ratio with other SEC-reporting companies, such as peer companies.

The SEC Staff also stated that the staff did not believe that precise uniformity or comparability of the pay ratio across companies is "necessarily achievable given the variety of factors that could cause the pay ratio to differ from one company to the next." The Pay Ratio Adopting Release lists certain of such factors:

- differences in companies' industry and business type;
- variations in the way companies organize their workforces to accomplish similar tasks;
- differences in the geographical distribution of employees (domestic or international, as well as in high- or low-cost areas);
- the degree of vertical integration and/or reliance on contract and outsourced workers; and
- differences in ownership structure.

The SEC Staff also acknowledged in the Pay Ratio Adopting Release that many of the people and organizations that commented on the proposed pay ratio rulemaking raised significant concerns about the costs (principally data collection and verification costs) of providing the required pay ratio disclosure. In that regard, consider the description of the required calculations, attached as Exhibit A to this response letter. The length of Exhibit A (i.e., 15 pages) speaks for itself in terms of the costs outweighing the benefits. One wonders whether the SEC staff ever re-reads its final rulemakings after they are promulgated....

Q5C. Do the current rules strike the right balance between eliciting material information and the costs to provide such information?

See my responses to prior questions.

6. Cost-Benefit Analysis of SEC's Executive Compensation Rules. With the experience of almost 20 years of implementing the 2006 rule amendments, how can the Commission address challenges that companies, investors and the SEC staff have encountered with executive compensation rules and the resulting disclosures in a cost-effective and efficient manner while continuing to provide material compensation information for investors? For example:

Q6A. Are there requirements that are difficult or costly to comply with and that do not elicit material information for investors?

Yes. Regulation S-K, Item 402(u), (v) and (w).

Q6B. Are there ways that we can reduce the cost or otherwise streamline the compensation information required by the rules?

Of course. In 2010, I had a meeting with Chairman Atkins in which I explained to him how technology could be used to reduce the cost of compliance with the executive compensation disclosure rules by an estimated 66-75%, while at the same time achieving a level of quality assurance that the SEC staff could only imagine. Given the passage of time, he may not remember that meeting.

III. *Executive Compensation Hot Topics: Exploring the Challenging Issues*

7. Regulation S-K, Item 402(v) (Pay vs. Performance); Exchange Act Rule 10D-1 and Regulation S-K, Item 402(w) (Clawback of Erroneously Awarded Incentive-Based Compensation). In August and October 2022, respectively, the SEC adopted rules implementing the requirements of Dodd-Frank Sections 953(a) and 954 related to:

- **pay-versus-performance (i.e., Regulation S-K, Item 402(v)), and**
- **the clawback of erroneously awarded incentive-based compensation (i.e., Exchange Act Rule 10D-1).**

Q7A. Now that companies have implemented the new rules, are there any lessons the SEC can learn from their implementation?

I am not in a position to respond to this question.

Q7B. Can these rules be improved? If so, how? For example, which requirements of these rules are the most difficult to comply with and how could we reduce those burdens while continuing to provide investors with material information and satisfy these statutory mandates?

The SEC's review of my rewrites of -

- SEC Release No. 34-95607, File No. S7-07-15 (August 25, 2022) (the "**Pay vs. Performance Adopting Release**") and Regulation S-K, Item 402(v), and
- SEC Release Nos. 33-1116; 34-96159; IC-34732 (October 26, 2022) (the "**Compensation Recovery Policy Adopting Release**") and Exchange Act Rule 10D-1 –

along with the explanations I have put together concerning the application of these relevant rules, would provide a wealth of information about how the rules could be improved.

As I have no doubt the SEC staff assigned to draft the two releases would confirm, the reference to these "statutory mandates" was a big part of the problem at the time the rulemakings were prepared. If one does not know how to construe the intent or language chosen by the Congressional staffers who drafted the statutes (as the staff admitted in the Pay Ratio Adopting Release), the challenge is, of necessity, virtually impossible.

Q8: Since adoption of the pay vs. performance rules in Regulation S-K, Item 402(v) , I have continued to hear concerns regarding the rule's definition of "compensation actually paid" (CAP). What has been companies' experience in calculating CAP and what has been investors' experience in using information to make investment and voting decisions?

I am not in a position to respond to this question.

9. Perquisites.

As noted above, the questions that follow cause me to despair that tomorrow's roundtable and the follow-up to the response letters submitted will be the "same old, same old" perfunctory process, with the SEC not doing nearly enough listening!

Q9A. What has been companies' experience in applying the *two-part analysis* articulated by the Commission in 2006 with respect to evaluating whether perquisites for executive officers must be disclosed?

Q9B. How do disclosure requirements resulting from the test, and whether a cost constitutes a perquisite, affect companies' decisions on whether or not to provide a perquisite? For example, how has the application of the analysis affected evaluations relating to the costs of security for executive officers?

Q9C. Are there types of perquisites that have been particularly difficult to analyze?

Q9D. How do investors use information regarding perquisites in making investment and voting decisions?

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I have one final cautionary note. Footnote 434 of the Compensation Recovery Policy Adopting Release reads, in relevant part, as follows:

> See comment letters from CCMC (noting that the number of public companies has steadily declined to the point that it is half what it was in 1996, and that a similar rate of decline in the number of IPOs occurred concurrently, while the same period experienced the explosion of the size of the proxy and emergence of disclosure overload issues).

When it comes to executive compensation disclosure, I would suggest that the SEC is doing a good job of regulating itself out of existence....

Donald H. Meiers, Chief Knowledge Officer
Rethink Legal Services

Exhibit A – Mechanics of the Regulation S-K, Item 402(u) Pay-Ratio Calculations

Under Regulation S-K, Item 402(u), a SEC-reporting company that is subject to the pay ratio disclosure requirements must, on an every fiscal year* basis, calculate:

- the annual **total compensation** of the company's principal executive officer (**PEO**), and
- the median of the annual total compensation of ***all*** of the company's employees, ***other than*** the company's principal executive officer (**PEO**) -

to be able to derive the ratio between these amounts.

> * Note that the Pay Ratio Adopting Release is silent on the subject of what is to be done if a company has a change in its fiscal year-end, such that the most recently completed fiscal period reflected in the Company's Regulation S-K, Item 402(c) Summary Compensation Table is a transition period. In such case, it would seem logical for the company to provide PEO-employee employee pay ratio for the transition period. But given the SEC Staff's acknowledgment of the considerable time and cost associated with complying with the PEO-median employee pay ratio disclosure requirement, perhaps the SEC Staff would take the position that such requirement does not apply to a transition period.

The following is explanatory information regarding each of the two components of the ratio.

The Numerator: Annual Total Compensation of an SEC-Reporting Company's Principal Executive Officer (PEO)

General

In general, under Regulation S-K, Item 402(u) an SEC-reporting company may calculate the "total compensation" (as determined in accordance with Regulation S-K, Item 402(c)(2)(x)) of the company's PEO for the company's most recently completed fiscal year using the same methodology the company is required to follow in preparing the compensation information presented in the Summary Compensation Table.

Exceptions to General Rule

Instruction 4(6) to Regulation S-K, Item 402(u)

In calculating the "total compensation" of an SEC-reporting company's named executive officers, including the company's PEO, the company is permitted to omit:

- the dollar value of benefits under group life, health, hospitalization, or medical reimbursement plans that do not discriminate in scope, terms, or operation, in favor of the company's executive officers or directors, and are available generally to all salaried employees [See Regulation S-K, Item 402(a)(6)(ii)] and/or
- the incremental cost to the company of perquisites and personal benefits, the aggregate amount of which is less than $10,000 [See Regulation S-K, Item 402(c)(2)(ix)(A)].

However, Instruction 6 to Regulation S-K, Item 402(u) provides that an SEC-reporting company, in the company's discretion, may include either of both of these items, for purposes of calculating the total compensation of the ***median employee*** in any fiscal year. If the company determines to do so, the company must include the item(s) included in the calculation of the PEO's total compensation for such fiscal year, but solely for purposes of deriving the PEO-median employee pay ratio. In that case, the SEC filing containing the pay ratio disclosure would need to include disclosure explaining the difference between the PEO's total compensation for the applicable fiscal year, as reflected in the Summary Compensation Table vs. the PEO's total compensation used in deriving the PEO-median employee pay ratio.

Instruction 10 to Regulation S-K, Item 402(u): How to Handle Multiple PEOs in Most Recently Completed Fiscal Year

If more than one person served as an SEC-reporting company's PEO during the company's most recently completed fiscal year, Instruction 10 to Regulation S-K, Item 402(u) gives the company a choice between two methods to calculate the total compensation of the PEO - for purposes of deriving the PEO-median employee pay ratio - for such fiscal year:

- Add the total compensation provided to each PEO, only for the period in the applicable fiscal year in which he/she served as PEO, to derive the PEO total compensation for that fiscal year; or

- Calculate the total compensation of only the PEO serving in such capacity as of the date within the three-month window selected to identify the company's median employee (see *"The Median Annual Total Compensation of an SEC-Reporting Company's 'Employees' - Date of Determination of 'Employees': Date within the Last Three Months of the Most Recently Completed Fiscal Year"* below), and then annualize the compensation provided to that PEO during the period in which he/she served as the PEO during the applicable fiscal year.

Whichever method an SEC-reporting company chooses, the company is required to disclose the method chosen.

> Note that Regulation S-K, Item 402(u) and its instructions are silent on how to deal with a situation in which an SEC-reporting company has more than a single individual serving concurrently as co-PEOs.

The Denominator: Median Annual Total Compensation of an SEC-Reporting Company's "Employees"

Date of Determination of "Employees": Date within the Last Three Months of the Most Recently Completed Fiscal Year

An SEC-reporting company that is subject to the PEO-median employee pay ratio disclosure requirement is to identify the employees to be included in the calculation of the median of the annual total compensation of all employees, other than the PEO, ***as of a date, to be chosen by the company, within the last three months of the company's most recently completed fiscal year***. See Regulation S-K, Item 402(u)(3).

The SEC Staff stated in the Pay Ratio Adopting Release that the three-month window – as opposed to the originally proposed date of determination (i.e., the last day of the most recently completed fiscal year) – serves to:

- provide an SEC-reporting company with additional time to identify the median annual total compensation of its employees (and, if applicable, those of the company's consolidated subsidiaries) before the company is required to disclose its PEO-median employee pay ratio in its Form 10-K annual report or Schedule 14 proxy statement/Schedule 14C information statement, which must be filed no later than 120 days after the end of that most recently completed fiscal year; and

- avoid certain anti-competitive effects with respect to retailers (particularly those with fiscal years that are coincident with the calendar year), which tend to have a significant number of employees at fiscal year-end.

Instruction 1 to Regulation S-K, Item 402(u) requires an SEC-reporting company to disclose:

- the date the company has chosen to identify the employees to be included in the calculation of the median of the annual total compensation of all employees, other than the PEO; and

- any change to that date in any subsequent fiscal year, along with a brief explanation of the reason(s) for the change.

Employees to be Included in the Calculation: Employees of an SEC-Reporting Company and its Consolidated Subsidiaries

Regulation S-K, Item 402(u)(3) provides that, for purposes of the calculation of the median annual total compensation of an SEC-reporting company's employees, an "employee" **includes** any individual ***employed*** by:

- the SEC-reporting company, and/or

- any of the SEC-reporting company's ***consolidated**** subsidiaries -

whether working on a full-time, part-time, seasonal, or temporary basis.**

> * For purposes of the calculation of the median annual total compensation of an SEC-reporting company's employees, **the company only needs to include the employees of any subsidiary that the company consolidates in its financial statements**. Under U.S. generally accepted accounting principles (GAAP), a company (call it Company A) that holds the "controlling financial interest" in another company (call it Company B) is required to consolidate Company B in Company A's financial statements. The usual condition for consolidation is a controlling financial interest in the other company through ownership of more than 50% of the other company's outstanding voting shares. See FASB ASC Topic 810 (*Consolidation*), Subtopic 810-10 (*Overall*), Section 810-10-15 (*Scope and Scope Exceptions*), Paragraph 810-10-15-8.
>
> **Note that neither Regulation S-K, Item 402(u) nor the Pay Ratio Adopting Release addresses the subject of ***furloughed*** employees. However, the staff of the SEC's Division of Corporation Finance has issued interpretive guidance that indicates that an SEC-reporting company needs to determine, based on the company's particular facts and circumstances, whether it is appropriate to include a furloughed employee(s) in the pool of employees for purposes of the calculation of the median

annual total compensation of such employees. The interpretive guidance does not elaborate on what facts and circumstances would be relevant to that determination, other than to indicate that the analysis should be based on whether the furloughed employee(s) fits within any of the four categories of employees encompassed by the "employee" definition – that is, individuals working on a –

- full-time,
- part-time,
- seasonal, or
- temporary basis.

See Regulation S-K, Compliance and Disclosure Interpretations, Question 128C.04.

Conversely, the definition of "employee" does not include any individual who, despite performing services to the SEC-reporting company and/or any of its consolidated subsidiaries, is employed, and whose compensation is determined, by an ***unaffiliated third party***. This would encompass an individual who is working in the capacity of an independent contractor or a leased/borrowed worker. See SEC Release Nos. 33-10415; 34-81673; File No. S7-07-13 (September 21, 2017), which addresses the manner in which a company may determine whether a worker is an employee or an independent contractor.

Exemptions to Allow Exclusion of Certain Employees Located Outside the United States

The definition of "employee" in Regulation S-K, Item 402(u)(3) encompasses all employees, whether located within or outside the United States. However, Regulation S-K, Item 402(u)(4) provides two exemptions to allow an SEC-reporting company to exclude certain employees located in a jurisdiction(s) outside the United States (which Regulation S-K, Item 402(u)(4) refers to as "**non-U.S. employees**"):

- a **data privacy exemption** [See Item 402(u)(4)(i)]; and

- a ***de minimis* exemption** [See Item 402(u)(4)(ii)].

For the reasons explained below, a company must establish whether it can make use of the data privacy exemption before analyzing whether the *de minimis* exemption is available.

The Data Privacy Exemption

Under the data privacy exemption, an SEC-reporting company may exclude – from the 'pool' of employees included in the calculation of the median of the annual total compensation of the company's (and, if applicable, the company's consolidated subsidiaries') employees – any employee who is employed in a foreign jurisdiction (i.e., outside any state, territory, or possession of the United States) *if* that foreign jurisdiction has data privacy laws and/or regulations that prevent the company from obtaining and/or processing the information necessary to comply with the pay ratio disclosure requirements, notwithstanding the company's ***reasonable efforts*** to do so.

The Pay Ratio Adopting Release makes note of the SEC Staff's recognition that many countries have data privacy and other laws that prevent the transfer of payroll data outside the applicable country's borders –

even if the transfer is intra-company. In that regard, the Pay Ratio Adopting Release, which was published in August 2015, notes that, at the time of the Release:

- the E.U. prohibited the transfer of personal data to a third country – such as the United States - that is deemed not to have an adequate level of privacy protections; and

- China, Japan, Mexico, Canada, Peru, Australia, Russia, Switzerland, Argentina, and Singapore had adopted, or were considering, similar rules.

At this point, the list of countries cited in the Pay Ratio Adopting Release may be outdated or incomplete.

There is no limit or cap on the number of non-U.S. employees who may be excluded from a company's employee population under the data privacy exemption.

Reasonable Efforts to Obtain and Process Information Pertaining to Employees in Foreign Jurisdictions With Data Privacy Laws

The "**reasonable efforts**" an SEC-reporting company must undertake before being able to take advantage of the data privacy exemption include, *at a minimum*, seeking an exemption or other relief under the applicable jurisdiction's governing data privacy laws and/or regulations.

If the appropriate authorities in the applicable jurisdiction grant the SEC-reporting company an exemption from the data privacy laws and/or regulations, the company must include the employee(s) in that jurisdiction in the company's employee population, for purposes of the calculation of the median of the annual total compensation of the company's employees – unless such employee(s) is/are covered by the *de minimis* exemption (discussed below).

If the SEC-reporting company excludes any employee(s) in a particular jurisdiction under the data privacy exemption, the company must exclude *all* employees in that jurisdiction. This requirement is intended to prevent any potential manipulation of the company's employee population, for purposes of the calculation of the median of the annual total compensation of the company's employees.

Legal Opinion

In addition to the reasonable efforts requirement, the data privacy exemption requires that an SEC-reporting company obtain a **legal opinion** – with respect to the applicable jurisdiction – that the company:

- is unable to obtain and/or process the necessary information pertaining to the employees in that jurisdiction to comply with the Regulation S-K, Item 402(u) PEO-median employee pay ratio disclosure requirement without violating that jurisdiction's laws or regulations; and

- has not been able to obtain an exemption or other relief under that jurisdiction's data privacy laws and/or regulations.

The legal opinion must be filed as an exhibit to the SEC filing in which the pay ratio disclosure is included (e.g., a Form 10-K, Schedule 14A proxy statement, or Schedule 14C information statement).

Disclosure if Relying on Data Privacy Exemption

If an SEC-reporting company avails itself of the data privacy exemption, the company must include in the SEC filing containing the PEO-median employee pay ratio disclosure:

- a list of the jurisdictions in which the excluded employees are located;
- the approximate number of employees excluded from each such jurisdiction;
- an identification of the specific data privacy laws and/or regulations in each such jurisdiction;
- an explanation of how compliance with the Regulation S-K, Item 402(u) PEO-median employee pay ratio disclosure requirement violates the data privacy laws and/or regulations of each such jurisdiction; and
- information regarding the efforts the company made to seek an exemption or other relief under the data privacy laws and/or regulations of each jurisdiction.

The *De Minimis* Exemption

Unlike the data privacy exemption, under which there is no limit or cap on the number of non-U.S. employees who may be excluded from an SEC-reporting company's (including, if applicable, the company's consolidated subsidiaries') employee population, **the *de minimis* exemption has a hard cap, of 5%, and that cap has the be adjusted downward to reflect the aggregate number of non-U.S. employees that the company excludes under the data privacy exemption, expressed as a percentage of the company's (and, if applicable, the company's consolidated subsidiaries') employee population.** As such:

- if the company excludes non-U.S. employees under the data privacy exemption who represent **5% or more** of the company's aggregate (i.e., including, if applicable, consolidated subsidiaries') employee population, the company cannot exclude any non-U.S. employees in reliance on the *de minimis* exemption; and
- if the company excludes non-U.S. employees under the data privacy exemption who represent **less than 5%** of the company's aggregate employee population, the cap on the number of non-U.S. employees who can be excluded under the *de minimis* exemption is reduced by the percentage of non-U.S. employees represented by the employees excluded under the data privacy exemption. See Regulation S-K, Item 402(u)(4((ii)(A).

If the data privacy exemption is inapplicable, an SEC-reporting company may:

- exclude all of the company's (and, if applicable, the company's consolidated subsidiaries') non-U.S. employees from its aggregate employee population, for purposes of the calculation of the median of the annual total compensation, if such ***non-U.S. employees make up 5% or less of the total number of employees***. If the company chooses to rely on this exemption, it must exclude all non-U.S. employees.
- exclude up to 5% of the company's (and, if applicable, the company's consolidated subsidiaries') non-U.S. employees from the company's aggregate employee population, for purposes of the

calculation of the median of the annual total compensation of the company's employee population, if such ***non-U.S. employees make up more than 5% of the total number of employees***. In this case, if the company excludes any non-U.S. employee in a particular jurisdiction, the company must exclude all such employees in that jurisdiction.

If more than 5% of the company's employees are located in a single non-U.S. jurisdiction, the company may not exclude any employees in that jurisdiction under the *de minimis* exemption. See Regulation S-K, Item 402(u)(4)(ii).

Consider this example, which serves to illustrate the above points:

- As of the date of determination of an SEC-reporting company's employee population, the company has non-U.S. employees located in two non-U.S. jurisdictions.

- Non-U.S. employees in one such jurisdiction represent 2.5% of the company's employee population. This jurisdiction has data privacy laws that, despite the company's reasonable efforts to obtain or process the information necessary for compliance with the pay ratio disclosure requirement, preclude the company from doing so.

- Non-U.S. employees in the other jurisdiction represent an additional 2.5% of the company's employee population. This jurisdiction has no data privacy laws or regulations.

On these facts, the company may exclude the non-U.S. employees located in the first jurisdiction (who represent 2.5% of the employee population) under the data privacy exemption. The company may also exclude the non-U.S. employees in the second jurisdiction (who represent an additional 2.5% of the employee population), because the total number of exempted non-U.S. employees under both the data privacy and the *de minimis* exemptions equals no more than 5% of the company's employee population.

[Note: Presumably the company would have to exclude all of the non-U.S. employees in both jurisdictions in reliance on the *de minimis* exemption, assuming that the company has no other non-U.S. employees in any other jurisdiction outside the U.S., since, per the requirements of Regulation S-K, Item 402(u)(4)(ii), (1) the non-U.S. employees in these two jurisdictions represent 5% of the company's employee population, and (2) the company is required to exclude all of its non-U.S. employees.]

However, if the number of the company's non-U.S. employees in the second jurisdiction represented 3% of the company's employee population, the company could not exclude the non-U.S. employees in that jurisdiction because the number of excluded non-U.S. employees in both jurisdictions would exceed 5% of the company's total employees.

See the Pay Ratio Adopting Release, Section II.B.1.c.iii(c) (the De Minimis Exemption).

Disclosure if Relying on *De Minimis* Exemption

If an SEC-reporting company excludes non-U.S. employees from its employee population in reliance on the *de minimis* exemption, the company must disclose:

- the jurisdiction(s) in which those employees are located;

- the approximate number of such employees excluded in each such jurisdiction;

- the total number of the company's (and, if applicable, the company's consolidated subsidiaries') U.S. and non-U.S. employees, irrespective of either or both of the data privacy or *de minimis* exemptions; and

- the total number of the company's (and, if applicable, the company's consolidated subsidiaries') employees used in the *de minimis* cap calculation.

The Pay Ratio Adopting Release states that one of the purposes of the *de minimis* exemption is to help SEC-reporting companies with a small percentage of non-U.S. employees by relieving such companies from the need to determine how to integrate payroll systems and compensation arrangements in jurisdictions where the number of non-U.S. employees may not justify the effort.

An SEC-reporting company may use its existing internal records (e.g., tax or payroll records) to determine whether the *de minimis* exemption is available. See the SEC's release providing guidance on the pay ratio disclosure requirements contained in SEC Release Nos. 33-10415; 34=81673; File No. S7-07-13 (September 21, 2017).

Omission of Employees of a Newly-Acquired Entity(ies)

Instruction 7(2) to Regulation S-K, Item 402(u) provides that an SEC-reporting company may omit from the company's "employee" population any individuals who became employees of the company (or a company consolidated subsidiary) as a result of a business combination, or an acquisition of a business, for the fiscal year in which the transaction is completed.

Permitted Methods to Determine the Median Annual Total Compensation of All Employees other than the PEO

In the Pay Ratio Adopting Release, the SEC Staff acknowledges that calculating the "***total compensation***" (as determined in accordance with Regulation S-K, Item 402(c)(2)(x)) of *all* of the employees of an SEC-reporting company (and, if applicable, its consolidated subsidiaries), for purposes of identifying the median annual total compensation of such employees, could be cost-prohibitive.

With this in mind, Instruction 4 to Regulation S-K, Item 402(u) affords an SEC-reporting some flexibility with respect to:

- the employee population for which compensation data must be gathered and analyzed – specifically, by providing for the use of ***statistical sampling*** and/or ***any other reasonable method***, such as:

    - simple random sampling (drawing at random a certain number or proportion of employees from the entire employee population, with each employee in the employee population having an equal chance of being included in the sample),

    - stratified sampling (dividing the employee population into several groups, or strata - for example, based on location, business unit, type of employee, collective bargaining

agreement, or functional role, based on a belief that the strata are different from one another, and then engaging in random sampling within each strata),

- cluster sampling (dividing the employee population into groups, or clusters, based on the same criterion, drawing a subset of clusters that are believed to represent the employee population, and sampling employees within appropriately selected clusters), and

- systematic sampling (sampling according to a random starting point and a fixed sampling interval, with every nth employee drawn from a listing of employees sorted on the basis of some criterion);

and

- the manner in which employees' compensation is calculated – specifically, by allowing the use of a ***consistently applied compensation measure(s)*** in lieu of "total compensation" (as determined in accordance with Regulation S-K Item 402(c)(2)(x)).

In each of these respects, an SEC-reporting company may use ***reasonable estimates***, for example, with respect to:

- analyzing the composition of the employee population (e.g., by geographic unit, business unit, or employee type);

- characterizing the statistical distribution of compensation of the employee population being sampled (e.g., a lognormal, beta, gamma or other distribution, or a mixture of distributions).

The reasonable estimates must be disclosed.

Use of Statistical Sampling of the Employee Population

Instruction 4(2) to Regulation S-K, Item 402(u) expressly permits the use of statistical sampling for purposes of determining those employees in the 'pool' of employees out of which the median compensation is to be identified – potentially using more than one statistical sampling approach.

The instruction does not specify any parameters (e.g., sample size, confidence intervals) for such statistical sampling. An SEC-reporting company is free to decide on those parameters based on the company's facts and circumstances, so long as the parameters settled on are *reasonable*. In this regard, the Pay Ratio Adopting Release cites certain facts and circumstances that should be considered by an SEC-reporting company:

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

The Pay Ratio Adopting Release specifies that an SEC-reporting company using statistical sampling will need to:

- consider the underlying distribution of the company's employee compensation data (i.e., how widely employee compensation is spread out or distributed around the mean), and

- if the company has multiple business or geographic units, draw observations from each of such units, and make a reasonable assumption regarding each unit's compensation distribution –

for purposes of inferring the overall median based on the observations drawn.

Certain cases may not easily generate confidence intervals around the estimates or prescribe the appropriate sample size, which may result in increased compliance costs.

The Pay Ratio Adopting Release also states that if an SEC-reporting company uses statistical sampling, the company does not necessarily need to determine the exact compensation amounts of every employee in the sample.

Use of a Consistently Applied Compensation Measure in Lieu of "Total Compensation"

Instruction 4(3) to Regulation S-K, Item 402(u) expressly permits an SEC-reporting company to use a consistently applied compensation measure, in lieu of "**total compensation**" (which is difficult to calculate), with respect to all of the employees in the employee population (or a subset of that population, if the company uses statistical sampling or some other reasonable method), for purposes of identifying the employee (referred to in Regulation S-K, Item 402(u) as the "***median employee***") whose compensation represents the median of the annual total compensation of the company's employee population. If the company uses such a consistently applied compensation measure, the company must disclose the measure used.

The Pay Ratio Adopting Release makes reference to several such measures, specifically:

- total direct compensation (such as annual salary or hourly wages, as applicable, and any other performance-based/incentive compensation, in the form of cash and/or equity awards);

- cash compensation;

- taxable wages; and

- compensation information derived from the company' tax and/or payroll records (which is expressly made reference to in Instruction 4(3) to Regulation S-K, Item 402(u).

The consistently applied compensation measure chosen need not include every element of employees' compensation. Further, in calculating compensation (or components of such compensation) using any of these alternative measures, an SEC-reporting company may make *reasonable* estimates.

Any alternative compensation measure may be defined differently across an SEC-reporting company's various jurisdictions in which its employees are located, as long as the measure is consistently applied within each such jurisdiction.

Further, the calculation of employees' compensation using an alternative compensation measure may involve determining compensation for certain employees in different jurisdictions using different annual (or 12-month) periods than for other employees – as long as the same annual (or 12-month) period is used for all employees (for which compensation is determined) within the applicable jurisdiction.

Permitted Adjustments to the Compensation of Employees in the Employee 'Pool'

Regulation S-K, Item 402(u) allows – but does not require - an SEC-reporting company to make two types of adjustments to the compensation of the employees required to be in the 'pool' of employees for purposes of the calculation of the median annual total compensation:

- for employees located in jurisdictions other than the jurisdiction in which the PEO resides, ***cost-of-living adjustments to their compensation to the cost of living in the PEO's jurisdiction of residence*** [See Instruction 4(4) to Regulation S-K, Item 402(u)]; and

- for full-time and part-time employees who worked for the SEC-reporting company (or any of the company's consolidated subsidiaries) for less than the full fiscal year, ***annualization*** of such employees' compensation (i.e., projecting such employees' compensation as if they had worked for the full fiscal year) [See Instruction 5 to Regulation SOKm Item 402(u)].

Cost-of-Living Adjustments to Compensation of Employees Located in Jurisdictions other than that of the PEO

Out of concern that unadjusted cost-of-living differences between or among (i) countries/jurisdictions in which an SEC-reporting company (and, if applicable, the company's consolidated subsidiaries) has employees, and (ii) the jurisdiction in which the company's PEO resides, would result in the PEO-median employee pay ratio being less than fully informative, Instruction 4(4) to Regulation S-K, Item 402(u) permits an SEC-reporting company to make cost-of-living adjustments to the compensation of employees in jurisdictions other than the jurisdiction in which the company's PEO resides so that the compensation of such employees is adjusted to the cost of living in the jurisdiction of the PEO's residence.

Instruction 4(4) to Regulation S-K, Item 402(u) does not expressly require that a company, which opts to apply a cost-of-living adjustment to the compensation of employees located in any ***particular jurisdiction*** outside the jurisdiction in which the PEO resides, apply a cost-of-living adjustment to the compensation of employees located in any ***other such jurisdiction*** in which the company has operations. Instead, the Instruction simply provides that if a cost-of-living adjustment is applied to the compensation of employees located *in a particular jurisdiction*, the adjustment must be applied to all of the employees (or, if statistical sampling is used, the employees included in the sampling) located in that jurisdiction.

As such, it would seem that a company could selectively apply cost-of-living adjustments to the compensation of employees located only in jurisdictions with a lower cost-of-living than that of the jurisdiction in which the PEO is located, for purposes of reducing the PEO-median employee pay ratio.

However, there are at least two considerations that would seem to make taking such a selective approach inadvisable:

- Instruction 4(5) to Regulation S-K, Item 402(u) specifies that a company must ***consistently apply*** any adjustments the company uses to identify the median employee; and

- the company must disclose the PEO-median employee pay ratio without the effect of any cost-of-living adjustment(s).

Nonetheless, the flexibility afforded a company in determining the methodology to identify its median employee would seem to allow the company not to make cost-of-living adjustments with respect to certain jurisdictions *if*, for example, the difference in the cost-of-living in a particular jurisdiction from that of the jurisdiction in which the PEO resides is insignificant and the number of employees located in a particular jurisdiction is such that making a cost-of-living adjustment to the compensation of employees located in that jurisdiction would have little or no effect on the PEO-median employee pay ratio.

Ultimately, the goal of a company providing the PEO-median employee pay ratio disclosure is to apply a methodology that the company views as providing meaningful disclosure, taking into consideration the company's facts and circumstances.

If an SEC-reporting company ***makes a cost-of-living adjustment(s) for purposes of the calculation of the median annual total compensation of the company's employee population***, and the calculation reveals that the 'median employee' is an employee in a jurisdiction other than the jurisdiction in which the PEO resides, the company must use the same cost-of-living adjustment in calculating the median employee's annual total compensation. Further, the company must disclose the median employee's jurisdiction.

Conversely, if an SEC-reporting company ***does not make a cost-of-living adjustment(s) for purposes of the calculation of the median annual total compensation of the company's employee population***, and the calculation reveals that the 'median employee' is an employee in a jurisdiction other than the jurisdiction in which the PEO resides, the company may not make a cost-of-living adjustment to the median employee's annual total compensation.

If an SEC-reporting company makes a cost-of-living adjustment(s), the company must disclose the cost-of-living adjustment(s) the company makes, whether for purposes of identifying the median employee or calculating the median employee's annual total compensation, including the measure(s) used as the basis for the cost-of-living adjustment(s).

An SEC-reporting company electing to present a pay ratio that reflects a cost-of-living adjustment must disclose:

- the annual total compensation and pay ratio of the median employee ***with*** the cost-of-living adjustment, and

- the annual total compensation and pay ratio of the median employee (likely a different employee) ***without*** the cost-of-living adjustment.

Annualization of Full-Time/Part-Time Employees' Compensation

Instruction 5 to Regulation S-K, Item 402(u) permits an SEC-reporting company to "***annualize***" the total compensation of all "permanent" employees, to be included in the company's employee population for the applicable fiscal year, who were employed for less than the full fiscal year (or another annual period,

if the company makes use of a consistently applied compensation measure in lieu of annual total compensation) for any reason – for example:

- being first hired during the fiscal year (or such other annual period);
- taking an unpaid leave of absence during the fiscal year (or such other annual period);
- taking leave under the Family and Medical Leave Act of 1993 during the fiscal year (or such other annual period); or
- being called for active military duty during the fiscal year (or such other annual period).

In this context, "**annualization**" refers to taking the compensation of an employee who worked for only part of the fiscal year (or other annual period) and projecting that compensation as if the employee worked the full fiscal year (or other annual period) at the schedule the employee worked for the portion of the fiscal year (or other annual period) that the employee worked.

Annualization of employees' compensation is permitted only with respect to permanent (i.e., full-time or part-time) employees; no such adjustment is permitted with respect to seasonal or temporary employees.

An SEC-reporting company is not permitted to make a "***full-time equivalent adjustment***" to the compensation of a part-time employee for purposes of calculating the PEO-median employee pay ratio. A "full-time equivalent adjustment" refers to taking the compensation of a part-time employee and projecting what the employee's compensation would have been had the employee worked on a full-time basis. However, a company is free to provide additional pay ratios, including ratios that reflect one or more adjustments (such as full-time equivalent adjustments), *provided* such additional ratio(s) are clearly identified, not misleading, and are not presented with greater prominence than the required PEO-median employee pay ratio.

If an SEC-reporting company makes annualizing adjustments to the compensation of any of the company's permanent employees who worked less than the full fiscal year (or other annual period) for purposes of identifying the company's median employee or determining such median employee's annual total compensation, the company is required to briefly describe such adjustments, per Instruction 5 to Regulation S-K, Item 402(u).

Calculation of Annual Total Compensation of Median Employee

Once an SEC-reporting company has identified its "median employee," the company must then, and only then, calculate that employee's **total compensation**, in accordance with Regulation S-K, Item 402(c)(2)(x)) – both with and without cost-of living adjustments, if any.

By virtue of the flexibility afforded under Regulation S-K, Item 402(u), an SEC-reporting company is only required to dedicate the considerable time and effort the company dedicates to the preparation of the compensation information in its Summary Compensation Table *with respect to its named executive officers* for but one additional person: the **median employee**.

In calculating the **total compensation** of the median employee for the most recently completed fiscal year, an SEC-reporting company may:

- use reasonable estimates of the actual amounts of the median employee's total compensation or any elements of such compensation (e.g., the aggregate change in the actuarial present value of the median employee's accumulated benefit under all defined benefit and other actuarial pension plans) – so long as the estimates approximate the actual amounts of the median employee's total compensation or any such element [See Instruction 4(1) to Regulation SOK, Item 402]; and

- in the company's discretion, *include* certain amounts of compensation, such as:

    - the dollar value of benefits under group life, health, hospitalization, or medical reimbursement plans that do not discriminate in scope, terms, or operation, in favor of executive officers or directors, and are available generally to all salaried employees, and

    - the incremental cost to the company of perquisites and personal benefits, the aggregate amount of which is less than $10,000 –

    even though such amounts are not included in the calculation of the total compensation of the company's named executive officers (including the PEO) under Regulation S-K, Item 402(c). See Instruction 4(6) to Regulation S-K, Item 402(u)]

The median employee's total compensation must be calculated for an SEC-reporting company's ***most recently completed fiscal year*** – the same time period for the compensation information presented in the **Summary Compensation Table** with respect to the company's named executive officers, including the PEO. This is true notwithstanding that the company may have identified the median employee through use of tax and/or payroll records that reflected a different annual period. As stated in the Pay Ratio Adopting Release, "identifying the median employee is a separate process from calculating total compensation."

Required Frequency of Identification of Median Employee/Substitution of Median Employee

In order to help reduce the costs and burdens of compliance with the pay ratio disclosure requirements of Regulation S-K, Item 402(u), Instruction 2 to Regulation S-K, Item 402(u) allows an SEC-reporting company to:

- identify the median employee ***once every three fiscal years***, and

- substitute another employee – whose compensation approximated the median employee at the time of the median employee's identification – for the median employee, for purposes of the PEO-median employee pay ratio calculation, if there is a change in the median employee's circumstances in the second or third fiscal year of the three-fiscal year period (e.g., the median employee ceases to be a company employee or his/her compensation changes significantly) –

provided, in each case, that there has been no change in the company's employee population and/or employee compensation arrangements that the company reasonably believes would result in a significant change in the pay ratio.

If the company is able to use the same median employee for more than one fiscal year and opts to do so, the company must nonetheless calculate the median employee's total compensation ***for each fiscal year***

during which the median employee is the median employee. In this case, the company must disclose that the company is using the same median employee in the company's PEO-median employee pay ratio calculation and briefly describe the company's basis for its view that there has been no change in the company's employee population and/or employee compensation arrangements that would result in a significant change in the PEO-median employee pay ratio.

However, if, during the three-fiscal year period, there is a change in the company's employee population and/or employee compensation arrangements that the company reasonably believes would result in a significant change in the PEO-median employee pay ratio, the company is required to go through the process of identifying a new median employee for the fiscal year in which that change occurred.

As noted above, an SEC-reporting company may omit from the company's "employee" population any individuals who became the company's employees as a result of a business combination, or an acquisition of a business, for the fiscal year in which the transaction is completed.

However, for the immediately following fiscal year, the company is obligated to include these individuals – if they are "employees" of the company (or a consolidated subsidiary of the company) – in the total employee count.

Further, the company must analyze whether the change in the company's employee population prompted by the transaction and/or any resultant change(s) in employee compensation arrangements are such that the company reasonably believes there has been a significant change in the PEO-median employee pay ratio. In that case, the company is required to go through the process of identifying a new median employee for the fiscal year following the transaction.