

Tamir Fishman Equity Plan Services – News Update The SEC Adopts Rules on CEO Pay Ratio Disclosures

Source: The Securities and Exchange Commission Press releases and publications

Dear Client,

We would like to bring to your attention an update regarding a final rule adopted by the US Securities and Exchange Commission and may affect your company's reporting requirements in the annual report, starting 2017.

On August 5, 2015 the Securities and Exchange Commission ("SEC") adopted a final rule that requires a public company to disclose the ratio of the compensation of its chief executive officer (CEO) to the median compensation of its employees. The new rule provides companies with flexibility in calculating this pay ratio, and helps inform shareholders when voting on "say on pay."

Under current SEC rules, companies are required to provide extensive information about the compensation of its CEO and other named executive officers. However, companies currently are not required to disclose the same information for other employees. By the final rule a company would be required to calculate the annual total compensation for its median employee using the same rules that apply to the CEO's compensation. So, if for example, the CEO makes a million dollars and the median employee makes \$50,000, the ratio would be 20:1.

The new rule will require disclosure of the pay ratio in registration statements, proxy and information statements, and annual reports that call for executive compensation disclosure. Companies will be required to provide disclosure of their pay ratios for their first fiscal year beginning on or after **Jan 1, 2017**.

Highlights of the New Rule

Disclosure Requirements

As required by the Dodd-Frank Act, the rule would amend existing executive compensation disclosure rules to require companies to disclose:

- The median of the annual total compensation of all its employees, except the CEO;
- The annual total compensation of its CEO; and
- The ratio of those two amounts

Identifying the Median Employee - To identify the median employee, the rule would allow companies to select a methodology based on their own facts and circumstances. A company could use its total employee population or a statistical sampling of that population and/or other reasonable methods.

A company could apply a cost-of-living adjustment to the compensation measure used to identify the median employee. If a company applies this adjustment, it would need to use the same cost-of-living adjustment in calculating the median employee's annual total compensation.

A company also would be permitted to identify its median employee once every **three years** unless there has been a change in its employee population or employee compensation arrangements that it reasonably believes would result in a significant change to its pay ratio disclosure.

Determination of Total Compensation - A company would be required to calculate the annual total compensation for its median employee using the same rules that apply to the CEO's compensation. "Annual total compensation" means total compensation for the last completed fiscal year, calculated using the definition of "total compensation" in existing executive compensation rules, namely Item 402(c)(2)(x) of Regulation S-K. The rule would allow companies to use reasonable estimates when calculating any elements of the annual total compensation.

Identification of Employee Population - A company would be permitted to select a date within the last three months of its last completed fiscal year on which to determine the employee population for purposes of identifying the median employee. A company could exclude non-U.S. employees from the determination of its median employee in two circumstances:

- Non-U.S. employees that are employed in a jurisdiction with data privacy laws that make the company unable to comply with the rule without violating those laws. The company would be required to obtain a legal opinion from counsel on the inability of the company to obtain or process the information necessary for compliance with the rule without violating the jurisdiction's laws or regulations governing data privacy.
- Up to 5 % of its total employees who are non-U.S. employees, including any non-U.S. employees excluded using the data privacy exemption. If a company excludes any non-U.S. employee in a particular jurisdiction, it must exclude all non-U.S. employees in that jurisdiction.

Methodology, Assumptions, and Estimates - Companies would be required to briefly describe the methodology used to identify the median employee, and any material assumptions, adjustments (including cost-of-living adjustments), or estimates used to identify the median employee or to determine annual total compensation.

Filings Where Disclosure Is Required - Companies would be required to describe the information in registration statements, proxy and information statements, and annual reports that must already include executive compensation information as set forth under Item 402 of Regulation S-K.

Companies would not be required to:

- Disclose the pay ratio information in reports that do not require executive compensation information, such as current and quarterly reports.
- Update their disclosure for the most recently completed fiscal year until the company files its proxy or information statement for its annual meeting of shareholders (or annual report for companies that do not file proxy or information statements for annual meetings), but not later than 120 days after the end of the fiscal year.

The disclosure requirement would apply to all companies required to provide executive compensation disclosure under Item 402(c)(2)(x) of Regulation S-K. Smaller reporting companies, foreign private issuers, MJDS filers, emerging growth companies, and registered investment companies would not be subject to the requirement.

Companies should consider including use of the exemptions and adjustments in their description of material assumptions, adjustments, or estimates.

Companies must comply with the final rule for their first fiscal year beginning on or after January 1, 2017.

The pay ratio disclosure is not required in an initial public offering or a registration statement on Form 10.

We do recommend you as a preparation to this adoption of the rule to consult your auditors regarding any required steps to be taken in advance. The full SEC press release is available at <http://www.sec.gov/news/pressrelease/2015-160.html>

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