

# CEO Pay Ratio Checklist

## STEP 1: SELECT A MEASUREMENT DATE

- The measurement date must be a date within the last three months of the company's fiscal year (for example, a calendar year company can select any date in the period beginning on October 1 and ending on December 31).

### Practice Tips

- Consider identifying a date that best reflects the demographics of the company.
- If a company has many seasonal and/or temporary employees, consider selecting a date when less of those types of employees are employed.
- The measurement date can change from the prior year but this will need to be disclosed as well as the reasons for making the change.

## STEP 2: IDENTIFY THE RELEVANT EMPLOYEE POPULATION

- The median employee must be identified from among all of the company's employees as of the measurement date, subject to certain permitted exclusions for foreign employees as described in more detail below.
- "Employees" for this purpose include any individual who is employed by the company or its subsidiaries, including:
  - Full-time and part-time employees;
  - Seasonal and temporary employees;
  - Furloughed employees; and
  - Independent contractors if determined to be employees.
    - The company can apply the same tests used for employment law or tax purposes to determine if an independent contractor should be considered an employee.
- **Data Privacy Exemption** – Foreign employees who are employed in a jurisdiction where acquiring the necessary data would violate data privacy rules may be excluded, provided that the company:
  - Makes reasonable efforts to obtain the information, including seeking an exemption from the data privacy rules;

- Acquires a legal opinion that the company is unable to obtain the information without violating applicable data privacy rules and that the company was unable to obtain an exemption;
- Excludes all employees from that jurisdiction;
- Discloses in the pay ratio disclosure:
  - The excluded jurisdiction and the approximate number of employees in the jurisdiction;
  - The applicable data privacy rules prohibiting access to the data; and
  - How the pay ratio rule would violate those data privacy rules; and
- Files the legal opinion as an exhibit to the filing containing the pay ratio.

### Practice Tips

- Confirm with local counsel if there are any data privacy laws in that country that would prohibit collection of information.
- For most companies, it will be difficult to rely on the data privacy exemption as there aren't a lot of prohibitions on acquiring such data.
- **De Minimis Exemption** – Non-U.S. employees constituting 5% or less of the total employee population may be excluded.
  - In order to exclude an employee from a jurisdiction, all employees from that jurisdiction must be excluded.
  - Any employees excluded pursuant to the data privacy exemption described above count towards the 5% limit (however, more than 5% of the total employee population may be excluded if the company is only relying on the data privacy exemption).
  - If the company excludes employees under this exemption, the company must disclose in the pay ratio disclosure:
    - The jurisdictions excluded;
    - The approximate number of employees in each such jurisdiction; and
    - The total number of U.S. and non-U.S. employees with and without the excluded jurisdictions.

## Practice Tips

- The de minimis exemption may be useful where it impacts the median.
- It may also save a lot of time and effort for smaller companies with a small foreign employee population.

- **Recent Acquisitions** – Employees of acquired companies may be excluded in the year of the acquisition.
  - The company must disclose the approximate number of employees excluded from the calculation.
  - If a company applies the exception, in the following year, the company must determine whether including the employees of the acquired business constitutes a substantial change requiring identification of a new median employee.

## Practice Tips

- This exception may be useful where the compensation paid to acquired employees in the year of the acquisition does not reflect the compensation that is typically paid to employees of the company in similar roles (for example, because the acquired employees receive merger consideration or retention grants) and impacts the median.

## STEP 3: IDENTIFY THE COMPENSATION MEASURE USED TO IDENTIFY THE MEDIAN EMPLOYEE

- Any consistently applied compensation measure (“CACM”) that reasonably reflects the annual compensation of employees can be used to identify the median employee.
- Possible CACMs include for example:
  - Base salary and wages
  - Total cash compensation
  - Taxable compensation (the SEC permits using taxable wages or W-2 equivalents as defined in the local jurisdiction as a proxy for W-2s)
  - Total direct compensation
  - Total compensation as calculated under the SEC rules
- Hourly or annual rates of pay may not be used as the CACM.

- The company may use internal records that reasonably reflect annual compensation to identify the median employee, even if those records do not include every element of compensation, such as equity awards widely distributed to employees.
- In applying the CACM to identify the median employee, the company is not required to use a period that includes the date on which the employee population is determined or a full annual period, and may use compensation from the prior fiscal year so long as there has not been a change in the employee population or compensation arrangements that would result in a significant change in the pay distribution of the workforce.
- The compensation of permanent full-time and part-time employees who were not employed during the entire measurement period may be annualized; the compensation of seasonal and temporary employees may not be annualized.
- A company is permitted to make cost-of-living (“COLA”) adjustments to employees who live in a different jurisdiction than the CEO.
  - However, if the company makes COLA adjustments to identify the median employee and the median employee is an employee in a jurisdiction other than the jurisdiction in which the CEO resides, then the company must apply the COLA adjustments in calculating the median employee’s compensation and calculate and disclose the pay ratio without applying the COLA adjustments.

## Practice Tips

- The CACM must reasonably reflect the company’s compensation profile.
- Can exclude equity awards and bonuses if such payments won’t significantly impact pay distribution.
- If compensation elements from non-U.S. employees affect the ability to determine the CACM, considering using the de minimis exemption.
- Because COLA adjustments require significant additional work and disclosure, applying COLA adjustments may only be useful where a significant portion of the workforce is located in a country with a low compensation standard.
- Annualizing the compensation of full-time and permanent full time and part-time employees is probably not worth the time and effort.

## STEP 4: IDENTIFY THE MEDIAN EMPLOYEE FROM AMONG ALL EMPLOYEES OTHER THAN THE CEO USING THE CACM SELECTED

- The company may use reasonable estimates, statistical sampling and other reasonable methods to identify the median employee from the relevant employee population.
  - Can combine the use of reasonable estimates with the use of statistical sampling and/or other reasonable methodologies.
    - For instance, a company can use sampling for some geographic/business units and a combination of other methodologies and reasonable estimates for other geographic/business units.
- If the employee identified as the median employee received compensation with anomalous characteristics that would have a significant higher or lower impact on the pay ratio, the company may substitute another employee whose compensation is substantially similar based on the same CACM used to select the original median employee.
- The median employee only needs to be identified once every three years unless the company has significant changes in its employee population and/or compensation arrangements that would result in a significant change in the pay ratio.
- If it is no longer appropriate to use the median employee identified in year one as the median employee in years two and three because the median employee leaves the company or the employee's compensation changes significantly, the company may select another employee whose compensation is substantially similar based on the same CACM used to select the original median employee.

### Practice Tips

- Using estimates or statistical sampling may be overly burdensome for many companies and not actually save any time because the company will still need to determine the workforce headcount, demographics, and pay distribution within the company and will also need to develop a sampling technique that is accurate, representative and defensible.
- When determining which methodology will be used to identify the median employee, keep in mind that any methodology used will need to be disclosed in the pay ratio disclosure as well as any material assumptions, estimates and/or adjustments.

## STEP 5: CALCULATE THE TOTAL COMPENSATION OF THE MEDIAN EMPLOYEE AND THE CEO

- Total compensation must be calculated using the same SEC rules for calculating total compensation for the Summary Compensation Table, provided that:
  - Reasonable estimates may be used provided such estimates are disclosed; and
  - Perquisites less than \$10,000, as well as the value of non-discriminatory benefits that are otherwise not disclosed, may be included in the median employee's total compensation provided such perquisites are also included in the CEO's total compensation for purposes of the pay ratio.
- Government pension benefits even if funded by the company (e.g. mandatory government pensions or social healthcare) are not considered a "defined benefit plan" and the accrued pension benefit cannot be included.
- If COLA adjustments were used to identify the median employee and the median employee is an employee in a jurisdiction other than the jurisdiction in which the CEO resides, the same COLA adjustments must be used to calculate the median employee's total compensation.
- If the CEO changes during the relevant fiscal year, the company may either (i) annualize the compensation of the CEO serving on the measurement date or (ii) aggregate the total compensation paid to each person who served as CEO during the year.
- The median employee's total compensation needs to be recalculated every year to calculate the pay ratio.

### Practice Tips

- The company should consider whether perquisites less than \$10,000 or non-discriminatory benefits will contribute more to the median employee's total compensation than to the CEO's total compensation, and therefore, lower the ratio.
- When determining which methodology will be used to identify the median employee, keep in mind that any methodology will need to be disclosed in the pay ratio disclosure.

## STEP 6: CALCULATE THE RATIO OF THE MEDIAN EMPLOYEE'S TOTAL COMPENSATION TO THE CEO'S TOTAL COMPENSATION

## STEP 7: DRAFT 10-K OR PROXY DISCLOSURE

- The company must disclose:
  - The annual total compensation of the median employee and the annual total compensation of the CEO;
  - The pay ratio, as either (i) a ratio (e.g., 150 to 1 or 150:1) or (ii) a multiple (e.g., 150 times);
  - The measurement date and, if the measurement date changed from the prior year, the change in date and the reasons for making the change;
  - The methodology that the company used to identify the median employee;
  - Material assumptions, estimates and/or adjustments (such as COLAs) used in identifying the median employee or conducting any of the calculations;
  - Any changes in the methodology, assumptions, estimates and/or adjustments from the prior year, if the change had a material impact on determining the pay ratio;
  - If there were two CEOs during the relevant fiscal year, the methodology used to calculate the CEO's annual total compensation (see Step 5);
  - If a company uses the data privacy exemption to exclude non-US employees:
    - The names of the excluded jurisdiction(s);
    - The approximate number of affected employees in each excluded jurisdiction;
    - How complying with the pay ratio rule would violate privacy laws;
    - The specific laws that would be violated; and
    - The company's efforts to obtain an exemption;
  - If a company uses the de minimis exemption to exclude non-U.S. employees:
    - The names of the excluded jurisdiction(s);
    - The approximate number of employees excluded from each jurisdiction;
    - The total number of U.S. and non-U.S. employees regardless of the exemption; and
    - The total number of U.S. and non-U.S. employees used for the de minimis exemption calculation;
  - If a company excludes persons who became employees as a result of an acquisition, the approximate number of

- employees being omitted and the name of the acquired business that is being excluded;
  - If the company makes COLA adjustments to identify the median employee and the median employee is an employee in a jurisdiction other than the jurisdiction in which the CEO resides, both the pay ratio with the COLA adjustments and the pay ratio without applying the COLA adjustments; and
  - Whether the median employee identified in year one is the same median employee being used for years two and three and the basis for the company's reasonable belief that there were no changes that would significantly affect the ratio.
- In addition, the company may disclose:
    - The pay ratio outside of the CD&A (unless the pay ratio played a role in determining named executive officer compensation) or the executive compensation section;
    - That the pay ratio is a reasonable estimate calculated in a manner consistent with Item 402(u);
    - Additional ratios, based on alternative calculations (for example, additional ratios excluding part-time, seasonal, temporary and/or foreign employees), provided that such additional ratios are not misleading and not presented with greater prominence than the required pay ratio; and/or
    - The employee's position, tenure and geographic location to provide context.
  - A company should not disclose any personally identifying information about the median employee.

### Practice Tips

- In drafting the disclosure, consider impact on investor and employee relations.
- If the pay ratio is high because of certain employee groups such as seasonal and temporary employees and/or employees living in jurisdictions with a low compensation standards, consider including alternative ratios.
- Disclosing the pay ratio after all the compensation tables may help to avoid distraction and being considered part of the compensation committee report and say on pay vote.
- Disclosing the median employee's position, tenure or geographical disclosure may help to contextualize disclosure.

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