Compensation Considerations Due to Upcoming Loss of EGC Status

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  - We encourage questions (even though your audio lines are muted)
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  - If time permits, your questions will be answered at the end of this presentation. And if there is insufficient time, the speaker will respond to you via e-mail after this presentation

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About Anthony “Tony” Eppert

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- Tony practices in the areas of executive compensation and employee benefits
- Before entering private practice, Tony:
  - Served as a judicial clerk to the Hon. Richard F. Suhrheinrich of the United States Court of Appeals for the Sixth Circuit
  - Obtained his LL.M. (Taxation) from New York University
  - Obtained his J.D. (Tax Concentration) from Michigan State University College of Law
    - Editor-in-Chief, Journal of Medicine and Law
    - President, Tax and Estate Planning Society

Upcoming 2022 Webinars

- 2022 webinars:
  - Aging Executives: Thoughts on Designing Succession Strategies (11/10/22)
  - [Topic TBD] (12/8/22)

- 2023 webinars:
  - New Compensatory Thoughts & Practices from ISS (Annual Program) (1/12/23)
  - Start-Up Compensation Designs: Focus on Founders (Part 1 of 2) (2/9/23)
  - Start-Up Compensation Designs: Focus on Key Employees (Part 2 of 2) (3/9/23)
  - Current 280G Mitigation Techniques (4/13/23)
  - Private Equity Compensatory Design Trends & Practices (5/11/23)
  - Equity Awards & Employment Taxes: Design Considerations (6/8/23)
  - Form 4 Training Course (7/13/23)
  - Anatomy of ISS: A Current Compensatory Perspective (8/10/23)
  - Preparing for Proxy Season: Start Now (Annual Program) (9/14/23)
  - PubCo Governance & Internal Controls: A Compensatory Perspective (10/12/23)
  - Keep It Boring: Drafting Miscellaneous Provisions in a Contract (11/9/23)
  - [Topic TBD] (12/14/23)

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Our Compensation Practice – What Sets Us Apart

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- Compensation issues are complex, especially for publicly-traded issuers, and involve substantive areas of:
  - Tax,
  - Securities,
  - Accounting,
  - Governance,
  - Surveys, and
  - Human Resources

- Historically, compensation issues were addressed using multiple service providers, including:
  - Tax lawyers,
  - Securities/corporate lawyers,
  - Labor & employment lawyers,
  - Accountants, and
  - Survey consultants

Our Compensation Practice – What Sets Us Apart (cont.)

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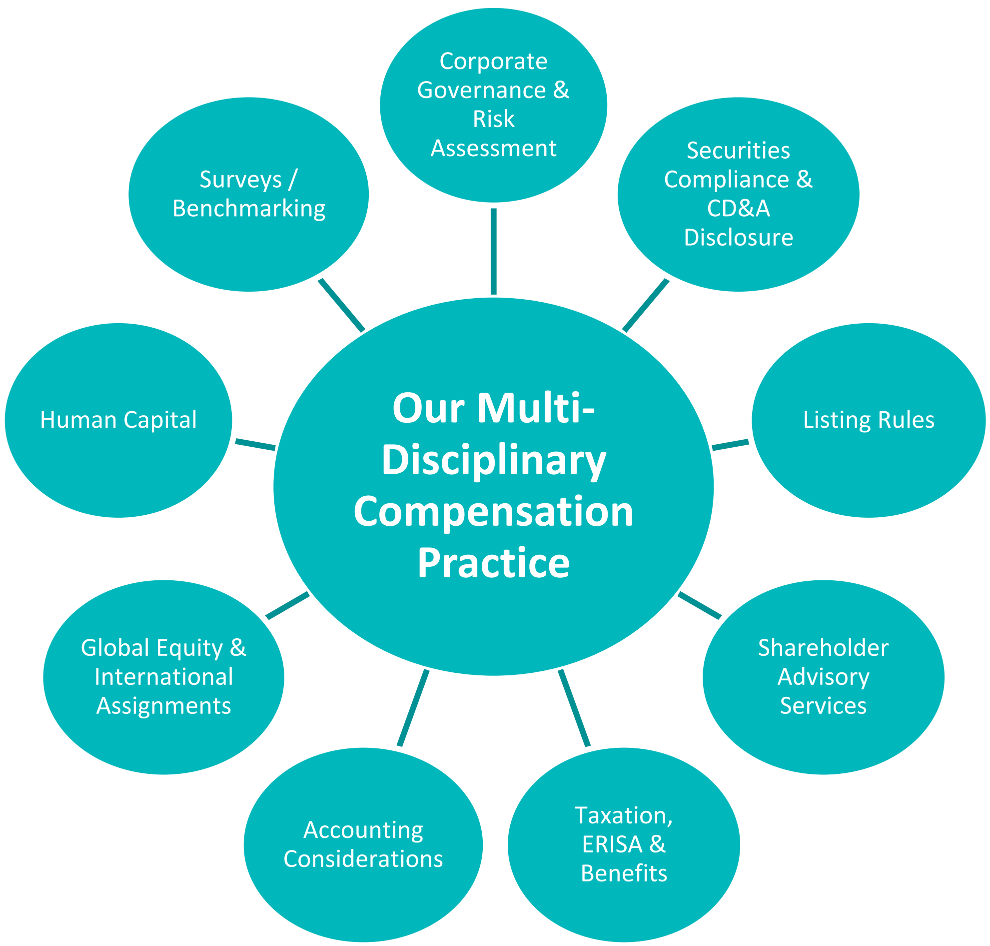
- The members of our Compensation Practice Group are multi-disciplinary within the various substantive areas of compensation. As multi-disciplinary practitioners, we take a holistic and full-service approach to compensation matters that considers all substantive areas of compensation



Our Compensation Practice – What Sets Us Apart (cont.)

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- Our Compensation Practice Group provides a variety of multi-disciplinary services within the field of compensation, including:

Traditional Consulting Services

- Surveys
- Peer group analyses/benchmarking
- Assess competitive markets
- Pay-for-performance analyses
- Advise on say-on-pay issues
- Pay ratio
- 280G golden parachute mitigation

Corporate Governance

- Implement "best practices"
- Advise Compensation Committee
- Risk assessments
- Grant practices & delegations
- Clawback policies
- Stock ownership guidelines
- Dodd-Frank

Securities/Disclosure

- Section 16 issues & compliance
- 10b5-1 trading plans
- Compliance with listing rules
- CD&A disclosure and related optics
- Sarbanes Oxley compliance
- Perquisite design/related disclosure
- Shareholder advisory services
- Activist shareholders
- Form 4s, S-8s & Form 8-Ks
- Proxy disclosures

Design/Draft Plan

- Equity incentive plans
- Synthetic equity plans
- Long-term incentive plans
- Partnership profits interests
- Partnership blocker entities
- Executive contracts
- Severance arrangements
- Deferred compensation plans
- Change-in-control plans/bonuses
- Employee stock purchase plans
- Employee stock ownership plans

Traditional Compensation Planning

- Section 83
- Section 409A
- Section 280G golden parachutes
- Deductibility under Section 162(m)
- ERISA, 401(k), pension plans
- Fringe benefit plans/arrangements
- Deferred compensation & SERPs
- Employment taxes
- Health & welfare plans, 125 plans

International Tax Planning

- Internationally mobile employees
- Expatriate packages
- Secondment agreements
- Global equity plans
- Analysis of applicable treaties
- Recharge agreements
- Data privacy

Purpose of this Presentation

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- An issuer that is no longer eligible for "emerging growth company" ("***EGC***") status must comply with certain additional requirements that are not otherwise applicable to EGCs, including:
  - A requirement to make substantial new executive compensation disclosures in the issuer's proxy statement, and
  - A requirement to have a say-on-pay vote, which is an advisory vote by the issuer's stockholders on the executive compensation programs of the issuer's named executive officers ("***NEOs***")
- With respect to NEO compensation, the expanded disclosure requirement will include a compensation discussion and analysis (the "***CD&A***"), which requires:
  - Expanded disclosure of the issuer's executive compensation program,
  - Disclosure of the issuer's executive compensation **<u>philosophy</u>**, and
  - Additional tabular disclosure
- The expanded disclosure requirements, coupled with the issuer having to adopt say-on-pay, requires a thorough review of the issuer's compensation programs for its NEOs, and a determination of whether changes are necessary
  - Put another way, compensation disclosure often drives design. As a result, an enhanced disclosure requirement is likely to drive compensatory design changes
- The purpose of this presentation is to highlight design changes that should be considered

Background: Loss of EGC Status

- An issuer qualifying as an emerging growth company ("***EGC***") at the time of its IPO is treated differently from other publicly-traded companies and such issuer enjoys limited compensation disclosure. Benefits of EGC status include:
  - Exempt from say-on-pay, say-on-frequency and say-on-golden parachute shareholder votes;
  - Exempt from pay ratio disclosure;
  - Exempt from pay v. performance disclosure;
  - Exempt from having to file a CD&A within its proxy statement;
  - The NEO determination is limited to only the CEO and two other executive officers;
  - The only required tabular disclosure is the Summary Compensation Table, the Outstanding Equity Awards Table, and the Director Compensation Table

- An issuer will retain EGC status until the earlier of:
  - The last day of the issuer's fiscal year that contains the 5th anniversary of the issuer's IPO,
  - The last day of the first fiscal year in which the issuer has annual gross revenues of $1.235bb or more (reflecting the SEC's September 9, 2022 inflation adjustments that are mandated by the Jumpstart Our Business Startups Act)
  - The date the issuer becomes a large accelerated filer, and
  - The date the issuer issued more than $1bb in non-convertible debt during the preceding 3-year period

Background: Exiting EGC Status & Item 402

- A comparison of EGC and non-EGC requirements

Requirement under Item 402	EGC	Non-EGC Issuers
Officers Included as NEOs:	PEO Next 2 most highly paid executive officers	PEO PFO Next 3 highest paid executive officers An additional two individuals for whom disclosure would have been required but for the fact they were not serving as an executive officer at the end of the last completed fiscal year
CD&A:	Essentially not required	Required
Summary Compensation Table:	Required, but only cover last two fiscal years	Required and cover last three fiscal years
Grants of Plans-Based Awards Table:	Not required	Required
Option Exercises and Stock Vested Table:	Not required	Required
Pension Benefits and Non-Qualified Deferred Compensation:	Not required	Required
Potential Payments upon Termination or Change-in-Control:	Not required	Required
Say-on-Pay:	Not required	Required
Say-on-Frequency Vote:	Not required	Required
Golden Parachute Advisory Vote:	Not required	Required
Pay Ratio Disclosure:	Not required	Required
Pay v. Performance Disclosure:	Not required	Required

Compensation Committee Charter

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- Will the Board of Directors or a committee oversee the additional disclosure requirements and compensatory changes?

- Under the Compensation Committee Charter, does the Compensation Committee have the requisite authority to address the additional disclosure requirements and any resulting changes to NEO compensation
  - This question is an important first step because many EGCs (though not a majority) retain such authority within the full Board (*i.e.*, the Compensation Committee can only make recommendations to the full Board of Directors with respect to NEO compensation)
  - If such authority does not reside with the Compensation Committee, then determine whether changes should be recommended such that the Board of Directors delegates this responsibility to the Compensation Committee and then amend the Compensation Committee Charter accordingly

CD&A – Compensation Philosophy

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- A compensation philosophy is a formal view of the issuer's position regarding the compensation of its NEOs
  - It explains the "why" behind NEO pay,
  - It creates a framework for consistency, and
  - It is based upon both internal and external factors that affect NEO retention, performance, tenure and alignment (the latter addressing the alignment of the NEOs' interests with those of the issuer's long-term stockholders)

- An issuer's compensation philosophy is the starting point of any CD&A and permeates throughout the entire CD&A

- Determinations to consider include:
  - Should base salaries be targeted to the competitive market and/or to a percentile of a designated peer group
  - Should short-term annual incentives approximate a certain percentage or multiple of base salary, or a certain percentage of long-term incentives
  - If long-term incentives should be designed to focus NEOs on the long-term financial performance of the issuer, along with achieving certain designated strategic objectives, then should long-term incentives be targeted to:
    - The competitive market,
    - A percentile of the designated peer group, and/or
    - A multiple of base salary and annual incentives

CD&A – Formal or Informal Peer Group

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- The Compensation Committee Charter might reference (or require) NEO pay packages to be competitive to a peer group (the latter to be identified by the Compensation Committee)
  - As background, peer group development is the process of developing a list of issuers to serve as the market or benchmark for evaluating NEO compensation levels on either a formal or informal basis
  - An effective peer group includes the issuer's competition

- Questions to consider include:
  - Should a formal peer group be developed to be disclosed in the CD&A, along with an explanation on how the issuer's NEOs compare to the NEOs of the issuer's peer group
  - Should the compensation of the NEOs be set in whole or part by benchmarking against the issuer's peer group (*e.g.*, we target total compensation at the 60th percentile)

CD&A – Base Salaries

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- How did the Compensation Committee determine the base salaries of its NEOs
  - This must be disclosed
  - For example:
    - Were base salaries based upon a formal or informal peer group review
    - Did the Compensation Committee attempt to set base salary as a percentage of Total Compensation or in connection with any other metric

- Discussion points within the CD&A should include:
  - How base salaries were determined
  - How the issuer's decisions with respect to base salaries of the NEOs fit into the issuer's overall compensation objectives
  - Whether the foregoing affects decisions with respect to other elements of pay packages for the issuer's NEOs

CD&A – Short-Term Incentives

- The CD&A must indicate how the Compensation Committee determined the short-term incentives of its NEOs

- Questions to answer include:
  - Was the determination by the Compensation Committee based upon a formal peer group review
  - How did the Compensation Committee determine the minimum, threshold and maximum payout levels
  - How were the performance metrics determined
  - Was short-term incentive set as a percentage of base salary

CD&A – Long-Term Incentives

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- Same questions on the prior slide apply equally to the disclosure associated with long-term incentives

- Additional questions to answer include:
  - How did the Compensation Committee determine the split between time-based and performance-based awards, and was there a weighting of one over the other, and if yes, what was the weighting
  - Was the amount of the long-term incentives set as a percentage of the NEO's total compensation
  - With respect to equity awards, why did the Compensation Committee choose one form over another (*e.g.*, why was restricted stock chosen over stock options)
  - With respect to time-based vesting awards, how and why was the vesting schedule chosen
  - With respect to performance-based vesting criteria, how was the performance measure chosen and what is the rigor associated with the threshold, target and maximum performance levels

CD&A – Supplemental Material

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- Consider whether to highlight what "we do and don't do"
  - Issuers will often highlight programs that mitigate compensation risk and that are considered "best practices" and good compensation governance. Such programs include:
    - Stock ownership policies,
    - Hold policies,
    - Any clawback policies (policies in addition to Section 304 of SOX),
    - Anti-hedging policies, and
    - Anti-pledging policies

- Should the issuer include other supplemental material such as:
  - An executive summary
  - A realized or realizable pay table
  - Graphics to demonstrate the issuer's performance versus the performance of the peer group

Pay Ratio Disclosure

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- The pay ratio disclosure rule requires most issuers to disclose:
  - The annual total compensation of their CEO,
  - The annual total compensation of the median employee of the issuer (excluding the CEO) and its consolidated subsidiaries,
  - A reasonable estimate of the ratio of the amount determined in the above two items,
  - The date the above was determined (which must be within the last 3 months of the last completed fiscal year), and
  - The methodologies the issuer used to identify the median employee and to calculate total compensation, including:
    - All material assumptions, COLAs and consistently applied compensation measures ("CACMs") used to identify the median employee or to determine total compensation
    - Any estimates must be clearly disclosed

- The ratio may be presented numerically (*e.g.*, 75:1) or in narrative form
  - Disclosure in the form of a percentage is not permitted as the sole form of disclosure

Pay Ratio Disclosure (cont.)

- Disclosure of additional ratios are permitted. However, the additional ratios:
  - Must be clearly identified,
  - Cannot be misleading, and
  - Cannot be presented with greater prominence when compared to the required pay ratios (*i.e.*, this portion of the rule is similar to the rule applicable for any supplemental table to the Summary Compensation Table)
- In designing the calculations and drafting the disclosure, issuers should expect that questions will be asked with respect to the disclosure of the median employee's total compensation
- To that end, consider adding explanatory language. For example, consider:
  - Proactively addressing differences in ratios between the issuer and its peers (*e.g.*, employees in low cost jurisdictions, seasonal and part-time employees, and differences between an issuer that both manufactures and sells a product compared to an issuer that only sells such product)
  - Providing explanatory disclosure geared towards the viewpoint of the issuer's other employees that may view the median employee's total compensation

Say-on-Pay and Frequency Say-on-Pay

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- Say-on-pay is a non-binding, advisory vote on the compensation of the issuer's NEOs, as disclosed in the proxy statement
  - Without a stockholder communication initiative, beneficial owners typically do not provide voting instructions to brokers. Brokers are not permitted to vote without voting instructions from the beneficial owners. As a result, if broker votes are subtracted from the denominator, then institutional shareholder advisory services such as ISS have a disproportionately higher voting influence
- Frequency addresses how often the say-on-pay vote must occur.
  - The issuer may choose every year, every 2 years or every 3 years (though 1 year is the most common)
    - The goal of a 1 year frequency is to make the say-on-pay vote routine
    - An additional benefit of a 1 year frequency is as follows: If ISS identifies a pay-for-performance disconnect or discovers a problematic pay practice and no say-on-pay vote is on the ballot, then ISS may recommend an "against" on the re-election of the members of the Compensation Committee. However, if a say-on-pay vote is on the ballot, then ISS is likely to limit its adverse actions to the say-on-pay vote. For this reason, an annual say-on-pay vote can be protective
  - The frequency must be voted upon at least every 6 years
- The timing of when the first say-on-pay vote must occur depends upon how long the issuer was an EGC. Depending on the facts, the answer will either be 2 years from the issuer's IPO or 1 year from the date the issuer lost EGC status

Tabular Disclosure

- Verify whether any additional NEOs need to be disclosed

- Prepare to include the following:
  - The Summary Compensation Table will include the last 3 fiscal years of the issuer,
  - A Grants of Plan-Based Awards Table,
  - A Option Exercises and Stock Vested Table,
  - If applicable, a Pension Benefits and Nonqualified Deferred Compensation Table, and
  - A Potential Payments upon Termination or Change in Control
    - Disclosed as either a table or in narrative format

- Consider whether to include more narrative disclosure with respect to the Director Compensation Table
  - Especially in light of the recent focus on director compensation and the inability of directors to qualify for the business judgment rule defense related to their decisions with respect to their own compensation

Pay v. Performance: Overview

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- On August 25, 2022, the SEC adopted long-awaited rules addressing pay v. performance disclosure requirements, as required pursuant to Dodd-Frank Wall Street Reform and Consumer Protection Act

- Purpose of the rule is to include information that shows the relationship between executive compensation actually paid and the financial performance of the issuer, taking into account any change in the value of the shares of stock and dividends of the issuer and any distributions

- Here is an OVERVIEW of the final rules:
  - Issuers with fiscal years ending on or after December 16, 2022 will be required to include pay v. performance disclosures within the proxy and information statements they file in March – June 2023
  - Rules do not apply to EGCs, foreign private issuers and registered investment companies
  - Scaled disclosure is permitted for Smaller Reporting Companies
  - The new disclosure table covers the PEO individually, and an average for the other NEOs
  - A new disclosure table measures total compensation in the SCT, the compensation actually paid to the executives, and the financial performance of the issuer
  - Financial performance measures include: TSR, peer group TSR, net income and a financial performance measure as chosen by the issuer that represents the most important financial measure the issuer uses to link pay v. performance

Pay v. Performance: Rules

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- New proxy disclosure table
  - Table must cover the 5 most recently completed fiscal years
  - Table must cover the PEO (individually) and the other NEOs as an average
  - Table must disclose Total Compensation (as disclosed in the SCT) and "compensation actually paid"
  - Additional disclosure in the table includes:
    - Issuer's TSR,
    - TSR of the issuer's peer group,
    - Issuer's net income, and
    - A tabular list of at least 3 (and up to 7) financial performance metrics that were used by the issuer in determining compensation actually paid
- Narrative text following the table must include:
  - A description of the relationship between "compensation actually paid" and each of the above performance measures, and
  - A description of the relationship between the issuer's TSR and the weighted TSR of the issuer's peer group
- The first proxy statement will only require disclosure for 3 years, and each of the two years thereafter will add another year, such that eventually 5 years of disclosure will be required (with scaled back disclosure for EGCs and SRCs)

Sample Tabular Presentation

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					Value of Initial Fixed $100 Investment Based On:			
Year	Summary Compensation Table Total for PEO	Compensation Actually Paid to PEO	Average Summary Compensation Table Total for Non-PEO NEOs	Average Compensation Actually Paid to Non-NEO PEOs	Total Shareholder Return	Peer Group Total Shareholder Return	Net Income	[Company-Selected Measure]
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)
Y1								
Y2								
Y3								
Y4								
Y5								

Pay v. Performance: Rules (cont.)

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- New methodology - Compensation Actually Paid
  - Calculating "compensation actually paid" could become complex because it substantially differs from the determination of compensation under the SCT rules
  - With respect to equity awards, "compensation actually paid" means value is determined as follows:
    - If equity was granted in a covered year and remains outstanding and unvested as of the last day of such year, then value is determined using the fair value of the awards as of the end of such year
    - If equity was granted in a prior covered year and are outstanding and unvested as of the end of the covered year, then value is determined using the change in fair value from the prior year end to this year end
    - If the equity was granted in a prior or same fiscal year and becomes vested as of the end of a covered year, then value is determined using the change in fair value as of the vesting date
    - And if the equity was granted in a prior covered year and does not later vest, then a deduction for the amount of fair value at the end of the prior fiscal year is required
  - Key is that fair value determinations will have to be determined at the end of each fiscal year (whereas the status quo prior to the final rules only necessitated a determination of fair value in connection with the grant of the award). Thus, there will be advanced Monte Carlo simulations and Black-Scholes calculations

Pay v. Performance: Rules (cont.)

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- Additionally, the issue must describe in a narrative or graphically (or both):
  - The relationship between each of the performance metrics set forth in the table and compensation "actually paid"
  - The relationship between the TSR of the issuer and the TSR of the issuer's peer group

- The issuer must report 3-7 financial measures that it deems are its most important financial measures in linking executive compensation to issuer performance for the recently completed fiscal year
  - If less than 3 financial measures were used, then all such measures must be listed irrespective of importance
  - Non-financial measures may be used if such are among the "most important" and at least 3 (or less if the issue used less than 3) "most important" financial performance measures were disclosed
  - No ranking or weighting of the measures is required

- Supplemental disclosure is permitted
  - Same rules apply with respect to supplemental disclosure of the SCT
  - The use of supplemental disclosure to address realizable or actual pay will likely increase due to the pay v performance disclosure rules

Pay v. Performance: Rules (cont.)

- Issuers are provided flexibility on the placement of the pay v performance disclosure
  - Placement could be outside or inside the CD&A
- If placed outside the CD&A, then consider having its placement after the typical required tabular disclosure so that the pay v performance disclosure is not covered by the Compensation Committee report and not covered by the say-on-pay vote
- However, what is more likely is that the issuer already addresses pay v performance in its executive summary to the CD&A or within the CD&A itself. As a result, certain aspects of the pay v performance disclosure should be woven into the CD&A, with the required table being disclosed after the typical required tabular disclosure

Don’t Forget Next Month’s Webinar

- Title:
  - Aging Executives: Thoughts on Designing Succession Strategies
- When:
  - 10:00 am to 11:00 am Central
  - November 10, 2022