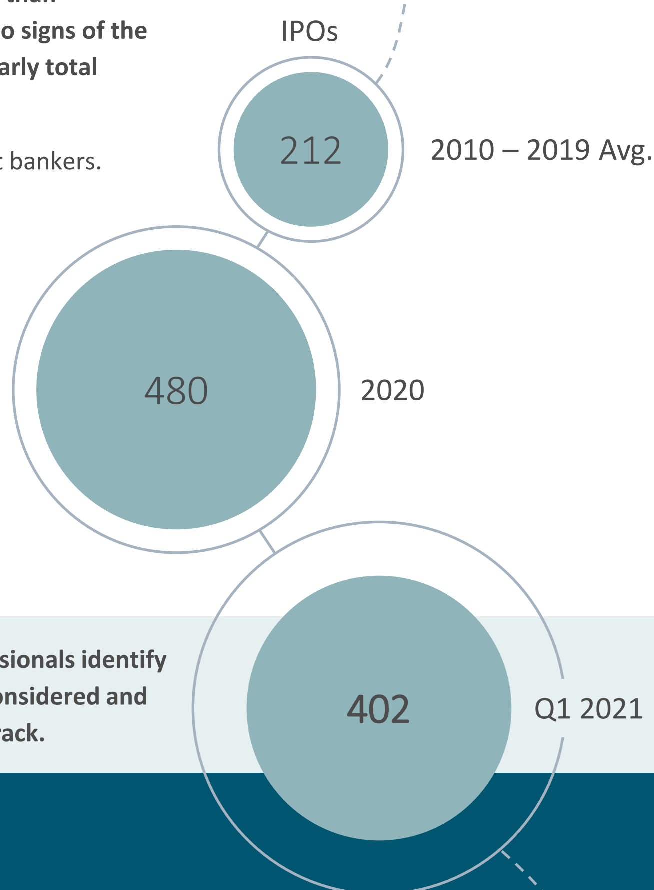
IPO: To, through, and beyond

A roadmap for equity professionals

IPOs are happening at a record pace. An astounding 480 IPOs in 2020 more than doubled the yearly average of 212 for the previous decade, and there are no signs of the pace slowing. As of the end of Q1 2021, we saw 402 IPOs, beating every yearly total from 2000 to 2019.[1] Is this our version of the Roaring Twenties?

IPO preparations extend well beyond valuations, roadshows, and investment bankers. Compensation professionals play a critical role in this transformation by ensuring that the compensation strategy and systems are in place to deliver on human capital needs. The IPO process is a complex, multifaceted, and fast-paced activity, and compensation and rewards professionals are well served to begin strategic planning far ahead of the expected IPO date.

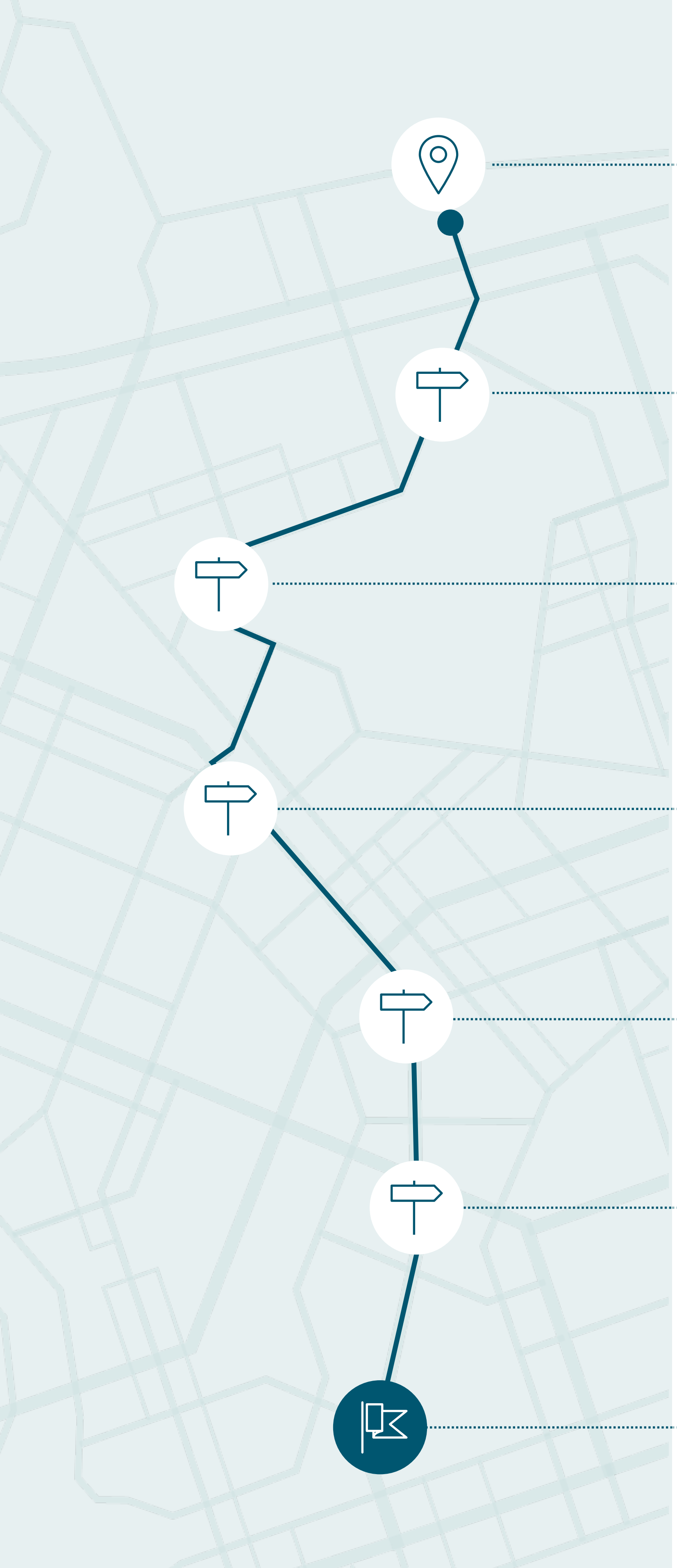
Equity compensation is a particularly important focus area because it is significantly affected by the public listing. Equity compensation philosophy, plan documents, administration, employee services, processes, procedures, and your available pool of consultants and subject-matter experts may all require a deep review, which could mean change.



This document is designed together with Aon to help compensation professionals identify and plan accordingly. Of course, facts and circumstances must always be considered and you should consult your advisors as necessary to ensure that you stay on track.

A word on SPACs: The use of Special Purpose Acquisition Companies (SPACs) has exploded. SPACs are a strategy to get to market more quickly than a traditional IPO. That accelerated timeline could shrink the planning window from 12+ months to a matter of weeks. Companies considering a SPAC exit may want to preemptively begin planning well before SPAC details emerge, as truncated timelines can create many unforeseen issues.

Source: stockanalysis.com/ipos/statistics



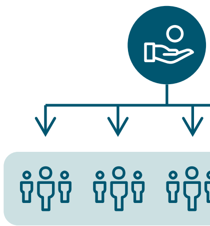
In a hurry? Just click below to jump to a topic.

Click on a section to learn more

18 months to IPO

Compensation philosophy and peer group selection

What is a **compensation philosophy?** Typically, it is a formal document that outlines a framework for employee compensation as well as the rationale. It should be **effective at attracting new talent as well as retaining and motivating current employees**. For pre-IPO companies, the use of equity in the compensation philosophy is critical.



Done right, long-term incentives reward employees who benefit the company, and can play a major role in contributing to a success-oriented culture. Additionally, equity compensation has historically delivered value in a very cost-effective form. According to recent research by both Aon and Fidelity, over the last decade, on average, equity compensation has delivered greater value to employees than the compensation cost recognized for those awards.[2] Because your needs may change as your company grows, it's important to review and update the compensation philosophy so that equity plans are positioned to execute on the post-IPO compensation strategy. As part of setting the company's strategy and pay philosophy for the future, this stage should include an assessment of which employees should have an equity stake, and when that should be implemented. For example, if a company has historically granted equity only to executives or only as a sign-on bonus, this is the time to decide who deserves equity, at what frequency they should receive it, and grant sizing.

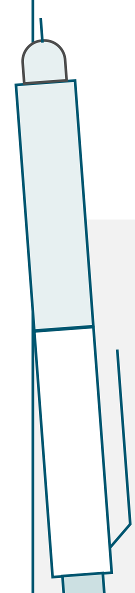
2. Fidelity Internal Analysis on grants issued 2010-2020 where Fidelity recordkeeps the fair value. Aon's internal study on grants issued between 2010-2020 by the companies comprising the S&P 500 over that timeframe.

18 months?
I don't have that kind of time.

IPOs aren't always accompanied by a comfortable time frame. If your IPO is looming, your timeline will be accelerated, and some items will need to be conducted concurrently.

Key things to consider

- If an equity philosophy and plan exists, ensure that the plan allows for the types of compensation and programs that align with the company's long-term goals, especially comparing compensation levels, and targets across publicly traded peers.
- If an equity philosophy and plan does not exist, work with the compensation committee, executive team, and outside counsel to establish a plan(s) from which the company can grant equity-based awards. It will generally be easier to obtain approval for new plans or modifications for existing plans while the company is still privately held. Additionally, an evergreen feature, which is an automatic replenishment of the share pool, is likely only available for plans that are approved before IPO. After IPO, when shares are no longer closely held and plans are subject to shareholder approval, proxy advisors and institutional shareholders will generally vote against plans with evergreen provisions.
- Establish processes to ensure that the proper requirements, documentation, and approvals are in place for individual equity grants.
- Review plan eligibility with respect to consultants, vendors, and nonemployees to ensure that it is consistent with public company needs. Additionally, consider whether Board of Directors' grants should be granted from the general plan or a separate plan.
- Address features unique to public companies, such as including flexibility with award types, ensuring that the plan reserve is adequate, lifting private company exercise limitations, removing contractual restrictions (e.g., right-of-first-refusal provisions), providing for the tender of shares to facilitate tax withholding (particularly for Section 16 officers) and aligning eligibility with compensation philosophy and your competitive landscape.



In this phase, it is important that a company begins to understand the types of equity used by peers and competitors and how that competitive landscape may change as the company moves toward becoming a public entity. Therefore, it is important to establish a peer group of publicly traded companies for these purposes.

Peer groups of 15-20 companies may help maintain stability by ensuring that there is sufficient number of members even if subsequent mergers or corporate actions eliminate some peers from your group.

Important considerations in peer group selection include industry, revenue, market cap, profitability, risk profile, debt leverage, time since IPO, and other key company-aligned metrics.

Benchmark grant sizing and grant design / structure against peer groups.

Equity is structured very differently for public companies, and constantly evolving. Understanding the current landscape is critical for staying competitive.

Understand typical pay mix by level in your sector. Significant differences will appear across sectors. For example, executives in Life Sciences receive LTI grants equal to almost 200% of their base pay, compared to Technology, where executive LTI grants are closer to 80% of their base pay.[3]

Assess how broadly equity may be used by your publicly traded peers and start to contemplate programs to help address your broad-based equity needs, such as annual broad-based grants or an employee stock purchase plan (ESPP).

409A Valuations

In the lead-up to IPO, you will likely need 409A valuations more frequently. Accurate assessments of the value of shares can help you adjust targeted equity levels for employees.

3. Radford Global Compensation Database, 2020 data analysis

Executive compensation

Compensation philosophy and peer group this way

Your earlier work on compensation philosophy and creating a peer group will have established a framework for when and what your company intends to do with equity awards. As you get closer to IPO, it is time for a deeper dive into the executive compensation details.

- Assess both current and expected equity grants to executives pre-IPO to validate that equity levels are appropriate and as intended
- Establish equity design for post-IPO grants
- Understand the effect that restructuring or IPO will have on current employment agreements—specifically the impact on equity awards
- Verify that employment agreements do not create any potential obstacles by triggering a change-in-control or acceleration payments as the company transitions to a public entity.
- Create a framework for how Board members will be compensated in a public setting, including the use of equity, typically in the form of time-based RSUs
- Establish processes to design, grant, and administer Board-level equity awards
- Establish processes to design rules regarding gifting of awards/securities to family members by employees

Be mindful of cheap stock regulations

The SEC will likely scrutinize any equity granted within a year of IPO if granted significantly below the IPO listing price. Make sure to document the valuation process to mitigate risks of 409A issues and additional compensation expense. Some companies even preemptively submit a “cheap stock letter” to the SEC.

12 – 18 months to IPO

Administration and employee services

Companies granting pre-IPO equity likely have some system in place to record and track those grants. Those solutions may range from employing spreadsheets to assistance from law firms and using software systems. **However, the needs of both employers and employees can change dramatically upon IPO, and administering a public company equity compensation program is significantly more complex with increased regulatory compliance, oversight, and disclosure.** Companies should evaluate their current capabilities and, if necessary, select solutions that can meet their anticipated needs as a public company in advance of IPO. Focus on selecting a provider with extensive experience in managing restricted securities as well as demonstrated experience in meeting the needs of established public companies. Because direct listings and SPAC's can move more quickly than a traditional IPO and may have nontraditional lock-up provisions, private companies can no longer count on the lock-up as a haven to upgrade systems and staff. Administration and employee services may need to be ready to go on IPO date.

When's the right time to consider changes to your administration and employee services? We suggest this process begins 12–18 months in advance of IPO. However, there is no one-size-fits-all answer. The right time to address the suitability of your current administration and employees services is a matter of complexity and risk.

Considerations in evaluating complexity and risk include:

- ✓ the number of employees receiving equity awards
- ✓ the types of awards granted
- ✓ the extent of non-U.S. employees who may receive equity awards
- ✓ the 409A valuation
- ✓ the possible path to becoming a public company (i.e., traditional IPO, direct listing, or SPAC)
- ✓ the degree of internal expertise and staffing
- ✓ the interest in launching new plans on IPO

Virtually all public companies use a captive or designated broker to facilitate administration and compliance. Many companies value integrated services and look for a provider that can support multiple current or future benefits including 401(k), NQDC, HSA, student debt, and charitable giving, in addition to stock plan services.

With respect to recordkeeping and brokerage solutions, **there are three distinct phases of an IPO**, each requiring different support for you and your employees:

- **BEFORE** — Six months leading up to IPO
- **DURING** — Six months following IPO or the duration of your lock-up period
- **AFTER** — Post-restriction/lock-up period; ongoing public company

The lowdown on lock-ups

A lock-up is a period of time, often six months, following IPO where employees are restricted from selling shares. Because executives and employees may have significant share holdings and/or options, a lock-up may prevent a flood of shares being sold at once into the market and help ensure stabilization of the company's price over time. Lock-ups are typically negotiated by the company with an underwriter. Early release programs typically provide employees an opportunity to sell some of their shares through controlled periods, and management of these programs should be considered in selecting a broker.

Needs will change through the before, during, and post-restriction phases.
The following offers important considerations for your stock administration and brokerage needs post-IPO:

SYSTEM CAPABILITIES AND SUPPORT

- Ability to support early exercise, 83(b) elections, and dual classes of securities
- Access to resources for control and restricted security processing and special account setups (i.e., trusts)
- Automation of data feeds (payroll, tax, grant) to streamline post-IPO administration
- Robust data security to protect your data and your employees' data
- Ability to support various program types including performance-based equity plans and ESPPs

FINANCIAL REPORTING SOLUTIONS

- Integrated SOC 1 financial reporting and attestation
- Financial reporting that meets reporting and audit requirements, including full period-end data lockdown
- Support for both U.S. GAAP and IFRS (if applicable)
- Resources to help with stock-based compensation valuation/expense, disclosure, dilution, proxy, and corporate tax reporting

INTERNAL STAFFING NEEDS

- Fully outsourced administration arrangements may reduce internal headcount needs. Internal headcount and expertise will still be necessary to ensure effective administration of your equity plans.

STABILIZATION BEYOND IPO

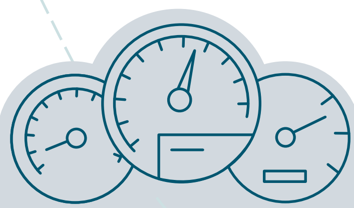
- Flexibility in working with your team and employees as you ramp up to public company experiences
- Training and resources to quickly bring current and future team members up to speed

EMPLOYEE SERVICES

- Employee support aligned with complexity of needs, from executive to rank and file
- Communication, education, and training materials tailored to employees' needs before, during, and after IPO
- Accessible, intuitive solutions for managing equity plans, including the ability to transact through mobile apps
- Dedicated phone support for executive and employee needs
- Language services, currency exchange, and accessible support for current or future global employees who receive equity
- Help with planning needs and wealth acquired through IPO, including guidance on using pre-IPO stock in tax-efficient charitable giving

PLAN DATA AND BENCHMARKING

- Access to information on how other companies with similar characteristics operate their plans
- Strategic insights and data to support key decisions



Selection and implementation of an administration service provider pushes data quality into the spotlight.

Consider:

- When was the last time it was reviewed/audited?
- Has/Will the equity and the financial data been/be managed in a single system?
- Is employee information up to date (complete grant records, termination information, addresses for terminated employees with long shares, etc.)?

Systematic conversion routines and dedicated implementation resources may assist with the conversion and reconciliation.

This is also the time to begin thinking about a **transfer agent.** Most private companies don't have a need for a transfer agent, but, as a public company, you'll likely want to outsource this service to manage the registration of direct shareholders, dividends, proxy tabulation, and escheatment. The transfer agent plays a critical role in the delivery of shares to your plan administrator to settle stock option exercises, restricted stock releases, and employee stock purchases. Consult your plan administrator regarding transfer agents.

Broad-based equity

With an established compensation philosophy in place and executive compensation mapped out, it is time to focus on the rest of the employees. There are two main ways to share ownership on a broad basis. The use of equity grants and an ESPP are not mutually exclusive and can be done in tandem.

Traditional Equity Grants

- Can be a recurring program or a one-time grant prior to IPO
- Broad-based equity grants can be expensive but ensure that everyone is a stakeholder
- Vesting is typically time based
- Using equity on a broad basis can be a more daunting process for a larger employee base
- Determining equity levels throughout your employee hierarchy can be a challenge

ESPPs

ESPPs are a popular way to share ownership on a broad basis *after* IPO, but the best time to think about an ESPP is *before* IPO. Nearly 50% of the S&P 500® offer an ESPP[4], and 76% of Technology and Life Sciences companies with an IPO since 2017 had an ESPP at IPO[5].

ESPP design considerations

- **Understand** market practice and prevalence of ESPPs, design of offering, typical share pool allocations, compensation expense, and evergreen prevalence.
- Most ESPPs are tax qualified under Section 423, which requires **shareholder approval**. Shareholders nearly universally approve ESPPs, but, approval is even easier when the company is closely held and obtaining shareholder approval doesn't require waiting for the next annual meeting. Pre-IPO approval can also enable an evergreen provision to automatically replenish shares (a feature that is not likely to be approved by shareholders after IPO because most proxy advisors and institutional shareholders are not supportive of evergreen provisions and will vote against it).
- **Draft ESPP and related offerings documents** for compensation committee and shareholder approval.
- ESPPs approved **while the company is still private** can be launched on IPO date to help employees share in the potential success of an IPO. However, SEC rules prohibit soliciting investments on unregistered securities, so until the Form S-8 is filed, you can’t offer the plan to employees. A common solution to this challenge is to automatically enroll everyone as of IPO date and give employees a limited period of time to confirm their enrollment and contribution amount.

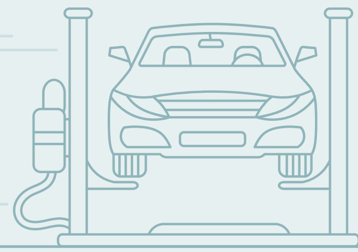
Is an ESPP right for you?

While more than 75% of recent public companies in Technology and Life Sciences had an ESPP at IPO, it doesn’t mean that an ESPP is right for all companies. If a company plans to continue broad-based grants following IPO, they may believe employee ownership is sufficiently addressed. Furthermore, company size, sector, and philosophy are all considerations in evaluating an ESPP.

4. "How common are Employee Stock Purchase Plans?" Aon, April 2020
5. Radford Global Compensation Database

6 months to IPO Preparing to launch

As the big day nears, compensation professionals turn their attention to establishing processes and procedures, ensuring access to the right resources to support a public company equity program, and employee communications and readiness.



Attention, Please!

Areas that may need to be addressed:

- **Ensure equity awards are granted** with the proper structure for a newly public company
- **Establish insider trading policies** and trading windows
- Plan for required **executive compensation disclosures**
- Prepare for **SEC Section 16 compliance**, including identification of Section 16 officers
- Document share **pool tracking** for dilution and monitoring for replenishment

Additionally, companies should be proactively planning for the lock-up period.

- Will the company provide **liquidity opportunities** during the lock-up through an early release program?
- Will **early release provisions** be consistently applied or will active and terminated employees have different provisions?
- Will **plan events** occur during the lock-up?
  - Will option exercises be permitted? (e.g., Exercise-and-Hold, Net Exercise)
  - Will there be a release of shares during lock-up? If so, how will taxes be funded?

Prepare for ongoing administration

While private, many companies rely on their legal team or outside counsel to oversee their plans. With significantly increased transaction volumes for public companies, relying on outside counsel for plan administration is likely no longer feasible. Some considerations in planning for ongoing administration:

- **Organizational Alignment:** Human Resources most commonly has primary responsibility for stock administration. However, Finance and Legal are also options. Regardless of primary responsibility, stock administration is a multi-department team effort.
- **Payroll:** Many companies upgrade not only stock administration services, but also payroll services, around IPO. Is a payroll conversion planned? How does that fit into your equity administration implementations? Are you planning for automation between systems?
- **Taxation:** Many companies shift from ISOs to other equity types around IPO. This shift can impact tax planning.
  - *Withhold-to-Cover* (aka netting shares) is the most common tax withholding method for full value awards, but requires company cash to cover taxes
  - *Sell-to-Cover* doesn't affect company cash flow but requires sufficient trading volume to support sales and may raise concerns about selling shares during closed windows
  - Many companies mandate a tax withholding method to simplify administration
  - Regardless of how taxation is covered, consider transaction volume and payroll integration
- **Financial Reporting:** It is important to ensure that your valuation methodologies and financial reporting processes will hold up in a public environment, especially as potential auditor scrutiny increases.

Public company equity programs are generally not a "do-it-yourself" proposition. Many companies build out their available resources to include:

- Compensation consulting
- Design and valuation expertise for complex award types
- Global equity expertise for jurisdictional due diligence and compliance
- Third-party tax advice for mobile employees
- Performance tracking and certification of equity grants

3 months to IPO

Time to focus on your employees

Employees are an important consideration as you near IPO. Understand what your administration provider can help you with and establish a plan for communicating with employees. Employees will need help with getting started, keeping on track, and taking action.

IPOs can deliver significant wealth to employees, and, for many employees, it may be the first time they have experienced such wealth creation. An IPO readiness team composed of your administration provider and your internal team can help your employees understand the process and how to incorporate their newly formed wealth into their overall financial plan. Helping employees with newfound wealth and managing their equity compensation is a task that shouldn't be underestimated. Employees may need help from an advisor with deep understanding of their equity plans and managing the lock-up and Rule 144, in addition to experience with taxes, AMT, estate planning, charitable giving, and overall financial planning.

Some specific areas where employees may need help following IPO:

- Understanding how registration and security restrictions may affect their ability to sell shares
- How early release programs work (if applicable)
- How Incentive Stock Option holding periods work for preferential tax treatment

"I'm realizing that I've outgrown my current advisor."

—Employee at a newly public company

Equity has become increasingly complex in recent years, and the lock-up period where stock trading is restricted is particularly important to your employees. **Having an administrator that can help employees understand all aspects of their equity and what trading is allowed in their restricted long shares is critical.** Beyond this period, employees continue to need support to make the most of their equity plans. Furthermore, research indicates positive outcomes, both for employees and employers, when employees incorporate **equity compensation into their financial planning**.[6]

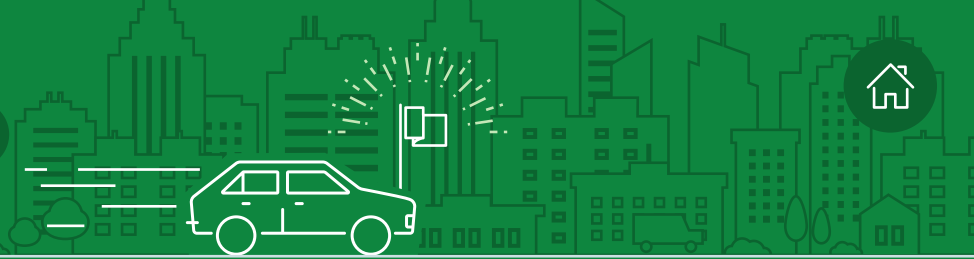
Relevant employee education topics include:

- An Equity Overview
- Vesting criteria
- Exercisability
- Taxation
- ESPP
- Insider Trading and Trading Restrictions

Special consideration should be given to the particular employee education necessary in the six months prior to IPO.

6. Fidelity Investments, "Unlocking Success - For you and your employees", June 2020

You've made it! **Now what?**



Reaching IPO is certainly cause for celebration, but for equity professionals, the work does not stop there. Managing a public company equity plan is significantly more complicated than managing a privately held plan. This paper is focused on steps to get equity compensation plans and practices ready for IPO, many of which will help in this transition.

The work associated with getting equity compensation plans to, through, and beyond IPO should not be underestimated. While this not an exhaustive treatment – and all plans should be carefully reviewed by counsel – we hope this paper has provided some insight into timelines and considerations for your equity plans.

Interested in learning more?

Contact your Fidelity representative to learn more about our integrated benefits offerings and specifically how we can help companies to, through, and beyond IPO.

Contact Aon for equity compensation design support and strategy with your rewards programs as you move through the IPO process at rewards-solutions@aon.com.

Additional resources

Several great resources you may want to explore:

- Aon's study on ESPP prevalence
- Aon's Understanding the Evolution of Equity Compensation at Private Companies
- Aon's Executive Compensation Guide for SPAC Targets
- Fidelity Capital Markets
- Fidelity Charitable: 5 steps to maximize benefits of an IPO with charitable giving
- Fidelity's ESPP data analysis
- Fidelity's Unlocking Success for Employees and Companies
- Fidelity's ESPP Guide for pre-IPO companies

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Aon's rewards practice, a segment of the firm's human capital business, provides clients with a powerful mix of data, analytics and advice to help them make better and more equitable rewards decisions. This includes compensation and benefits benchmarking and the design of executive, employee and sales compensation plans.

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