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Is Your Company About to Graduate from the JOBS Act? Here's Your Planning Checklist

Once a company exits the JOBS Act, it must hold Say-on-Pay votes and disclose a host of new governance and compensation information— planning early makes for a much easier transition.

The JOBS Act, which turned five years old in April, has benefited many "emerging growth companies" (EGCs) by exempting them from a host of governance and compensation requirements for up to five years after they go public. For many of the earliest companies to complete initial public offerings (IPO) as EGCs, the time to consider life after the JOBS Act is now. In our experience, planning for exiting EGC status should begin at least six to 12 months in advance of a company's first 10-K and proxy filings post-EGC.

Even before the five-year EGC limit expires, a company can lose EGC treatment by tripping any one of the following triggers, including:

- Earning $1.07 billion or more in annual revenue
- Issuing more than $1.0 billion in nonconvertible debt securities in any rolling three-year period
- Qualifying as a "large accelerated filer," principally defined as having at least a $700 million public float as of the last business day of the issuer's most recently completed second quarter (i.e., June 30 for calendar year filers)

The public float trigger deserves special attention. The June 30 measurement date for calendar-year end companies is fast approaching, and with the latest bull market run, it is likely that many current EGCs will no longer qualify in a few short weeks.

To better understand the implications of moving out of the JOBS Act, the following table summarizes key disclosure requirements applicable to regular issuers (i.e., non-EGC companies):

Item 402 Requirement	Emerging Growth Companies	Regular Issuers
Definition of Named Executive Officers	▪ Anyone serving as Principal Executive Officer ▪ Next two highest paid executive officers ▪ Up to two additional executive officers who would have been among the top two but were not executive officers at year end	▪ Anyone serving as Principal Executive Officer and Principal Financial Officer ▪ Next three highest paid executive officers ▪ Up to two additional executive officers who would have been among the top three but were not executive officers at year end
Compensation Discussion and Analysis (CD&A)	▪ Not required ▪ Only limited narrative disclosure of the material elements of pay, employment agreements, severance plans and change-in-control benefits is required	▪ Narrative disclosure covering all aspects of pay programs ▪ How each element of pay is determined and how the amount of pay is determined ▪ Disclosure of the "why" regarding pay decisions and results ▪ Requires a robust, transparent disclosure (10 to 20+ pages) ▪ Discussion of compensation committee governance practices
Summary Compensation Table	▪ Covers last two fiscal years ▪ Pension calculations not required	▪ Covers last three fiscal years ▪ Includes information related to pension plans
Grants of Plan-Based Awards Table	▪ Not required	▪ Detailed listing of all cash and equity award grants made during the most recent fiscal year
Option Exercises and Stock Vested Table	▪ Not required	▪ Summary of amounts realized from stock option exercises in the year ▪ Summary of amounts realized from equity awards vesting in the year
Pension Benefits and Nonqualified Deferred Compensation tables	▪ Not required	▪ Summary of qualified and nonqualified pension benefits to named executive officers ▪ Summary of nonqualified defined contribution account activity for each executive officer
Potential Payments Upon Termination or Change in Control	▪ Not required	▪ Amounts payable upon any termination and/or change of control

The Planning Stage: What to Expect Post-EGC Status

While companies must meet significant additional disclosures requirements once they are no longer covered by the JOBS Act, not all changes happen immediately. Below is a brief summary of the most important changes and when they typically take effect:

- **Compensation Discussion and Analysis (CD&A) and other executive compensation disclosures and/or tables described above**: "Non-smaller reporting companies" are generally required to make all the executive compensation-related disclosures described above at the first filing date following exit from the JOBS Act. Those that remain smaller reporting companies retain similar scaled disclosure requirements. However, as a practical matter, any company losing EGC status based on exceeding the public float threshold will also exceed the smaller reporting company threshold.

- **Say-on-Pay vote**: Issuers must generally hold their first Say-on-Pay vote within one year following the date on which they cease to be an EGC. However, for those that maintained EGC status for less than two years, the vote must be held within three years of their IPO (i.e., could be a period of greater than a year).

- **Say-on-Pay vote frequency**: Required as early as the first annual shareholder meeting following emergence from EGC status.

- **Say-on-Golden Parachute vote**: Required to be held at a shareholder meeting where shareholders are approving an acquisition, merger or related transaction.

- **Pay ratio disclosure**: Assuming current pay ratios rules scheduled to go into effect in January 2018 are not delayed or amended before then, companies exiting the JOBS Act will be required to disclose this ratio for the first fiscal year commencing on or after they cease to be an EGC.

- **Pay-for-Performance disclosure**: To be determined based on final rules adopted by the SEC; we anticipate non-EGC companies will have to comply at the first filing date following emergence from the JOBS Act.

- **Auditor's opinion on effectiveness of internal controls**: For companies that do not qualify as smaller reporting companies (i.e., less than $75 million market cap) an attestation from the auditor must be included in the next 10-K filed following emergence from EGC status.

Planning early for post-EGC disclosure and voting requirements is critical in the present environment. Additional disclosures in combination with the requirement to hold Say-on-Pay votes expose former EGC companies to a significantly heightened level of scrutiny from investors and proxy advisory firms. We recommend educating your board on potential governance changes and starting the investor outreach process well in advance of the first full filings in order to anticipate potential investor discontent and reduce the likelihood of unfavorable votes. A critical first step is cataloguing each of the practices that will be disclosed for the first time in your CD&A to compare against the proxy voting policies of the company's significant shareholders. For example:

  - Do the company's equity practices qualify as sufficiently "performance-based" to withstand scrutiny from shareholders and proxy advisory firms, in the event that the firm's pay-for-performance policies are triggered?

- Has the company adopted (or should it consider) stock ownership guidelines, clawback policies, and other "risk mitigating" policies that garner more favorable treatment in Say-on-Pay voting?

- Is the company benchmarking pay against a peer group that shareholders and proxy advisory firms would find objectionable?

Say-on-Pay Focus: Pre- and Post-EGC Emergence

Most EGCs experience some level of proxy advisory firm review of their executive pay programs even in the absence of a Say-on-Pay vote or related executive compensation tables and disclosures. However, the scope of proxy advisory firm scrutiny expands dramatically as companies leave EGC status. Below, we compare the depth of proxy advisory firm review of compensation practices before and after exiting the JOBS Act.

Proxy advisory firm review of EGC compensation:

Institutional Shareholder Services (ISS) will analyze an EGC's compensation-related disclosures even when there is no Say-on-Pay proposal on the proxy ballot. If ISS identifies pay-for-performance disconnects and/or a violation of its Problematic Pay Practices Policy, it will recommend against any compensation committee nominees up for re-election. This can pose a challenge for EGCs, since one of the more common ways for regular filers to address potential ISS issues is to provide additional context in the proxy. EGCs that have availed themselves of the reduced executive compensation disclosure obligations, by contrast, have no such remedy available since they are not permitted to selectively add disclosures in a piecemeal fashion. However, EGCs can provide expanded footnotes to the tables in the proxy statement to describe design features for incentive plan payouts or provide the rationale for sizing of awards.

Glass Lewis does not conduct full executive compensation reviews until a company holds its first Say-on-Pay vote. Prior to that, Glass Lewis may make adverse vote recommendations in cases where egregious practices are identified, but routine comments and vote recommendations based on compensation practices is not common.

Proxy advisory firm review following EGC emergence:

For companies emerging from EGC status, the level of proxy advisor review increases substantially. Both ISS and Glass Lewis will consider the full range of newly available compensation information to evaluate Say-on-Pay proposals, and will run detailed pay-for-performance analyses using the data. Both firms will also expect more fulsome disclosures surrounding a company's performance and how it ties to pay decisions. Additionally, both ISS and Glass Lewis like for the CD&A to address the following issues:

- Any benchmarking philosophy for setting executive pay levels

- Target annual and long-term incentive payout opportunities

- Specific metrics/weightings/targets and actual results (including how actual results translate into final payouts) for any short- or long-term incentive payouts:

    - If the annual incentive program is discretionary, a list of factors taken into account and the relative importance of such factors could be explained to attempt to mitigate any negative scrutiny

  - If there are other shareholder-friendly design features (e.g., maximum payout caps, use of negative discretion, etc.) they should be discussed

- Any perceived best practices, such as stock ownership guidelines, clawback policies, and anti-hedging/anti-pledging policies, etc.

Beyond Compliance: Considering Governance Best Practices

While there are numerous compliance matters to check off once a company leaves the protection of the JOBS Act, there are also matters of governance best practices that change. At this stage, the composition of a company's investor base typically shifts to be less concentrated and more institutionally-held.

We recommend boards think about adopting the following initiatives ahead of exiting the JOBS Act:

- **Adoption of risk mitigating features**: Whether your company has director stock ownership guidelines or not, it's important to review them in advance of becoming a regular filer. We usually recommend the adoption of a stock ownership guideline of at least three times (3x) base salary for CEOs and one times (1x) base salary for NEOs with a stock retention net of taxes until ownership guidelines are met to align with market best practices.

- **Run a preliminary ISS pay-for-performance report**: This will allow the board and leadership team to assess how current executive compensation programs stack up to ISS' standards, helping prevent any surprises in the first official Say-on-Pay vote. You will know ahead of time if, and what, compensation programs could run afoul of ISS, allowing the board to make a judgment on whether to modify programs to address these concerns ahead of holding the first Say-on-Pay vote.

- **Remaining Dodd-Frank Act items**: While the SEC has yet to finalize some key Dodd-Frank governance and compensation provisions— including clawbacks, pay-for-performance disclosure and hedging disclosure— we advise our clients to understand what these proposals would require. In light of the new administration in the White House and Congress, it is possible that some of these proposals, including the CEO pay ratio rule, will be amended, delayed, or thrown out altogether. However, at the current pace of business in Washington, companies can't afford to assume these items will disappear before the 2018 proxy disclosure season.

If you have any questions about transitioning from an emerging growth company and want to speak with a member of our compensation consulting group, please write to consulting@radford.com.

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