IPO Report

2023

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2023 IPO Report – What's Inside

REVIEW

Stubbornly high inflation, rising interest rates and the lingering effects of the COVID-19 pandemic, combined with geopolitical tensions and concerns about the global economic outlook, caused the IPO market to nosedive in 2022—only one year after surging to its highest level of activity in more than 20 years.

Deal flow, total gross proceeds and offering sizes all plunged from 2021 levels. The companies that managed to complete IPOs in 2022 had much lower annual revenue than in recent years, and aftermarket performance was the worst in recent history.

Excluding IPOs by special purpose acquisition companies (SPACs) and direct listings, the IPO market produced 79 IPOs in 2022, barely one-fifth of the 2021 total of 381 IPOs and the lowest annual figure since 2009, when there were 54.

Total gross proceeds in 2022 were $7.8 billion, compared to the record high of $134.9 billion in 2021. The 2022 tally is the lowest since 1990.

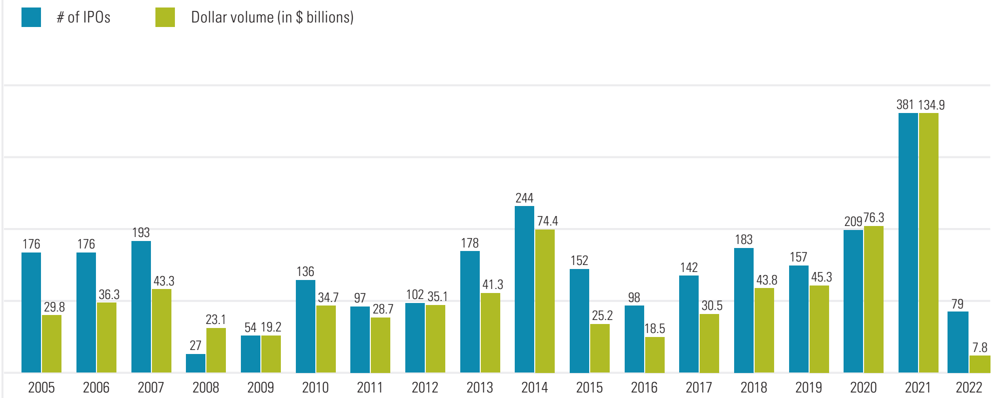
IPOs by emerging growth companies (EGCs) accounted for 87% of the year's IPOs, a share modestly lower than the 93% in 2021 and the 89% average that has prevailed since enactment of the JOBS Act in 2012.

The median offering size for all 2022 IPOs was $17.6 million, a staggering 90% lower than the $176.9 million median recorded in 2021 and 85% below the $120.0 million median between 2016 and 2020. The percentage of IPOs raising gross proceeds of less than $25 million spiked to 61% in 2022, up from only 9% of IPOs in 2021 and 8% of all IPOs between 2016 and 2020.

The median annual revenue of all IPO companies in 2022 was $4.7 million, sharply down from the $67.4 million median in 2021 and the $66.9 million median that prevailed during the five-year period from 2016 to 2020.

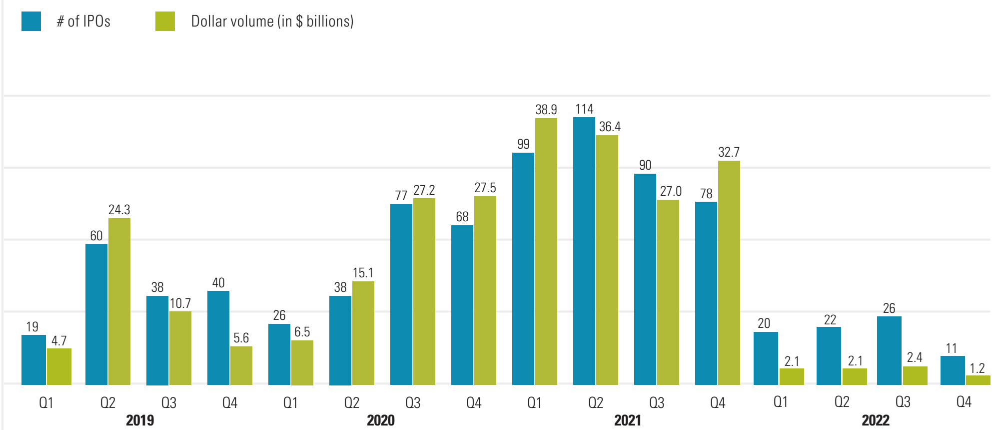
In 2022, only 17% of life sciences IPO companies had revenue, down from 48% in 2021. At $12.0 million, the median annual revenue of non–life sciences IPO

US IPOs by Year – 2005 to 2022



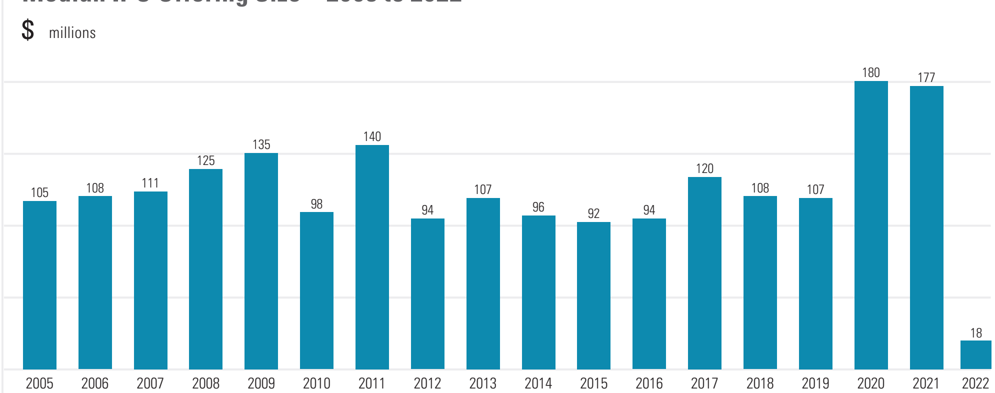
Source: SEC filings

US IPOs by Quarter – 2019 to 2022



Source: SEC filings

Median IPO Offering Size – 2005 to 2022



Source: SEC filings

companies in 2022 was a mere fraction of the $203.2 million figure for 2021.

The percentage of profitable IPO companies increased from 28% in 2021 to 34% in 2022, compared to 29% of all IPO companies between 2016 and 2020. Only a single life sciences IPO company in 2022 was profitable (4% of all life sciences IPO companies), compared to 46% of non–life sciences IPO companies.

In 2022, IPO companies produced a median first-day gain of 8%—one of the few bright spots of the year—although the figure was down from the 16% recorded in 2021.

The median first-day gain for life sciences IPO companies in 2022 was 3%, compared to 11% for non-life sciences IPO companies.

There were 20 "moonshots" (IPOs in which the stock price doubles on the opening day) in 2022, only four fewer than in the prior year, although only one 2022 moonshot ended the year above its offering price. The other 19 ended the year down a median of 79% from their offering prices.

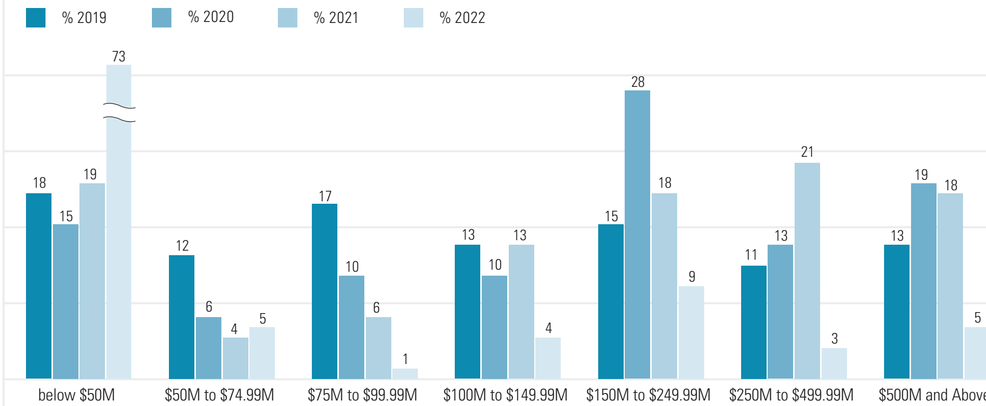
The percentage of "broken" IPOs (in which the stock closes below the offering price on the first trading day) rose from 25% in 2021 to 37% in 2022, the highest level since 2008, when almost two-thirds of the year's IPOs were broken. A higher percentage of 2022 life sciences IPOs (43%) than non–life sciences IPOs (34%) were broken.

IPO companies ended 2022 trading a median of 55% below their offering price, making the median decline of 19% for IPO companies in 2021 look moderate in comparison. The aftermarket performance of IPO companies in 2022 was the worst in recent history, outpacing the median decline of 42% in 2008.

The year's best-performing IPOs were by Belite Bio (trading 402% above its offering price at year-end), Arcellx (107%), Amylyx Pharmaceuticals (94%) and Mobileye Global (67%).

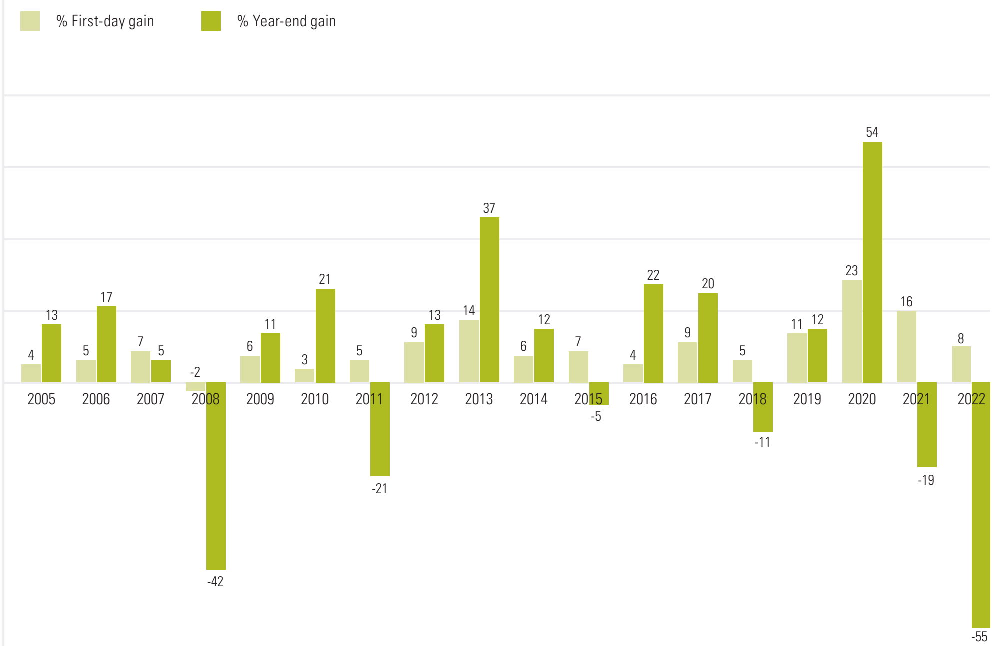
At the end of 2022, 80% of the year's IPO companies were trading below their offering price—up from the 64% in the same position at year-end in 2021. The 2022 result was the worst for this metric since

Distribution of IPO Offering Size – 2019 to 2022

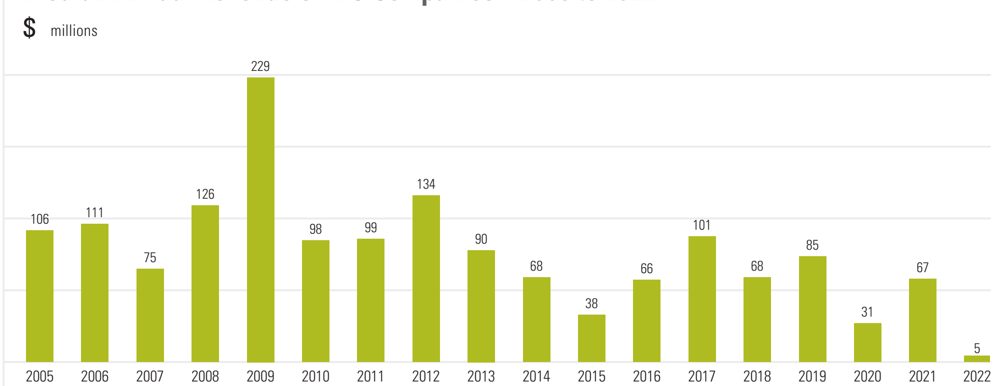


Source: SEC filings

Median IPO First-Day and Year-End Gain by Year – 2005 to 2022



Median Annual Revenue of IPO Companies – 2005 to 2022



Source: SEC filings and IPO Vital Signs

2008, when 81% of IPO companies ended the year trading below their offering price.

Life sciences companies fared marginally better than their non–life sciences counterparts, with 74% trading below their offering price at year-end, compared to 82% of other companies.

Individual components of the IPO market fared as follows in 2022:

— ***VC-Backed IPOs:*** The number of IPOs by VC-backed US issuers suffered a steep decline, dropping from 157 in 2021 to 20 in 2022—the lowest annual figure since 2009. The market share of this segment contracted for the fourth consecutive year, from 56% in 2021 to 42% in 2022, reflecting the proliferation of smaller IPOs by non–VC-backed companies. The median offering size for US-issuer VC-backed IPOs in 2022 was $52.3 million, less than one-third of the $176.0 million median in 2021 and well below the $120.0 million over the five-year period from 2016 to 2020. At year-end, US-issuer VC-backed IPO companies were trading down a median of 23% from their offering price.

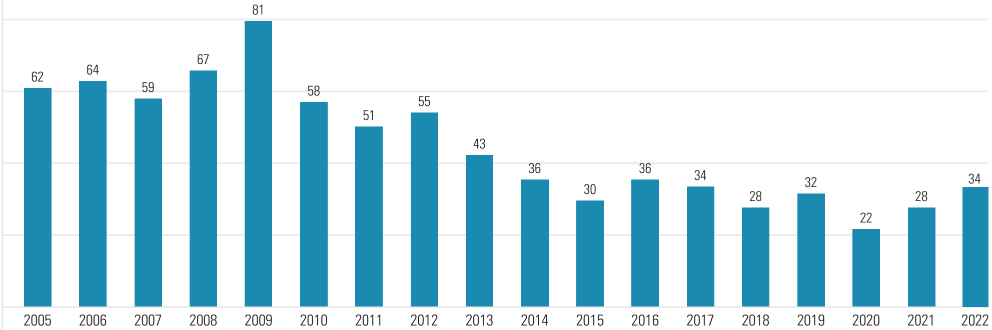
— ***PE-Backed IPOs:*** After almost tripling from 30 in 2020 to 86 in 2021, the number of private equity–backed IPOs shrank to just two in 2022. PE-backed issuers accounted for 4% of all US-issuer IPOs in 2022, compared to 31% in 2021 and 19% over the five-year period from 2016 to 2020. The median offering size for PE-backed IPOs in 2022 was $336.0 million, nearly equal to the $335.9 million in 2021 and 8% higher than the $310.0 million median over the five-year period from 2016 to 2020. PE-backed IPO companies ended the year a median of 14% above their offering price.

DIRECT LISTINGS

A "direct listing," in which a private company files a registration statement to register the resale of outstanding shares and concurrently lists its shares on a stock exchange, provides an alternative path to public ownership and liquidity. There was a single direct listing in 2022, down from six in 2021 and the lowest annual count since 2018—the year of the first direct listing.

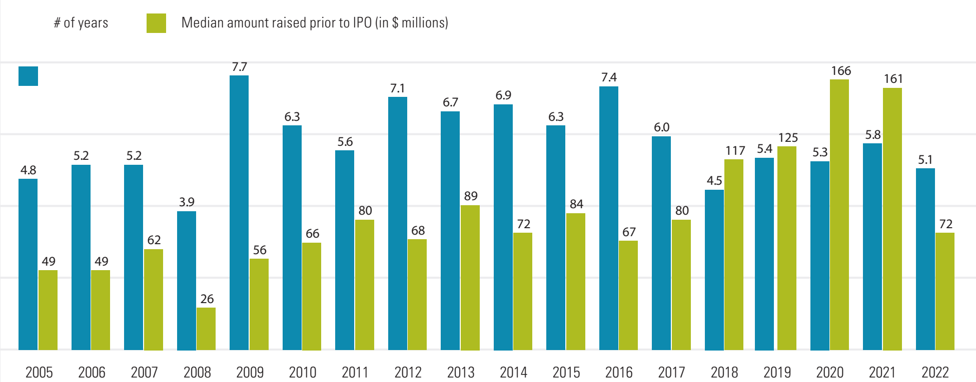
Percentage of Profitable IPO Companies – 2005 to 2022

%



Source: SEC filings and IPO Vital Signs

Median Time to IPO and Median Amount Raised Prior to IPO – 2005 to 2022



Source: PitchBook

— ***Life Sciences IPOs:*** There were 23 life sciences company IPOs in 2022—the lowest annual tally in the last 10 years—down from 138 in 2021. The life sciences company share of the IPO market was 29% in 2022, down from 36% in 2021 and 41% for the five-year period from 2016 to 2020. At $36.0 million, the median offering size for life sciences IPOs in 2022 was 71% lower than the $125.9 million in 2021. At year-end, life sciences IPO companies were trading a median of 23% below their offering price, compared to the median loss of 66% for non–life sciences IPO companies.

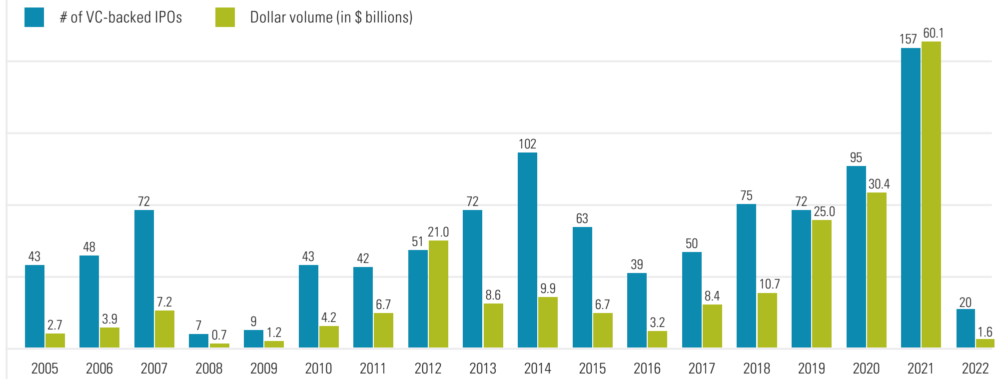
— ***Tech IPOs:*** Deal flow in the technology sector declined to 25 IPOs in 2022 from 148 IPOs in 2021, ending six consecutive years of growth. The tech sector's share of the US IPO market declined to 32% in 2022, from 39% in 2021, but equaled the sector's market share over the five-year period from 2016 to 2020. The median offering size for tech IPOs in 2022 was $15.0 million, compared to $322.5 million in 2021. Tech IPO companies ended the year a median of 71% below their offering price.

— ***Foreign-Issuer IPOs:*** The number of US IPOs by foreign issuers decreased from 100 in 2021 to 31 in 2022. Foreign-issuer IPOs accounted for 39% of the market in 2022, representing an increase from the 26% in 2021 and their highest share of the US market since the 40% in 2010. Among foreign issuers, companies from China led the year with nine IPOs, followed by companies from Hong Kong (with six IPOs) and Canada (with five IPOs). Foreign-issuer IPO companies ended the year down a median of 69% from their offering price.

US Market Review and Outlook

In 2022, 26 companies based in the eastern United States (east of the Mississippi River) completed IPOs, compared to 22 western US–based issuers. California led the state rankings with 11 IPOs, followed by Massachusetts (eight IPOs), Texas (five IPOs) and Florida and New York (each with four IPOs).

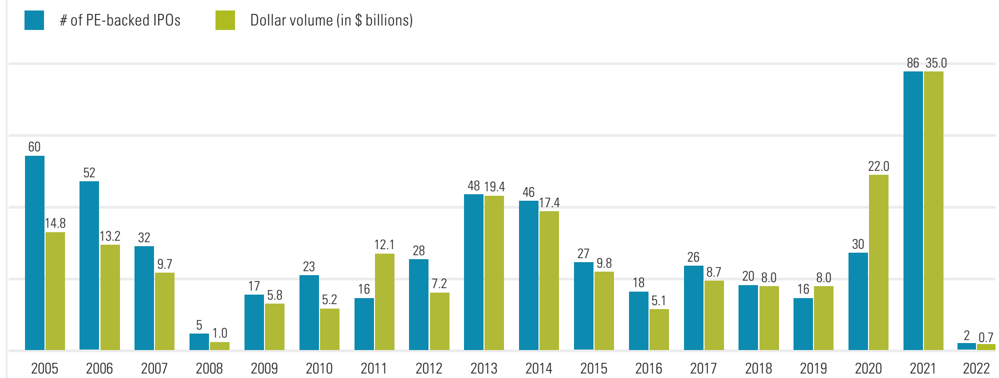
Venture Capital–Backed IPOs – 2005 to 2022



Source: SEC filings

Based on US IPOs by VC-backed US issuers

Private Equity–Backed IPOs – 2005 to 2022



Source: Refinitiv and SEC filings
Based on US IPOs by PE-backed US issuers

OUTLOOK

IPO market activity in the coming year will depend on a number of factors, including the following:

— ***Economic Growth:*** After declining in the first two quarters of 2022, US GDP rebounded to produce full-year growth of 2.1%, down from 5.9% in the prior year. The labor market remained surprisingly resilient in 2022, although the spate of big-tech layoffs in early 2023 suggests softening labor conditions in some sectors. If strong job growth and rising wages continue in the coming year, they are likely to complicate the Fed's ongoing efforts to curtail inflation. Faltering growth or even recessionary conditions, as predicted by many observers, would dampen enthusiasm for new offerings in 2023.

— ***Capital Market Conditions:*** Market turbulence persisted throughout 2022. Down at one point by over 20%, the Dow rallied in the fourth quarter to trim the year's decline to 9%. The tech-heavy Nasdaq Composite Index fared less well, ending the year down 33% (although it is up almost 10% through the first two months of 2023). The S&P 500 declined 19% for the year. Stabilization of the capital markets in 2023 would likely contribute to an uptick in IPO flow.

— ***Venture Capital Pipeline:*** Although the overall level of venture capital investment declined from $345.3 billion in 2021 to $240.0 billion in 2022, more than 500 VC-backed companies raised rounds of at least $100 million in 2022. The continuing ability of many VC-backed companies to raise private "IPO-sized" rounds gives them the flexibility to delay their public debuts until market conditions are more favorable. However, the effects of the stunning collapse of Silicon Valley Bank in March 2023—the dominant banking player in the venture capital ecosystem—on VC-backed companies and venture capital financing and liquidity activity more broadly remain to be seen. Nevertheless, following a poor year for IPO exits, investor demands for liquidity will likely push the most attractive IPO candidates to test the public market at the earliest opportunity in 2023.

— ***Private Equity Impact:*** While PE-backed companies largely stayed on the sidelines of the IPO market in 2022, fundraising nearly matched the prior year. In 2022, US private equity firms raised $528.4 billion, compared to $534.6 billion in 2021. The enormous amount of "dry powder" that private equity firms are seeking to deploy and the present uncertainty around the timing and extent of IPO deal flow may pose challenges for them in the coming year.

The IPO market enters 2023 facing continued headwinds. The IPO pipeline contains a wide array of qualified companies but it may take time for market conditions to improve sufficiently to see a significant resumption in deal flow. ■

SPAC IPOS

In 2022, there were 86 SPAC IPOs with total gross proceeds of $12.0 billion, a dramatic drop from the 613 SPAC IPOs with total gross proceeds of $144.5 billion in 2021. The first quarter of 2022 accounted for about two-thirds of the year's activity, with 55 SPAC IPOs raising $9.0 billion. The number of SPAC IPOs fell sharply to 15 in the second quarter and declined further to eight in both the third and fourth quarters, the lowest quarterly totals since the first quarter of 2017. Despite its overall contraction, the SPAC IPO market outpaced conventional IPO market deal flow for the third consecutive year and achieved higher gross proceeds for the second consecutive year.

CALIFORNIA

IPO activity by California-based companies plunged in 2022. The state's IPO count dropped from 97 in 2021 to 11, the lowest annual total since 2008–2009, when California produced a total of nine IPOs during the Great Recession.

Gross proceeds plummeted from a record annual high of $47.3 billion in 2021 to just $209.7 million in 2022. After producing 11 billion-dollar offerings in 2021, California saw only two IPOs with proceeds in excess of $25 million in 2022—AN2 Therapeutics ($69 million) and Belite Bio ($36 million).

Technology and life sciences companies accounted for 73% of the state's IPO total in 2022—down modestly from their 78% share in 2021 and well below their 88% share in the five-year period between 2016 and 2020.

The number of VC-backed California IPOs fell from 69 in 2021 to six in 2022. The 2022 tally represents 30% of all US-issuer VC-backed IPOs, down by nearly a third from the state's 44% share in 2021 and the 43% share that prevailed during the five-year period from 2016 to 2020.

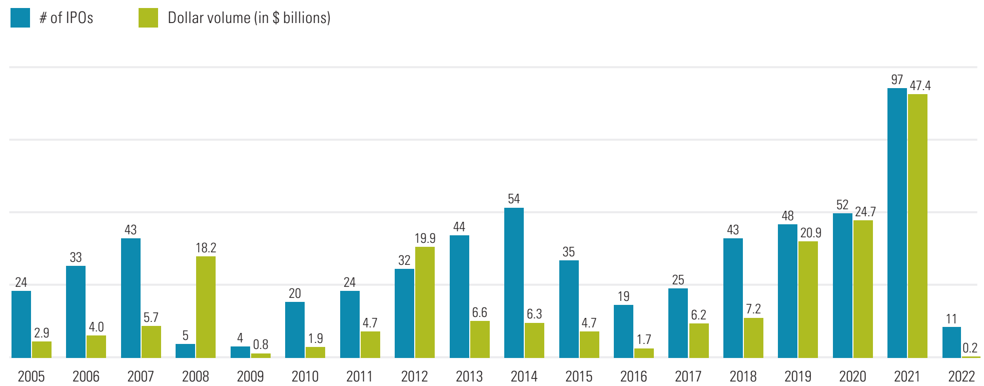
California IPO companies produced a median first-day gain of 3% in 2022. Surgical implant maker Tenon Medical was the state's top performer, with a first-day gain of 350%, followed by Mobile Global Esports (up 180%), Belite Bio (up 77%) and Hempacco (up 30%).

At year-end, California IPO companies were trading down a median of 71% from their offering price, with only 18% of California IPO companies trading above their offering price.

The best-performing California IPOs of the year were Belite Bio (the top performer in the country, up 402% at year-end) and Loop Media (up 32%).

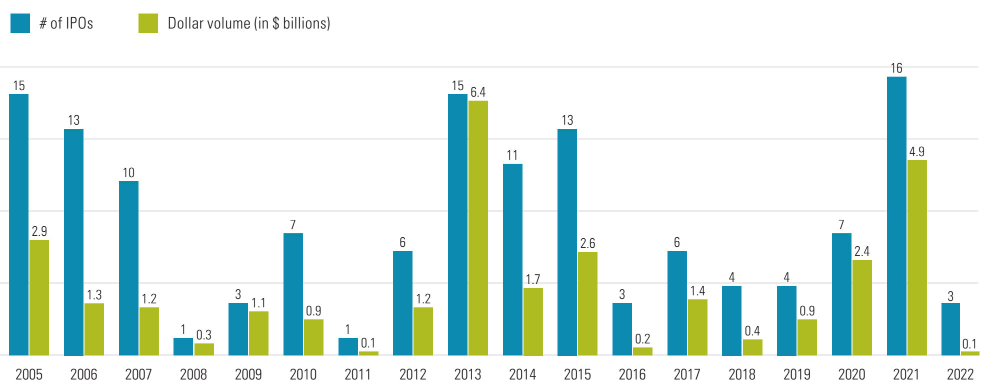
With the largest pool of VC-backed companies in the United States and a wealth of entrepreneurial talent, California should remain a major source of strong IPO candidates in the coming year, with deal flow dependent on market conditions.

California IPOs – 2005 to 2022



Source: SEC filings

Mid-Atlantic IPOs – 2005 to 2022



Source: SEC filings

MID-ATLANTIC

The mid-Atlantic region of Virginia, Maryland, North Carolina, Delaware and the District of Columbia produced just a trio of IPOs in 2022, down sharply from 16 IPOs in 2021 and tied for the region's third-lowest annual tally since 2008.

Maryland accounted for all of the region's IPOs in 2022, marking the first time in more than 25 years that both North Carolina and Virginia sat on the IPO sidelines.

After doubling each year from 2018 to 2021, gross proceeds in the mid-Atlantic region nosedived, falling from $4.9 billion in 2021 to $130.8 million in 2022 as deal flow and offering sizes contracted.

The largest mid-Atlantic IPO of 2022 came from clinical-stage biopharmaceutical company Arcellx, with proceeds of $124 million. Bucking nationwide trends, Arcellx enjoyed a first-day gain of 12% and ended the year trading at more than twice its offering price.

The region's other two IPOs in 2022 were by micro-cap companies. Both declined from their offering price in first-day trading and dropped further by year-end. Overall, mid-Atlantic IPO companies were trading a median of 37% below their offering price at the end of 2022.

The region's traditional strengths in the life sciences, technology, financial services and defense sectors should continue to produce attractive IPO candidates as market conditions improve.

NEW ENGLAND

The number of New England IPOs slumped from 34 in 2021 to eight in 2022.

Massachusetts produced all of the region's IPOs in 2022—accounting for the second-highest state total in the country for the ninth time in the past 10 years.

Gross proceeds in the region, after tripling between 2019 and 2020 and increasing further to $6.5 billion in 2021, declined to $1.2 billion in 2022.

The largest New England IPO in 2022 was by HilleVax ($200 million), followed by CinCor Pharma ($194 million) and Amylyx Pharmaceuticals ($190 million).

The life sciences sector contributed all eight of the region's 2022 IPOs, down from 27 in the prior year. The region's share of all US-issuer life sciences IPOs in the country increased from 25% to 40%, well above the 31% that prevailed over the five-year period from 2016 to 2020.

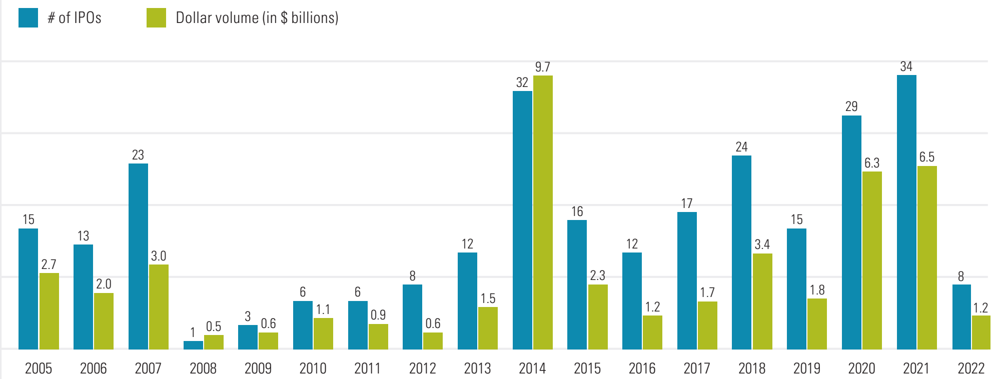
All of New England's 2022 IPOs came from VC-backed companies. The region accounted for 40% of all US-issuer VC-backed IPOs in 2022, up from 19% in 2021 and from its 25% share over the five-year period from 2016 to 2020.

New England IPO companies produced a median first-day gain of 4% in 2022. The region's top performers in first-day trading were Acrivon Therapeutics (up 33% from its offering price), Third Harmonic Bio (up 16%) and HilleVax (up 12%).

At year-end, New England's 2022 IPO companies were trading down a median of 5% from their offering price, with only 37% of the region's IPO companies trading above their offering price. The best-performing New England IPOs at year-end were Amylyx Pharmaceuticals (up 94%), PepGen (up 11%) and Prime Medicine (up 9%).

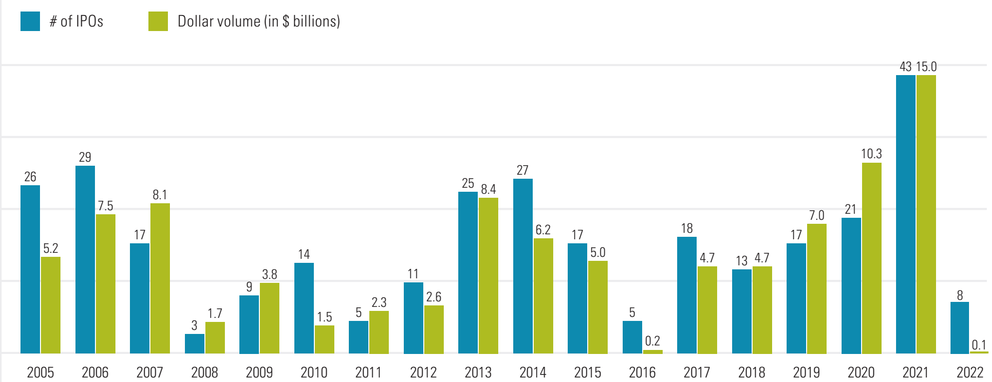
With the region's world-renowned universities and research institutions continuing to spawn tech and life sciences companies, and with strong levels of venture capital investment, New England should continue to generate compelling IPO candidates in the coming year, with the pace of deal flow dependent on market conditions.

New England IPOs – 2005 to 2022



Source: SEC filings

Tri-State IPOs – 2005 to 2022



Source: SEC filings

TRI-STATE

The number of IPOs in the tri-state region of New York, New Jersey and Pennsylvania dropped from 43 in 2021 to eight in 2022.

New York produced four of the region's 2022 IPOs (down from 33 in 2021), while New Jersey and Pennsylvania each accounted for two.

Gross proceeds from tri-state IPOs slid from $15.0 billion in 2021 to just $145.2 million in 2022.

After producing 20 VC-backed IPOs in 2021, the tri-state region produced only two in 2022—the $16 million IPO of New Jersey–based Nuvectis Pharma and the $7 million IPO of Pennsylvania-based Lipella Pharmaceuticals.

Tri-state IPO companies in 2022 declined a median of 9% in first-day trading.

Only two of the region's IPO companies ended their first day of trading above their offering price, led by New York–headquartered Treasure Global with a first-day gain of 345%.

At year-end, tri-state IPO companies were down a median of 24% from their offering price. The best-performing tri-state IPO was by Nuvectis Pharma (up 50% from its offering price at year-end), followed by Arena Group Holdings (up 29%) and LINKBANCORP (up 25%).

With its high level of venture capital activity and its sophisticated capital markets ecosystem, the tri-state region can be expected to produce IPOs from emerging life sciences and technology companies and larger, private equity–backed companies when market conditions improve. ■

PROFILE OF SUCCESSFUL IPO CANDIDATES

What does it really take to go public? There is no single profile of a successful IPO company but, in general, the most attractive candidates share the following attributes:

- **Outstanding Management:** An investment truism is that investors invest in people, and this is even truer for IPO companies. Every company going public needs experienced and talented management with high integrity, a vision for the future, lots of energy to withstand the rigors of the IPO process and public company life, and a proven ability to execute. An IPO is not the best time for a fledgling CEO or CFO to cut their teeth.
- **Market Differentiation:** IPO candidates need a superior technology, product or service in a large and growing market. Ideally, they are viewed as market leaders. Appropriate intellectual property protection is expected of technology companies, and in some sectors, such as life sciences and medical devices, patents are de rigueur.
- **Substantial Revenue:** Substantial revenue is generally expected—at least $50 million to $75 million annually—in order to provide a platform for attractive levels of profitability and market capitalization.
- **Revenue Growth:** Consistent and strong revenue growth—25% or more annually—is usually needed, unless the company has other compelling features. The company should have visibility into sustained expansion to avoid the market punishment that can accompany revenue or earnings surprises.
- **Profitability:** Strong IPO candidates generally have track records of earnings and a demonstrated ability to enhance margins over time, although IPO investors often appear to value growth more highly than near-term profitability.
- **Market Capitalization:** The company's potential market capitalization should be at least $200 million to $250 million, in order to facilitate development of a liquid trading market. Substantial post-IPO ownership by insiders may mean a larger market cap is required to provide ample float.

Other factors can vary based on a company's industry and size. For example, many life sciences companies will have much smaller revenue and not be profitable. More mature companies are likely to have greater revenue and market caps but slower growth rates. High growth companies are likely to be smaller and usually have a shorter history of profitability.

Beyond these objective measures, IPO candidates need to be ready for public ownership in a range of other areas, including accounting preparation; corporate governance; financial and disclosure controls and procedures; external communications; legal and regulatory compliance; and a variety of corporate housekeeping tasks. ■

HOW DO YOU COMPARE?

The characteristics of the IPO market in 2022 were significantly different than in the preceding three years. In 2022, deal flow fell by more than two-thirds, offering sizes were much smaller and IPO companies had far less annual revenue. US-incorporated issuers completing US IPOs in 2022 were significantly less likely to include selling stockholders, utilize a directed share program or engage a "Big 4" accounting firm, and their IPOs generally received more SEC comments and took longer to complete.

METRIC	2019–2021	2022
Annual number of IPOs	249	79
IPO companies qualifying as EGCs under JOBS Act	92%	87%
Median offering size	$163.9 million (18% < $50 million and 17% > $500 million)	$17.6 million (73% < $50 million and 5% > $500 million)
Median annual revenue of IPO companies	$59.0 million (48% < $50 million and 15% > $500 million)	$4.7 million (80% < $50 million and 8% > $500 million)
IPO companies that are profitable	27%	34%
Percentage of IPOs with selling stockholders and median percentage of offering represented by those shares	Percentage of IPOs—20% Percentage of offering—32%	Percentage of IPOs—6% Percentage of offering—16%
IPOs with directed share programs (median percentage of offering represented by directed shares was 5% for both periods)	44%	22%
IPO companies using a "Big 4" accounting firm	74%	27%
Stock exchange on which the company's common stock is listed	Nasdaq—78% NYSE—22%	Nasdaq—88% NYSE—12%
Median underwriting discount	7%	7%
Number of SEC comments contained in initial comment letter	Median—16 25th percentile—12 75th percentile—21	Median—21 25th percentile—17 75th percentile—25
Median number of Form S-1 amendments filed before effectiveness	Four	Six
Number of days from initial submission to effectiveness of Form S-1	Median—104 25th percentile—83 75th percentile—158	Median—216 25th percentile—133 75th percentile—271

The cornerstone of the JOBS Act is the creation of an "IPO on-ramp" that provides "emerging growth companies" (EGCs) with a phase-in period, which can continue until the last day of the fiscal year following the fifth anniversary of an IPO, to come into full compliance with certain disclosure and accounting requirements. Although the overwhelming majority of all IPO candidates qualify as EGCs, different items of EGC relief are being adopted at different rates, with some additional variation among types of IPO companies.

The prevalence of elections for some items of EGC relief—such as the ability to submit a draft Form S-1 registration statement for confidential SEC review and to provide reduced executive compensation disclosure—has remained consistently high across different types of EGCs.

Practices with respect to other items of relief—particularly those related to financial disclosure and the application of new or revised accounting standards—have varied, often reflecting the company's size, maturity or industry, and have exhibited strong trends over time as investor expectations and market practices have evolved.

CONFIDENTIAL SUBMISSION OF FORM S-1

— *Description:* An EGC is able to submit a draft Form S-1 registration statement to the SEC for confidential review instead of filing it publicly on the SEC's EDGAR system (and in 2017, a similar process became available to all companies going public). A confidentially submitted Form S-1 need not be filed publicly until 15 days before the road show commences, enabling an EGC to delay disclosure of sensitive information to competitors and employees. Confidential review can also enable an EGC to abandon its IPO plans without any public disclosure at all if market conditions preclude an offering.

— *Trends:* Overall rates of adoption have consistently remained very high—96% of all EGCs since enactment of the JOBS Act in 2012.

REDUCED EXECUTIVE COMPENSATION DISCLOSURE

— *Description:* An EGC need not provide Compensation Discussion and Analysis (CD&A); compensation information is required only for three named executive officers (including the CEO); and only three of the seven compensation tables otherwise required must be provided.

— *Trends:* EGCs have uniformly and overwhelmingly embraced the ability to provide reduced executive compensation disclosure. Overall, 99% of all EGCs (including all EGCs since 2020) have excluded CD&A from their Form S-1.

REDUCED FINANCIAL DISCLOSURE

— *Description:* An EGC must provide only two years of audited financial statements (instead of three years), plus unaudited interim financial statements, and is only required to include MD&A for the periods presented in the required financial statements.

— *Trends:* Overall, the percentage of EGCs electing to provide only two years of audited financial statements has increased dramatically, from 27% in 2012 to 95% in 2022. From the outset, life sciences companies—for which older financial information is often irrelevant—were very likely to provide two years of audited financial statements, with the percentage choosing this option reaching 100% in 2022. Technology companies—which generally have substantial revenue and often have profitable operations—have been slower to adopt this practice, but the percentage providing two years of audited financial statements grew from 22% in 2012 to 91% in 2022.

Two Years of Audited Financial Statements

	2012–2016	2017–2019	2020–2022	Overall
Life Sciences	87%	97%	98%	94%
Technology	37%	63%	88%	64%
All EGCs	65%	84%	94%	80%

ACCOUNTING STANDARDS ELECTION

— *Description:* EGCs may elect not to be subject to any accounting standards that are adopted or revised on or after April 5, 2012, until these standards are required to be applied to nonpublic companies.

— *Trends:* Through 2016, the vast majority of EGCs opted out of the extension of time to comply with new or revised accounting standards. During this time period, the decision appears to have been motivated by the uncertain value of the deferred application of future, unknown accounting standards and concerns that a company's election to take advantage of the extended transition period could make it more difficult for investors to compare its financial statements to those of its peers. Since then, a major shift has occurred, with the percentage of EGCs adopting the extended transition period jumping from 11% for the period through 2016 to 50% between 2017 and 2019 and to 92% between 2020 and 2022. This change in behavior appears to have been motivated by the desire of many EGCs to delay the application of new revenue recognition and lease accounting standards (which became mandatory for public companies in 2018–2019) or, at a minimum, to take more time to evaluate the effects of these standards before adopting them. ■

Delayed Application of New or Revised Accounting Standards

	2012–2016	2017–2019	2020–2022	Overall
Life Sciences	10%	45%	92%	50%
Technology	12%	62%	93%	56%
All EGCs	11%	50%	92%	51%

EXITING EGC STATUS

In many cases, a company exiting EGC status qualifies as a "smaller reporting company" (SRC) under SEC rules and can continue to enjoy most of the disclosure and financial reporting accommodations that are available to EGCs. Please see pages 10–11 for discussion of the most significant disclosure and financial reporting consequences from the loss of EGC or SRC status.

One of the most successful efforts to encourage capital formation as an engine of economic growth was the passage of the JOBS Act in 2012. The JOBS Act created an "IPO on-ramp" to provide "emerging growth companies" (EGCs) with a phase-in period for coming into full compliance with the disclosure and financial reporting obligations applicable to more mature public companies. The phase-in period can run until the last day of the fiscal year following the fifth anniversary of the completion of a company's IPO.

This on-ramp has been well traversed. Since enactment of the JOBS Act, the overwhelming majority of companies completing IPOs have qualified as EGCs and availed themselves of at least some of the disclosure and reporting relief provided by the on-ramp. Many EGCs have, however, found themselves taking an off-ramp sooner than anticipated because they cease to qualify as an EGC due to revenue growth or an increased public float.

Often, a company exiting EGC status experiences only a gradual increase in its disclosure and reporting burden because it qualifies as a "smaller reporting company" (SRC) under SEC rules. SRCs enjoy most of the disclosure and financial reporting accommodations that are available to EGCs as well as relief from several other disclosure obligations. More than 40% of all US public companies can qualify as an SRC, in part because of SEC rule amendments that became effective in late 2018.

The chart on page 11 summarizes the most significant disclosure and financial reporting consequences from the loss of EGC or SRC status. A company losing both EGC and SRC status should understand the impact of each status change on its disclosure and financial reporting obligations.

LOSS OF EGC AND/OR SRC STATUS

Eligibility for treatment as an EGC and/or SRC is lost under the following circumstances:

Emerging Growth Company

A company ceases to be an EGC if the company:

— has total annual gross revenues of $1.235 billion or more in any fiscal year (subject to adjustment every five years for inflation, with the next adjustment due in April 2027);

— has issued more than $1.0 billion in non-convertible debt securities at any point in the past three years; or

— becomes a "large accelerated filer" (a company that, as of the end of any fiscal year, has a public float of at least $700 million (measured as of the last business day of its second fiscal quarter of that year), has been subject to the Exchange Act for at least 12 calendar months, and has filed at least one Form 10-K).

Smaller Reporting Company

A company ceases to be an SRC if, as of the last business day of its most recently completed second fiscal quarter, it:

— had annual revenues of $100 million or more in its most recent fiscal year and a public float of $250 million or more; or

— had annual revenue of less than $100 million in its most recent fiscal year but had a public float of $700 million or more.

MONITORING EGC AND SRC STATUS

The events that cause a company to lose its status as an EGC and/or an SRC are well defined, and the transition from the EGC/SRC reporting regime can be abrupt and disruptive absent appropriate advance planning. A company should monitor its EGC/SRC status and begin preparing for the disclosure and financial reporting requirements that will become applicable to it upon the loss of such status well in advance of the event that will make it ineligible for treatment as an EGC and/or SRC.

Emerging Growth Company

— Prior to any non-convertible debt issuance, the company should determine whether, upon closing, it will have issued more than $1.0 billion in non-convertible debt securities in the past three years.

— At the end of the second fiscal quarter of each year, the company should calculate its public float.

— At the end of the third fiscal quarter of each year, the company should evaluate whether it expects to have total annual gross revenues of $1.235 billion or more for that year.

Smaller Reporting Company

— At the end of the second fiscal quarter of each year, the company should calculate its public float.

— At the end of each fiscal year, the company should determine whether it had annual revenue of $100 million or more for that year.

EGC and SRC status are determined separately and many companies exiting EGC status will remain an SRC, preserving many of the benefits of EGC status. ■

EGC ELECTIONS

Based on IPOs completed by EGCs through 2022, below are the rates of adoption with respect to several key items of EGC relief:

Item of Relief	Life Sciences	Technology	Other Sectors	Overall
Confidential submission of Form S-1	98%	95%	92%	96%
Two years of audited financial statements (instead of three years)	94%	64%	75%	80%
Omission of CD&A	100%	99%	98%	99%
Delayed application of new or revised accounting standards	49%	56%	46%	51%

PRINCIPAL CONSEQUENCES OF LOSS OF EGC AND/OR SRC STATUS		
Requirement Subject to Accommodation	**Loss of EGC Status by a Non-SRC**	**Loss of SRC Status by a Non-EGC**
Financial Statement, MD&A and Audit Requirements		
Three Years of Audited Financials and Corresponding MD&A Disclosure in Form 10-K	No change	May no longer comply with the modified financial statement requirements applicable to SRCs Now required to present three years of audited financials and corresponding MD&A disclosure
Auditor's Opinion on Effectiveness of Internal Control over Financial Reporting (ICFR)	The company's next Form 10-K must include an audit report on the effectiveness of the company's ICFR	No change* *If the company was previously an SRC and a non-accelerated filer, the company's next Form 10-K must include an audit report on the effectiveness of the company's ICFR
Compliance with New or Revised Accounting Standards Issued by FASB	No longer permitted to postpone compliance with accounting standards that are adopted or revised by FASB after April 5, 2012, unless and until these standards are required to be applied to non-public companies	No change
Executive Compensation and Corporate Governance Disclosure Requirements		
Executive Compensation Disclosure	*Expansion of existing disclosure requirements:* — Must add an additional year of summary compensation table information — Increases the number of named executive officers for whom disclosure is required to include the company's principal financial officer and an additional most highly compensated executive officer *New disclosure requirements:* — Compensation discussion and analysis (CD&A) — Compensation committee report — Grants of plan-based awards table — Option exercises and stock vested table — Pension benefits table — Change in present value of pension benefits — Nonqualified deferred compensation table — Quantification of potential payouts upon termination or change in control — CEO pay ratio — Compensation policies as related to risk management — Pay-versus-performance disclosure	*Expansion of existing disclosure requirements:* — Must add an additional year of summary compensation table information — Increases the number of named executive officers for whom disclosure is required to include the company's principal financial officer and an additional most highly compensated executive officer — Must provide more extensive pay-versus-performance disclosure *New disclosure requirements:* — Compensation discussion and analysis (CD&A) — Compensation committee report — Grants of plan-based awards table — Option exercises and stock vested table — Pension benefits table — Change in present value of pension benefits — Nonqualified deferred compensation table — Quantification of potential payouts upon termination or change in control — CEO pay ratio — Compensation policies as related to risk management
Additional Proxy Votes Say-on-Pay Say-on-Frequency Say-on-Golden Parachutes	Must begin to hold say-on-pay and say-on-frequency votes no later than (i) three years after the company's IPO, if the company was an EGC for less than two years after completing its IPO, and (ii) one year after losing EGC status for all other EGCs. Must hold say-on-golden parachutes vote if seeking stockholder approval of a merger or acquisition transaction.	No change
Other Disclosure Requirements		
Disclosure of Quantitative and Qualitative Description of Market Risk	No change	Must provide quantitative and qualitative disclosures related to derivatives and exposures to market risk from derivative financial instruments, other financial instruments and certain derivative commodity instruments in each periodic report
Description of the Company's Business	No change	Must include a more fulsome description of business in Form 10-K
Stock Performance Graph	No change	Must provide a stock performance graph beginning with its next annual report to stockholders

Counsel of Choice for Capital Markets Transactions

Serving market leaders in technology, life sciences, financial services and a wide variety of other industries

verve THERAPEUTICS
Initial Public Offering of Common Stock
$306,682,000
July 2021
Public Offering of Common Stock
$258,750,000
July 2022
Counsel to Issuer

SYROS
PIPE Placement of Common Stock and Pre-Funded Warrants
$130,000,000
September 2022
Counsel to Issuer

Medtronic
Public Offering of Senior Notes
$2,000,000,000
March 2023
Counsel to Issuer

dynatrace
Public Offering of Common Stock
$677,250,000
February 2023
Counsel to Underwriter

xilio THERAPEUTICS
Initial Public Offering of Common Stock
$129,906,000
October 2021
Counsel to Issuer

TechTarget
Rule 144A Placement of Convertible Senior Notes
$414,000,000
December 2021
Counsel to Issuer

CINCOR
Initial Public Offering of Common Stock
$212,653,000
January 2022
Public Offering of Common Stock and Pre-Funded Warrants
$258,750,000
August 2022
Counsel to Underwriters

IVERIC BIO
Public Offerings of Common Stock
$288,581,000
July and October 2021
$345,431,250
December 2022
Counsel to Issuer

ThermoFisher SCIENTIFIC
Public Offerings of Senior Notes
¥110,100,000,000
October 2022
€1,250,000,000
$1,200,000,000
November 2022
Counsel to Issuer

trevi THERAPEUTICS
Public Offering of Common Stock and Pre-Funded Warrants
$58,079,500
September 2022
Counsel to Issuer

Decibel THERAPEUTICS
Initial Public Offering of Common Stock
$137,916,000
February 2021
Counsel to Issuer

ARCELLX
Initial Public Offering of Common Stock
$142,312,500
February 2022
Public Offering of Common Stock
$128,800,000
June 2022
Counsel to Underwriters

Fulcrum Therapeutics
Public Offerings of Common Stock
$194,810,000
January and August 2021
Counsel to Issuer

DANAHER
Public Offering of Senior Notes
$1,000,000,000
December 2021
Counsel to Issuer

KYMERA
Public Offering of Common Stock
$257,008,000
July 2021
Counsel to Underwriters

inozyme pharma
Public Offering of Common Stock and Pre-Funded Warrants
$73,061,500
April 2022
Counsel to Issuer

CoNCERT
Public Offering of Common Stock
$54,625,000
June 2022
Counsel to Underwriters

Karyopharm Therapeutics
PIPE Placement of Common Stock and Warrants
$165,000,000
December 2022
Counsel to Issuer

Apellis
Public Offering of Common Stock and Pre-Funded Warrants
$402,500,000
March 2023
Counsel to Issuer

cue
Initial Public Offering of Common Stock
$230,000,000
September 2021
Counsel to Issuer

PerkinElmer For the Better
Public Offerings of Senior Notes
$3,100,000,000
March and September 2021
Counsel to Issuer

ICOSAVAX
Initial Public Offering of Common Stock
$209,300,000
August 2021
Counsel to Underwriters

Nuvalent
Public Offering of Common Stock
$264,500,000
November 2022
Counsel to Issuer

ANALOG DEVICES
Public Offerings of Senior Notes
$4,000,000,000
(including $750,000,000 of sustainability-linked notes)
October 2021
$300,000,000
September 2022
Counsel to Issuer

astria THERAPEUTICS
Public Offering of Common Stock
$115,000,000
December 2022
Counsel to Issuer

STATE STREET
Public Offerings of Senior Notes
$5,000,000,000
February, May, August and November 2022 and January 2023
Counsel to Issuer

MicroStrategy
Rule 144A Placements of Convertible Senior Notes
$1,050,000,000
February 2021
Senior Secured Notes
$500,000,000
June 2021
Counsel to Issuer

AMYLYX
Initial Public Offering of Common Stock
$216,018,000
January 2022
Public Offering of Common Stock
$246,330,000
October 2022
Counsel to Underwriters

Epizyme
Public Offering of Common Stock
$85,000,000
January 2022
Counsel to Issuer

THESEUS
Initial Public Offering of Common Stock
$178,755,000
October 2021
Counsel to Underwriters

LSB INDUSTRIES
Public Offerings of Common Stock
$406,796,250
August and November 2022
Counsel to Selling Stockholders

VIRIDIAN
Public Offerings of Common Stock and Preferred Stock
$97,750,000
September 2021
$310,787,500
August 2022
Counsel to Underwriters

Werewolf THERAPEUTICS
Initial Public Offering of Common Stock
$120,000,000
May 2021
Counsel to Issuer

S&P Global
Rule 144A Placement of Senior Notes
$5,500,000,000
(including $1,250,000,000 of sustainability-linked notes)
March 2022
Counsel to Issuer

In recent years, a variety of alternative paths to public ownership and trading liquidity have emerged. The reverse merger is both one of the newest and among the oldest alternatives to a conventional IPO for a private company seeking to become publicly traded.

BACKGROUND

In a "reverse merger," a private company merges with and into a publicly traded company, with the combined company remaining publicly held. The mechanism is referred to as a "reverse" merger because, as a practical matter, the private company acquires the public company, with the pre-merger stockholders of the private company owning a majority of the stock of the combined company, even though the public company is nominally the legal acquirer.

Reverse mergers have a long and often ignominious history. Going back decades, promoters have formed and peddled unlisted shell companies to unsophisticated private companies as a quick means to public ownership. This type of reverse merger generally results in a company that bears the burden and expense of being public but has unsatisfactory trading liquidity, no meaningful access to the public capital markets and an inability to attract institutional investors.

THE NEW REVERSE MERGER

Despite some abuses of the technique, reverse mergers remain a legitimate transaction structure for smaller private companies with significant cash needs in high-risk industries, such as life sciences, that lack the financial profile or other attributes demanded by the IPO market. Public companies that are attractive reverse merger candidates typically have the following attributes:

— material net cash, replicating the proceeds that would be raised in a traditional IPO;

— limited operations, and limited and known liabilities;

— given its stockholder base, a reasonably high degree of confidence that it can deliver the requisite stockholder votes to approve the transaction; and

— a national securities exchange listing (preferably Nasdaq or the NYSE) that will remain following completion of the transaction.

When their valuations decline significantly or their business plans falter, public companies may become suitable reverse merger candidates. Since the fourth quarter of 2021, the number of such candidates has grown dramatically as more and more life sciences companies find themselves trading at valuations below their cash in hand.

This trend, coupled with challenging conditions in the traditional IPO market, has led to a significant uptick in reverse mergers with publicly held life sciences companies since the beginning of 2022. These transactions have originated most frequently with pre-commercial life sciences companies that are listed on a major exchange and suffer a scientific setback or other disruption leading to a restructuring (or winding down) of operations—often while holding significant amounts of cash. In these circumstances, the reverse merger transaction results in the public company effectively reinvesting its cash into the business of the private company, giving the public company's legacy stockholders the opportunity to hold stock in a new business, while the formerly private company takes advantage of the public company's existing cash and stock exchange listing.

TRANSACTION CONSIDERATIONS

Exchange Ratio

The exchange ratio for a reverse merger transaction is typically based on the relative valuations of the public and private companies. Although the private company's valuation is often tethered to the valuation from its most recent private financing, the final valuation will ultimately be the product of negotiations between the parties. The public company's valuation, by contrast, will typically equal its anticipated available net cash at closing (after customary deductions and excluding any capital concurrently raised by the combined company) plus a negotiated premium for its public stock listing.

BASIC STRUCTURE OF A REVERSE MERGER

In a typical reverse merger:

— a privately held company merges with a publicly listed company;

— the pre-merger stockholders of the private company own a majority of the stock of the combined company;

— the management and other employees of the private company become the management and employees of the combined company;

— the composition of the combined company board reflects representation proportional to the post-closing ownership split;

— the business of the private company becomes the business of the public company; and

— the combined company changes its name to that of the private company.

In many cases, the combined company will seek to raise additional capital (either privately, concurrently with the completion of the merger, or publicly, following the merger) to extend its cash runway.

SEC Filing and Review

A reverse merger transaction typically requires a merger proxy statement and/or a Form S-4 registration statement to be prepared and filed with the SEC. The merger proxy/Form S-4 is usually more complicated and time-intensive than the Form S-1 for a conventional IPO, for several reasons:

— The merger proxy/Form S-4 must include separate audited financial statements for each company, plus pro forma combined financial statements reflecting the combination of the two companies.

— The merger proxy/Form S-4 must include detailed descriptions of each company's process leading up to execution of the merger agreement and its board's reasons for recommending approval of the merger. A description of the fairness analysis provided by the public company's financial advisor to the board (including relevant inputs to the fairness analysis, such as financial projections for the private company) must also be included.

- Scrutiny by the SEC staff of merger proxy/Form S-4 filings for reverse mergers has been increasing, particularly in the background, fairness analysis and financial projections sections. The staff often focuses on the process undertaken by each company, including measures taken by the public company to mitigate potential conflicts of interest, the reasons why the public company elected to pursue a reverse merger rather than a liquidation, wind-down or other alternative, and the reasons why the private company decided to pursue a reverse merger rather than a traditional IPO.
- Merger proxy/Form S-4 filings often attract strike lawsuits claiming deficient disclosures and/or an inadequate board process, and activist investors sometimes publicly state their intention to vote against the transaction unless the terms are modified—in either case introducing delays until a resolution is reached.

These factors can contribute to a longer timeline—often 3–6 months (or longer) between signing of the merger agreement and closing of the transaction—than for a conventional IPO.

BOARD PROCESS

A public company evaluating whether to engage in a reverse merger is often already in a difficult position. The company may be facing "stock-drop" lawsuits, may be attempting to monetize its legacy assets, and may be under significant investor pressure to increase stockholder value. Although a reverse merger presents the possibility of a "whole company" solution, the board—as in other strategic and change of control transactions—must run a thoughtful process, typically with the assistance of a financial advisor and outside legal counsel.

The board of a company contemplating a reverse merger transaction should establish a clear record of the process it follows and the determinations it reaches, including through carefully crafted board minutes. Thorough recordkeeping should begin with the initial consideration and evaluation of a potential transaction—which often starts with auction-style market outreach to multiple private companies—and continue throughout the duration of the process.

MERGER AGREEMENT

In a typical reverse merger transaction, the merger agreement is structured as a "public style" agreement, in which there are no post-closing remedies for either party and the representations, warranties and covenants are, to a large degree, reciprocal. However, the following points typically are the subject of particular focus in negotiations:

- *Minimum Net Cash Closing Condition:* Most merger agreements for reverse mergers require the public company to have a specified minimum amount of "net cash" at closing (below which the private company could refuse to close), an adjustment mechanic to the exchange ratio if net cash is below a specified threshold, or both.
- *Net Cash Definition:* Given the minimum net cash closing condition and the importance of the amount of net cash to the premise and economics of a reverse merger transaction, the parties typically spend significant time understanding and negotiating the specific liabilities and obligations—including contingent or potential liabilities—that will be deducted from available cash to determine the amount of "net" cash at closing.
- *Contingent Value Rights/Dividends:* Because the valuation of the public company in a reverse merger transaction often ascribes no value to its legacy assets, it is not uncommon for the public company to issue to its pre-closing stockholders "contingent value rights" representing the right to receive proceeds, if any, from the post-closing monetization of its legacy assets. Depending on the amount of its available cash, the public company may also negotiate the right to pay a cash dividend to its stockholders prior to closing, subject to the minimum net cash closing condition.
- *Termination Fees; Reimbursement of Expenses:* The circumstances in which one party to a reverse merger must pay a termination fee and/or reimburse the other party's expenses are broader than in the typical public M&A context. ■

ADDRESSING CONFLICTS OF INTEREST

In many reverse merger transactions in the life sciences sector, a public company's potential counterparties may include private companies in which venture capital firms (or other investment firms) affiliated with the public company's directors are also investors, or for which one or more of the public company's directors serve as a director, thus presenting actual or potential conflicts of interest.

While a board's conduct is generally assessed under the deferential "business judgment" standard—which presumes that in making a business decision the directors acted on an informed basis, in good faith, and in the honest belief that the action taken was in the best interests of the company—the existence of conflicts of interest may result in a court reviewing a transaction under the "entire fairness" standard, which requires defendants to prove that the transaction was a product of fair dealing (how the transaction was structured, initiated and negotiated) and resulted in a fair price (a price that a reasonable seller would consider within a fair value range). Entire fairness is the most onerous standard of review under Delaware corporate law.

Accordingly, the board of each company should, at the outset of any process or negotiations (and continuously along the way), assess actual or potential conflicts of interest and consider whether to implement procedural safeguards that could result in greater judicial deference if the transaction is challenged. For example, Delaware courts have held that the "business judgment" standard of review of a conflicted transaction can be preserved by conditioning the transaction from the outset on approval by a fully empowered special committee of disinterested directors and approval by a fully informed, uncoerced vote of the holders of a majority of all shares held by disinterested stockholders (a so-called "majority of the minority" vote).

Even if the board concludes that conditioning the conflicted transaction on a "majority of the minority" vote is not viable, the board can shift the burden of proof to the plaintiff by establishing a fully empowered special committee at the outset, in which case the plaintiff must prove that the transaction is unfair.

While executives at pre-IPO companies may be primarily focused on their company's financial statements, they shouldn't neglect their own. Personal financial planning is a key component of the IPO process, including planning for future sales of company stock by executives who seek liquidity or wish to diversify their assets. Rule 10b5-1 under the Exchange Act can provide an effective means for executives to sell company stock while reducing exposure to claims of insider trading.

Effective February 27, 2023, the SEC amended Rule 10b5-1. As discussed below, these amendments change the rules of the road for successful use of Rule 10b5-1 trading plans—particularly for company directors and officers—and create new company disclosure requirements.

BACKGROUND

Insider trading laws prohibit the purchase or sale of a company's securities on the basis of material nonpublic information (MNPI) about the company. Under Rule 10b-5 of the Exchange Act, persons with MNPI are prohibited from buying or selling the company's securities until the information has been publicly disclosed and the market has had an opportunity to absorb it. As a result, executives have limited opportunities to buy or sell company stock.

Rule 10b5-1 provides a path for executives and other individuals to purchase and sell shares of the company's stock and offers protection from insider trading liability. For many years, the rule has provided an affirmative defense to insider trading claims for transactions that meet the following conditions:

— The purchase or sale must be made pursuant to a binding contract, specific instruction or written plan (a "plan") that is established while the person adopting the plan (the "plan adopter") is unaware of MNPI.

— The plan must specify the price, amount and date of purchases or sales or how the price, amount and date will be determined (expressed as specific numbers, dates and dollar amounts or described in ranges or formulas that are automatically applied), or not permit the plan adopter to exercise any subsequent influence over how, when or whether to effect purchases or sales.

— The transaction must occur pursuant to the plan (i.e., the plan adopter cannot alter or deviate from the plan and cannot engage in hedging transactions).

— The plan adopter must have adopted the plan in good faith and not as part of a plan or scheme to evade the prohibitions of Rule 10b-5.

Many executives have come to rely on these trading arrangements, commonly referred to as "Rule 10b5-1 trading plans" or "pre-arranged trading plans," to engage in transactions involving company stock. The key benefit of using such a trading plan is that pre-arranged transactions can take place on future dates even if, at the time of the transactions, the person who set up the plan is actually aware of MNPI.

In recent years, the SEC, members of Congress and other observers have voiced increasing alarm about the potential for abuse of Rule 10b5-1 plans, based in part on academic research suggesting to some that insiders using Rule 10b5-1 plans consistently outperform trading by insiders who do not use such plans. To address these concerns, in December 2022, the SEC adopted rule amendments to impose significant new restrictions on the adoption and use of Rule 10b5-1 trading plans by company directors and officers, and by other persons seeking to take advantage of the affirmative defense provided by Rule 10b5-1. The new requirements are summarized in the accompanying chart and discussed in more detail below.

COOLING-OFF PERIODS

Rule 10b5-1 plans must include a cooling-off period following plan adoption or modification. There is no financial hardship exception from the required cooling-off periods.

For directors and officers, the cooling-off period prohibits purchases or sales until the *later of*:

— 90 days following the date the plan is adopted or modified; and

— two business days following the company's disclosure in a Form 10-K or 10-Q of its financial results for the fiscal quarter in which the plan was adopted or modified.

Because the cooling-off period ties to the later of these two dates, the timing of the company's financial disclosure may impact

CONDITIONS OF RULE 10B5-1 AFFIRMATIVE DEFENSE

Condition (*denotes new condition under amended rule)	Applicable to		
	Directors and Officers	Other Persons (Except Issuer)	Issuers
Plan adopter must be unaware of MNPI when adopting plan	Applies	Applies	Applies
Plan must specify the price, amount and date of trades or how the price, amount and date will be determined	Applies	Applies	Applies
Transactions must occur pursuant to plan	Applies	Applies	Applies
Plan adopter must adopt plan in good faith	Applies	Applies	Applies
Plan adopter must act in good faith throughout life of plan*	Applies	Applies	Applies
Cooling-off period required after adoption or modification of plan before transactions commence under plan*	Applies (90–120 days)	Applies (30 days)	N/A
Plan adopter must certify upon plan adoption that such plan adopter is unaware of MNPI and is acting in good faith*	Applies	Applies	N/A
Multiple, overlapping plans generally prohibited*	Applies	N/A	N/A
Generally limited to one single-trade plan during any consecutive 12-month period*	Applies	Applies	N/A

the cooling-off period. However, in no case is the cooling-off period for directors and officers required to exceed 120 days following plan adoption or modification. Persons who are not company directors and officers are required to observe a shorter cooling-off period—only 30 days—following plan adoption or modification.

Once a Rule 10b5-1 plan has been adopted, the adopter is allowed to make certain housekeeping changes without triggering a new cooling-off period. Permitted changes include updating the account information or substituting a new broker-dealer or other agent to execute trades under the plan. However, if the adopter makes changes to the sale or purchase prices or price ranges, the amount of securities to be bought or sold, or the timing of transactions, a new cooling-off period is triggered.

DIRECTOR AND OFFICER CERTIFICATIONS

Company directors and officers (but not others) must personally certify in the Rule 10b5-1 plan that they are unaware of any MNPI about the company or its securities and that they are adopting the plan in good faith and not as part of a plan or scheme to evade the prohibitions of Rule 10b-5. This certification is intended to remind directors and officers of their obligation not to adopt or trade under a Rule 10b5-1 plan while aware of MNPI. The certification is required any time a director or officer adopts or modifies a Rule 10b5-1 trading arrangement.

EXPANSION OF GOOD FAITH REQUIREMENT

Company directors and officers and other persons must act in good faith not only when entering into the plan but also throughout the duration of the plan. As an example, the affirmative defense would not be available for an officer who improperly influences the timing of a corporate disclosure to benefit a trade scheduled to occur under the officer's Rule 10b5-1 plan. The obligation to act in good faith is generally limited to activities within the control of the plan adopter—actions outside of the person's control or influence, such as plan cancellations directed by the company, may not by themselves implicate the good faith condition.

LIMITATIONS ON THE NUMBER OF TRADING PLANS AND ON SINGLE-TRADE PLANS

Rule 10b5-1 places restrictions on the use of multiple, overlapping Rule 10b5-1 plans. In most circumstances, company directors and officers and other individuals may not implement multiple plans that contemplate transactions during an overlapping time period. In addition, plan adopters may only implement one single-trade plan—a plan designed for a single purchase or sale transaction—during any consecutive 12-month period.

Despite the general prohibitions on multiple, overlapping plans and single-trade plans, Rule 10b5-1 provides exceptions for the following:

— Using more than one broker-dealer or other agent to execute trades as part of a single "plan," provided the contract with each broker-dealer or other agent, when taken together, satisfies all of the applicable conditions of Rule 10b5-1.

— Maintaining two separate Rule 10b5-1 plans, so long as trading under the later plan does not begin until after all trades under the earlier plan are completed or expire, and the later plan observes the required cooling-off period. If the first plan is terminated early, an additional cooling-off period begins on the date of such termination.

— Maintaining multiple Rule 10b5-1 plans if all but one of those plans is limited to the sale of securities to satisfy certain tax withholding obligations (for example, "sell-to-cover" transactions in connection with the vesting of restricted stock). This accommodation does *not* extend to sales following the exercise of options, because these sales involve discretionary action on the part of the optionholder.

ADDITIONAL CONSIDERATIONS FOR EXECUTIVES

In addition to the legal requirements outlined above, Rule 10b5-1 plans must comply with applicable company policies. The insider trading policy adopted by the company in connection with its IPO may contain other requirements that apply to Rule 10b5-1 plans, such as company review of the plan before its adoption or additional restrictions on plan use. Further, executives should consider the impact of the company's IPO timeline—and in particular, the commencement and expiration of the IPO lock-up period—on the adoption of Rule 10b5-1 plans and the beginning of any transactions thereunder.

USE OF RULE 10B5-1 PLANS BY ISSUERS

While the discussion above focuses on executives, Rule 10b5-1 plans aren't just for individuals. Issuers can also adopt Rule 10b5-1 plans and routinely do so in conjunction with share repurchase programs. Issuers are eligible for the Rule 10b5-1 affirmative defense to insider trading, provided their transactions meet the conditions outlined in the chart on page 16. Unlike directors, officers and other persons, issuers are not required to observe a cooling-off period or to provide certifications upon plan adoption or modification, nor are issuers subject to restrictions on the use of multiple, overlapping plans or single-trade plans. ■

NEW COMPANY DISCLOSURE REQUIREMENTS

The amendments also impose new Rule 10b5-1 plan disclosure requirements in Form 10-K and 10-Q filings. Companies will be required to provide quarterly disclosure if, during the last completed quarter, any company director or officer adopted, modified or terminated either:

— a Rule 10b5-1 trading plan that meets the new requirements outlined above; or

— a "non–Rule 10b5-1 trading arrangement," which is a trading plan put into place while the adopter was unaware of MNPI and which specifies the price, amount and date of the trade (or how the price, amount and date will be determined), but which does not meet the other requirements for a Rule 10b5-1 trading plan.

Companies must provide a description of the material terms of such trading plans, including the name and title of the director or officer, the date of plan adoption, modification or termination, the plan's duration, and the aggregate number of securities to be sold or purchased pursuant to the trading plans. Price terms need not be disclosed.

Blackout Provisions in Insider Trading Policies

New Annual Disclosure Requirement Will Soon Shed Light on Policies and Practices

Although an insider trading policy is not technically required of public companies, every IPO company should adopt one. While this has long been the case, a new SEC requirement to provide annual disclosure about whether or not the company has an insider trading policy, and if not why not, should make insider trading policies universal.

BLACKOUT PROVISIONS

Nearly all companies establish regular quarterly "blackout" periods (sometimes called "restricted" periods) during which trading in the company's securities is prohibited, regardless of whether the person trading is actually aware of material nonpublic information concerning the company. Blackout periods are intended to prevent transactions from taking place during periods when there is a high risk that someone is aware of material nonpublic information. In addition, companies typically reserve the right to impose special blackout periods in connection with prospective or pending corporate developments (such as merger discussions or the investigation of a cybersecurity incident) that may constitute material nonpublic information.

Many aspects of an insider trading policy—such as prohibitions on trading in the company's securities while aware of material nonpublic information—reflect legal requirements and should apply to all directors, officers, employees, family members and controlled entities. However, because blackout periods are not mandated by law, the company must determine when its regularly scheduled quarterly blackout periods will begin and end, the universe of employees who will be subject to these periods, and what transactions will be prohibited during these periods.

— ***Beginning and Ending Dates:*** Regularly scheduled quarterly blackout periods typically commence at some point during the final month of each fiscal quarter and end one or two trading days after the company has publicly announced its earnings for the quarter. Some companies extend the end of their quarterly blackout period until one or two trading days after the applicable periodic report is filed with the SEC. Pre-commercial life sciences companies often use a shorter blackout period in light of the immateriality of quarterly financial results.

— ***Employees Subject to Blackouts:*** Regularly scheduled quarterly blackout periods almost always apply to executive officers, other members of senior management, and employees with access to financial or material nonpublic information (as well as outside directors). Practices with respect to other non-management employees vary, often reflecting a company's scale and culture. Companies that have a relatively small number of employees or a corporate culture of broadly sharing information often apply blackout periods to all employees. Companies with large numbers of employees, multiple facilities and more restricted access to sensitive information often choose to apply blackout periods only to designated non-management employees (such as finance and legal staff).

— ***Prohibited Transactions:*** Except in transactions pursuant to Rule 10b5-1 trading plans, persons subject to regularly scheduled quarterly blackout periods are generally prohibited from making open market purchases and sales and are regularly prohibited from gifting or pledging company stock or engaging in a variety of option exercise transactions (such as broker-assisted cashless exercises).

MARKET PRACTICES

The National Association of Stock Plan Professionals and Deloitte Tax LLP co-sponsor periodic surveys that elicit information on the insider trading compliance practices of public companies of various sizes and across industries. Selected data from the last three surveys relating to regularly scheduled quarterly blackout periods is set forth in the tables below. ■

TIMING OF BLACKOUT PERIODS

Time Period	2017 Survey	2020 Survey	2022 Survey
Beginning:			
More than 25 days before quarter close	24%	28%	23%
16–25 days before quarter close	21%	20%	20%
11–15 days before quarter close	32%	32%	32%
1–10 days before quarter close	9%	10%	9%
0–10 days after quarter close	13%	10%	16%
*Ending:**			
0 days	4%	3%	2%
1–2 trading days	74%	78%	75%
3 calendar/trading days	15%	10%	16%
More than 3 calendar/trading days	7%	7%	7%

** number of days after announcement of quarterly earnings*

PROHIBITED TRANSACTIONS

Transaction	2017 Survey	2020 Survey	2022 Survey
Broker-assisted cashless option exercises	89%	84%	86%
Stock-for-stock option exercises	63%	62%	65%
Share withholding upon option exercises	54%	50%	58%
Cash option exercises	55%	51%	43%
Share withholding upon restricted stock/RSU awards	36%	32%	35%
Gifts of company stock	40%	45%	44%
Pledges of company stock	42%	47%	46%

Delaware Expands its Liability Protection Toolkit

Corporate Charter May Now Exculpate Officers From Personal Liability for Breaches of the Duty of Care

Delaware law has long permitted a company's corporate charter to include a provision eliminating the personal monetary liability of directors (but not officers) to the company or its stockholders for certain breaches of fiduciary duty. Effective August 1, 2022, Section 102(b)(7) of the Delaware General Corporation Law was amended to permit similar, but more limited, exculpation of specified officers.

The overwhelming majority of public companies are incorporated in Delaware, making Section 102(b)(7) and its recent amendment particularly important. For IPO companies incorporated in Delaware, an officer exculpation provision should be part of the liability protection toolkit.

FIDUCIARY DUTIES

Under Delaware law, the fiduciary duties of directors and officers consist of the *duty of care* (an obligation to act on an informed basis after due consideration of relevant materials and appropriate deliberations) and the *duty of loyalty* (an obligation to refrain from deriving a benefit from a transaction not generally available to all stockholders and to otherwise act in good faith).

SAMPLE OFFICER EXCULPATION PROVISION

"To the fullest extent permitted by the General Corporation Law of the State of Delaware, no director or officer of the Corporation shall be personally liable to the Corporation (in the case of directors) or its stockholders (in the case of directors and officers) for monetary damages for any breach of fiduciary duty as a director or officer. No amendment, repeal or elimination of this provision shall apply to or have any effect on its application with respect to any act or omission of a director or officer occurring before such amendment, repeal or elimination. If the General Corporation Law of the State of Delaware is amended to permit further elimination or limitation of the personal liability of directors or officers, then the liability of a director or officer of the Corporation shall be eliminated or limited to the fullest extent permitted by the General Corporation Law of the State of Delaware as so amended."

OFFICER EXCULPATION

As amended, Section 102(b)(7) permits the exculpation of specified officers from personal monetary liability to the company or its stockholders for breaches of the duty of care. The new provision is narrower than the existing director exculpation provision—officers cannot be exculpated for claims brought in the name of the company (known as derivative claims) or for claims brought by the company.

For purposes of Section 102(b)(7), the officers eligible for exculpation are the company's president, chief executive officer, chief operating officer, chief financial officer, chief legal officer, controller, treasurer and chief accounting officer; an individual identified in public filings as one of the most highly compensated officers of the company; and an individual who, by written agreement with the company, has consented to be identified as an officer for this purpose.

LIMITATIONS ON EXCULPATION

Exculpation provisions—both for officers under the amended statute and for directors under the statute prior to its amendment—may not eliminate or limit the liability of a director or officer for:

- breaches of the duty of loyalty to the company or its stockholders;
- acts or omissions not in good faith or those that involve intentional misconduct or a knowing violation of law;
- unlawful dividends, stock repurchases and stock redemptions (applicable to directors only); or
- any transaction from which the director or officer derived an improper personal benefit.

ADVANTAGES OF THE OFFICER EXCULPATION PROVISION

Adoption of an officer exculpation provision provides several advantages:

- The provision better aligns the protections available to officers with those currently available to directors and may enable the company to reduce certain litigation expenses and minimize the wasted time inherent in litigation. For example, an exculpation provision can thwart the plaintiffs' litigation tactic of adding officers to duty of care lawsuits so that claims against the officers continue even when identical claims against directors are dismissed.
- The provision can help a company remain competitive in recruiting and retaining officers who otherwise might choose employment with other companies that exculpate officers from personal monetary liability to the maximum extent permitted by law.
- Limiting concern about personal liability can empower officers to best exercise their business judgment in furtherance of stockholder interests without being distracted by the potential risk of claims following actions taken in good faith.
- The cost of maintaining D&O insurance may increase if the company does not adopt an exculpation provision. ■

THE LIABILITY PROTECTION TOOLKIT

To help protect directors and officers from personal liability, IPO companies incorporated in Delaware typically:

- provide in their corporate charters for the exculpation of directors and eligible officers from personal monetary liability for breaches of the duty of care;
- provide in their corporate charters for the indemnification of, and advancement of expenses to, directors and officers;
- enter into separate indemnification agreements with each director and officer that cannot be amended without the consent of the director or officer and often contain provisions that are more favorable to directors and officers than the general corporate charter provisions;
- provide in their corporate charters that claims against directors and officers for breaches of fiduciary duty must be brought in the Delaware Court of Chancery (rather than other state courts);
- provide in their corporate charters that claims arising under the Securities Act of 1933, including IPO claims, must be brought in federal court (rather than state court); and
- procure an adequate amount of D&O insurance before completing an IPO.

A "clawback policy" creates or confirms a company's right to recover compensation previously paid to an employee in certain circumstances, such as if the amount paid is later discovered to have been too high due to erroneous calculation of a financial metric on which it was based or if an employee has engaged in conduct that harms the company.

SOMETHING OLD

Compensation clawbacks are not a new concept for public companies.

In 2002, the Sarbanes-Oxley Act included a provision requiring disgorgement of incentive compensation paid to the CEO and CFO in the event of accounting restatements resulting from "misconduct." In the absence of a company policy requiring the company to pursue disgorgement, enforcement of this provision was left to the SEC, often in the context of settling other claims. Although the Sarbanes-Oxley Act did not clearly indicate whose misconduct would trigger this clawback, the SEC has successfully pursued cases where the CEO or CFO is not even alleged to have personally engaged in misconduct.

The Dodd-Frank Act, enacted in 2010, requires the SEC to adopt rules that prohibit the stock exchanges from listing the securities of a company that does not have a policy for the clawback of erroneously paid incentive compensation. The clawback requirements of the Dodd-Frank Act go beyond the scope of the clawback requirements imposed by the Sarbanes-Oxley Act.

In addition, many public companies have voluntarily adopted their own forms of clawback policies that exceed the reach of Sarbanes-Oxley, often in response to pressure from investors and other stakeholders.

SOMETHING NEW

The landscape for clawback policies will evolve during 2023.

In late 2022, more than a decade after Dodd-Frank's mandate, the SEC adopted a rule (Rule 10D-1) that will *require* companies listed on a national securities exchange, such as Nasdaq or the NYSE, to maintain clawback policies that meet certain specifications. Moreover, the new rule applies to all exchange-listed public companies, including emerging growth companies and smaller reporting companies. Even more notably, Rule 10D-1 goes well beyond the requirements of Sarbanes-Oxley's clawback provision and the scope of many voluntary clawback policies that public companies have in place.

Stock exchange listing standards implementing Rule 10D-1 are required to be effective no later than November 28, 2023, with listed companies required to adopt compliant policies within 60 days after the effective date. As a result, both new and old public companies—including IPO companies—will need to adopt a clawback policy that conforms to the new rule (or modify an existing policy to make it compliant) and implement and publicly disclose information about the policy.

Rule 10D-1 merely sets a baseline standard for a clawback policy. Although the stock exchanges are permitted to adopt listing standards requiring more stringent or comprehensive clawback policies than those specified in the rule, the listing standards proposed by Nasdaq and the NYSE in February 2023 adhere closely to Rule 10D-1. However, companies will be free to adopt clawback policies that go farther than required—for example, by including triggers based on misconduct apart from the company's financial statements, such as violations of a company's code of ethics or other corporate policies. Public companies may encounter pressure from investors and other stakeholders to adopt clawback policies that do more than just implement the minimum requirements of the Dodd-Frank Act and applicable listing standards.

THE NEW DODD-FRANK CLAWBACK

Rule 10D-1 imposes several requirements that go beyond the Sarbanes-Oxley provisions with which many public companies and executives are already familiar.

— *Enforcement*

- The SEC alone has enforcement authority under Sarbanes-Oxley; there is no private right of action for the company, a stockholder or a plaintiff to seek recovery under the statute.
- Prior to the adoption of Rule 10D-1, most voluntary clawback policies gave the company's board of directors a fair bit of discretion to determine whether to pursue a clawback and from whom.
- Under Rule 10D-1, public companies will be required to seek to enforce their clawback policies, subject to very limited exceptions, even if doing so would, in the board's view, cause more harm than good for the company.

— *Persons Covered*

- Under Sarbanes-Oxley, clawback was required only from the CEO and CFO.
- Voluntary clawback policies typically expanded the scope of coverage to include all executive officers or in some cases all employees.
- Rule 10D-1 applies clawback policies to all *current and former* executive officers, creating a broad universe of persons potentially subject to a clawback and introducing practical challenges with recouping compensation from departed executives.

— *Triggering Events*

- Under Sarbanes-Oxley, clawback was triggered only by an accounting restatement resulting from "misconduct," which was not limited to the CEO's or the CFO's own misconduct.
- Rule 10D-1 clawbacks will be triggered by an accounting restatement *regardless of misconduct* and *without regard to an executive's role* in the restatement. Clawbacks could be triggered if an honest error results in a restatement, and executive officers with no financial reporting responsibility could find themselves subject to a clawback.
- Rule 10D-1 clawbacks will be triggered by both "Big R" restatements and less severe "little r" restatements. A "Big R" restatement occurs when a

company amends previously issued financial statements to correct material errors. In a "little r" restatement, by contrast, if the previously issued financial statements are not materially misstated, accounting errors may be corrected prospectively without reissuing the prior financial statements.

— *Lookback Period*

- Under Sarbanes-Oxley, clawback could reach compensation received during the 12-month period following the filing of the financials that subsequently require restatement.
- Rule 10D-1 expands the lookback period to compensation received during the *three fiscal years* prior to the fiscal year in which a determination is made (or should have been made) to restate the prior financials.

— *Compensation Subject to Clawback*

- Sarbanes-Oxley covered incentive-based or equity-based compensation as well as any profits realized from sales of securities during the lookback period.
- Under Rule 10D-1, issuers will recover compensation, whether cash or equity, that is granted, earned or vested in whole or in part based upon attainment of a financial reporting measure, including measures such as EBITDA, TSR, stock price appreciation and other common financial measures used in executive compensation.

NEW DISCLOSURE REQUIREMENTS

In addition to adopting and maintaining a clawback policy that complies with Rule 10D-1, companies will be required to publicly disclose their clawback policies and to make public (and likely embarrassing) disclosures when a clawback-triggering event occurs.

For example, public companies will have to check a box on the cover page of their annual report on Form 10-K to indicate if there has been an accounting restatement that triggers a clawback. Companies also will be required to disclose the aggregate amount of recoverable compensation and any amounts that remain unrecovered for more than 180 days.

CONSIDERATIONS FOR IPO COMPANIES

New Rule 10D-1 has several implications for IPO companies:

— A critical component of the IPO process is the adoption of a variety of corporate governance policies that are required by SEC or stock exchange listing standards or that satisfy investor expectations or market demands. Under Rule 10D-1, a clawback policy now joins the long list of governance policies that IPO companies must adopt.

— In addition to understanding their responsibilities and potential liabilities as officers of a public company, executive officers—even those without financial reporting responsibility—will need to thoroughly understand the potential risk and financial impact of a compensation clawback.

— Because Rule 10D-1 does not require misconduct to trigger a clawback and covers both "little r" and "Big R" restatements, companies going public now have another reason to ensure that their internal control over financial reporting and related processes are ready for the post-IPO world.

— Executive officers could face significant financial consequences from a clawback. Among other issues, the clawback amount is calculated without regard to taxes the executive has already paid. Companies are prohibited from indemnifying or repaying executive officers for clawback payments. However, SEC rules do not prohibit an executive's purchase of third-party insurance for clawback claims as long as the company does not pay or reimburse the officer for the premiums—executives may wish to explore the availability of such insurance. ■

COMPARISON OF CLAWBACK PROVISIONS UNDER RULE 10D-1 AND SARBANES-OXLEY ACT

Subject	Rule 10D-1	Sarbanes-Oxley Act
Enforcement	By the issuer	By the SEC only
Persons covered	All current and former executive officers	CEO and CFO
"Misconduct" required?	No	Yes, although not necessarily by the CEO or CFO
Triggering event	Issuer is "required to prepare an accounting restatement due to the material noncompliance of the issuer with any financial reporting requirement under the securities laws, including any required accounting restatement to correct an error in previously issued financial statements that is material to the previously issued financial statements, or that would result in a material misstatement if the error were corrected in the current period or left uncorrected in the current period"	Issuer is "required to prepare an accounting restatement due to the material non-compliance of the issuer, as a result of misconduct, with any financial reporting requirement under the securities laws"
Clawback period	The three completed fiscal years immediately preceding the date on which the issuer is "required to prepare an accounting restatement"	The 12-month period following the first public issuance or filing with the SEC (whichever first occurs) of the financial document embodying such financial reporting requirement
Measure of recovery	Amount of incentive-based compensation received that exceeds the amount of incentive-based compensation that otherwise would have been received had it been determined based on the restated amounts, computed without regard to any taxes paid	Bonus, incentive-based or equity-based compensation, and any profits realized from sale of securities

As a company prepares to go public, one key task is to evaluate the capabilities and attributes of current board members and identify and recruit additional directors to help guide it through the IPO and thereafter as a public company.

While the pre-IPO board of directors is likely comprised of founders, investor representatives, subject matter experts and the CEO—each selected for their ability to advance the company's business objectives—public companies must also consider a variety of regulatory requirements and investor expectations when populating the board and board committees. In anticipation of an IPO, companies usually need to recruit additional directors to satisfy these requirements and expectations.

Post-IPO, given the focus on board composition by investors, regulators and other stakeholders, new public companies should be prepared to continually assess board composition and maintain flexibility to replace departing directors and add new directors to address evolving business needs, investor expectations and regulatory requirements. The board's nominating and corporate governance committee typically is tasked with leading the process of board evaluation, succession planning and director recruitment.

TABLE STAKES

Whether a company is private or public, every director needs appropriate functional skills, such as relevant industry and commercial knowledge; the availability to devote the necessary time to prepare for and attend board meetings; and the ability to positively contribute to the board's operation. Boards should also consider the expertise of directors for oversight of specialized areas, such as tax, corporate development, IT and shareholder engagement. Unblemished backgrounds and prior experience as a public company director cannot be overlooked.

Public company directors must also satisfy stock exchange requirements. For example, as threshold matters, a majority of the directors must be independent, and the board must consist of a sufficient number of independent directors to populate the three committees required by stock exchange rules (audit, compensation and nominating/corporate governance). Generally, an IPO company will need at least five independent directors for reasonable sharing of committee duties.

In addition to the board independence requirements, members of the audit committee must be "super independent" and financially literate, at least one member must have experience in finance or accounting, and at least one member should be an "audit committee financial expert" (to satisfy investor expectations and to avoid the need for the company to explain in its proxy statement why it does not have one). Although there is some discretion as to who qualifies as an audit committee financial expert, the role is often filled by a former audit partner, public company CEO or CFO, or venture capital investor. Members of the compensation committee must satisfy "enhanced" independence standards that are focused on independence from company management.

Although board independence and committee composition requirements have phase-in periods for companies going public, many IPO companies strive for full compliance at the time of the IPO.

ADDITIONAL CONSIDERATIONS

Beyond functional skills and compliance with stock exchange rules, the requirements and expectations for public company board composition have evolved to include consideration of diversity, overboarding, antitrust issues under the Clayton Act, and—likely coming soon—expertise with respect to climate and cybersecurity issues. Companies targeting an IPO need to factor these considerations into their director recruiting strategies.

Diversity

The effort to diversify boards continues, with the increasingly widespread expectation that diversity of membership should mean both gender diversity and the inclusion of members of historically underrepresented groups.

Influential institutional investors embed diversity in their proxy voting guidelines. For example, BlackRock's updated voting policy as of January 2023 states that boards should aspire to at least 30% diversity of membership, including, at large companies, at least two women and one director who identifies as a member of an underrepresented group (defined as individuals who identify as Black or African American, Hispanic or Latinx, Asian, Native American or Alaska Native, or Native Hawaiian or Pacific Islander; individuals who identify as LGBTQ+; individuals who identify as underrepresented based on national, indigenous, religious or cultural identity; individuals with disabilities; and veterans).

In addition, SEC rules require proxy statement disclosure about consideration of diversity in identifying director nominees and Nasdaq requires listed companies to disclose diversity information about board members. States are also playing an increasingly active role in promoting diversity on public company boards through

TOOLS FOR BOARD RECRUITMENT: SKILLS AND DIVERSITY MATRICES

A skills matrix is a useful tool for boards to internally evaluate and externally communicate existing director talent and future recruiting objectives. Although not required, a skills matrix is now a common feature in proxy statements. As a companion to a skills matrix, a diversity matrix (such as the one required for Nasdaq-listed companies—see template on page 23) has emerged as a common way to communicate board diversity. Determining the elements of the skills matrix and the approach to disclosure in the diversity matrix requires thoughtful discussion about the board's approach to building a skillful, well-represented board of directors.

BOARD DIVERSITY PLANNING

In recent years, a variety of stakeholders have become increasingly vocal in advocating for more diversity on boards of both private and public companies. The efforts to increase board diversity—by investors, securities regulators, stock exchanges, proxy voting advisory firms, state legislatures and even investment bankers, among others—have gained traction and now affect both the IPO process and life as a public company.

Companies should begin thinking about the recruitment of diverse directors as soon as they conclude that an IPO is a realistic goal. While securing new directors is not an absolute requirement for an IPO, starting the recruitment process early enough that new directors can be onboarded before the IPO will likely accelerate their integration into the fabric of the board.

legislation requiring board diversity disclosure (and, in the case of California, legislation—subsequently struck down and currently on appeal—imposing diversity quotas on public company boards).

Overboarding

Boards should consider the overboarding policies of key investors when recruiting directors and evaluating their existing board composition. Directors are considered to be "overboarded" if they serve on more boards of other companies than is permitted by the applicable investor's policy. The growing focus on overboarding reflects a concern that directors who serve on too many boards are "spread too thin" to serve effectively—a concern that was highlighted during the COVID-19 pandemic as all companies were thrust into crisis mode at the same time.

While overboarding policies vary, a simple and nearly universal rule of thumb is that a public company CEO may sit on only one other public company board without being deemed to be overboarded. Some investors also apply limits of one or two external boards to any executive officer of a public company. For directors who are not company executives, investor policies generally allow a director to serve on a maximum of four boards—although serving as the board chair or chair of certain committees may count as two boards under some policies.

The effects of overboarding can compound quickly. Joining a new board may cause a director to become overboarded with respect to all other boards on which the director serves—resulting in votes against the director at each company's next annual meeting. To address this situation, the corporate governance guidelines of most public companies require directors to discuss with the board any potential new board service for other companies before accepting a new position. Similar issues can arise—and be harder to avoid—when a private company goes public or merges into a public company and a member of its board continues to serve.

Historically, service on boards of private companies generally has not been counted when assessing whether a director is overboarded, but that may be starting to change. For example, in assessing overboarding, proxy voting advisory firm Glass Lewis now considers whether a director serves on the boards of any large private companies, and T. Rowe Price has flagged private company service as a secondary consideration.

Clayton Act

Board composition can also be affected by provisions of the Clayton Act that prohibit a person from serving as a director or officer of two or more competing companies. While these restrictions are not new, the Department of Justice's recent focus on these provisions has resulted in a number of highly publicized director resignations from public company boards, and enforcement actions. In light of the negative attention and board disruption that can result from allegations of violations or enforcement actions, boards should be mindful of these Clayton Act restrictions when recruiting directors within the same or adjacent industries.

Disclosure of Board Expertise

Subject matter expertise is a likely future area of additional required disclosure. Building on the concept of director expertise first introduced with the advent of the audit committee financial expert by the Sarbanes-Oxley Act, the SEC's pending rule proposals on cybersecurity and climate disclosure would require disclosure of the board's or a specific director's expertise relating to cybersecurity and climate oversight. The SEC has indicated that it plans to adopt final rules on these topics in 2023. ■

FORMAT OF NASDAQ ANNUAL DIVERSITY DISCLOSURE REQUIREMENT

BOARD DIVERSITY MATRIX (AS OF [DATE])				
Total Number of Directors	#			
	Female	Male	Non-Binary	Did Not Disclose Gender
PART I: Gender Identity				
Directors	#	#	#	#
PART II: Demographic Background				
African American or Black	#	#	#	#
Alaskan Native or Native American	#	#	#	#
Asian	#	#	#	#
Hispanic or Latinx	#	#	#	#
Native Hawaiian or Pacific Islander	#	#	#	#
White	#	#	#	#
Two or More Races or Ethnicities	#	#	#	#
LGBTQ+	#			
Did Not Disclose Demographic Background	#			

Data Sources: WilmerHale compiled all data in this report unless otherwise indicated. Direct listings and offerings by special purpose acquisition companies, REITs, bank conversions, closed-end investment trusts, oil & gas limited partnerships and unit trusts are excluded from IPO data, except as otherwise indicated. Offering proceeds generally exclude proceeds from exercise of underwriters' over-allotment options, if applicable. Venture capital data is sourced from SEC filings and PitchBook. Private equity–backed IPO data is sourced from SEC filings and Refinitiv.

Want to know more about the venture capital and M&A markets?

WilmerHale's *2023 Venture Capital Report* offers an in-depth US venture capital market analysis and outlook, including industry and regional breakdowns. We discuss the implications of the new beneficial ownership reporting requirements for private companies under the Corporate Transparency Act and the challenges posed by the expanding patchwork of state salary disclosure laws. We review SEC safe harbors that can help pre-IPO companies weather the rigors of the "quiet period" and highlight what you need to know about state taxes on qualified small business stock. Finally, we offer a roundup of deal term trends in VC-backed company M&A transactions and convertible note, SAFE and venture capital financings.

See our *2023 M&A Report* for a global M&A market review and outlook, plus an update on takeover defenses for public companies. We compare public and private company M&A deal terms, review deal term trends in VC-backed company acquisitions, and look at recent cases that place Delaware corporations in a stronger position to limit shareholder books and records demands.

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