

NYSE
IPO GUIDE

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Preface

Congratulations on making it to this important step in your company's history. When a company decides to go public, it takes a giant leap toward growing its enterprise. Yet the process can be complex to navigate. As you embark on your IPO journey, we hope you will find a valuable resource in this *NYSE IPO Guide*, updated for 2013. We are grateful to our partners on the project, including our publisher and expert contributors. Our collective goal is to help guide you through the process and contribute to a positive and successful IPO experience.

As the world's leading cash equities trading platform, the NYSE is the proud home to thousands of successful companies of all sizes, industries and geographies. For more than 200 years, our markets, people and technology have helped companies unlock their potential. Since our founding in 1792, we have maintained a commitment to transparent, orderly financial markets—a promise that continues today. The NYSE's market model offers cutting-edge technology enhanced by human judgment and accountability, access to the deepest pools of liquidity, unmatched brand visibility, as well as advocacy support on public-policy and regulatory issues affecting public companies, investors and all market participants.

Launching an IPO on the New York Stock Exchange or NYSE MKT, the leading U.S. market for small- and midcap companies, carries a range of advantages, including access to capital, improved branding, and increased liquidity. Our listed companies benefit from market intelligence, investor outreach, education, and advocacy. From listing day and beyond, our people—and products—will partner with you to help your company shine. And our events, networking and unparalleled information sources help you connect with peers and other business leaders to gain new insights and perspectives.

Given this, it is not surprising that we continue to rank no. 1 in terms of global IPO capital raising. We're also proud of our leadership in technology IPOs as well as among small, growth-stage, venture-backed companies that choose our dedication to client service and extensive network of professionals to lead them through their IPO experience. As mentioned in a recent *Forbes*

article, 16 of the top 20 technology IPOs in 2012 chose to list with the NYSE.

By accessing the U.S. capital markets via an IPO, you stimulate innovation, entrepreneurship and, ultimately, job creation. You create new and exciting investment opportunities for individuals and institutions. You fuel not only the growth of your company, but the growth of the overall economy.

We thank you for playing this important role in America's economic prosperity. We look forward to helping you navigate your IPO journey and seeing you through this significant milestone.

Duncan Niederauer
Chief Executive Officer, NYSE

Introduction: Advantages of a NYSE listing

One of the most important decisions in the IPO process is choosing the right market for listing of the company's securities. The NYSE market model is designed to maximize liquidity, encourage market activity and help participants trade more efficiently.

NYSE and NYSE MKT offer a combination of cutting-edge, ultrafast technology enhanced by the commitment of capital from traders who are accountable to you, the issuer. This market structure establishes reliable price discovery at the open, the close and during periods of volatility, such as times of market dislocation. Designated Market Makers (DMMs) add significant liquidity to the market, which is further enhanced by supplemental liquidity providers (SLPs) and floor brokers equipped with new, algorithmic trading tools. Their judgment and commitment of capital at the point of sale differentiates the NYSE from every other market globally.

DMMs

DMMs are at the center of the NYSE and NYSE MKT markets. DMMs act as a buffer against market volatility, increase liquidity and fulfill an obligation to maintain a fair and orderly market. The NYSE features both a physical auction convened by DMMs and a completely automated auction that includes algorithmic quotes from DMMs and other market makers.

Today, DMMs are among the most active trading firms on the NYSE. They follow strict requirements to maintain an orderly market, quote at the National Best Bid and Offer (NBBO) and facilitate price discovery during openings, closings and imbalances.

Complementing the liquidity of other quote providers are SLPs: electronic, high-volume NYSE market members that are incentivized to add liquidity. Several SLPs may be providing liquidity to your stock. SLPs are trading firms deploying their own capital using proprietary trading models.

Also providing liquidity on NYSE and NYSE MKT markets are trading floor brokers. These brokers leverage their physical point-of-sale presence with information technologies and algorithmic tools to offer customers the benefits of flexibility, judgment,

automation and anonymity with minimal market impact.

Global reach and visibility

Beyond market structure and market quality, a market's size and scope should also be considered when choosing a listings venue. The NYSE is a leading global operator of financial markets and provider of innovative trading technologies. Its exchanges trade equities, futures, options, fixed-income and exchange-traded products. The exchange offers comprehensive commercial technology, connectivity and market data products and services through NYSE Technologies.

As an innovative applied technology company in the financial space, the NYSE has built a universal trading platform that is being deployed to support not only its global exchange operations but also its customers around the world that are engaged in trading activities and operating exchanges. Twin data centers in the greater New York and London metropolitan areas offer one-stop access to liquidity with the highest levels of resilience and the lowest available latency (the time gap between trade placement and execution) to market participants.

Many listed companies return to the NYSE multiple times a year to use its facilities, including the NYSE trading floor, for analyst, investor or board meetings, as well as corporate announcements and events. The daily openings and closings also represent an opportunity for companies to elevate their own brand visibility. The NYSE offers a host of other visibility programs for its listed companies, including global investor conferences, virtual investor forums and multimedia channels.

IR services

Another important factor to consider when choosing a listing venue is customer service and the quality of products the marketplace offers. Successful companies require significant resources to build shareholder value. NYSE Market Access CenterSM is a full-service solution including global visibility and investor relations services, which enables management to remain focused on its business objectives as a public company.

Governance services

Companies seeking to create a leadership advantage through corporate governance, risk, ethics and compliance practices can tap the integrated resources of NYSE Governance Services. NYSE Governance Services leverages the expertise of Corpedia®, a leader in risk assessment and e-learning for ethics and compliance, and Corporate Board Member®, a trusted source on governance matters for company directors and C-level executives—both NYSE companies. It educates and works with companies to implement measurable practices that help them uphold the standards expected of them by their shareholders, customers, the public and the law.

Issuer advocate

The NYSE acts as an advocate for listed companies, championing policies that are consistent with the values of fair, efficient and transparent markets—from short-sale trading issues to corporate governance reform; from the cost of complying with the Sarbanes-Oxley Act of 2002 (SOX) to the difficulties of adhering to the United States' intricate and idiosyncratic accounting rules.

For example, the NYSE has sent numerous recommendations to regulators and lawmakers articulating companies' views on existing or proposed rules and regulations, particularly those designed to make markets more fair, transparent and efficient. The exchange has advocated for improved transparency around share ownership, for the streamlining of and more transparency around proxy fees, as well as for the passage of the Jumpstart Our Business Startups Act (the JOBS Act). The NYSE believes exchanges have a responsibility to help small companies grow by providing entrepreneurs with a source of capital. Looking beyond the IPO to seek new avenues for small businesses to access capital, the exchange launched the NYSE Big StartUp. This jobs-growth initiative connects big companies with startups and entrepreneurs, offers training, mentoring and education programs, as well as established a fund to ensure that capital is available to those least able to access it.

The NYSE will continue to have its pulse on the issues affecting its listed-company community and provide support in making sure their voices are heard among policymakers.

1

Why go public?

1.1 Advantages of conducting an IPO

J.P. Morgan (Investment Banking)

When considering an initial public offering (IPO), a company should evaluate the associated pros and cons, as well as the motivations for going public. This evaluation process is best conducted in conjunction with an investment bank, which can assist the company in working through the salient issues. There are numerous advantages to going public, the most pertinent of which are detailed below.

(a) Access to capital

The most common reasons for going public are to raise primary capital to provide the company with working capital to fund organic growth, to repay debt or to fund acquisitions. Further direct results include the following:

- Once the company is public, it has access to an entirely new, deep and liquid source of capital for any future needs it may have.
- Being publicly traded adds equity to the company's capital-raising toolkit, enabling the company to achieve and maintain an optimal capital structure.
- Following the IPO, the company will be able to tap the equity markets via follow-on offerings of primary and/or secondary shares, or a mix thereof. After the company has been public for one year, it will be eligible to access the equity capital markets on demand via a shelf registration statement.

(b) Liquidity event

Listing on the NYSE has numerous benefits, not only for the company but also for its shareholders. The IPO can be structured such that existing owners of the company can sell down their position and receive proceeds for their shares. In addition, once the company is public, the existing owners have a public marketplace through which they can monetize their holdings in a straightforward and orderly fashion.

(c) Branding event and prestige

By listing on the NYSE, the company will receive worldwide media coverage through the financial markets, which provide

constant live coverage on publicly traded companies. In addition, research analysts at broker-dealers will begin to write reports on the stock and the company, thus raising the profile of the company. Broader coverage across various sources will likely enhance the company's visibility, increase its stature with actual and potential customers and suppliers and thus help it grow its market share and competitive position.

(d) Public currency for acquisitions

Once the company is public, it can use its publicly tradable common stock in whole or in part to acquire other public or private companies in conjunction with, or instead of, raising additional capital. Publicly tradable stock is clearly more attractive to target shareholders than illiquid private company stock.

(e) Enhanced benefits for current employees

Stock-based compensation incentives align employees' interests with those of the company. By allowing employees to benefit alongside the company's financial success, these programs increase productivity and loyalty to the company and serve as a key selling mechanism when attracting top talent. Furthermore, issuing equity-based compensation will allow the company to attract top talent without incurring additional cash expenses. Being a public company provides employees with the ability to monetize the value of their stock-based compensation, whether it is options or restricted stock.

1.2 Potential issues

J.P. Morgan (Investment Banking)

While there are numerous advantages to going public, there are also a few considerations that the company, its management and shareholders should evaluate prior to embarking on the IPO process. The most successful companies with the smoothest IPO processes are those that fully weigh these considerations before embarking on an IPO and that begin making the necessary preparations months, if not years, beforehand.

(a) Loss of privacy and flexibility

In order to comply with securities laws, public companies must disclose various forms of potentially sensitive information publicly, which regulatory agencies, as well as competitors, can then access. Private companies can operate without disclosing proprietary information in a public forum. In addition, the focus of research analysts and the investor community on quarterly results and stock price performance may have the effect of constraining the operational flexibility enjoyed by the management of a private company.

(b) Regulatory requirements and potential liability

Correspondingly, public companies must regularly file various reports with the Securities and Exchange Commission (SEC) and other regulators. In order to comply with disclosure requirements, companies often need to completely revamp or expand their existing documentation policies, which can be costly and time-consuming. In addition, directors and officers are potentially liable for potential misstatements and omissions in the registration statement and in the company's ongoing reporting under the Securities Exchange Act of 1934 (the Exchange Act).

(c) Sarbanes-Oxley

The Sarbanes-Oxley Act was passed in 2002 as a reaction to a number of major corporate and accounting scandals, which cost investors billions of dollars and shook public confidence in the nation's securities markets. SOX set new standards for public companies, including requirements relating to accounting, corporate governance, internal controls and enhanced financial disclosure. SOX compliance can be a time-consuming and costly process for a newly public company. Although the JOBS Act relieves emerging growth companies (EGCs) of the obligation to have their independent auditors provide an attestation on internal controls under Section 404(b), they are still required to put in place internal controls sufficient for management to provide the certifications required by Section 404(a).

(d) Cost and distraction of management time and attention

Going public is a relatively expensive process, incurring one-off and ongoing costs for legal counsel, accounting and auditing services, D&O insurance, underwriting fees, printing, as well as for additional personnel to handle expanded reporting, compliance, and investor relations activities. Furthermore, planning and executing an IPO is a time-consuming process that can distract management from the company's core business. Ongoing public company obligations post-IPO should also be expected to take up significant management time.

1.3 Going public without an offering

J.P. Morgan (Investment Banking)

It is possible to go public without conducting a simultaneous offering, although this is typically not recommended except in specific factual circumstances. If the company does not conduct a simultaneous offering, its existing shares are listed on the exchange without being placed in the hands of new investors. Two examples of going public without an offering are (a) spin-offs of existing groups or divisions of already public companies and (b) foreign issuers listing American depositary receipts (ADRs) in the United States.

(a) Spin-offs

A spin-off from an existing company occurs when a public listed company spins off a part of its business into a separate public entity listed on an exchange. Typically, that part can function as a separate, stand-alone business, with characteristics distinct from those of the parent company. In such a transaction, each existing investor in the parent company will receive shares in the spin-off entity *pro rata* to its ownership in the parent. For example, Investor A, which owns 5% of Parent Company A, will receive 5% of the shares outstanding in SpinCo A. In this transaction, liquidity is generally preserved for the SpinCo, but the investor churn may be considerable. For example, Investor A may own Parent Company A for its other businesses, which still reside in Parent Company A, and have no interest in SpinCo A and quickly dispose of the

shares it receives. To this end, it is difficult to control the investor base in a spin-off transaction, whereas during an offering process shares are strategically placed with those investors known to be interested in owning them.

(b) Foreign issuers listing ADRs

A foreign company that is publicly traded on an international exchange outside the United States can list ADRs on the NYSE without conducting an offering. The stock is tied to the underlying international security and traditionally trades in tandem with that security. While the ADR will give the company incremental exposure to U.S. investors, there are often limitations on certain funds holding ADRs similar to those limitations applying to the holding of international investments, and typically the liquidity and trading of ADRs can suffer when compared to direct listings of the underlying stock.

Through a U.S. listing, foreign private issuers (FPIs) can significantly improve their access to the U.S. equity market. During the last decade, demand for foreign equities has grown appreciably among U.S. institutional and individual investors alike. This demand has been driven by a need for enhanced portfolio diversification, which holdings of foreign equities can provide, and a desire to tap into the higher economic growth rates found in many countries outside the United States—emerging markets in particular. •

2

Preparing to go public

2.1 Choosing advisors

J.P. Morgan (Investment Banking)

(a) Retention of advisors/service providers

Going public involves assembling a large and experienced team of professionals, including lawyers for the company and the underwriters, independent auditors, underwriters, insurance brokers, financial printers and data room providers. The company should carefully consider the skills and qualifications of all parties it hires, given the importance of the advice and services they will provide throughout the process as well as the messages their involvement with the IPO will signal to other advisors and to the market. The key advisors and service providers that the company and board need to evaluate and hire are as follows.

Company counsel: Company counsel work in concert with the company's management team, including in particular the company's chief financial officer (CFO) and general counsel, to represent the company's legal interests throughout the process. They are integrally involved in carrying out due diligence investigations into the company, drafting the registration statement and advising the company in relation to the various legal agreements it will enter into in connection with the IPO process, such as lock-up and underwriting agreements, as well as generally providing legal advice to the company throughout the process.

In selecting company counsel, it is important to choose a firm that has considerable expertise and a proven track record of executing IPOs as well as appropriate industry and sector expertise. At a more personal level, it is critical to select individual law firm partners with whom the management team has good rapport, as they will be spending a considerable amount of time together through the process.

Independent auditors and consulting accountants: The independent accountants are involved in performing an audit and, where relevant, review of certain financial statements prepared by management and included in the registration statement, and in providing a "comfort letter" to the underwriters which, among other things,

confirms the accuracy of certain financial numbers included in the registration statement. The underwriters and their counsel will conduct in-depth due diligence with the accounting firm around their relationship with the company, their independence under applicable rules and regulations, the integrity of the company's financial statements and the processes and methodologies underpinning their preparation and audit.

The decision to hire auditors is of critical importance, given that they will be integrally involved in the company's financial reporting for many years. Auditors should be hired well in advance of preparing for the IPO so that the financial statements and related disclosures to be included in the registration statement are presented on a basis consistent with prior-year audits. The SEC requires three years of annual historical audited financials (two years in the case of emerging growth companies) and these would ideally have been audited by a single firm of auditors. Although a "Big 4" firm is typically recommended for companies that are contemplating an IPO, there are a number of boutique and regional auditing firms that are also well regarded and talented. The company should consider industry expertise, reputation and fit with the company, among other factors, when selecting an auditing firm.

In many cases the company requires assistance in designing enhanced accounting processes and controls, preparing financial statements and other information for audit and to supplement its staff during the IPO process and transition to becoming a public company. The auditor may be unable to perform some of these tasks due to independence requirements, so a separate accounting consultant may be necessary. Accounting consultants provide useful skills, experience and resources to supplement the company's accounting and controls functions in this time of transition, though the company should ensure that it does not become reliant on them beyond the IPO and has assembled an appropriate team of in-house experts.

Underwriters: The underwriting syndicate consists of various banks, each having different roles and status within the syndicate. The lead banks are known as bookrunners and are so called because

they literally run the order book for the offering once it is in its marketing phase. Many companies will choose more than one bookrunner, in which case one will be appointed the lead bookrunner, or "lead left" bookrunner (so called because its name is listed first on the top line in the prospectus). The company should carefully choose the lead bookrunner for the IPO because of the critical role that it plays throughout the process. As the quarterback of the IPO, the lead bookrunner advises the company on all aspects of the IPO process, assists the company in shaping its investment thesis to be used while marketing the transaction, guides the company in its dealings with investors during the roadshow and develops the optimal pricing recommendation for the IPO.

The bookrunners as a group are closely involved in diligence, drafting the registration statement, crafting the marketing materials, creating the roadshow schedule, pricing the transaction and supporting the stock in the aftermarket. The bookrunners' research analysts will also be involved in undertaking due diligence on the company and play an important role in providing an independent view on the company to investors during the roadshow. The bookrunners should be chosen based on their relationship with the company, industry expertise, expertise in executing IPOs, track records with issuers and investors, distribution platform, research analyst capabilities and market-making ability.

Beneath the bookrunners sit a further group of underwriters, typically known as "Co-managers." The Co-managers' investment banking teams are significantly less involved in the day-to-day advisory role for which the bookrunners are responsible. They are, however, involved in most (if not all) of the due diligence undertaken. The Co-managers' research analysts will also take part in all analyst diligence that is conducted, and they will also play an active role in discussing their view of the company with investors while the roadshow is ongoing (although separate from the roadshow). The primary role of the Co-managers is to underwrite additional shares in the offering, provide additional research coverage post-IPO and assist in market making once the stock is public. Co-managers should be chosen based

on their relationship with the company, industry expertise, research analyst capabilities and market-making ability.

Underwriters' counsel: The bookrunners, on behalf of the underwriters, will select a counsel to act for them in connection with the IPO. This role includes advising the underwriters generally on managing their own liability in connection with the IPO, including ensuring that the offering disclosure does not contain any material misstatements or omissions, and that any issues that arise in due diligence are thoroughly and appropriately dealt with, whether by disclosure or otherwise. In addition, underwriters' counsel prepares drafts of the underwriting agreement and lock-up agreements and negotiates them with company counsel, as well as negotiating the terms of the comfort letter to be delivered to the underwriters by the company's auditors.

Other advisors: In addition to the above, it may be appropriate to appoint various other advisors in connection with the IPO, such as a compensation consultant (to advise the company on the structure of its stock-based compensation and related disclosures in the registration statement), a roadshow coach (to advise the management team, alongside the underwriters, on the most effective way of presenting the company and its business during the roadshow), and an investor relations firm.

Other service providers: Aside from the advisory team, the company will require the services of a number of service providers in connection with its IPO:

Financial Printers and Data Room Providers: The company will need to appoint a specialist firm of financial printers to typeset and format its registration statement and deal with the submission of it to the SEC via EDGAR, as well as process subsequent changes to the registration statement resulting from SEC comments and general updates. The financial printer is also likely to provide virtual data room services to the company, enabling documents required for the due diligence process to be uploaded and viewed electronically by the working group.

Transfer Agent: To list its stock on the NYSE, the company will need to appoint a transfer agent that complies with the connectivity and insurance requirements to operate within the direct registration system of the Depository Trust Company (DTC).

Electronic Roadshow Provider: Companies undertaking an IPO typically use an electronic roadshow for both the institutional and retail parts of the offering. This consists of a taped version of the roadshow, available for viewing electronically, and is usually arranged by the underwriters on behalf of the company.

Stock Option / Equity Administrator: Either before or, if not, upon becoming a public company, it is common for the company to appoint a third party to manage and administer its stock option program(s).

2.2 Financial information

KPMG LLP

(a) Registration statement

An entity making an offering of securities registered with the SEC under the Securities Act of 1933 (the Securities Act) must file a registration statement and distribute a prospectus in connection with the offering. The registration statement and prospectus must contain financial statements and other financial information regarding the financial condition of the company and the results of its operations.

The Securities Act and the related rules and regulations set out the requirements that the company must follow when making an offer to sell securities that do not meet one of the limited exceptions from registration. This framework includes the use of forms for registrations of offers (in particular, Forms S-1, S-3, S-4 and S-11). These forms specify the information that must be disclosed under Regulation S-X and Regulation S-K. Regulation S-X generally deals with financial statement form and content, while Regulation S-K generally deals with nonfinancial statement disclosures in the body of the registration statement. Form S-1 is the basic registration form used for a U.S.

company's IPO. Form S-3 is generally used for the registration of securities by a company that already has securities registered with the SEC, while Form S-4 is generally used for the registration of debt or equity securities issued in relation to a merger or acquisition. Form S-11 may be used for the registration of securities issued by certain real estate companies, including real estate investment trusts or securities issued by other companies whose business is primarily that of acquiring and holding for investment interests in real estate.

The SEC has specific and complex rules regarding the financial statements and other financial information that must be presented in a registration statement for an IPO. Some of the significant financial statement information that may be required includes:

- audited annual financial statements for recent fiscal years;
- unaudited interim financial statements for the most recently completed interim period and the corresponding period of the preceding year;
- selected financial information (usually summarized from the company's financial statements) for the past five fiscal years and most recently completed subsequent interim period and its comparative period;
- separate audited annual and unaudited interim financial statements for businesses that have been acquired or will probably be acquired that meet certain significance thresholds (described below). Depending on the significance of the acquisition, the company may be required to present one to three years of audited financial statements;
- separate audited or unaudited annual financial statements for significant investments accounted for under the equity method that meet certain significance thresholds;
- financial statements of guarantors of securities being offered and affiliates whose securities collateralize the securities being offered;
- *pro forma* financial information giving effect to certain events such as significant business acquisitions/dispositions, reorganizations, unusual asset exchanges and debt restructurings;

- segment reporting for companies that are engaged in multiple lines of business or with operations in more than one geographic area. Required disclosures include separate revenues and operating data for each segment;
- supplemental schedules for particular industries and circumstances; and
- enhanced disclosure of financial and operational metrics for companies in certain industries.

Companies that are classified in any of the following categories have modified reporting requirements:

- “Smaller reporting company,” as defined by Item 10(f)(1) of Regulation S-K, generally applies to new issuers with an expected public float of less than \$75 million when their registration becomes effective.
- “Emerging growth company,” as defined by Section 2(a) of the Securities Act, generally applies to companies that have their initial sale of registered equity securities after December 8, 2011 and have “total annual gross revenues” less than \$1 billion during its most recently completed fiscal year.
- “Foreign private issuer,” as defined by Section 3b-4 of the Exchange Act, generally applies to companies incorporated outside the United States that meet certain additional criteria.

Some additional details regarding the first two categories, criteria for qualification and some of the differences in reporting requirements are outlined later in this chapter on pages 21–22. See Chapter 9 for additional information regarding foreign private issuers. A table containing selected comparative financial statement reporting requirements for these categories is provided in the appendices. The following discussion focuses on the SEC requirements for companies that do not fall into any of the above three categories.

Audited financial statements: Audited annual financial statements required to be included in the registration statement include:

- balance sheets as of the end of the two most recent fiscal years; if the company has been in existence for less than one year, an audited balance sheet as of a date within 135 days of the date of filing the registration statement is required; and
- statements of income, cash flows, changes in stockholders’ equity and comprehensive income for each of the most recent three fiscal years or such shorter period as the company (and its predecessors) has been in existence. Designation of an acquired business as a predecessor is generally required where a company acquires in a single succession, or in a series of related successions, substantially all of the business (or a separately identifiable line of business) of another entity (or group of entities) and the company’s own operations prior to the succession appear insignificant relative to the operations assumed or acquired.

Audited financial statements for the company and its predecessor must be accompanied by an audit report issued by independent accountants that are registered with the Public Company Accounting Oversight Board (PCAOB) and audited in accordance with PCAOB standards. If any of the audited financial statements required to be included with the registration statement were audited by a predecessor independent accountant, consent may be needed from that independent accountant to allow for inclusion of those financial statements and their audit report in the registration statement.

The preparation of these financial statements often raises certain data collection, accounting and auditing issues, such as:

- the need to reevaluate existing accounting policies and consider expanding disclosures to comply with reporting requirements for public companies (e.g., segment information, tax-rate reconciliation, earnings per share and general compliance with Regulation S-X and SEC interpretations of generally accepted accounting principles (GAAP));
- the treatment of changes in accounting policies or financial statement

presentation that arise during the most recent period covered by the financial statements that may have a retroactive impact on the financial statements and other financial information presented for previous years; and

- the retrospective presentation of discontinued operations consistently across the periods covered by the financial information presented.

Accordingly, a company with financial statements covering the required number of years should revisit those financial statements and ensure that they are compliant with SEC requirements and recent SEC staff interpretations. Any modifications to previously issued audited financial statements will likely require the independent accountant to perform additional procedures.

Age of financial statements: Knowing the periods for which financial statements will be required to complete a particular financing is a critical step in planning an IPO. Financial statements must comply with the SEC’s age of financial statements requirements before the SEC staff will commence review of a filing.

The age of financial statements included in an IPO is measured by the number of days between the date of effectiveness of the registration statement and the date of the latest balance sheet in the filing. The latest audited annual financial statements included in the prospectus cannot be more than one year and 45 days old.

If more than 134 days have lapsed since the latest audited annual balance sheet, unaudited interim financial statements must also be included in the registration statement. Whenever updated interim financial statements are included, an interim income statement, statement of comprehensive income and statement of cash flows must be included for the corresponding period of the prior year. Interim financial statements for the first and second quarters must each be updated after 134 days. Interim financial statements for the third quarter must be updated 45 days after the following fiscal year-end, at which time audited financial

statements for the recently completed fiscal year are required.

Unaudited interim financial statements:

Article 10 of Regulation S-X provides guidance on the form and content of condensed interim financial statements. Interim financial statements (also referred to as stub-period financial statements) must be included in the registration statement if the period between the date of effectiveness of the registration statement and the date of the latest audited balance sheet in the filing exceeds a specified number of days. See section titled “Age of financial statements,” above. Interim financial statements include a balance sheet as of the end of the most recent interim fiscal quarter, statements of income, comprehensive income, stockholders’ equity and cash flows for the period between the latest audited balance sheet and interim balance sheet and the corresponding period of the preceding year. The interim financial statements can be presented in a condensed format but often are presented in a noncondensed format. The interim financial statements may be unaudited, but the company’s underwriters might request them to be reviewed by an independent accountant prior to filing as part of their requested comfort letter procedures.

Selected financial information: Item 301 of Regulation S-K requires selected income statement and balance sheet data for each of the last five fiscal years (or, if shorter, for the life of the company and its predecessor entities) and the most recent interim period to be included in the registration statement together with comparative information for the corresponding interim period of the prior year. The purpose of the selected financial data is to highlight certain significant trends in the company’s financial condition and results of its operations. It must include:

- net sales or operating revenues;
- income (loss) from continuing operations;
- income (loss) from continuing operations per common share;
- total assets;

- long-term obligations and redeemable preferred stock; and
- cash dividends declared per common share.

The selected financial data may also include any additional items that would enhance an understanding of the company’s financial condition and trends in its results of operations, such as cash and cash equivalents balances, working capital balances and summary comparative income statements.

Financial statements of an acquired business:

If the company has made or is proposing to make a significant acquisition of a business, an investment that will be accounted for under the equity method or multiple acquisitions of related or unrelated businesses, it may need to include audited financial statements of the acquired business plus appropriate unaudited interim financial statements to comply with Rule 3-05 of Regulation S-X.

Whether a proposed acquisition requires inclusion of financial statements in a registered offering depends on the significance of the acquisition and whether the acquisition is probable. The SEC has issued no formal guidance on the standard of probability for business combinations.¹ Generally, the determination is based on the preponderance of evidence supporting the conclusion that an acquisition is probable. However, the SEC views public announcement of a business combination as strong evidence of a probable acquisition. The company must assess the probability of an acquisition by considering factors such as the following in addition to the advice of its securities counsel:

¹The SEC Codification of Financial Reporting Policies, Section 506.02(c)(ii), provides the following: “Guidance as to when consummation of a transaction is probable cannot be given because such a determination is dependent upon the facts and circumstances. In essence, however, consummation of a transaction is considered to be probable whenever the registrants’ financial statements alone would not provide investors with adequate financial information with which to make an investment decision.”

- progress of the negotiations, considering such factors as progress of discussions among senior executives, execution of confidentiality agreements, execution of letters of intent, conduct of due diligence procedures, approvals of the board of directors and/or shareholders and submission to appropriate government regulators for acquisition approval;
- economic and legal penalties associated with failure to consummate, including costs incurred to date in pursuing the acquisition; and
- significance of required regulatory approvals.

The independent accountant that has audited the financial statements prepared for purposes of complying with Rule 3-05 need not be registered with the PCAOB, unless the acquired business is a public company in the United States. The number of years of audited financial statements required is determined by the size of the acquisition and its significance relative to the company based on the following three significance tests under Rule 1-02(w) of Regulation S-X:

- the amount of the company’s investment in the acquired business compared to its total assets;
- the total assets of the acquired business compared to the company’s total assets; and
- the pre-tax income from continuing operations of the acquired business compared to the company’s pre-tax income from continuing operations (“pre-tax income from continuing operations” is income before income taxes, extraordinary items and the cumulative effect of a change in accounting principle exclusive of amounts attributable to any noncontrolling interests).

The rules should be consulted as they contain specific instructions for modifying the calculation under certain circumstances.

The test generally is performed using the company’s and the target’s most recent audited financial statements prior to the date of acquisition. The following table summarizes the general rules for

General rules for acquisitions more than 75 days pre-IPO

Acquisition criteria	Reporting requirement ³
The acquisition does not exceed 20% for any of the three significance criteria.	No audited financial statements required.
The acquired business (or multiple acquisitions of related businesses) exceeds 20% but not 40% for any of the three significance criteria.	One year of audited financial statements required.
There have been multiple acquisitions of unrelated businesses whose significance is less than 20% individually but more than 50% for any of the three significance criteria when aggregated.	One year of audited financial statements required for a mathematical majority of the individually insignificant acquisitions.
The acquired business (or multiple acquisitions of related businesses) exceeds 40% but not 50% for any of the three significance criteria.	Two years of audited financial statements required.
The acquired business or any acquisition that is probable at the time of the offering exceeds 50% for any of the three significance criteria (or securities are being registered to be offered to the shareholders of the acquired business).	Three years of audited financial statements required, unless the business has under \$50 million in revenues, in which case only two years of audited financial statements required.

acquisitions that occurred more than 75 days before the offering.²

In addition, if audited financial statements are required, applicable interim financial information that would be required according to the guidelines described in “Age of financial statements” and “Unaudited interim financial statements” must also be included.

Staff Accounting Bulletin No. 80 (SAB 80) provides a special interpretation of Rule 3-05 of Regulation S-X for IPOs

²An exception to the general requirements occurs for an individual or multiple acquisitions that exceed 50% of any of the significance criteria, for which, if they have closed within the 75-day period prior to the offering or are “probable” at the time of the offering, the financial statements described above will be required.

Audited financial statements for the earliest of the three fiscal years required may be omitted if net revenues reported by the acquired business in its most recent fiscal year are less than \$50 million. Unaudited interim financial statements may need to be included, depending on the time of year that the offering takes place.

involving companies whose operations have been built by the aggregation of discrete businesses that remain substantially intact after acquisition. SAB 80 allows first-time issuers to consider the significance of businesses recently acquired or to be acquired based on the *pro forma* financial statements for the issuer’s most recently completed fiscal year. While compliance with this interpretation requires an application of SAB 80’s guidance and examples on a case-by-case basis, this interpretation allows currently insignificant business acquisitions to be excluded from the financial statement requirements, while still ensuring that the registration statement will include not less than three, two and one year(s) of financial statements for not less than 60%, 80% and 90%, respectively, of the constituent businesses of the issuer.

The acquisition or probable acquisition of real estate operations is subject to its own

³The number of years for which balance sheets and income statements are required to be presented is based upon the level of significance.

set of disclosure requirements under Rule 3-14 of Regulation S-X, which addresses income-producing real estate operations such as apartment buildings and shopping malls. Rule 3-14(a) requires as follows:

- Audited income statements must be provided for the three most recent fiscal years for any such acquisition or probable acquisition that would be “significant” (generally, that would account for 10% or more of the company’s total assets as of the last fiscal year-end prior to the acquisition). If the property is not acquired from a related party, only one year of income statements must be provided if certain additional textual disclosure is made. Rule 3-14(a) also requires certain variations from the typical form of income statement.
- If the property is to be operated by the company, a statement must be furnished showing the estimated taxable operating results of the company based on the most recent 12-month period, including such adjustments as can be factually supported. If the property is to be acquired subject to a net lease, the estimated taxable operating results shall be based on the rent to be paid for the first year of the lease. In either case, the estimated amount of cash to be made available by operations shall be shown. An introductory paragraph is required stating the principal assumptions which have been made in preparing the statements of estimated taxable operating results and cash to be made available by operations.
- If appropriate under the circumstances, a table should be provided disclosing the estimated cash distribution per unit for a limited number of years, with the portion thereof reportable as taxable income and the portion representing a return of capital together with an explanation of annual variations, if any. If taxable net income per unit will become greater than the cash available for distribution per unit, that fact and the approximate year of occurrence should be stated, if significant.

The SEC staff has noted that one element used in distinguishing a real estate operation from an acquired business subject to Rule 3-05 of Regulation S-X is

the predictability of cash flows ordinarily associated with apartment and commercial property leasing, which generally includes shopping centers and malls. Nursing homes, hotels, motels, golf courses, auto dealerships, equipment rental operations and other businesses that are more susceptible to variations in costs and revenues over shorter periods due to market and managerial factors are not considered to be real estate operations. In such cases, the Rule 3-05 requirements will apply.

Financial statements of an equity method investment: If the company holds an investment in unconsolidated subsidiaries or 50%-or-less owned entities accounted for under the equity method that exceeds significance thresholds as defined by Rule 3-09 of Regulation S-X, separate financial statements for the investee company may need to be filed with the registration statement, including an audit for certain periods.

Significance of investees is evaluated under Rule 1-02(w) of Regulation S-X based on the following tests:

- the company's and its other subsidiaries' investments in, and advances to, the investee exceed 20% of the total assets of the company and its subsidiaries consolidated as of the end of the most recently completed fiscal year; and
- the company's and its subsidiaries' equity in the pre-tax income from continuing operations of the investee exceed 20% of such income of the company and its subsidiaries consolidated for the most recently completed fiscal year.

If either of these tests is met, separate financial statements of the investee must be filed. Insofar as is practicable, the separate financial statements required shall be as of the same dates and for the same periods as the audited consolidated financial statements required to be filed by the company. The required financial statements of the investee must be audited only for those fiscal years in which either of the above tests is met; the remaining years can be unaudited. These audited financial statements may or may not be required to be audited by an independent accountant registered with the PCAOB, depending on the level of reliance placed on these audited

financial statements by the company's principal independent accountant. If the registrant's principal independent accountant makes reference to the audit of the investee in its report, then the investee audit must be performed by an independent accountant registered with the PCAOB.⁴

Under Rule 4-08(g) of Regulation S-X, for any unconsolidated subsidiaries and 50%-or-less owned entities accounted for under the equity method that meet any of the three Rule 1-02(w) criteria at the greater than 10% but not more than 20% significance level, summary financial information as described by Rule 1-02(bb) must be presented in the notes to the financial statements.

Financial statements of guarantors and for collateralizations: A guarantee of a public security (e.g., a guarantee of a public debt or public preferred equity security) is itself considered a security that must be registered under the Securities Act, absent an applicable exemption. Rule 3-10 of Regulation S-X requires each guarantor of registered securities to file the same financial statements required for the company in the filing. If certain criteria are met, condensed consolidating financial information may be provided in the company's financial statements in lieu of separate audited financial statements, unless a guarantor is newly acquired.

Under Rule 3-16 of Regulation S-X, audited financial statements must also be filed for each affiliate whose securities collateralize any class of registered securities if the greater of the aggregate principal amount, par value, book value or market value equals 20% or more of the principal amount of the secured class of securities being offered.

If any of the above situations is applicable, Rules 3-10 and 3-16 should be reviewed to determine the extent of financial information required to be included with the registration statement.

⁴The auditor of the financial statements of the nonissuer entity must be registered if, in performing the audit, the auditor played a "substantial role" in the audit of the issuer, as that term is defined in PCAOB Rule 1001(p)(ii). If the "substantial role" test is not met, the firm is not required to be registered. The inclusion or exclusion of such a report under Rule 2-05 of Regulation S-X does not affect this determination.

Pro forma financial information: *Pro forma* financial information may be required to assist investors in understanding the nature and effect of significant acquisitions, dispositions, reorganizations, unusual asset exchanges, debt restructurings or other transactions contemplated in the prospectus. In such cases, historical financial information is adjusted in the *pro forma* financial information to reflect the transactions and the impact of the offering on the company's capital structure. All significant assumptions must be disclosed.

Guidance regarding *pro forma* financial information is provided in Article 11 of Regulation S-X.⁵ Rule 11-01 of Regulation S-X specifies the circumstances under which *pro forma* financial information is required in filings with the SEC and sets forth general guidelines for the content of that information. Article 11 requires:

- a condensed *pro forma* balance sheet as of the end of the most recent period for which a consolidated balance sheet of the company is required, unless the transaction is already reflected in that balance sheet; and
- a condensed *pro forma* income statement for the company's most recently completed fiscal year and the most recent interim period of the company, unless the historical income statement reflects the transaction for the entire period.

Pro forma adjustments related to the *pro forma* condensed balance sheet and condensed income statement must include adjustments which give effect to events that are:

- directly attributable to the transaction;
- factually supportable; and
- expected to have a continuing impact on the company (applicable only to the condensed income statement).

⁵Certain *pro forma* disclosures are required by GAAP (e.g., Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 805 [Statement of Financial Accounting Standards (SFAS) 141R], ASC Topic 718 [SFAS 123(R)] and certain Emerging Issues Task Force (EITF) consensus) and should be provided where applicable. Those presentations may differ in style and content from the requirements of Article 11 of Regulation S-X.

As a result, any *pro forma* adjustments for expected future cost synergies or other similar adjustments that are not specifically supported by the acquisition documents will generally not be allowed.

If a business or assets are disposed of (or planned to be disposed of) after the latest balance sheet presented in the registration statement, but before the effective date of the IPO, the effect of the disposal should be reflected in the company's *pro forma* financial statements that are prepared in accordance with Article 11.

Segment reporting: For companies that operate in multiple lines of business or geographic regions, additional disclosure data may be required to be presented, which includes separate revenues and operating results information for each major line of business or geographic region. ASC Topic 280, "Segment Reporting" (ASC Topic 280), requires disclosures regarding segments for each year for which an audited statement of income is provided. Item 101(b) of Regulation S-K requires disclosure of certain financial information about industry segments, including revenues from external customers, profitability measures and total assets for each of the last three fiscal years presented.

ASC Topic 280 establishes standards for the way that public business enterprises report information about operating segments in annual financial statements, requires those enterprises to report selected information about operating segments in their interim financial reports and also establishes standards for related disclosures about products and services, geographic regions and major customers. It defines an "operating segment" as a component of an enterprise:

- that engages in business activities from which it may earn revenues and incur expenses (including revenues and expenses relating to transactions with other components of the same enterprise);
- whose operating results are regularly reviewed by the enterprise's chief operating decision maker⁶ to make

⁶The term *chief operating decision maker* identifies a function, not necessarily a manager with a specific title. That function is to allocate resources to and assess the performance of the segments of an enterprise. Often, the chief

decisions about resources to be allocated to the segment and assess its performance; and

- for which discrete financial information is available.⁷

Determining whether the company has multiple operating segments involves an assessment of how management runs its business. Aggregating two or more operating segments may be highly subjective and involves consideration of the similarities in the economic characteristics and in other factors such as the nature of the products and services, the nature of the production process, customer type or class, distribution channels and applicable regulatory environment.

The company must provide required disclosure information about an operating segment if it meets any of the following thresholds:

- Its reported revenue (including both sales to external customers and intersegment sales) is 10% or more of the combined revenue (internal and external) of all reported operating segments.
- The absolute amount of its reported profit or loss is 10% or more of the greater, in absolute amount, of:
 - the combined profit of all operating segments that did not report a loss; or
 - the combined loss of all operating segments that did report a loss.
- Its assets are 10% or more of the combined assets of all operating segments.

The company must disclose the factors used to identify the enterprise's reportable segments, including the basis of organization and the types of products and services from which each reportable segment derives its revenues. The company must also report for each of its reportable segments a measure of

operating decision maker of an enterprise is its chief executive officer (CEO) or chief operating officer, but it may be a group consisting of, for example, the enterprise's president, executive vice presidents, and others.

⁷Discrete financial information is considered to be any measure of a business activity's profit or loss. Depending upon the circumstances, this measure could be comprised of revenue and/or expenses.

profit or loss, total assets attributable to that segment, revenues from external customers and a reconciliation to the corresponding consolidated amounts. Furthermore, disclosure of items such as interest revenue and expense, depreciation and related expense, equity method investments and capital expenditures may be required under ASC Topic 280 if such amounts are included in the measure of segment profit or loss or in the determination of segment assets, as reviewed by the company's chief operating decision maker on a segment basis.

ASC Topic 280 also requires certain enterprise-wide disclosures regardless of whether the company has multiple reportable segments, if not already provided as part of the reportable operating segment information. These disclosures include revenues from external customers for each product and service or each group of similar products, as well as services and revenues by geographic area.

For interim periods, disclosure for each segment must include revenues from external customers, intersegment revenues, a measure of profit or loss, a reconciliation to the company's consolidated information and material changes to total assets.

The time and effort required in identifying, gathering and reporting financial information for operating segments may be significant. A first-time issuer should carefully consider the requirements for segment reporting and revisit its reporting obligations whenever (1) it enters into new lines of business, (2) it exits an existing line of business or engages in other restructuring activities or (3) the company's chief operating decision maker begins to analyze its business in a new or a different way.

Supplemental schedules for certain transactions:

Rule 5-04 of Regulation S-X requires that a number of supplemental schedules be provided for particular industries and under certain circumstances. Each of these schedules contains additional financial information that must be audited by the company's independent accountant:

- Schedule I—Condensed Financial Information of Registrant must be filed when the restricted net assets of

consolidated subsidiaries exceed 25% of consolidated net assets as of the end of the most recently completed fiscal year. For purposes of this test, restricted net assets of consolidated subsidiaries are the amount of the company's proportionate share of net assets of consolidated subsidiaries (after intercompany eliminations), which, as of the end of the most recent fiscal year, may not be transferred to the parent company by subsidiaries in the form of loans, advances or cash dividends without the consent of a third party (e.g., lender, regulatory agency, foreign government).

- Schedule II—Valuation and Qualifying Accounts must be filed in support of valuation and qualifying accounts (e.g., allowance for doubtful accounts, allowance for inventory obsolescence) included in each balance sheet.
- Schedule III—Real Estate and Accumulated Depreciation must be filed for real estate held by companies with a substantial portion of their business involving acquiring and holding investment real estate, interests in real estate or interests in other companies a substantial portion of whose business is acquiring and holding real estate or interests in real estate for investment. Real estate used in the business is excluded from the schedule.
- Schedule IV—Mortgage Loans on Real Estate must be filed by certain companies for investments in mortgage loans on real estate.
- Schedule V—Supplemental Information Concerning Property-Casualty Insurance Operations must be filed when the company, its subsidiaries or 50%-or-less owned investees accounted for under the equity method have liabilities for property-casualty (P/C) insurance claims. The schedule may be omitted if reserves for unpaid P/C claims and claims adjustment expenses of the company and its consolidated subsidiaries, its unconsolidated subsidiaries and its 50%-or-less owned equity method investees did not, in aggregate, exceed one-half of common stockholders' equity of the company and its consolidated

subsidiaries as of the beginning of the fiscal year. For purposes of this test only, the proportionate share of the company and its other subsidiaries in the reserves for unpaid claims and claim adjustment expenses of 50%-or-less owned equity method investees taken in the aggregate after intercompany eliminations shall be taken into account.

Companies in specific industries, including insurance, may have additional supplemental information requirements that vary from those listed above. The schedule information may be provided separately or in the notes to the audited financial statements.

Industry guides: Item 801 of Regulation S-K sets out five industry “guides” requiring enhanced disclosure of financial and operational metrics for companies in certain industries:

- Guide 3—Statistical Disclosure by Bank Holding Companies;
- Guide 4—Prospectuses Relating to Interests in Oil and Gas Programs;
- Guide 5—Preparation of Registration Statements Relating to Interests in Real Estate Limited Partnerships;
- Guide 6—Disclosure Concerning Unpaid Claims and Claim Adjustment Expenses of Property-Casualty Insurance Underwriters; and
- Guide 7—Description of Property by Issuers Engaged or to Be Engaged in Significant Mining Operations.

Guidance for disclosures for companies with oil and gas operations is provided in Item 1200 of Regulation S-K.

Smaller reporting companies: Smaller reporting companies, as defined by Item 10(f)(1) of Regulation S-K, may be eligible for scaled reporting requirements. These scaled requirements streamline and simplify the disclosure requirements to make it easier and less costly for smaller reporting companies to comply. Under the rules, a company qualifies as a “smaller reporting company” if it:

- has a public common equity float of less than \$75 million; or
- has no public float (e.g., companies with no common equity outstanding or

no market price for their outstanding common equity) and has annual revenues of \$50 million or less, upon entering the system; or

- in the case of an initial registration statement, had a public float of less than \$75 million as of a date within 30 days of filing its initial registration statement.

In the case of a company filing an initial registration statement, the public float is computed by multiplying the aggregate worldwide number of common equity shares held by nonaffiliates before the offering plus the number of common shares being offered in a Securities Act registration statement by the estimated public offering price of the common equity shares.

If smaller reporting company status is achieved, the registration statement may comply with the SEC's scaled disclosure system. The scaled disclosure requirements are integrated into Regulation S-X (Article 8 for financial statement requirements) and Regulation S-K (for nonfinancial statement disclosure requirements). A few of the key differences in financial statement requirements are as follows:

- Audited annual financial statements—These include statements of income, cash flows, changes in stockholders' equity and comprehensive income for the past two years, as contrasted to three years for large companies. The balance sheet requirement is the same.
- Financial statements for significant acquisitions—Rule 8-04 of Regulation S-X requires two years of financial statements for a business acquired by a smaller reporting company if the acquisition is greater than 50% significant. Under Rule 3-05, a third year is required if the acquisition is greater than 50% significant and the acquired business had revenues of at least \$50 million in its most recent fiscal year.
- Audited financial statements for significant equity method investments—Article 8 does not require the filing of separate financial statements of investees as would be required under Rule 3-09, but summarized financial information must be disclosed.

If the company qualifies as a smaller reporting company in an initial registration statement, it must reassess this status at the end of its second fiscal quarter in each subsequent fiscal year. If the company fails to meet the test, a transition to the larger company reporting requirements commences with the first quarter of the subsequent fiscal year.

Emerging growth company: The JOBS Act created a new category of public equity issuers called emerging growth companies that are exempt from certain SEC reporting requirements for up to five years. (For a more detailed discussion of the JOBS Act, see Chapter 4). An EGC⁸ is a company that has not had an initial sale of registered equity securities on or before December 8, 2011 and has total annual gross revenues⁹ less than \$1 billion for its most recently completed fiscal year.

Among the reduced reporting requirements allowed an EGC under the JOBS Act are the following:

- An EGC may limit presentation of audited financial statements in the initial registration statement of its common equity securities to the two most recent fiscal years.^{10,11,12} The JOBS Act does not change the existing

requirement that registrants present unaudited financial statements for the most current interim period and comparative prior year period in registration statements.

- An EGC may comply with the management’s discussion and analysis (MD&A) and selected financial data requirements of Regulation S-K by presenting information about the same periods for which it presents financial statements in an initial registration statement.
- Because an EGC is not required to present more than two years of audited financial statements in a registration statement for an initial public offering of its common equity securities, the SEC will not object to limiting the years of financial statements provided under Rule 3-05 or 3-09 to two years. The SEC staff would also not object if an EGC voluntarily provides the third year of audited financial statements in the initial registration statement but chooses to provide only two years of audited financial statements under Rules 3-05 or 3-09 when three years of audited financial statements may otherwise be required based on the significance of the acquired business or equity method investment. An EGC will also be allowed to apply these accommodations to any other registration statement it files.
- An EGC may apply the effective date provisions applicable to nonpublic companies for adoption of new or revised accounting standards issued by the FASB but must make this choice at the time the company is first required to file a registration statement, periodic report, or other report with the SEC.¹³

⁸An FPI may also qualify as an EGC.

⁹“Total revenues” means the revenues presented in a company’s most recent fiscal year’s income statement prepared under U.S. GAAP (for domestic companies and foreign companies that present a reconciliation to U.S. GAAP) or International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board (IASB).

¹⁰The JOBS Act provision that permits an EGC to file only two years of audited financial statements is limited to the registration statement for the EGC’s initial public offering of common equity securities. However, an EGC will not be required to include, in its first annual report on Form 10-K or on Form 20-F, audited financial statements for any period prior to the earliest audited period included in the registration statement filed in connection with its initial public offering of common equity securities.

¹¹If an EGC is not a smaller reporting company, it must include three years of audited financial statements in its initial registration statement for debt securities.

¹²An FPI qualifying as an EGC may comply with the scaled disclosure provisions in a Form 20-F. If an FPI takes advantage of any benefit available to an EGC, then it will be treated as an EGC.

¹³EGCs must adhere to public company effective dates for all standards issued prior to April 5, 2012. Any update to the FASB’s Accounting Standards Codification after April 5, 2012 would be eligible for adoption according to the private company timetable. If an EGC elects to comply with public company effective date provisions, it must comply with them consistently for all new and revised standards throughout the period it qualifies as an EGC.

- An EGC is exempt from the requirement for auditor attestation of internal control over financial reporting (ICFR).¹⁴
- An EGC may report using the scaled disclosure requirements available to smaller reporting companies for executive compensation disclosures.

An EGC retains this status until the earliest of:

- the last day of its fiscal year in which it has total annual gross revenues of \$1 billion or more;
- the last day of its fiscal year following the fifth anniversary of the date of the first sale of common equity securities pursuant to an effective registration statement;
- the date on which the issuer has issued more than \$1 billion in nonconvertible debt during the previous three-year period; or
- the date on which the issuer is deemed to be a large accelerated filer.

An EGC must continually reevaluate its ability to qualify for EGC status. If an entity fails to qualify for EGC status at any point, the entity must follow certain transitional rules and commence complying with non-EGC reporting requirements during the year in which the entity no longer qualifies as an EGC. See Chapter 4 for further details of transitional offboarding rules.

Summary: Planning an IPO is a complex undertaking that requires the compilation and collection of numerous financial statements and related information. Knowing what financial statements and other information will be required to complete a registration statement is a critical step in planning an IPO. The company should consult the SEC rules and regulations, as well as its auditor

¹⁴Under existing SEC rules and regulations, newly public entities, other than nonaccelerated filers, begin complying with Section 404(b) auditor attestation of the Sarbanes-Oxley Act with their second annual report filed with the SEC. An EGC will be exempt from this requirement as long as it qualifies as an EGC; however, management’s reporting on internal control is still required, as according to Section 404(a).

and other advisors, to determine what financial information requirements might be applicable in its circumstances to allow for the planning of sufficient time and resources to complete the filing within manageable time frames.

(b) Transition to being a public company

The completion of an IPO marks the start of life as a public company. One of the first challenges for a successful transition is adapting to the new, often more complex, requirements of operating as a public company. New processes may need to be adopted, and management must now consider how decisions affect a much larger group of stakeholders and be conscious of ensuring regulatory compliance. Some of the transition areas that should be considered going forward are outlined below.

Controls and procedures: The level of investor confidence in the reliability of financial disclosures can be a key factor in a public company's success. To help ensure investor—and market—confidence, a public company's internal controls systems must comply with all regulatory requirements. These requirements include quarterly certifications by executives and an audit report on the effectiveness of internal control over financial reporting required by Section 404 of the Sarbanes-Oxley Act, typically as of the second fiscal year-end after the IPO (although an EGC is exempt from the auditor attestation requirement in Section 404(b) of the Sarbanes-Oxley Act for as long as it qualifies as an EGC).

Complying with Section 404 requires a significant investment of resources over several months to move through a project plan that includes a number of phases, such as:

- assessing financial statement and general and specific fraud risks;
- evaluating the control environment, entity-level controls and general IT controls;
- identifying significant accounts and disclosures;
- defining significant locations and business units;
- documenting processes involving major classes of transactions;
- identifying significant risk points and key mitigating controls;

- providing preliminary assessment of effectiveness of design and operation of key controls;
- remediating missing and ineffective controls;
- demonstrating consideration of the regulatory risks and environment; and
- conducting final tests that support an assertion of effective internal controls over financial reporting.

Section 6.1 contains a more detailed discussion of the SOX compliance requirements.

Financial accounting department:

The process leading up to filing of the registration statement requires the gathering of various financial information. The company can utilize external advisors to assist in gathering this information, but once an IPO is completed, internal resources should be in place to support the ongoing reporting needs of a public company. The company will need to:

- prepare ongoing reports that provide financial and nonfinancial information at a level of detail and in a time frame that generally was not required in the past;
- develop a public entity organizational structure and recruit appropriate personnel to satisfy its public reporting requirements;
- develop sufficient resources or processes to perform regular and consistent financial close and reporting processes to meet reporting requirements;
- develop or enhance its accounting and reporting policies and procedures;
- enhance the training and skills of its existing workforce involving accounting and reporting requirements of public companies;
- develop or enhance its budgeting, forecasting and financial modeling processes to reflect its operations as a stand-alone entity with public shareholders; and
- change underlying business processes to meet appropriate metrics or best-in-class services.

After the IPO, the company will be subject to strict SEC reporting time lines for quarterly and annual reporting. It will

also be required to file current reports on Form 8-K after the occurrence of certain specified material events within four business days of the occurrence of the event. Many private companies are unaccustomed to formal accounting closes for interim reporting periods and the strict reporting time lines for both quarterly and annual periods. In anticipation of going public, the following are some actions that the company should take in advance of the IPO:

- Evaluate the current financial close process in light of post-IPO requirements and consider early implementation of an accelerated close time line that will be required of an SEC issuer, including the gathering of disclosure information for notes to the financial statements. Reducing the financial close cycle time will most likely involve changes in processes, IT systems and possibly resources. The transition to an established process can take time, but it is imperative that these modifications be in place before the first Form 10-Q or Form 10-K is required.
- Evaluate the finance and accounting departments' organizational structure and skill sets of key personnel in light of post-IPO reporting requirements, and identify gaps. Gaps can be filled by recruiting additional staff and providing training for current personnel.
- Draft an accounting policy manual. Many private companies have informal policies and procedures, but public companies should have documented accounting policies as a component of their internal control environment.

Budgeting and forecasting: After the IPO, investors will expect the company to implement the plans presented in the prospectus. The following are some of the organizational changes that the company should consider:

- Review business strategies, forecasting processes and cost infrastructure in order to help ensure its competitiveness and meet shareholder expectations.
- Develop an investor relations infrastructure and resources.
- Develop or enhance budgeting, forecasting and financial modeling processes.

- Determine key performance indicators to be used to communicate business performance to stakeholders that are in line with industry practices.
- Design appropriate compensation programs that align and incentivize employee behavior and focus with the overall business strategy and key objectives.

The company's strategic plan should encompass both external and internal factors that span the entire organization. The plan establishes the framework for the annual budget, providing the top-down direction, financial targets and key assumptions.

The annual budget should focus on key operational drivers of the business for both revenue and cost with key inputs from senior management. The budget process should be flexible and have a short cycle time to accommodate market-driven changes.

Forecasting should be a periodic update to the budget (and strategic plan) that reflects changes and impacts actually being experienced in the marketplace. Although implementation of forecasting is generally the domain of the finance department, ownership of the process belongs with the recipients of the results, including operational management. The process should involve a focused, bottom-up process based on specific, measurable drivers and should closely involve operational managers.

If the company does not have adequate sales forecasting, it may consider using key performance indicators, industry trends or other third-party data to benchmark target sales numbers. Similarly, external cost trends and industry averages can help quantify or even qualify expense forecasts. Creating standardized relationships between internal and external financial and operational sources can provide both insight and consistency in the forecasting process, and also identify a baseline to measure the company's performance relative to the industry.

At a minimum, forecasts should be updated semiannually, but more frequent updates are preferable. The actual results may prompt changes in strategies, priorities and resource allocation, with

subsequent period forecasts reflecting the impacts of such changes. Ideally, the subsequent year's budgeting process should be embedded in the forecasting process during the latter part of the current fiscal year.

XBRL: During 2009, the SEC issued new rules and related guidance that requires public companies (both domestic and foreign private issuers) to provide their financial statements to the SEC in a separate exhibit to certain reports and registration statements in an interactive data format using Extensible Business Reporting Language (XBRL). The rules are designed to make it easier for analysts and investors to locate and compare data on financial and business performance in a standard format across all public companies. The XBRL rules also require public companies to post their XBRL filings on their corporate websites. With interactive data, all of the items in a financial statement are labeled with unique computer-readable "tags," which make financial information more searchable on the Internet and readable by spreadsheet and other software.

XBRL is not required for IPOs, but a company with an IPO that becomes effective will be required to comply with the XBRL rules commencing with periodic filings starting with its first Form 10-Q filed after the registration statement becomes effective. The rules should be consulted regarding when initial compliance with the rule commences, as this will be dependent on the timing of the IPO.

Technology considerations: Information technology is a critical enabler for the company in creating value and achieving financial reporting and regulatory compliance. Companies that have not adequately invested in technology and tools for financial reporting and business operations may struggle with technology and system limitations in meeting the needs of a public company. This may require additional resources to ensure business processes are adapted to meeting IT system needs. In addition, the company may need to implement new technology and systems or customize existing systems and reports.

The IT effort required for compliance with establishing, evaluating and obtaining an audit of ICFR should not be underestimated. Information technology plays a large role within the internal control structure and is an integral part of SOX compliance. A systems-embedded approach to the financial reporting process can include automated key controls to reduce the overall number of controls.

IT strategy can be a key driver in accelerating the accounting close process through the reduction or consolidation of multiple general ledgers, charts of accounts and reporting systems. For systems that have disparate interfaces or lack real-time reporting capabilities, modifying the existing system's capabilities or building the case for an enterprise resource planning system may be warranted.

Greater use of IT systems can also enhance the budgeting and forecasting process and allow for the leveraging of information more effectively. Communication requirements to key stakeholders after the IPO about the performance of the company should be aligned with external reporting. Implementation of an integrated system providing both external and management reporting can provide timely, quality information.

Summary: Becoming a public company often requires management to make numerous improvements to business processes and the underlying systems as they react to the demands of investors, government regulators and other stakeholders. Preparing for this change in status may require considerable time and effort. To achieve a more seamless transition, the company should consider taking steps to operate and report like a public company before the IPO becomes effective to ease the post-IPO transition.

2.3 Antitakeover defenses and other governance matters

Cleary Gottlieb Steen & Hamilton LLP

Before going public, the company will need to ensure that its governance structure meets SEC and stock exchange requirements. This is the ideal time for the company to consider organizational matters more generally, implement desired changes to the company's jurisdiction of organization, subsidiary

framework and capital structure and put in place a strong board and governance structure, including antitakeover defenses, for a number of reasons:

- Changes after the IPO will be very visible, likely requiring disclosure, governance document posting and potential filings.
- Post-IPO changes may require stockholder approval, which may be difficult to obtain.
- Some governance requirements, such as identifying independent directors, should be initiated early in the process, as they may take considerable time.

It is important that the company work closely with the underwriters to develop a properly balanced board and governance structure, as certain elements may affect investor interest and, ultimately, pricing. The company should also anticipate the makeup of its stockholder base. What percentage of stockholders are likely to be institutional investors compared to retail investors? Are there likely to be any hedge funds or stockholder activists? Going forward, these characteristics of the stockholder base will be an important element of investor relations. Governance matters have become a central focus of activist stockholders, as well as investment advisory firms such as ISS and Glass Lewis, which evaluate a company's governance structure in making stockholder voting recommendations.

This chapter describes the governance structure for a U.S. domestic company and, in particular, a Delaware corporation. For a discussion of governance issues relevant to foreign private issuers, see Section 9.7.

Board of directors and board committees:

A public company's board composition and structure are often very different from those of a private company. A U.S. public company must comply with governance requirements imposed by stock exchange listing requirements and SEC rules, as well as related disclosure requirements. For more information about these stock exchange listing requirements, see Section 6.2.

In particular, the stock exchanges, including the NYSE, require that the board of directors have a majority of independent directors within one year of listing. In addition, post-IPO, the

company must have an audit committee meeting SEC and stock exchange rules on composition, independence and financial expertise and under stock exchange rules must also have compensation and nominating committees made up of independent directors. As required under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), the stock exchange rules now also contain additional independence requirements for compensation committee members. Some of these governance requirements can be phased in following the IPO, but the company generally must be fully compliant within one year. "Controlled companies," or companies with a majority stockholder, are exempt from most of these requirements except the audit committee rules. Other SEC and U.S. tax rules also typically influence the composition of the compensation committee, as discussed in Section 2.4, as well as "interlocking" relationships with other companies.

Beyond the required structures, the company should carefully consider the right mix of board member qualifications; and a larger board, with more than seven or eight members, might warrant the formation of other standing committees, such as a finance committee or a risk committee.

Antitakeover defenses: Antitakeover defenses are a key element of pre-IPO governance planning. Achieving the right balance is important, as too strong a defense profile may be disfavored by investors, which often benefit from stock price premiums in a takeover context; many of these protections may attract negative stockholder attention and proposals for change down the road. The defenses an IPO company may consider include the following:

- **Poison pill (or "rights plan")**—Increasingly a focus of pressure from activist stockholders, the poison pill remains the most potent structural takeover defense. Under a typical poison pill or rights plan, the company issues rights to the existing stockholders. These rights allow holders (other than a bidder) to purchase stock in the target or in the acquiring company at a steep discount

(usually half price) if a hostile bidder acquires a certain percentage (usually 15% or 20%) of the outstanding shares. This dilutes the voting power of the bidder and makes it more expensive to acquire control of the target. Although their terms and conditions vary considerably, the purpose of a poison pill is to force potential bidders to negotiate with the target's board of directors. The rights usually have redemption provisions that permit the company to redeem the rights at a nominal price. If the acquisition is friendly and the board approves the deal, it may use this feature to redeem the pill or otherwise exempt the transaction.

- **Controlling changes to the board of directors**—Various charter or bylaw provisions related to changes in directors can make it more difficult for hostile bidders or dissidents to influence and control a board of directors, although these are also under pressure from activist stockholders. For example, with a typical classified or staggered board having three classes of directors, each elected for a three-year term, only one-third of the directors are up for renewal at each annual meeting. The company may wish to avoid other provisions that make it easier for an insurgent group to force changes in directors and thus gain control, such as cumulative voting, which can result in the election of a director with the support of only a small percentage of stockholders, and provisions allowing stockholders to remove directors without cause, increase the number of directors without limit and fill board vacancies. The company should also consider whether to adopt a plurality or majority voting standard for director elections. While plurality voting generally increases the likelihood that management's director nominees will be elected, majority voting provides for a more democratic process and has gained in popularity over the past several years, with a strong focus by activist stockholders and investment advisory firms.

- **Stockholder action provisions**—The company can improve its defensive posture by regulating the methods by which a hostile bidder can call for and obtain a stockholder vote on director elections or other proposals that may facilitate a takeover. Charter and bylaw provisions can be used to limit the ability of the hostile bidder to call special meetings or bypass the meeting requirement altogether by the use of a written consent of the stockholders. The company may also wish to consider provisions requiring stockholders to give adequate advance notice and supply information before their proposals are added to the agenda of a regular or special meeting.
- **Supermajority voting**—“Supermajority” voting requirements may be imposed for mergers and other specified transactions between the company and an “interested stockholder,” which may be defined, for example, as a holder of more than 10% of the outstanding shares. Thus, an 80% vote might be required to approve an acquisition of the company by a major stockholder, instead of the more typical 50% or 66%. A fair price condition may be incorporated into the supermajority provision, requiring a supermajority vote, for example, when an interested stockholder proposes a merger at any price less than the highest price paid for any share of company stock by the interested stockholder.
- **Business combinations with interested stockholders**—For example, under Delaware law, an “interested stockholder” (generally a holder of 15% or more of the voting stock) is generally prohibited from engaging in a business combination with the company for three years after the holder became an interested stockholder. Although a Delaware corporation can expressly elect in its charter not to be subject to this “freeze-out” statute, it can be an effective antitakeover defense.
- **Issuance of shares**—The company should ensure that it has a sufficient amount of common and “blank check” preferred stock authorized under its charter. In many jurisdictions, the

company may include in its authorized and unissued stock a certain amount of undesignated preferred shares. The board will be authorized to issue preferred shares in one or more series and to determine and fix the designation, voting power, preference and rights of each series. The existence of blank check preferred stock allows the board to issue preferred stock with supervoting, special approval, dividend or other rights or preferences without a stockholder vote. However, NYSE rules generally require stockholder approval by a majority of votes cast before a company issues shares representing 20% or more of the outstanding voting power outside a public offering. Also, if there is a poison pill, the company should make sure it has sufficient authorized shares for the shares to be issued if the pill is triggered.

- **Change of control provisions**—A common feature of loan agreements and other significant contracts is a provision restricting a change of control of the company, resulting in an event of default if breached. These provisions protect the lender or other contracting party, but reduce the company’s flexibility, particularly in restructuring efforts or friendly takeover transactions, as well as making the company less attractive to a potential acquirer. In 2009, the Delaware Chancery Court raised questions regarding the interpretation and validity of certain of these provisions, as a contractual term that could affect the stockholder franchise. The company should carefully consider these provisions in its existing and proposed agreements, and if they cannot be eliminated, they should be approved at the board level.

Corporate housekeeping: In anticipation of going public, the company should review and clean up documents with provisions that are intended for a private company (e.g., charter documents and stockholder agreements). Similarly, it is important for the company to review corporate minutes and other records to confirm that corporate formalities have been observed and

properly documented, including for the issuance of stock of the company and its subsidiaries.

2.4 Providing for employees

Cleary Gottlieb Steen & Hamilton LLP

In preparing for an IPO, the company should review all of its employee compensation and benefits arrangements in light of the opportunities and responsibilities resulting from the IPO. The major opportunity is the ability to compensate employees with publicly traded stock. The new responsibilities include becoming subject to tax and securities laws that did not previously apply, including Section 162(m) of the Internal Revenue Code of 1986 (the Code), rules for compensation disclosure in annual reports and proxy statements and Section 16 of the Exchange Act. This chapter describes these topics for a U.S. domestic company that does not qualify as an emerging growth company. For certain differences applicable to emerging growth companies, see Chapter 4, and to foreign private issuers, see Chapter 9.

The company’s compensation committee might consider hiring a compensation consultant to help structure new arrangements in light of the IPO. As required by the Dodd-Frank Act, stock exchange listing rules require the compensation committee of a post-IPO company to have the authority and adequate funding to retain or obtain advice from compensation advisers, including compensation consultants and independent legal counsel, and to be directly and solely responsible for overseeing them. In addition, the compensation committee is required to consider specific factors regarding the independence of its advisers but may nevertheless receive advice from an adviser who is not considered to be independent based on those factors. Whether or not it retains advisers, the compensation committee is required to exercise its own judgment in fulfillment of its fiduciary duties.

(a) Equity compensation

Incentive plans: Having publicly traded stock opens up new avenues for compensating employees of the company.

In connection with its IPO, the company should carefully consider putting in place a new equity incentive compensation plan or reviewing and revising any existing plans in light of its status as a public company. Any post-IPO plan should allow the company sufficient flexibility in terms of types of awards and their terms and conditions. The plan should state the aggregate number of shares available to be issued under it. The company needs to consider carefully shareholder dilution concerns and estimated burn rates when determining this number. The company may also wish to hire a firm specializing in stock plan administration to handle the logistics of its equity compensation program.

Any adoption of new plans or changes to existing ones should occur prior to completion of the IPO and, if possible, should be approved by the shareholders of the private company. A plan that has been adopted prior to the IPO may take advantage of grandfather provisions under stock exchange listing rules, enabling it to grant all of the stock reserved under the plan without seeking public shareholder approval of the plan until it either runs out of shares or is materially modified. In addition, if a plan that grants employees tax-favorable “incentive stock options” pursuant to Section 422 of the Code is adopted and approved by the shareholders of the company prior to the IPO, it will not require further approval by shareholders after the IPO until the earlier of 10 years from the adoption date or any amendment of the plan to add additional shares or change eligibility for participation. Pre-IPO plan adoption also provides an advantage under Section 162(m) of the Code, as discussed below.

If the company has previously granted compensation to its employees in the form of equity awards pursuant to exemptions from registration under the Securities Act and Exchange Act, it should review the prior grants to ensure that no action is required (or that any action that may be required is taken) by the company to adjust the terms of the awards as may be necessary or appropriate. For example, if the pre-IPO company is a limited liability company, the awards should be amended to refer to common stock, with any further adjustments necessary to maintain

economic equivalency. If pre-IPO awards were subject to conditions common to private company equity (e.g., a repurchase right upon termination of employment), the company should consider deleting those provisions if they do not cease automatically in accordance with their terms, keeping in mind potential tax and accounting issues. The company should also carefully review its equity valuation methods with respect to pre-IPO grants, both to confirm proper accounting treatment and, with respect to stock options or stock appreciation rights, to confirm that they were granted with exercise prices equal to (or greater than) fair market value in light of Section 409A and Section 422 of the Code.

The company may wish to make equity grants in connection with the IPO to its executives and other employees. These grants would permit the employees to participate in the increase in value of the company following the IPO. The company will need to determine the amount and the type of equity award and may be required to disclose the aggregate amounts and also specific amounts with respect to its “named executive officers”—its principal executive officer, principal financial officer and the three other most highly compensated executive officers (and up to two former executive officers) whose total compensation for the last fiscal year exceeded \$100,000—in the registration statement, as well as a description of the plan.

Other plans: The company could consider adopting a stock purchase plan permitting employees to purchase stock from the company through payroll deductions either at the market price or at a discount, although this is not as common in connection with an IPO as equity incentive plans. Stock purchase plans may be designed to allow for employee-favorable tax treatment under Section 423 of the Code. Adopting a stock purchase plan prior to an IPO provides grandfather benefits under stock exchange listing rules and Section 423 of the Code similar to those for equity incentive plans. In addition, if the company has a defined contribution plan for its employees (e.g., a 401(k) plan), following the IPO, the company could consider making company contributions in stock or adding a company stock fund as an investment

option; but either action must be very carefully reviewed prior to implementation.

Form S-8: The company may register the sale of stock to employees, directors and certain independent contractors under a compensatory plan on a short-form registration statement—Form S-8. Form S-8 incorporates by reference company information from Exchange Act filings. The prospectus delivered to participants need not be filed with the SEC and primarily addresses the terms of the plan.

(b) Section 162(m) of the Internal Revenue Code

Following the IPO, the company will be subject to Section 162(m) of the Code. Under Section 162(m), the company may not take a deduction in its U.S. taxes for compensation paid to a “covered employee” to the extent it exceeds \$1 million for the taxable year (subject to certain exceptions). Covered employees include the CEO and the three most highly compensated executive officers of the company (other than the CEO and the CFO) on the last day of the taxable year, as determined in accordance with the Exchange Act’s executive compensation disclosure rules.

Transition relief: Section 162(m) provides transition relief for a company that becomes subject to Section 162(m) through an IPO (so long as such company was not previously part of an affiliated group that included a company with common stock registered under the Exchange Act).

If compensation (cash or stock) is paid by the company pursuant to a plan or agreement that existed prior to the company becoming publicly held and was disclosed in the IPO prospectus “in compliance with all applicable securities law,” the compensation is not subject to the deduction limit until the earliest of the following:

- expiration of the plan or agreement;
- material modification of the plan or agreement;
- issuance of all employer stock and other compensation allocated under the plan or agreement; or
- the first shareholders’ meeting at which directors are to be elected after the end of the third calendar year following the year of the IPO.

This transition relief also applies to any compensation received pursuant to the exercise of a stock option or substantial vesting of restricted stock granted under such a plan or agreement, so long as the grant occurred on or before the earliest of the specified events.

Performance-based compensation:

Performance-based compensation is not subject to the deduction limit of Section 162(m). To qualify as performance-based, the compensation must be paid solely on account of the attainment of one or more preestablished, objective performance goals, and the following requirements must be satisfied:

- Certain actions are taken by a board compensation committee consisting solely of two or more “outside directors” (as defined in Section 162(m)).
- The performance goal:
 - is established in writing by the committee before 25% of the performance period has elapsed and in no event later than the 90th day of the performance period;
 - is substantially uncertain to be achieved at the time it is established;
 - is objective such that a third party having knowledge of the relevant facts could determine whether it is met; and
 - precludes discretion to increase the amount of compensation payable that would otherwise be due upon the attainment of the goal.
- The material terms of the performance goal are disclosed to, and approved by, a majority vote of shareholders before the compensation is paid, including the performance goal criteria and the maximum amount of compensation a participant could receive during a stated period.

Although a newly public company will initially benefit from the IPO transition relief, it will eventually need its compensation committee to be comprised of outside directors for purposes of this performance-based compensation exception and to conform its plans and practices to the extent necessary.

(c) Section 16 of the Exchange Act

Upon the IPO, company directors and officers (as defined in Section 16) and 10% beneficial owners of company stock will become “Section 16 insiders” subject to the reporting and short-swing profit provisions of Section 16 of the Exchange Act. For more information about Section 16 filings, see Section 7.3.

(d) Executive compensation and other arrangements

The company should also review its employment, severance and change-in-control agreements, if any, and consider the pros and cons of adopting or amending those agreements in light of the company’s changed circumstances. When making its decision, the company should keep in mind the detailed compensation disclosure that will be required both in the IPO prospectus and, going forward, in its annual proxy statements and the intense scrutiny that disclosure will receive. In addition, the company should review any arrangements that may be considered direct or indirect loans or other extensions of credit by it or its subsidiaries to any of its executive officers or directors, as these must generally be terminated prior to effectiveness of the registration statement filed with the SEC to comply with SOX.

(e) Say-on-pay voting

SEC rules implemented under the Dodd-Frank Act require shareholder votes on executive compensation, or “say-on-pay.” The company is required to hold the following votes at the company’s first annual meeting following its IPO:

- Say-On-Pay Vote—a nonbinding shareholder vote to approve the compensation of the company’s named executive officers as disclosed and described in the company’s most recent proxy statement. The vote must occur at least once every three calendar years.
- Say-On-Pay Frequency Vote—a nonbinding shareholder vote to approve the frequency of the say-on-pay vote. The say-on-pay frequency vote must occur at least once every six calendar years.

These two votes are both nonbinding votes that do not overrule the compensation

decisions of the company’s board of directors, and they do not impose additional fiduciary duties on the board of directors or any committee.

The SEC rules also require a company to provide disclosure about compensation arrangements with executives to be entered into in connection with an acquisition, merger, consolidation or sale or other disposition of all or substantially all assets of the company. These arrangements are commonly referred to as “golden parachutes.” Unless the golden parachute compensation arrangements were previously subjected to a say-on-pay vote (whether or not approved by shareholders), a nonbinding shareholder advisory vote on the arrangements must also occur at the meeting at which the company’s shareholders are asked to approve the related transaction.

(f) Clawback policies

The Dodd-Frank Act also requires the SEC to publish rules (to be implemented by stock exchanges) prohibiting any company from listing a security if it fails to adopt a specified clawback policy. The clawback policy, which is triggered upon an accounting restatement due to material noncompliance with the financial reporting requirements of the federal securities laws, requires recovery of any incentive compensation from executive officers that was based upon the erroneous financial data. This financial recoupment is required from any current or former executive officer during the three-year period preceding the date on which the company is required to prepare the restatement, regardless of whether there was misconduct by the covered executive officers. (The Sarbanes-Oxley Act authorizes the SEC to seek similar recoupment from the CEO and CFO, but only if the restatement is the result of misconduct, albeit not necessarily by the CEO or CFO.) Under the formula, the clawback is calculated as the excess amount paid out to such executive officers over what would have been paid out based upon the restated results.

The SEC has not yet published rules implementing this requirement,

so adoption of a clawback policy is not yet mandatory. Nonetheless, as a result of shareholder proposals and good corporate governance practices, many companies have begun to implement and publicly disclose clawback policies, although not necessarily based on the Dodd-Frank model. Accordingly, a company preparing for an IPO may want to consider implementation of a clawback policy.

2.5 NYSE Governance Services: Reviewing and verifying your program, meeting regulatory standards

NYSE Governance Services

In anticipation of an IPO, a company should review and verify its internal readiness from an ethics and compliance standpoint, specifically taking into account the requirements of the seven “hallmarks” set forth by the U.S. Federal Sentencing Guidelines for Organizations, as amended (FSG).¹⁵ Compliance with the FSG is vitally important since it can lead to a reduced sentence for organizations convicted of a federal crime if the organization can demonstrate that, notwithstanding the violation, it had an effective ethics and compliance program in place. In addition, each listed company must have a code of conduct and ethics complying with SEC rules and market listing requirements that is applicable to all directors, officers and employees. Therefore, having a truly “effective compliance and ethics program,” as set forth by the FSG, is one of the most important first steps in planning an organization’s IPO.

According to the FSG, an effective compliance program is one through which an organization exercises “due diligence to prevent and detect criminal conduct” and otherwise promotes “an organizational culture that encourages ethical conduct and a commitment to compliance with the law.” It is important to note that the FSG do not require that an

effective program catch every instance of criminal conduct; rather, the commission emphasizes the need for a program that is “generally effective in preventing and detecting criminal conduct.” The FSG set forth seven factors used to evaluate a program’s effectiveness, including written standards, board oversight, high-level personnel assigned to program, due diligence, training and communication, monitoring and auditing and enforcement. It is important to note that these are considered minimum requirements.

Any program that fails in one of these categories would not be deemed effective, although the FSG do allow the size of the company to determine the formality of its program.

In order to assess a company’s readiness for an IPO from an ethics and compliance perspective, it should take into account the requirements of the seven “hallmarks” set forth by the FSG, review and update the company’s ethics and compliance program and confirm that the organization meets all requirements for a truly effective program.

To address these hallmarks while preparing for IPO, the company should consider the following:

- Written standards—develop appropriate written standards, policies and procedures. If the company already maintains a code of conduct or other policies addressing ethics and compliance issues, review and verify that all areas are up-to-date and reflect best practices, as appropriate.
- Board of directors oversight—delegate oversight responsibility to a subcommittee (e.g., the Audit Committee or the Corporate Governance Committee) and adopt or amend committee charters, as appropriate.
 - Ensure that a compliance officer is regularly reporting to a subcommittee of the board (i.e., at every regularly scheduled meeting and more often as necessary) and that the subcommittee is regularly reporting to the full board (i.e., at every regularly scheduled meeting and more often as necessary), both of which have had detailed discussions as a group about the

content, format and functioning of the compliance program.

- Provide code of conduct and relevant policy training to the board. The FSG do not require that the board complete the same training program administered to the organization’s employee base. Rather, the FSG state that the board should be “knowledgeable about the content and operation of the compliance and ethics program.”
- High-level personnel assigned overall responsibility for the program—assign responsibility for the compliance program to an appropriate high-level individual.
 - Note that the FSG specifically require that the individual(s) given operational responsibility have adequate resources, appropriate authority and direct access to the governing authority or subgroup thereof. Many companies have gotten themselves into trouble (e.g., Fannie Mae) when senior management has attempted to interfere with the compliance officer reporting directly, for example, to the chair of the audit committee without “clearing” the report through senior management first. Under the stipulations of the FSG, this is not adequate.
 - Additionally, the FSG require that anyone who the organization knew or should have known had engaged in illegal activities or other conduct inconsistent with an effective compliance and ethics program should not be included among the group of individuals charged with responsibility for the compliance program. A robust program under the FSG would perform background checks upon hire and additional screening upon promotion and would require annual conflict of interest certifications in which those individuals responsible both for oversight and operations of the compliance program would disclose any government, vendor, customer or competitor conflicts, board memberships and substantial gifts

¹⁵See generally United States Sentencing Commission, Guidelines Manual (“USSG”), and Chapter Eight –Sentencing of Organizations (Nov. 2010).

and criminal history. Those forms would be vetted on an annual basis to make certain the individuals responsible for setting an ethical tone were not themselves creating problems for the company.

- Training and communication—periodically issue communications surrounding the ethics and compliance program and conduct effective ethics and compliance training throughout the company.
- Monitoring and auditing—periodically monitor and audit the organization’s ethics and compliance program to determine its effectiveness. Measure the performance of the ethics and compliance program through benchmarking and internal data review.
- Enforcement—build effective incentives and disincentives into the company’s compliance program.
 - To date, many companies have not incorporated incentives into their compliance program. Those that have generally consider ethical behavior as a component of annual performance reviews (with full disclosure ahead of time) and in promotion decisions.
 - The FSG require that a company take appropriate disciplinary measures for either engaging in criminal conduct and for failing to take reasonable steps to prevent or detect that conduct. Thus, a robust code will detail a variety of consequences and make certain that some sort of punitive action is an option both against the individual committing the criminal conduct and against his or her supervisor.
 - In the event criminal conduct is detected, the company should document its response—and, in particular, any changes that were made to the code or program in response to that conduct. The FSG expect compliance programs to be living entities that adapt and change over time.●

3

The IPO process

3.1 Process timeline

J.P. Morgan (Investment Banking)

The process of planning and executing an IPO is time-intensive and, for a domestic issuer, typically takes 14 to 16 weeks from organizational meeting to closing, though the exact time taken can vary widely and depends on market conditions, the complexity of the transaction, the company's readiness prior to embarking on the IPO process and many other factors. Achieving this timeline requires significant preparatory efforts, in particular to ensure the required financial disclosure is available on a timely basis such that drafting of the principal document can proceed as outlined below.

There is typically a large team of professionals involved in the IPO process, including the company, legal counsel, auditors and underwriters, among others. The key workstreams are drafting of the registration statement, due diligence (business, financial and legal), preparation of transaction documentation and other marketing materials (e.g., roadshow presentation).

The preparation process can be broken down into the following key stages:

The pre-filing phase

(a) Week 1

Organizational meeting: All key members of the IPO working group meet to discuss the specifics of the offering, including timing, key tasks, and roles and responsibilities for the IPO process. The meeting is typically held at the company's headquarters or company counsel's offices, with 20 to 40 people attending. The lead bookrunner(s) typically prepares an organizational book that details all of the aforementioned items. This meeting is usually combined with a presentation from the company's CEO, CFO, general counsel and key divisional managers on the company's business. All together, these meetings typically last a day, at the end of which the working group will have a good understanding of the company's business, financial position and any key issues affecting it, as well as a clarity on the critical path for execution of the IPO.

(b) Weeks 2 to 5:

Drafting: The principal document that is created when going public is a registration statement and has the dual purpose of registering the securities with the SEC and acting as a marketing document when selling the IPO to investors. The drafting of the registration statement is a collaborative process among the company, the underwriters (typically led by the lead bookrunner(s)), the company's and underwriters' counsel and the company's auditors. The company relies heavily on the bookrunners to craft an appropriate marketing story and consults closely with its auditors when preparing the financial disclosure.

Due diligence: The purpose of due diligence is twofold: first, and most importantly, to ensure the accuracy, completeness and truthfulness of the company's registration statement; second, to provide the underwriters (and certain other offering participants) with a so-called due diligence defense against liability arising in connection with any material misstatements and/or omissions in the offering disclosure. Due diligence is conducted by all members of the working group and is iterative in nature, continuing right up to closing of the IPO, though it should be substantially complete by the time of the initial filing of the registration statement.

The underwriters and their counsel will conduct extensive business and financial due diligence on the company, focusing primarily on the company's operations, procedures, financials (both historical and prospective), competitive position and business strategy, as well as on the management team and key board members. As part of this process, the underwriters will have detailed discussions with the company's management, customers, suppliers and any other relevant parties, and will review agreements with and documentation relating to any of the aforementioned parties, workforce, creditors or other related parties.

Counsel to the company and the underwriters will also conduct legal due diligence, which is primarily documentary in nature and focuses on verifying the company's legal records, material contracts,

any litigation and compliance with local, state and federal laws and regulations.

Legal and other documentation: In addition to assisting with drafting the registration statement and participating in due diligence, the company's and underwriter's counsel will work with the underwriters, the company and the auditors to draft and complete the following documentation:

- underwriting agreement;
- lock-up agreements for existing shareholders (typically signed before filing of the registration statement);
- legal opinions;
- comfort letter; and
- press releases announcing the filing, launch and pricing of the transaction.

Determine listing venue: The company, with the assistance of the bookrunners, should determine whether it is eligible to list on the NYSE or another exchange, hold discussions with the exchange and reserve a ticker symbol.

(c) Week 6

Valuation update with the investment bank: It is prudent to have relatively frequent valuation updates with the bookrunners, particularly as market conditions shift and as the company achieves key milestones throughout the IPO process. This ensures that all parties are regularly updated and aligned on valuation expectations and avoids any mismatch as the company progresses toward launch of the IPO.

Legal and other documentation: Continue drafting and negotiating legal documentation and comfort letter.

Syndicate equity research analyst briefing: At some point prior to the initial SEC filing, it is customary for the company to provide a briefing to the underwriters' equity research analysts. This will typically be a modified form of the company presentation delivered by management to the working group at the beginning of the IPO process. It will be followed by an iterative process between the research analysts and management as they develop their understanding of the company, its business model, and their views on valuation.

Underwriter internal approvals: Prior to filing the initial draft registration statement with the SEC, or otherwise making public the underwriters' names in connection with the IPO, the underwriters will typically need to clear internal committees. This involves presenting the company to an internal committee, a review of the draft registration statement disclosure and discussion of any issues that came to light during the due diligence process.

SEC submission of draft registration statement: To commence the process of SEC review of the registration statement, the company must file it with the SEC, together with various exhibits. Under the JOBS Act, emerging growth companies have the option of making a confidential submission, as opposed to a public filing, and many EGCs take advantage of this option, as discussed further in Section 4.3. Companies that elect confidential review must make a public filing of the draft registration statement at least 21 days before the start of the IPO roadshow.

The waiting period

(d) Weeks 7 to 8

Roadshow presentation and marketing strategy: While the IPO working group awaits comments from the SEC on the draft registration statement, it is prudent to further develop the marketing story for the IPO roadshow. The lead bookrunner(s) will generally spearhead this process, while working closely with the company to create a short, detailed slide deck to be shown to investors during the roadshow. This presentation is typically 20 to 30 slides in length and details the offering, the company's products and services, key selling points, industry trends and growth opportunities, competitive positioning and financial performance.

For EGCs, as discussed further in Section 4.3, another topic of discussion with the bookrunners is whether to take advantage of the JOBS Act provisions allowing them to "test the waters" prior to launch of the IPO, in order to assess potential demand for the offering and identify and address any issues that investors may raise.

Legal and other documentation: Continue drafting and negotiating legal documentation and comfort letter

Agree on offering structure: The company, in conjunction with the lead bookrunner(s), should determine the appropriate proceeds to raise in the IPO in order to be well capitalized for 18 to 24 months after the IPO, taking into account its strategic goals, as outlined in the registration statement. In addition, the company should approach its shareholders and discuss the extent to which they may wish to sell part of their holdings in the IPO. In doing so, the company will be mindful of any IPO participation rights granted to shareholders under registration rights and other similar agreements that may exist with existing stock holders.

(e) Weeks 9 to 13

Receiving and addressing SEC comments: The SEC takes approximately 30 days to complete its initial review of the draft registration statement, at which point it will respond to the company and its counsel via a formal comment letter in which it makes certain observations on the company's draft disclosure and invites the company to address these by making revisions and filing a series of amendments, to its draft registration statement. The initial comment letter is the beginning of an iterative process with the SEC, which typically requires at least three amendments and can last up to six weeks, depending on a number of variables.

Legal and other documentation:

Continue drafting and negotiating legal documentation and comfort letter.

Roadshow presentation: Continue refining the roadshow presentation and rehearsals with CEO/CFO and any other members of the roadshow team.

Valuation and price range discussions: Continue periodic valuation discussions with the underwriters and formulate a preliminary price range to be provided confidentially to the SEC as an indication of where the offering price range will be. This often involves a share split or consolidation to achieve the desired range.

Agree on marketing strategy: The company and the bookrunners should decide which regions and specific cities to visit on the IPO roadshow, the length of the roadshow and which investors to target as potential buyers of the IPO.

The marketing/execution phase

(f) Week 14

Registration statement and other documentation: Having cleared all SEC comments and amended the registration statement to reflect any stock split and the offering price range, finalize all other documentation, including underwriting agreement, comfort letter and launch press release.

Roadshow preparation: Finalize the roadshow presentation, hold roadshow rehearsals and make all logistical preparations for roadshow launch. Finalize legal documentation.

(g) Weeks 15 and 16

Launch IPO: File an amendment to the registration statement with price range (the so-called "red herring"): Conduct management presentations to the bookrunners' equity sales forces, and commence the roadshow, consisting of between 8 and 12 days of investor meetings.

Pricing and closing: Having built a book of demand, the bookrunners will agree on the offering price with the company and shareholders and, having executed the underwriting agreement, proceed to allocate the IPO to investors. The following day, the company begins publicly trading on the NYSE, rings the opening bell and hosts other key marketing events associated with being a public company. Three business days later, the IPO closes, at which point stock is delivered to investors against payment of the offering price, and various legal opinions are delivered by counsel.

(h) Aftermarket

Depending on the trading performance of the stock, the underwriters may either intervene to "stabilize" the stock in order to smooth out short-term volatility (in the case of a stock that falls below issue price post-IPO) or exercise the greenshoe (in the case of a stock that trades comfortably above issue price post-IPO).

3.2 SEC registration

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Before undertaking an IPO, the company must file a registration statement with the SEC, and it must be declared effective

by the SEC. The registration statement includes the prospectus that is provided to prospective investors and other material that is also publicly available. The registration statement is the company's responsibility, even if the IPO is made up entirely of shares being sold by existing shareholders (a "secondary" offering) and the company will not sell any shares or receive any proceeds.

The preparation of the registration statement is a principal focus of the IPO process. It has three different aspects:

- Regulatory—The registration statement must comply with detailed SEC rules governing its content and will be subject to intensive review by the SEC staff.
- Marketing—The prospectus, which is part of the registration statement, is the central item in the marketing of the offering, so it must effectively convey the arguments for investing in the company.
- Liability protection—A materially misleading statement or omission can result in liability to purchasers for the company, the underwriters and other participants, so particular care should be taken with the contents of the registration statement and the prospectus.

Reconciling these three aspects of the registration statement is an important challenge for the IPO working group.

Somewhat different rules apply to the registration process for an emerging growth company (described in Chapter 4) and a foreign private issuer (see Chapter 9). The remainder of this chapter describes the registration process for a U.S. domestic company that does not qualify as an EGC.

(a) Statutory framework

The IPO process can be divided into three main stages based on the regulatory framework set forth in Section 5 of the Securities Act. Before the registration statement is filed there is a "quiet period," when no offers are permitted. Between filing and effectiveness of the registration statement, there is a "waiting period," when offers may be made, but written offers are subject to content regulation and filing requirements. Only in the third stage, after the registration statement becomes effective, are sales to investors permitted.

The preliminary prospectus—often called a "red herring" because of the red legend on the cover indicating its preliminary nature—is the principal instrument for marketing the shares during the waiting period. Copies of the preliminary prospectus are distributed to the salesforce of the underwriting and selling syndicate members and provided to prospective buyers. It is substantially complete, except for the key points that are determined at the end of the marketing period: the price, the actual proceeds, the underwriting commitments and related matters. Although the price is not yet available, the preliminary prospectus includes an estimated range for the final price.

The "final" prospectus, with final information on pricing and underwriting, must be filed within two business days after pricing. It is often delivered to investors as well, though this is no longer required.

(b) Gun jumping

The law regulates *offers* of securities (and particularly *written offers*) as well as *sales*. During the quiet period, no offers may be made, whether written or oral. During the waiting period, no written offers may be made except by means of the preliminary prospectus. Violations of the restrictions on offers during each stage are sometimes referred to as "gun jumping" and can result in the SEC imposing a delay or "cooling-off period" to allow the effects of the impermissible offer to dissipate.

These rules can take an IPO participant by surprise, particularly because of the broad definitions given to the terms *offer* and *written*. For example, under some circumstances a discussion of the company's business prospects could be construed as an offer, and a discussion with a journalist who plans to publish could be construed as a written offer. Because the terms are so broad, offering participants must be careful to distinguish between permissible communications and illegal offers and avoid any conduct or communications that could be construed as impermissibly conditioning the market for the securities to be offered.

(c) SEC review and declaration of effectiveness

The IPO cannot be completed until the registration statement is effective,

which generally requires an affirmative declaration by the SEC staff. Before providing this declaration, the staff reviews the registration statement, provides comments and requires that its comments be addressed to its satisfaction. The comments are provided in written comment letters. The company's response generally takes the form of an amendment to the registration statement, accompanied by a response letter explaining how the company has addressed the matters raised in the staff's comment letter.

SEC review of an IPO registration statement is very thorough, and the process of responding to the comments is a major driver of the timing of the IPO and often the content of the disclosure. The staff usually provides the first comment letter within four to six weeks of filing. After that, the amount of time required to reach effectiveness can vary widely, depending on the nature of the comments and the work required to resolve them. Difficult accounting comments can take months to resolve and can substantially change the information content of the prospectus.

In some IPOs, it may be useful to raise issues with the SEC staff before the first filing by requesting a pre-filing conference. This is most common where there is a question of accounting or financial presentation that will shape the financial statements or where an accommodation under the SEC's rules will be needed. The SEC staff is willing to provide this kind of guidance in advance, subject to reviewing the implementation in the filing. Often a pre-filing conference leads to an exchange of letters to document the precise contours of the staff's guidance.

The first filing of the registration statement in an IPO is typically a "quiet filing," meaning that the preliminary prospectus, although publicly available, is not actually sent to investors. It may omit the price range, but if so it must be amended to include a price range before the marketing can begin. Only after the SEC comment process is complete (or nearly so) does the marketing of the offering begin, using the preliminary prospectus included in the most recent amendment of the registration statement.

The declaration of effectiveness is not actually required until the

underwriters are ready to complete sales to investors, after the marketing is complete and the IPO has been priced. The usual practice in an IPO is for the registration statement to be declared effective just before pricing. This is achieved by requesting “acceleration” of effectiveness, as otherwise effectiveness would occur pursuant to a statutory timeline that may not coincide with the offering timeline. The company then has up to 15 business days after effectiveness to file the final prospectus reflecting the pricing and underwriting details. Occasionally, however, this final prospectus is filed in a “pricing amendment” just before the declaration of effectiveness.

(d) Contents of registration statement

The registration statement for an IPO is on Form S-1 for a U.S. issuer. The registration statement must be signed on behalf of the company and, in their individual capacities, by the company’s principal executive officer or officers, its principal financial officer and its controller or principal accounting officer. It must also be signed by a majority of the board of directors, although usually every director signs.

The principal sections of the registration statement are a simple cover page, the prospectus (called Part I in the SEC’s forms) and Part II. The contents of the prospectus are discussed in Section 3.3.

Part II contains additional information that must be publicly filed with the SEC but need not be provided to prospective purchasers. It includes certain undertakings on the part of the company that are required to implement SEC policies, signatures, consents from auditors, counsel and other experts and some additional disclosures required by the SEC’s forms.

The most important element of Part II is the requirement to file exhibits. These include charter documents, the underwriting agreement, employee benefit plans, a list of subsidiaries and opinions of counsel. They also include the company’s material agreements, which can include a wide range of agreements relating to, for example, employment arrangements, joint ventures, licenses, financing, acquisitions and arrangements with suppliers or customers.

(e) Filing and confidentiality

The company must file the registration statement electronically using the SEC’s electronic document system, EDGAR. In order to do so, the company must have a central index key (CIK) number, which is an account number obtained from the SEC for filing purposes. The financial printer will typically handle the mechanics of filing. Although documents are filed electronically, paper “courtesy copies” are usually provided to the SEC reviewing staff.

Once it has been filed, the registration statement is available to the public, as is each subsequent amendment. Correspondence with the SEC staff concerning the registration statement is also filed through EDGAR, but it is not made publicly available immediately. Instead, the SEC makes it all publicly available a short time—generally 45 days—after the IPO. The SEC will not ordinarily review an IPO registration statement of a domestic issuer that is not an EGC until it has been filed. As a result, the back and forth between the company and the SEC is generally a matter of public record.

The public nature of SEC filings can present problems for the company, because sometimes the exhibits or the comment correspondence include material that the company would prefer to keep confidential. If public disclosure would result in competitive harm to the company, it may submit a request to the SEC staff for confidential treatment for portions of material contracts included as exhibits to the registration statement. The grounds for confidential treatment are narrow, however, and may not cover everything the company considers sensitive. The SEC staff processes confidential treatment requests filed with IPOs concurrently with the review of the registration statement. All issues must be resolved and the confidential treatment request must be complete before the acceleration of effectiveness of the registration statement.

(f) Filing fees

The company must pay a filing fee to the SEC at the time the registration statement is filed. Registration fees are a major source of the agency’s funding and are established by the SEC based on annual revenue targets.

They are based on the aggregate offering price of the securities registered. For the SEC’s 2013 fiscal year, they stood at \$136.40 per million dollars, so for a \$100 million IPO they would amount to \$13,640.

The fee must accompany the initial filing, but since the price and size of the offering are not yet known, the amount is based on good-faith estimates. The SEC will not refund fees if the total dollar value actually offered falls short of the amount registered, so the company should take care not to overestimate, though the company may be able to use excess fees to offset filing fees for future registration statements up to five years after the IPO. On the other hand, if the total dollar value actually offered exceeds the amount on which fees were paid, the company must amend the registration statement and pay additional fees. It is not unusual in an IPO to pay additional fees during the process as the estimated dollar value is refined, but it is important not to be surprised at the last minute by the need to pay additional fees.

3.3 Prospectus

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(a) Required disclosures

The prospectus constitutes Part I of the registration statement used to register an IPO with the SEC and is also the central document used to market the IPO to prospective investors. It contains disclosures about the company’s business, results of operations, financial condition, management and other issues. The financial and business information included in the prospectus is very similar in scope to what is included in an annual report on Form 10-K for a U.S. issuer. However, the level of detail is often much greater in an IPO prospectus than in the periodic reports of established public companies.

An IPO prospectus must meet all requirements of the applicable SEC form (Form S-1 for a U.S. issuer), but it is presented as a freestanding document and does not include the text of the form itself or even follow the order of items in the form. Instead, the organization of an IPO prospectus is typically based on a combination of the SEC’s form, the expectations of the SEC staff and market

customs developed in prior IPOs. Against this background, there is some limited scope for innovations in organization or presentation based on the particular circumstances or investment thesis of the company.

The balance of this chapter discusses some of the major elements of the prospectus for a U.S. domestic issuer that is not an EGC, but space does not permit an exhaustive review. For information about prospectus requirements for an EGC, see Chapter 4, and for certain differences applicable to a foreign private issuer, see Chapter 9.5.

Prospectus drafting style: Under the SEC's rules, all information in a prospectus must be presented "in a clear, concise and understandable manner," and the cover page, back page, summary section and risk factors section must follow "plain English principles." In its rules and elsewhere, the SEC has fleshed out what these requirements mean, including such features of good expository writing as short sentences; definite, concrete, everyday language; use of the active voice; no legal jargon; no double negatives; and tabular and bullet point presentations.

More generally, prospectus drafting should avoid bullish rhetoric and "puffery" by using neutral language, being balanced and complete and avoiding any factual statements that cannot be substantiated. An overly cautious approach is not necessarily desirable either, and wholesale repetition of risks and qualifications is unnecessary. Discussions of the business outlook, or of the company's future performance, must be handled with particular care. These kinds of "forward-looking statements" are usually necessary, but they are limited in scope to limit potential disclosure liability. They must be carefully worded so that descriptions of the company's beliefs and expectations will not be mistaken for statements of fact, and they are accompanied by discussions of the factors that could cause actual outcomes to differ from those anticipated.

Summary "box": The prospectus must include a summary. This is typically presented with a border around the

margins of each page and is consequently often referred to simply as the "box." It usually describes the offering and briefly describes the company, with a focus on its most distinctive features. The summary description of the company is usually treated as the most important part of the prospectus from a marketing point of view.

Financial information: A typical IPO prospectus provides the most important financial information three times. These requirements are discussed in detail in Section 2.2. The prospectus must include audited financial statements and, depending on the age of the audited financial statements, unaudited interim financial statements. It must also include selected financial information covering five full years, if the company has been in existence that long. There is also summary financial information in the summary box. In the selected financial information and the summary, information from the financial statements is often accompanied by other key statistics about the company's operations or performance.

The prospectus must also include a capitalization table. This summarizes the company's capitalization as of a recent date and shows how the capital structure will be affected by the IPO and the application of the IPO proceeds.

Risk factors: A prospectus must set forth under the caption "Risk factors," right after the summary box, the most significant factors that make the offering speculative or risky. It should include a discussion of the most significant risk factors for the company, not an exhaustive list of every conceivable risk. The discussion should be concise and well organized, with headings that adequately communicate each risk described, and should avoid boilerplate.

Business of the company: The business section of the prospectus sets forth a straightforward discussion of the company's business and operations. This section usually begins with a brief overview and continues with a presentation of the company's distinctive

features, often described as its strengths and its strategy. This section then goes on to describe the business in full. The SEC's forms provide broad guidance on how to describe the company's business, but most of the content of the discussion is based on common sense and on a review of what other comparable companies have covered. The forms specifically contemplate the following topics:

- principal products produced and services rendered and methods of distribution;
- sources and availability of raw materials;
- intellectual property;
- dependence on single customers or suppliers;
- competitive conditions;
- material effects of the regulatory environment;
- research and development expenditures; and
- number of employees.

Management's discussion and analysis: Management's discussion and analysis is among the most important sections of the prospectus. It takes its name from the beginning of the cumbersome title used in the SEC's rules, "Management's Discussion and Analysis of Financial Condition and Results of Operations." (The corresponding item for a foreign private issuer is called "Operating and Financial Review and Prospects" but is still referred to as MD&A.)

MD&A serves to provide investors with the information necessary to understand the company's financial condition, changes in financial condition and results of operations. Complementing the financial statements, the MD&A explains the company's performance and its financing to investors "as seen through the eyes of management" (as the SEC has put it). In addition to discussing performance in past periods, the MD&A must address any known ways in which future performance could differ and identify trends and uncertainties that may affect the company going forward. It should discuss each segment separately if material to an understanding of the business as a whole.

Three elements are the core of every MD&A:

- Overview—There should be a summary discussion of the most important issues affecting the company's past and future economic performance. This discussion is ordinarily at the beginning, and it varies widely in scope and breadth.
- Discussion of results of operations—There must be a detailed comparative discussion of results for each of the past three years and any subsequent interim period. This discussion must zero in on the major drivers of financial performance and on the factors that might cause future results to differ from those in past periods.
- Discussion of liquidity and capital resources—There must be a full discussion of the company's liquidity, its funding requirements and its anticipated sources of funds. This discussion must focus on the company's ongoing requirements more than on its past performance.

In addition, MD&A must address several other specifically mandated disclosures, including a table of contractual obligations and a discussion of any off-balance-sheet arrangements.

Other matters: The following additional topics concerning the company must also be addressed in the prospectus:

- dividend policy;
- material legal proceedings;
- directors, senior management and advisors;
- related-party transactions (see Section 7.5);
- terms of the shares being offered; and
- principal property.

The prospectus will include a description of the offering, including the proposed use of proceeds, dilution resulting from the offering, underwriting arrangements and selling shareholders, if any.

The requirements of the applicable SEC form do not limit what should be included in a prospectus. In addition to the information expressly required to be included, a general rule under the Securities Act requires the company to include such further material information,

if any, as may be necessary to make the required statements, in the light of the circumstances under which they are made, not misleading.

Industry guides: The SEC requires special disclosures from companies in certain industry sectors, as set forth in five industry guides. In particular, banks and bank holding companies, casualty insurers and mining companies must supply enhanced disclosure subject to the requirements of the guides. Compiling the information necessary to comply with the industry guides can be a substantial undertaking requiring specialized expertise.

(b) Drafting process

Drafting logistics: Primary responsibility for drafting the prospectus, other than the financial statements, usually falls to the company's counsel, working with company personnel. Underwriters and their counsel usually draft the plan of distribution, which describes contractual and regulatory aspects of the IPO. Sometimes underwriters and their counsel also prepare first drafts of sections that will be key to the marketing effort, such as the description of the company's strengths and strategy that leads off the summary box.

The core working group reviews, comments and participates in drafting sessions that include representatives of the company and its auditors, the company's counsel, the underwriters and their legal counsel. These drafting sessions are often conducted at in-person meetings, though they can also be held by videoconference or conference call. In addition to advancing the draft, the drafting sessions serve as a core component of the due diligence process by allowing the core working group to go meticulously through all content of the prospectus.

"Benchmarking" is an important aspect of the drafting process. It involves determining what comparable issuers disclose in their prospectuses and periodic reports and what issues the SEC staff has raised in comment letters to such issuers. A review of comparable disclosure and issues raised in comment letters can help identify the significant disclosure issues

of relevance to the company's offering and may provide a roadmap for how best to address these issues. Judicious borrowing from comparable sources provides a helpful shortcut in what can otherwise be an arduous process.

After the bulk of the drafting and due diligence has been conducted, the core working group distributes a draft of the registration statement to all directors and key officers and, depending on the circumstances, also to selling shareholders and other key shareholders. The underwriters should satisfy themselves that the company has established adequate procedures for collecting and evaluating comments on the document from those persons to whom it has been furnished. This is particularly important for MD&A and for any forward-looking statements that are included in the registration statement.

Financial printer: A financial printer should be selected early in the IPO planning stages. Drafts of the registration statement will undergo several revisions over the course of the due diligence period and as comments from the SEC staff are incorporated into the document. At the beginning stages of the process, the company's counsel will take the lead in reflecting any such changes in the registration statement. However, as the registration statement nears completion, it is the role of the financial printer to:

- work with the company to ensure that the registration statement is formatted in the way required by the SEC and any other regulatory institutions;
- process requested changes to the registration statement until the final draft;
- prepare EDGAR-suitable versions of documents to be submitted electronically to the SEC on the company's behalf; and
- print and distribute hard copies of the preliminary prospectus and final prospectus.

In choosing a financial printer, several factors should be considered. An IPO may require the participation of constituents in multiple countries and time zones. The financial printer should have a sufficiently broad and secure distribution network

and equipment that is accessible 24 hours a day. Customer service should be reliable and capable of supporting a deal of international scope. The financial printer should make use of technology tools to streamline delivery of the project, which may require making use of best practices in manufacturing concepts, analytical techniques, process management and standardized procedures. Following the IPO, the financial printer should be equipped to handle annual compliance and future transaction needs. The benefit of using the same financial printer for future needs is that it reduces the time required for data collection and ensures that former project knowledge is properly applied.

(c) Due diligence investigation

The process of verifying that the information in the prospectus and the registration statement is materially complete and accurate is broadly referred to as “due diligence.” While the guiding purpose is to limit the risk of liability, the accuracy and completeness of the prospectus are essential goals for other reasons as well. For the company and its personnel, they provide the foundation for applying best disclosure practices and building the confidence of investors. For underwriters, a robust due diligence exercise is required under a formal internal approval or commitments process designed to protect against reputational risks and to meet other institutional goals. An underwriting firm has a vital reputational interest in the soundness of the company’s business plan and a disclosure document that completely and accurately describes the risks associated with that plan. Similar reputational concerns apply to directors and shareholders. In addition, due diligence can help identify business issues that need to be addressed, such as necessary third-party consents and waivers for the transaction.

Although these additional goals are important, the due diligence process is driven by the risk of liability. The parties that may be liable if there are material misstatements and omissions in the prospectus and registration statement (including documents incorporated by reference) include the company, its directors, the officers who sign the registration statement, the company’s

auditors, any selling shareholders and the underwriters. Controlling shareholders may also be liable. Chapter 8 contains a further discussion of the risk of liability facing directors and officers.

The company itself faces strict liability, but underwriters, directors and officers may assert a defense if they performed a reasonable investigation and believed the registration statement and prospectus were materially accurate and complete. This defense is often referred to as the “due diligence defense.” The applicable liability standards—and some subtleties applicable to the liability of particular IPO participants—are discussed more specifically in Section 8.1.

In practice, the due diligence process requires an organized approach to verifying the information in the prospectus and registration statement and to asking questions about the company. Key general questions to explore at the beginning of the process include the following:

- What are the strengths and weaknesses of the company’s business plan? Is the company’s management capable of executing the plan?
- What internal or external events or trends could jeopardize success?
- Is there anything that, a year or two from now, with the benefit of hindsight, the company might wish it had disclosed?

Financial and business due diligence:

Financial and business due diligence involves extensive review and discussion of the company’s historical financial information, operations, current business, business plans, projections and other data. It is generally carried out through:

- formal due diligence sessions with key members of management;
- informal meetings with key members of management;
- drafting sessions;
- facility visits;
- preparation and review of forecasts;
- “sensitivity” analysis;
- discussions with key customers, suppliers, creditors and investors;
- review of securities analyst reports;
- review of industry information and disclosure regarding comparable companies (e.g., SEC filings and annual reports of other companies in the same

industry, research reports on industry and competitors, trade publications);

- meetings with auditors and obtaining auditor comfort letters on financial information;
- third-party reports, where appropriate; and
- involvement of specialized counsel, where appropriate (e.g., issues of intellectual property, mining rights or regulatory matters).

In carrying out business due diligence, underwriters and their counsel should conduct extensive interviews with management. Specific questions about the business should be asked. Moreover, additional information may be gleaned and inconsistencies identified by asking different members of management the same questions. Back-up data for industry data and statistics should also be requested and reviewed. Specialized consultants may be called upon to assist in the investigation where the nature of the business or a particular issue warrants it.

Although the investment bankers and their staff will conduct the lion’s share of the financial due diligence, it is important for the lawyers to be actively involved in the process, to understand the financial status of the company and identify possible problems presented in the financial statements.

Legal due diligence: Underwriters’ counsel will generally take the lead in conducting legal due diligence by preparing a document request list that exhaustively identifies materials they wish to review. During the preparation process, it may be helpful to review document request lists for companies in the same industry or from the same country. The list should be used as a checklist and aid to organizing the due diligence process, rather than an inflexible set of bureaucratic requirements or limits for the due diligence investigation.

Legal due diligence will often involve the following:

- discussions with company personnel about the company’s legal affairs;
- closing documents, including officer certificates, public authority certificates such as certified charters and good standing certificates; and

- document review by the company's and underwriters' counsel, including:
 - charter documents of the company and its material subsidiaries;
 - minutes of meetings of shareholders, the board of directors and key committees, and materials prepared for board and committee meetings;
 - material contracts, including shareholders' agreements and joint venture agreements, and forms of contracts;
 - filings, correspondence and other communications with supervisory and regulatory authorities;
 - materials relating to intellectual property, including licenses, patents and trademarks;
 - materials relating to pending litigation, including counsel's litigation letters to auditors;
 - auditors' letters to management;
 - D&O questionnaires; and
 - other documents that may further the legal due diligence investigation.

Corporate governance due diligence:

Underwriters and their counsel typically review the company's corporate governance policies and Sarbanes-Oxley compliance programs. Issues to be considered may include:

- the company's disclosure controls and procedures and internal controls;
- the company's code of ethics, exemptions to the code and past waivers;
- the independence of the board of directors;
- the company's policy on handling whistleblower complaints;
- the company's document retention policy; and
- nonaudit services provided by the company's independent auditors.

Legal opinion and negative comfort letter:

It is typically a condition to closing the IPO that counsel for the company and the underwriters provide both a legal opinion and a negative comfort letter, or "Rule 10b-5 letter." The due diligence investigation provides counsel with the basis for these letters, and the letters in turn form part of the due diligence

process on which offering participants rely. Opinions usually cover such matters as observance of corporate formalities, existence of the company and material subsidiaries and matters relating to the securities themselves. They may also address compliance with material contracts, among many other matters.

The negative comfort letter generally says that nothing has come to the attention of counsel that would cause counsel to believe that the registration statement or prospectus is false or misleading in any material respect.

Identifying potential problems: The due diligence process also aims to identify potential impediments to the transaction. Examples include contractual rights of another party that the IPO could trigger or modify, because it results in a change in the company's share ownership. Provisions of this kind may exist in financing documentation, agreements with or among the company's shareholders (e.g., preemptive or registration rights) or other important contracts or governmental authorizations. The process should also identify risks to future financial performance or competitive position and limitations on operational or financial flexibility. Examples include upcoming expiration or renewal dates, or early termination provisions, in customer or supplier contracts, government authorizations or IP licenses.

Paper data room v virtual data room: A secure repository for the documents to be reviewed during the due diligence process is critical. The company or its counsel may host a "paper data room," in which hard copies of proprietary business documents and financial data are made available for inspection. The paper data room has obvious limitations, given that participants may be spread across several cities, states or countries. Not only is inspection limited to the hours of operation of the host but review of documents for out-of-town participants is inconvenient.

The "virtual data room" provides an excellent solution to the challenges presented by a traditional paper data room. Virtual data rooms can offer secure, web-based access to documents, particularly in

convenient PDF format, and parallel access for each of the review groups. Moreover, the use of a virtual data room eliminates the need for travel and increases efficiencies by making documents available around the clock.

The following points can be important factors in selecting a virtual data room provider:

- Established track record—The provider should have proven technology and a strong customer-focused background.
- Leading technology—The ideal solution should integrate leading technology, support industry standards and work with globally accepted data formats.
- Project management expertise—Confidentiality is paramount, as is the provider's ability to understand the transactional business environment and assign project managers who are educated and experienced in the specific transaction at hand.
- Global production facilities—Choosing a provider with document-scanning facilities in cities around the world will ensure that accelerated document capture is quick and efficient.
- User support—It should be possible to make changes and address questions immediately, for all users and in multiple languages.
- Security—Security processes on application, staff and infrastructure; SSAE 16 Type II, multilocation data hosting with zero-downtime network guarantee; database replication at multiple locations; and a core competency in handling sensitive financial and business information are critical. (A SSAE 16 Type II service auditor's report (or a SOC 1 Report) includes the service auditor's opinion on the fairness of the presentation of the service organization's description of the system, the suitability of the design of the system to achieve the specified control objectives, and whether the system was operating effectively during the period under review.)
- Rapid deployment—Top-tier providers should be able to provide the tools to create indexes in minutes, not days, and enable document review in real time as documents are captured, processed and posted.

- Simplified user rights—Management of user rights should allow for easy restriction and access functionality quickly and easily.
- Data management—Multiple file uploads should be possible, to save time.
- Collaboration tools—Tools such as e-mail alerts, document notes and Q&A capabilities enhance the collaborative efforts of reviewer groups.
- Site customization—There should be enough flexibility to customize the site to the owner’s specific requirements and to integrate corporate branding.
- Intuitive interface—This should be simple enough that next-to-no training is required and users can quickly find documents.
- Expanded rights management—This should be robust enough that the data room owner can administer the site for those seeking complete control.

3.4 Underwriting, marketing, and sale *J.P. Morgan (Investment Banking)*

(a) Underwriting

Role of the bookrunners: The company should carefully choose the joint bookrunners for the IPO and, in particular, the lead left bookrunner, because of the significant role that they play throughout the process. As the quarterback of the IPO, the lead bookrunner advises the company on all facets of the IPO process, assists the company in shaping its investment thesis to be used while marketing the transaction, guides the company with investors while on the road and develops the optimal pricing recommendation for the company.

Advising the company: There are many complexities in an IPO process, including:

- IPO sizing, including the primary versus secondary component;
- leverage levels and overall capital structure at and post-IPO;
- co-manager selection;
- comparable company selection;
- valuation;
- roadshow presentation and investment thesis development; and
- marketing strategy and roadshow logistics.

Shaping the investment thesis: Perhaps the most important contribution that the bookrunners make during the IPO process is helping the company shape its investment thesis. From the registration statement that is filed with the SEC to the roadshow presentation that is delivered to investors, the marketing message that the company uses during the IPO is critical to its initial success as a public company. Through intensive diligence and drafting sessions, the bookrunners will become well versed in the company’s strategy and key selling points and will assist the company in effectively communicating those messages to investors. The registration statement and the roadshow presentation are the two most important marketing documents, allowing investors to quickly absorb the equity story and evaluate their investment decision.

Marketing the transaction: While developing the marketing materials, the bookrunners will also develop a cohesive marketing strategy for the company. In order to maximize the success of the offering, the bookrunners will determine the most important regions to visit with the goal of reaching the largest number of high-quality investors that will become meaningful long-term shareholders for the company. For EGCs, another topic of discussion with the bookrunners is whether to take advantage of the JOBS Act provisions allowing them to “Test the Waters” prior to launch of the IPO, in order to assess potential demand for the offering and identify and address any issues that investors may raise.

Setting the price range: Prior to being mandated and throughout the IPO preparation process, the bookrunners will keep the company apprised of market conditions and trading valuations of its key comparables, as well as the subsequent implications for the company’s proposed IPO valuation. The bookrunners will use a combination of comparable companies’ value, broad market conditions and recent IPO value to determine the appropriate value for the company. Once the appropriate equity value range is determined, the bookrunners will advise the company on

an appropriate “price range” with which to market the offering, which is typically \$2 wide and falls in the teens (e.g., \$14–\$16). The company will often need to execute a stock split—or more commonly a reverse stock split—to solve for this desired price range.

Key players in the investment bank:

- **Investment banking coverage:** The investment banking coverage team consists of industry experts who typically own the client relationship. This team will be the key point of contact for the company throughout its life cycle for any investment banking advice or assistance it may need, including on the IPO, mergers and acquisitions, debt and capital structure. As such, the team will be or become experts on the company, its needs, its strengths and areas for development, as well as its overall vision and strategy. The coverage team will act as a liaison with the company and the equity capital markets professionals, who will be the captains of the IPO process, as well as any subsequent equity issuance that is desired.
- **Equity capital markets:** The equity capital markets team sits between the investment banking team and the syndicate, sales and trading, and research functions, acting as a liaison between the private and public sides of the investment bank. This team advises the company on all of the execution-related decisions, liaises with research to collect public-side feedback, and coordinates with the sales and trading functions on market and investor color.
- **Syndicate:** Within most equity capital markets groups lies a syndicate function, which is the main point of contact during the roadshow. The syndicate coordinates with sales in entering investor orders into the book, speaking directly with investors regarding questions or concerns, developing the roadshow and marketing strategy and ultimately assisting in a pricing recommendation.
- **Sales and trading:** The sales force acts as the front line of the investment

bank in dealing with investors, calling clients in order to schedule meetings, soliciting feedback on the transaction (both qualitative and quantitative) and ultimately entering orders. It works closely with the traders in order to determine supply and demand and execute trades for the investors.

Role of the co-managers: The co-managers on an IPO are typically significantly less involved in the day-to-day advisory role for which the bookrunners are responsible. They are, however, involved in the majority (if not all) of the diligence conducted. The co-managers' research analysts will also take part in all analyst diligence that is conducted. The primary role of the co-managers is to underwrite additional shares in the offering, provide additional research coverage post-IPO and assist in market making once the stock is public.

(b) Roadshow

The roadshow is the pivotal portion of the IPO process, where the company (accompanied by representatives from the bookrunners) conducts a series of one-on-one and group meetings with investors who will potentially purchase the shares being offered in the IPO. Several weeks prior to launching the roadshow, the bookrunners will work with the company to determine the length and scope of the roadshow and to identify specific investor targets.

Once the prospectus has been filed with the price range on the cover, the roadshow typically launches with a management presentation to the bookrunners' sales force. The bookrunners will also create an internal sales force memo that will be used by the sales force. The memo is used as a "cheat sheet" by the salesperson when speaking to investors and gives him or her sufficient background to answer general questions.

The bookrunners handle all roadshow logistics for the company. The roadshow typically lasts 8 to 12 days, depending on the size of the IPO, the scope of the business and the wishes of the management team, among other things.

The roadshow typically consists of some combination of the following cities/regions globally:

- New York;
- Boston;
- Mid-Atlantic (Philadelphia, Baltimore);
- Mid-West (Chicago, Minneapolis, Kansas City, Denver);
- Texas (Dallas, Houston);
- West Coast (San Francisco, Los Angeles, Salt Lake City, Seattle);
- London;
- Frankfurt/Milan; and
- Hong Kong/Singapore.

A typical roadshow day involves:

- five to seven one-on-one meetings and/or conference calls;
- a group breakfast and/or lunch; and
- travel to the next day's city.

Each investor meeting typically lasts 30 to 45 minutes and can take the format of either a formal management presentation of the roadshow slides with subsequent Q&A or simply informal Q&A, depending on the investor's familiarity with the prospectus and/or the roadshow slides. Investors have access to the management presentation (audio and video), as well as the roadshow slides via NetRoadshow, a system by which the bookrunners make these documents available to relevant investors utilizing a password-protected system. The SEC also requires similar information to be made available to retail investors via retailroadshow.com, where only the management slides are available. Both systems make the management slides available during the marketing period only; upon pricing, all materials are taken down and no longer accessible. After each investor meeting, the sales force person responsible for covering each respective account will follow up with the investor to get feedback on the meeting, the company, and modeling/valuation and whether it is inclined to place an order.

(c) Book-building process

The goal of the bookrunners is to convert accounts into the order book as early as possible. On an IPO roadshow, it is not uncommon for accounts to begin coming into the book in small sizes during the first day or two of the roadshow. Typically, these are smaller accounts (frequently

hedge funds) that like to participate in IPOs as a matter of practice and would not be seen on the roadshow. In addition, Europe is often the first region visited during a roadshow and European accounts therefore tend to come into the order book early in the process.

When the book begins to build, investors will fall into two camps: Those without a price limit (market order) and those that have scaled orders at various prices. For example, if the IPO filing range is \$16 to \$18 per share and Investor A has a market order of 1 million shares, the order stands at 1 million shares at \$16, \$17, \$18 and potentially even above the filing range. A scaled order by Investor B, in contrast, may indicate 1 million shares at \$16, 750,000 shares at \$17 and 500,000 shares at \$18. The goal of the bookrunners is to get as many market orders as possible in order to maximize price for the company, while still balancing appropriate value for investors and ideally achieving a Day 1 trading "pop" of approximately 15%. Retail orders are also important to the order book, but typically retail demand is not a driver of overall pricing, as retail investors are "price takers."

Key points are emphasized to investors throughout the roadshow in order to indicate the strength of the order book and therefore the potential success of the IPO. Key terms include "level of subscription" or "subscription rate," which shows the number of shares in the order book relative to the number of shares being offered. When the offering is oversubscribed, investors will know that the demand for the offering is high and that their order will likely be cut back. The amount of price sensitivity in the book is also a key benchmark. Another key metric of success for the company is the "hit ratio," which is the percentage of investors with which the company held a roadshow meeting that subsequently placed orders. The goal of the company and the bookrunners is to achieve as high a hit ratio as possible, indicating that the management team has successfully told a compelling story to investors on the road.

For most IPOs, the majority of orders will come in the last two to three days of the roadshow. On pricing day, the

bookrunners will “scrub” the demand to identify which orders are “real” as opposed to those that have been placed to “game” the allocation process. The overall demand in the order book is known as gross demand, while the actual shares that the bookrunners will look to allocate is known as allocable demand.

(d) Pricing, trading and closing

The pricing meeting typically includes the company and key selling shareholders, as well as the bookrunners. In advance of the offering, the board establishes a pricing committee to formally approve the offering. When pricing a deal, numerous factors that occurred over the roadshow are taken into account—general market conditions, the performance of the overall market and the company’s peers during the roadshow will all affect levels of pricing and demand.

Additionally, new issuance activity and the performance of recent precedent transactions will have an overall effect on the company’s IPO price, either positively or negatively. After reviewing the roadshow summary—which includes an overview of accounts with which management met, the hit ratio/success rate from these meetings and key feedback themes, as well as gross demand, allocable demand and price sensitivity in the order book—the bookrunners will communicate the price per share recommendation to the company and give the pricing committee time to deliberate on the recommendation. The ultimate goal of the pricing recommendation is to achieve the best possible price for the company while allocating to the highest-quality shareholder base and ensuring that the investor base is achieving attractive valuation and will receive an IPO “pop” on the first and subsequent days of trading. It is in the best interests of the company, key beneficial shareholders and the bookrunners that the stock trades well in the aftermarket.

Once the company and its pricing committee have formally agreed on an IPO price with the bookrunners, the underwriting agreement is executed by the company, any selling shareholders and the underwriters, pursuant to which the underwriters make a firm commitment (subject to certain customary conditions)

to purchase the IPO shares and resell them to investors at the IPO price. The bookrunners begin the allocation process overnight, determining exactly how much stock (if any) to allocate to which accounts. The goal of the allocation process is to create a high-quality, long-term, focused shareholder base for the company. Once allocations to each account have been agreed upon by the bookrunners and the company, the syndicate “breaks” prior to the market opening the day after pricing and allocations are communicated to each of the individual investors.

On the first trading day, the NYSE will coordinate a time at which the newly public stock will officially open. The Designated Market Maker (DMM) is responsible for opening the stock at that time. In addition, the stabilization agent is the bookrunner chosen to open the trading in the stock after the offering and to provide support to the stock price. The market will look to the stabilization agent as the syndicate bid in trading support for the offering. The stabilization agent may commit capital to provide liquidity in the common stock market if the stock or market comes under pressure immediately after the offering and can also use the short position created by the IPO over-allotment (typically 15%) to repurchase up to 15% of the shares offered in the event the shares fall below the offer price.

The IPO will officially close three days after the first trading day of the stock (T+3). At that point, all of the funds will be wired, stock transfers will be completed, the legal documentation will become unconditional and the IPO will officially close. ●

4

The IPO on-ramp under the JOBS Act

4.1 The JOBS Act: Emerging growth company status

Fenwick & West LLP

(a) Background

In April 2012, President Obama signed into law the JOBS Act. One of the aims of the JOBS Act was to increase the number of companies electing to complete an IPO and to provide those companies a transition period, or “on-ramp,” to the public markets, allowing them to focus resources on growth of their businesses before having to expend resources toward complying with many of the regulations often cited as costly and burdensome for newly public companies. The so-called IPO on-ramp provisions, which are contained in Title I of the JOBS Act, reduce a number of existing financial disclosure, corporate governance and other regulatory burdens on a new category of issuer, referred to as an “emerging growth company.”

(b) Qualifying as an emerging growth company

Subject to certain exceptions, an EGC is defined as an issuer of securities that had gross revenues of less than \$1 billion during its most recently completed fiscal year. An issuer would qualify as an EGC even if its gross revenues exceeded \$1 billion in years prior to its most recent fiscal year.

Gross revenues are measured with reference to total revenues as presented on the income statement presentation under U.S. GAAP (or IFRS as issued by the IASB, if used as the basis of reporting by a foreign private issuer). If the financial statements of a foreign private issuer are presented in a currency other than U.S. dollars, total annual gross revenues for purposes of this test should be calculated in U.S. dollars using the exchange rate as of the last day of the most recently completed fiscal year. When calculating gross revenues, financial institutions may exclude gains and losses on dispositions of investment portfolio securities.

(c) Length of transition period

An issuer that is an EGC as of the first day of that fiscal year will continue to maintain that status until the earliest of:

- the last day of the fiscal year in which it achieves \$1 billion of gross revenues;
- the last day of the fiscal year that includes the fifth anniversary of its IPO;
- the date on which it has issued more than \$1 billion in nonconvertible debt during any previous rolling three-year period (excluding issuances in A/B debt exchange offers); or
- the date on which it is deemed to be a “large accelerated filer” (which requires, among other things, having common equity held by nonaffiliates with a market value of \$700 million or more).

4.2 Advantages of emerging growth company status

Fenwick & West LLP

(a) Overview

The IPO on-ramp provisions of the JOBS Act offer EGCs a number of advantages during the IPO process, including:

- confidential submission and review of IPO registration statements;
- reduced financial statement audit and disclosure requirements;
- reduced executive compensation disclosure requirements;
- the ability to engage in oral or written “test-the-waters” communications with certain types of potential investors to gauge interest before or after filing; and
- liberalization of the use of research reports and easing of restrictions on analyst communications.

The IPO on-ramp provisions of the JOBS Act also reduce the costs and burdens of being a public company for EGCs after completion of their IPOs by providing:

- an exemption from the public accounting firm attestation to issuer internal controls required by Section 404(b) of the Sarbanes-Oxley Act;
- scaled-back financial and compensation disclosure requirements for future registration statements, periodic reports and other reports to be filed with the SEC;
- exemptions from “say-on-pay” votes (and votes on the frequency

- of “say-on-pay” votes), certain other required shareholder actions and certain proxy statement disclosures;
- exemptions from mandatory audit firm rotation and any auditor’s discussion and analysis requirements; and
- relief from the requirement to comply with any update issued by the FASB to its Accounting Standards Codification until the date that a company that is a private company is required to comply with such new or revised accounting standard if such standard does not apply to private companies.

In this regard, EGCs that are foreign private issuers and that reconcile their home country GAAP financial statements to U.S. GAAP may also take advantage of the extended transition period for complying with updates issued by the FASB to its Accounting Standards Codification in their U.S. GAAP reconciliation.

(b) Confidential submissions

EGCs have the option to confidentially submit to the SEC a draft registration statement for confidential, nonpublic review by the SEC prior to public filing. This allows an EGC to explore the possibility of an IPO without exposing any confidential information to its competitors or the market generally until 21 days before the date on which it begins to conduct its roadshow (see Section 3.4(b)) and without risking the embarrassment associated with pulling the IPO should the EGC do so.

The confidential submission process is only available for EGCs that have not already completed a public offering of common equity securities, including offerings under employee benefit plans or pursuant to a resale registration statement. EGCs that have completed public offerings of debt securities may use the confidential submission process. Foreign private issuers may also be eligible to submit their draft registration statements on a nonpublic basis under existing policies of the SEC’s Division of Corporation Finance; however, the benefits of this policy are not available to foreign private issuers that take advantage of any benefit available to EGCs.

(c) Scaled disclosures

EGCs may “scale back” financial and compensation disclosures in their IPO registration statements and subsequent filings under the Exchange Act. In particular, IPO registration statements for EGCs may contain:

- two years of audited financial statements, including those of acquired businesses, rather than the three-year requirement described in Section 2.2(a);
- selected financial information for the years including and after the earliest audited period presented (i.e., as little as two years of selected financial information), rather than the five-year requirement described in Section 2.2(a);
- MD&A for the periods covered by the audited financial statements (i.e., as little as two years plus “stub” periods), rather than the periods described in Section 3.3(a); and
- the streamlined and simplified compensation disclosures required of smaller reporting companies, meaning that the registration statement need not include, among other things, a detailed compensation discussion and analysis section or tabular information for more than three executive officers and certain executive compensation tables.

With respect to the scaled executive compensation disclosure requirements, EGCs must still consider whether there is additional, material compensation disclosure that would be useful to investors to understand how the EGC’s executive compensation programs operate.

EGCs may follow all or some of these “scaled” disclosure provisions, except in their initial filing or submission they must decide whether to take advantage of the extended transition period for complying with any of the FASB’s updates to its Accounting Standards Codification. If an EGC decides to take advantage of such an extended transition period, it may later choose to reverse its election. Although the JOBS Act refers to domestic company rules and forms, a foreign private issuer that qualifies as an EGC may comply with the scaled disclosure provisions to the extent relevant to the form requirements for foreign private issuers.

While these changes are designed to reduce costs, EGCs may find that providing the traditional level of historical financial disclosure is helpful in the IPO marketing process. In the first year subsequent to the enactment of the JOBS Act, most EGCs have still presented financial statements for a full three years and also five years of selected financial data.

(d) Test-the-waters communications

As discussed in Section 3.2(b), issuers must avoid illegal offers and not engage in communications and activities that might be viewed as impermissibly affecting the market for the securities to be offered. The JOBS Act amends Section 5 of the Securities Act to add a new Section 5(d), which permits EGCs to engage in oral and written communications with institutional or highly sophisticated prospective investors to gauge their interest in a contemplated securities offering before or during the “quiet period” or during the “waiting period” described in Section 3.2(a). These communications are not a substitute for the traditional roadshow and book-building processes described in Section 3.4(b) and (c). While practices in this area are evolving, issuers should pay careful attention to the timing, content and delivery mechanism of each communication. In particular, written communications are subject to SEC review and could complicate the IPO process if they are inconsistent with the prospectus or roadshow presentation. The SEC has been requesting copies of any “testing-the-waters” communications made in reliance on Section 5(d) as well as any research reports.

(e) Other benefits

The “IPO on-ramp” provisions make becoming a public company more attractive by reducing costs and burdens for EGCs after they go public, often by simplifying and streamlining disclosures. One of the most significant of these benefits is an exemption from the requirement contained in Section 404(b) of SOX to obtain an internal controls attestation and report from a registered independent public accounting firm while the issuer remains an EGC. For many, perhaps most, companies seeking to complete an IPO, this will delay by at least three years the need to comply with this

requirement of SOX. It should be noted, however, that, as explained in Chapter 2, EGCs will still be required to establish and maintain disclosure controls and procedures and internal controls, and their principal executive officer and principal financial officer will still be required to certify Form 10-Q and 10-K filings.

4.3 Process timeline

Fenwick & West LLP

The time-intensive process of submitting confidentially and executing an IPO as an EGC can take the 12 to 16 weeks from initial filing to effectiveness it typically takes for a non-EGC issuer to complete the process described in Section 3.1. As with IPOs of non-EGC issuers, the exact time taken to complete an IPO for an EGC can vary widely and depends on market conditions, the complexity of the transaction, the EGC’s readiness prior to embarking on the IPO process and many other factors. Like the process outlined in Section 3.1, the IPO process for EGCs can be broken down into the following stages.

(a) Prior to official IPO process launch

Decision to go public: While the EGC should still evaluate its internal readiness, including industry position and growth prospects, it also has the flexibility to assess investor interest in a contemplated offering of its securities, to determine whether it is ready to go public.

Testing the waters: The EGC and its advisors should consider whether to engage in test-the-waters communications with “qualified institutional buyers” or “accredited investors” to gauge interest in a contemplated offering of its securities.

Internal controls: Once the decision has been made to prepare for an IPO, the EGC should still take the actions other issuers take: select an appropriate board of directors, prepare audited financials (with a qualified independent registered public accounting firm), and begin establishing internal controls.

Selection of advisors: The EGC should still carefully select its IPO advisors, including

the right investment bank and counsel experienced in the industry and types of initial public offerings of the EGC.

(b) Week 1

Organizational meeting: The traditional organizational meeting would still occur in the case of an IPO for an EGC. However, if an EGC is uncertain of its ultimate timing for its IPO, it may decide to work more informally with a few underwriters to prepare for an eventual formal kickoff of the IPO process with the organizational meeting.

(c) Weeks 2 to 5

Drafting: The EGC would still prepare the same Form S-1 registration statement and prospectus. The drafting process is also largely the same as for traditional IPOs. In general, the contents of the document are same as those outlined in further detail in Section 3.2(d). The contents are different in the following ways:

- The financial statements may include two (rather than three) years of audited financial statements and selected financial statement information for the previous two (rather than five) years.
- The MD&A of the EGC's performance need not cover more than the past two (rather than three) years plus any "stub" periods;
- The compensation disclosure and analysis for executives need not include more information than is required of a smaller reporting company, meaning that the document need not include, among other things, compensation discussion and analysis or tabular information for more than three executive officers and may omit certain compensation-related tables such as the grant of plan-based awards, and option exercise tables; and
- The EGC must make affirmative disclosure in the registration statement as to whether it will elect to "opt out" of new accounting standards that are not also applicable to private companies.

Due diligence: The due diligence process for an IPO of an EGC is the same as that for traditional IPOs. Because this process is time-intensive, an EGC should consider

its overall readiness to complete an IPO before embarking on the IPO process.

Legal and other documentation: In addition to the prospectus, the EGC and underwriter's counsel will work with the investment bank, the EGC and the auditors to draft and complete the documentation outlined in Section 3.1(b) (e.g., underwriting agreement, comfort letter, etc.) The primary differences in the documentation of traditional IPOs and those of an EGC include:

- the underwriting agreement will contain additional representations and warranties relating to a company's status as an EGC and representations and covenants relating to test-the-waters communications; and
- the lock-up agreements for existing shareholders no longer need contain what are known as "booster shot" provisions—where the typical 180-day lock-up period can be extended if the EGC issues an earnings or other material press release or if material news about the EGC is released prior to the expiration of the lock-up period.

Determine listing venue: The EGC should still determine earlier in the process whether it is eligible to list on the NYSE or other exchange and reserve a ticker symbol.

(d) Week 6

Confidential submission: An EGC may elect to submit a draft Form S-1 registration statement to the SEC confidentially, rather than making a public filing. In general, draft registration statements submitted through the confidential submission process are the same as registration statements filed outside of it. However, they need not be signed or include the consent of auditors and other experts, although the EGC must provide a signed copy of the report of the independent registered public accounting firm with any submission. Confidential submissions must be made via the SEC's EDGAR filing system with the tag "DRS" or, in the case of subsequent submissions, "DRS/A." Once the initial public filing is made, there is no need to file the prior confidential submissions as exhibits, as the EDGAR system will automatically make

those submissions public at the time of the initial public filing.

Valuation update with the investment bank: As is the case in traditional IPOs, it is prudent to have relatively frequent valuation updates with the investment bank.

(e) Weeks 7 to 8

Testing the waters: The EGC and its advisors should consider whether to engage in test-the-waters communications with "qualified institutional buyers" or "accredited investors" to gauge interest in the contemplated offering of its securities. In addition to helping the EGC gauge investor interest in the offering, such communications could provide valuable information and experiences and impact the crafting of the marketing story for the impending roadshow.

Roadshow presentation: The preparation of the roadshow presentation and the roadshow itself is not notably different for EGCs than it is for companies engaging in traditional IPOs. Before finalizing the key roadshow messages, the EGC has the ability to take advantage of the testing-the-waters provisions of the JOBS Act to help further refine the roadshow messaging.

Discuss offering structure: The EGC and the investment bank should determine if there will be more than sufficient investor demand for the contemplated offering of its securities so that the EGC can determine whether to make the decision to publicly file the registration statement. The EGC should also solicit interest from selling shareholders on any potential shares that they may want to sell as part of the IPO in accordance with any notice requirements to the shareholders.

(f) Weeks 9 to 13

Receiving and addressing SEC comments: The SEC comment process for confidential submissions takes a similar amount of time as for traditional IPOs—with the SEC taking approximately 30 days to review and provide comments on the initial submission. Subsequent rounds of comments can take a range of time, depending on the complexity of the issues and additional disclosures included by

the EGC. Comment letters and related correspondence for completed IPOs of EGCs are made public within a few months of the effective date of the registration statement.

A Form S-1 registration statement and all prior amendments should be filed publicly with the SEC at least 21 days before the roadshow launch.

Legal and other documentation:

Lock-up agreements and Financial Industry Regulatory Authority (FINRA) questionnaires should be widely circulated to directors and officers of the company shortly before the public filing if the EGC and the underwriters have elected not to circulate those on a more widespread basis while the EGC was still submitting confidential drafts.

Marketing strategy: Continue to consider engaging in test-the-waters communications.

(g) Week 14

Finalize offering size and structure and convey valuation information to the SEC in order to resolve any issues regarding valuation of the EGC's common stock in prior equity transactions, such as grants of employee stock options.

(h) Weeks 15 to 16

- File a Form S-1 amendment with the red herring prospectus that includes price range and offering size.
- Launch roadshow.
- Price the IPO.
- The next day, the EGC begins publicly trading on the NYSE, rings the opening bell and hosts other key marketing events associated with being a public company.
- Close the IPO.

4.4 Conclusion

Fenwick & West LLP

The JOBS Act has helped relieve some of the burdensome requirements smaller companies face in accessing the U.S. capital markets and made going public more attractive by reducing the associated costs and burdens for a period of transition while these companies grow.

While it remains to be seen how much of an impact the “IPO on-ramp” provisions will have on the number of issuers who prepare to go public, many traditional IPO practices are changing as EGCs take advantage of the ability to “test the waters” prior to their IPOs and the confidential submission process. Many EGCs are benefiting from being able to explore an IPO without disclosing confidential information to its competitors or the market generally, and avoid any embarrassment associated with pulling the IPO should the EGC do so.

After EGCs have had a longer period of reporting as public companies, disclosure practices may continue to evolve. After only one year of life under the JOBS Act, EGCs may face pressure from investors to increase the amount of disclosure they provide, particularly in the areas of executive compensation.

There may be more benefits in store for EGCs. The JOBS Act provides a plan for future changes to existing disclosure requirements to modernize and simplify the registration process and reduce the costs and other burdens associated with these requirements for EGCs for the purpose of further streamlining the registration process to making it more efficient and less burdensome for the SEC and for prospective EGCs. ●

5

IR and communications

5.1 Preparing an IPO communications strategy

FTI Consulting

There is a strong temptation to view IPO communications as a listing-day event, meticulously planning for the inevitable publicity surrounding day-one trading. In reality, preparation should begin well before the registration statement is filed to ensure consistent messaging and a strong baseline of communications before the “quiet period” begins.

Although the IPO prospectus will be the primary selling document for the offering, investors and media will look as broadly as possible for further insight into the company, its business and its competitive position. The company should therefore conduct a thorough assessment of its brand and reputation, as perceived by customers/clients, employees, vendors, regulators, industry analysts and other key stakeholders as early as possible in the IPO process so that any remedial actions can be taken before it becomes constrained by quiet period rules. Generally, communications made more than 30 days before the filing of the registration statement will not be considered impermissible “gun jumping,” as long as they do not talk about the offering.

In particular, the company should review any public commentary about its financial results or growth prospects to identify discrepancies between what previously was disclosed/anticipated and the information that will be presented in the upcoming SEC filings.

The company’s communications review should include the following:

- Media relations activities—the IPO will attract attention from an expanded media universe focused on performance, growth potential and other financial events. While the majority of the work in building these new media relationships begins after the quiet period, the company should ensure that key industry reporters accurately understand its business strategies and differentiators in advance of the initial filing of the registration statement. Activities could include a series of reporter briefings (assuming an appropriate news hook), a review of boilerplate language,

updates to executive biographies and the creation of company fact sheets, which can be posted to the website. Additionally, the company should review its press release strategies to maximize opportunities for a consistent flow of announcements during the quiet period (i.e., establish a baseline of new product/client announcements, key milestone updates and other news to avoid the appearance of “gun jumping” during the registration period).

- Website—many prospective investors and covering reporters will visit the company’s website, so it is important that the site reflects the image the company wishes to convey, that corporate information is easily accessible and that all data points are consistent with those provided in the IPO registration statement. In addition to reviewing the site for accuracy, the company should consider adding information about its mission, vision, and values; an online media kit; executive biographies; lists of historical accomplishments and other reference documents. These materials will be important media and investor relations tools to bridge the gap when communicators are unable to speak directly with their constituents.
- Marketing materials and other customer communications—the company should review its marketing materials and customer communications to ensure that messaging and statistics are consistent with the language in the IPO registration statement. Equally important, it should train public-facing employees (e.g., receptionists, sales force, customer service representatives and others) to respond to external inquiries within the confines of SEC regulations and to forward questions outside their respective areas of responsibility to the appropriate communications representatives.
- Employee communications—as with any major change, an IPO can lead to employee uncertainty. Employees may have questions about how the IPO will affect their jobs, what new opportunities are available and whether they will be able to purchase shares.

Additionally, they must understand that compliance with disclosure rules and internal control requirements is everyone’s responsibility and that there are repercussions for the individual and the organization for not adhering to these rules. Training and education on the IPO process—articulating the expected milestones—as well as setting clear expectations about what it means to be part of a public company, will help eliminate confusion.

- Business partner communications—outreach to this group is very much contingent upon the degree to which relationships with business partners are expected to change following the listing, if any. A company may be required to disclose information about its top vendors or customers in its registration statement and subsequent filings with the SEC following the IPO. In these cases, outreach to inform partners of the required disclosure or to communicate any changes in interaction with them may be advisable. Additionally, management may want to consider communicating to business partners more generally around the IPO listing to promote the message of “business as usual” or to reinforce the benefits (e.g., growth, investment, change in capital structure) of the transaction.

Among the company’s most important tasks in building out a communications platform as it prepares to go public is the development of a comprehensive strategy to interface with a crucial new audience—the investment community. The way in which the company communicates to the financial markets significantly impacts its status in its industry, the perceived value of its business, management credibility and ultimately the valuation of its securities in the markets.

Preparing for an IPO includes establishing protocols for how the company will engage with investors, what information and operating metrics it will provide, how it will report its financial results and what communications channels it will use. The IPO process will place the company under acute public scrutiny and set in motion a whirlwind of activity. It is

critical that preparations begin during the pre-IPO phase to allow adequate time for benchmarking and planning, and so the company will be ready to go “live” by the time the IPO prices.

Key elements of an effective financial communications strategy include the following:

- Consistency—investors will be looking for new information in every interaction with management, and any variations in messaging, content, tone or frequency/timing of communications can be seen as an indication of changes in the business or outlook that could affect the company’s stock price. Consistency in communications is paramount, yet the company must also allow sufficient flexibility to adjust to business conditions.
- Benchmarking—an important first step is establishing a framework for how the company will communicate to the financial community. Key to this process is analyzing and benchmarking how industry-leading and peer companies communicate to their financial audiences. Investors, the media and other key stakeholders assign companies to peer groups against which they evaluate the company’s performance. It is therefore important to understand thoroughly the standards against which the company will be evaluated—in terms of both peers and best practices.

This benchmarking study should encompass a full range of materials scrutinized by investors, including financial and regulatory filings, press releases and transcripts or webcasts of public events such as earnings conference calls, investor conferences and analyst events, and should include the timing of peer group reporting as well as content. As a general rule, the company will be judged on the completeness, quality and accuracy of the information package it provides to the financial community.

- Financial and business metrics—the company should identify early in the process the metrics and other information it plans to provide to investors post-IPO and consider

whether this information can be included in the registration statement to provide additional consistency. Specific consideration should be given to the metrics that peers use to describe their businesses and provide guidance on future performance, as well as additional supporting material they provide. Understanding and accommodating these standards—or proactively addressing differences—will keep the company in sync with what investors are accustomed to receiving from other companies in the same industry and demonstrate a commitment to open and honest communications. Additional financial and operating characteristics critical to understanding the nature and strength of the business can and should be provided.

- Nonfinancial disclosures—one of the most frequent and visible communication opportunities is the reporting of quarterly financial results. In addition to meeting SEC disclosure requirements, investors expect management to interpret results and provide additional commentary on business developments via the earnings release and conference call. These communications should go beyond the prescribed financials and the financial metrics by incorporating business commentary, industry and segment trends and other qualitative information.
- Guidance—guidance continues to be a controversial topic within the investment and corporate governance communities. However, an important driver of equity valuation is the ability of investors to forecast future earnings and cash flows. How the company provides forward-looking commentary through guidance can significantly affect the valuation of its stock. Research has demonstrated that relatively frequent, accurate and granular guidance is associated with a lower cost of capital; yet the risk of not meeting expectations, a possible duty to update and potential liability concerns demand careful consideration. To be aligned with investor expectations, and to address any differences in disclosure,

guidance policies of peers should also be analyzed and factored into the decision.

- Online communications tools—the investor relations section of the company’s website is often the first landing spot for investors seeking more information about the company. As such, it should be user-friendly, interactive and easily accessible. Visitors accessing the site must be supplied with the information they need to conduct initial due diligence on the company and help them advance their investment decisions about the stock. Information that can be dynamically updated regarding the business, key executives and strategy will help investors better understand the company and its future prospects.
- Training—management teams without public company experience should be trained to communicate with investors within the regulatory framework. The market will respond favorably to executives who are forthcoming and open about their businesses. However, engaging with investors in real time subjects executives to the risk of making selective disclosures of material nonpublic information, which is prohibited under Regulation Fair Disclosure (FD). It is critical for executives to understand the parameters of what they can discuss. Trainings may also be helpful for executives unfamiliar with Wall Street to better understand the different roles of the sell side and buy side and how that may impact how they interact with different individuals.

Even as the company seeks to refine its communications strategies, it is important to understand that investors will look well beyond its direct shareholder communications for insight into its business prospects and investment potential. In addition to traditional investor relations, the company should consider its corporate and media communications strategy as part of an entire communications approach. This includes assessing news trends, building relationships with reporters, influential bloggers and industry analysts, and understanding how peer companies are portrayed in the media.

Developing strategies for disseminating positive announcements and managing difficult news will pay long-term dividends, helping build the company's brand, enhance its reputation, build management credibility and protect valuation. Companies must have the proper response mechanisms in place to address crisis situations quickly and effectively, including those crises that may occur while the company is still in the IPO quiet period.

Planning, vigilance and transparency are the most effective investor relations tools a company possesses. By developing a comprehensive communications strategy that provides for consistent communications, meets (or exceeds) peer standards and provides required disclosures, the company can prepare, pre-IPO, to thrive in a public environment and adapt efficiently to the many surprises and challenges that will inevitably arise.

5.2 Communicating with the market post-IPO

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While an IPO marks a significant milestone in a company's history, it is only the beginning of an ongoing process of building value for its shareholders.

The company's operating performance will be an important driver of value creation. However, financial markets in their role as a discounting mechanism assign value to the company's future earnings and cash flows supported by, among other things, intangible factors such as investors' confidence in the business model, their belief in management's ability to execute the stated strategy and their perceptions of the company's credibility, transparency and corporate governance structure. All these intangibles are greatly influenced by how the company communicates to the financial community.

From management's perspective, the goals of investor communications are to:

- optimize the value of the company's equity (or conversely, minimize the cost of equity capital) over time within the context of both the company's performance and macroeconomic and industry trends; and

- protect management's credibility and reputation within the financial community.

Since investors have no role in the operations of the company, they rely on management to protect their investment and keep them informed on the status of the business. This requires a commitment of management to engage the financial community in a credible, honest dialogue.

Regulatory parameters for communicating to the investment community:

Communications strategies must accommodate not only the information that must be filed with the SEC under securities regulations but also broader communications "best practices" that can be more complex and demanding. In particular, management must determine whether a corporate development or change in outlook is material and must be reported; this determination can be difficult when there is uncertainty about the future or a wide range of variability around potential outcomes. Furthermore, Regulation FD provides that if management discloses material nonpublic information to some investors or analysts, it must make the same information available to everyone. In practice, this requires management to provide access to material information simultaneously to all market participants, necessitating careful attention to the timing, content and delivery mechanism of each communication.

One key example of how Regulation FD affects financial communications is the decision by many companies to instate an earnings "quiet period" in the weeks leading up to the reporting date, during which they will not meet with or talk to investors. This quiet period and the inability to respond directly to a question come at the awkward time when the company's results are known by management but not yet reported publicly.

When companies have reported results and are ready to resume meeting with investors, they generally not only file the earnings information with the SEC but also issue a press release using a distribution service and post it to their investor relations websites to ensure equal access for all interested parties.

If an inadvertent disclosure of material nonpublic information does occur, it is important for the company to make that information public promptly. Regulation FD defines "promptly" to mean as soon as reasonably practicable, but in no event after the later of 24 hours or the commencement of the next day of trading. (Regulation FD is discussed further in Section 5.4.)

Developing and refining a core message platform:

Essentially, the company's shareholders are placing a bet on its future success. Accordingly, ideal communications provide a roadmap to the future and then maintain an ongoing flow of information about the company's progress in achieving its goals. Developing and maintaining a core message platform that clearly communicates the company's goals, market opportunities and growth strategies is critical for ensuring that the value drivers are well articulated and consistently delivered across its communication vehicles and channels. These messages should build on those developed in the pre-IPO phase, with adjustments made as needed to dispel any lingering concerns or misperceptions about the company's positioning in the market, its performance within the current economic climate and the issues surrounding the industry as a whole. To ensure consistency, all audiences should be considered when developing the message platform.

In cases where there is significant investor churn in the period following the IPO, it may be advisable to do a more thorough vetting of perceptions to ensure the company is addressing the concerns of the current investor base. Specifically, the company should conduct research that:

- ascertains the investment community's current views of the company, management team, strategy and prospects;
- analyzes drivers behind buying and selling activity post-IPO;
- identifies areas of potential misunderstanding of the company's positioning/prospects; and
- compares its own communications efforts to those of the peer group to identify areas that may require further explanation going forward.

Based on these findings, the company can tailor messages—and, in some cases, the actual financial disclosures—to move perceptions closer to the desired state. Once refined, key messages should permeate all communications, including presentations, fact sheets and websites, targeted to investors.

Disclosure guidelines and processes:

As the visibility and sponsorship of the company increase, the volume of incoming inquiries and demands on management time and attention will likely escalate. It is important to understand that all audiences are interconnected and information flows freely among them and that investors may act on information or perceptions that exist in any domain. This argues for close coordination among all people charged with speaking to the public.

To ensure consistency of message and protect against improper disclosure, it is strongly recommended that management establish at the very beginning a formal disclosure policy and protocols to manage incoming inquiries about financial and investment topics, as well as the flow of outgoing information. This policy should include guidelines on when the company will speak to investors, what information is allowed to be communicated and which members of management or the investor relations team are authorized to speak for the company. All employees should be made aware of these guidelines and of their obligations to maintain the confidentiality of material nonpublic information. The guidelines should be reviewed regularly.

Importantly, disclosure policies should be designed not only to manage the flow of information but also to ensure its quality, accuracy, consistency and timeliness. In addition to ensuring reliable, rigorous communications, this will also help to reduce the risks of liability that can arise from any materially false, misleading or incomplete public disclosures.

Setting expectations: The company's success will be measured by execution against expectations, whether those are set through formal guidance, analyst estimates or metrics disclosed during the IPO process. If the company provides its own guidance, these expectations need to be

sufficiently ambitious so as to demonstrate a robust business, yet achievable and realistic so they can be met consistently. Expectations can be established by providing quantitative and qualitative guidelines such as growth targets, margins and market share over varying timeframes, depending on the visibility into and predictability of the business. Once these parameters are established, the company must carefully consider whether a variance from expectations is material enough to warrant proactive disclosures and, if so, what constitutes the proper timing of the announcement and the forum for discussing it.

It is important for newly-public companies to understand that results outside the anticipated ranges—be it on the upside or the downside—can significantly impair management credibility for effectively communicating with Wall Street and potentially lead to a misperception that the company's results will be unpredictable or volatile, neither of which is constructive for the stock's valuation. Although many companies mistakenly believe that earnings that beat expectations will propel their stock price forward, the benefits are often short-lived, as they encourage shorter-term investors to bet on the company's ability to beat sell-side analyst estimates, rather than focusing on the long-term strategy and value creation.

Forums for communicating with investors:

There are a number of important forums for conveying the company's investment and business propositions and maintaining an ongoing dialogue with investors:

- Quarterly earnings—reporting earnings to investors is perhaps the most important medium for providing commentary about the business to the financial community. The typical earnings process includes a press release with financial data, or an advisory directing investors to the company's website for details, as well as a conference call and Q&A with sell-side analysts and institutional investors. The related SEC filing—Form 10-Q or Form 10-K—is more formal and much more extensive; some companies file it concurrently with the

earnings release, while others file it later (particularly for year-end results). These important communications provide an opportunity to demonstrate openness and candor through the way that management speaks to the company's successes and challenges, how its strategy is succeeding and what investors can expect in terms of future performance. Effective preparation is critical to ensure that management has anticipated investor questions and can either proactively or reactively address issues, as appropriate.

For many IPO companies, the initial earnings period brings unique challenges as they find themselves reporting results for the first time while still in a quiet period. It is critical to effectively balance quiet period restrictions with the desire to set a strong precedent for transparency and good corporate governance.

- Investor meetings—there are multiple forums in which management can personally engage investors:
 - nondeal roadshows, where the company meets with institutions in one-on-one or group meetings;
 - sell-side brokerage firm and investment bank investor conferences, often with a group presentation, followed by one-on-one or small group breakout meetings for more detailed discussions; and
 - company-sponsored events such as analyst/investor days on-site or group meetings at company headquarters to showcase the broader leadership team and company facilities—with companies increasingly using webcasts at large-scale analyst/investor days to expand the live and on-demand global attendance at such events.

Regardless of the format, these meetings provide valuable opportunities to contextualize financial results, explain growth strategies and develop relationships with investors. Yet even under the best conditions, management cannot meet with all the best firms and the best contacts at any one event. As investor relations teams work to establish

the meeting schedule for the period immediately after the IPO quiet period is lifted, the priority should be to meet targeted investors that are currently underweighted in the company's shares and "on-the-fence" targets that were included in the IPO roadshow but did not buy at the offering. These targets should then be supplemented with appropriate long-term investors that did not participate in the roadshow. Building these relationships creates a new level of potential buyers of the stock when "bridge" institutions or insiders want to sell their shares.

- Press releases—even routine company announcements have the ability to impact the company's stock price, and all press releases should be developed with an eye toward what the content means for the business and how the news will be perceived by the investment community. Whenever possible, press releases should tie news events to the company's stated strategy and demonstrate momentum and progress against its long-term objectives. If the announcement will impact the company's expectations for the quarter or year, these issues also should be addressed in the announcement.
- Conference calls and webcasts—depending on the importance and complexity of the announcement, it may also be necessary to hold a conference call or webcast for the investment community. These allow management to provide additional color on the event that prompted the announcement, discuss how it will affect the company going forward and respond to questions. Clearly explaining complicated information and, when possible, allowing investors to pose questions that can be addressed in real time bolsters management's credibility and mitigates the risk of misunderstandings.
- Financial, business and trade media—print and broadcast media allow the company to communicate information to a much wider audience while also bolstering credibility through commentary by objective third parties. Whether it is positioning financial results or underscoring themes related

to management strength and market position, effective financial, business and trade media relations strategies can influence investment decisions and provide a reputational cushion in difficult times.

- Social and online media—media influence has been extended further as social media takes a more prominent role in companies' communication strategies—and particularly in the investor relations strategies of companies in technology-centric industries and those with larger retail investor bases. Each day, millions of people participate in live, passionate, authentic conversations via social media forums and blogs. These communications channels allow companies to engage directly with stakeholders, but they also come with serious responsibilities in terms of disclosure requirements and the assumption that companies will continue to communicate through good times and bad. It is essential that online media strategies are executed with the same level of foresight and legal supervision as traditional media strategies.

Managing the shareholder base: Since investors have differing perspectives on what creates value in the markets, it is crucial to ensure that the investment style, holding period and industry focus of the company's shareholder base are aligned with, among other things, its business model and the investment proposition.

Managing the company's shareholder base is an active process. Investors that are poorly informed about the company or whose investment style is at odds with the investment thesis are more prone to sell their positions, creating downward pressure on the stock price and increased market volatility. Furthermore, there is a natural attrition of shareholders as portfolio managers shift assignments and market conditions change. Ongoing diligence is required to identify the most important holders, monitor changes in the composition of the shareholder base and engage holders in dialogue to help keep them informed about the business and anticipate their future actions.

Beyond these efforts, there is an ongoing need to replenish the pipeline by identifying and courting new investors. The ideal target group consists of long-term investors that have a track record for investing in the company's industry and whose portfolio holdings have business and financial characteristics similar to those of the company. While there will likely be interest from the company's covering analysts to market the company to prospective investors, management should take responsibility for managing the investor base and targeting potential new shareholders.

Sell-side analysts: In order to increase visibility among the buy side, the company should develop sell-side sponsorship to generate independent financial models, determine an appropriate multiple that will help to drive the long-term valuation of the company and help market the investment story to the buy-side investment community. Analysts are a key component in the capital markets and they play a critical role in communications between management and the investment community.

Once public, management should strive to secure research coverage by nonsyndicate analysts, who will be viewed as more impartial. An ideal mix of analysts would include quality bulge-bracket firms that add credibility and cachet to the company's profile, combined with strong tier-two regional firms that take a more active role in analyzing and covering the company.

Prioritizing management's time with analysts can be challenging, and there are a multitude of things to take into account when deciding with which firms management should spend their time, including quality of research, quality of marketing events and general opinion of the company under coverage.

Quality of research is a critical consideration, although the ability for a firm to provide truly unique research is rare, making this characteristic of increased importance. Number of companies in an analyst's universe, reputation with the buy side and an in-depth knowledge of the space are all factors to consider in determining the quality of research.

Additionally, management gets the majority of its face time with the investment community through marketing events with the sell side, such as conferences and nondeal roadshows, and, as such, firms that are willing to work with management to set up a quality schedule should be able to spend time with management over those that focus purely on short-term investors and high-paying clients.

When interacting with the sell side, it is important to treat all analysts equally. For instance, it may be beneficial to spend time with analysts that are neutral or underweight on the company to discuss their investment thesis and to understand the drivers behind their rating. It is, however, typically preferred to market with supporters of the company's stock because they spend the most time promoting a company's story with the investment community.

Conclusion: An investor once said, “We don’t shoot the messenger, we shoot the cheerleader.” The financial community can be remarkably perceptive and insightful; information—especially that which is market moving—flows through it rapidly and it has a long institutional memory. Regular, consistent and open communications with investors are instrumental in achieving an appropriate valuation and high regard for the company's management.

5.3 Employee and business partner communications

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There are two other important stakeholder groups a public company should take into consideration. Employees and business partners are integral to the success of a company, but new regulations and compliance with the SEC may change the relationship with these stakeholders. Many companies may no longer be able to provide the same level of operational and financial transparency, and management teams need to educate employees and business partners of this reality, while maintaining their support during this process.

Employees: Employees are the company's most valued ambassadors. Engaging them

as part of the IPO process creates a culture of understanding that helps ensure clear and consistent communication with all other stakeholder groups.

Unfortunately, IPOs are potentially disruptive from a cultural standpoint. Executives and staff of private companies that have never previously been public are often accustomed to receiving financial and operational data that can no longer be shared under SEC regulations after the company goes public, and some employees will be asked to take on modified roles.

To manage this transition, the company must realign its people around its go-forward strategies and growth prospects, while simultaneously preparing them for new communications constraints. Employees should be educated about the rationale for a public listing, how it can benefit them (e.g., new career opportunities and employee stock purchase plans) and—perhaps most critical—what new responsibilities the company must assume as a publicly traded entity.

Compliance with SEC and exchange rules needs to be a company-wide effort, and employees must understand that even casual comments made to outside parties (e.g., “I made a big sale today” or “Business has been picking up lately”) can take on additional meaning for the company's new financially-minded stakeholders. Under the watchful eye of investors, financial analysts, regulators and financial and business media, employee actions have the potential not only to affect the company's corporate reputation, brand and stock price but also to subject the company and themselves to risk and liability from inappropriate disclosures. This risk has been exacerbated as employees engage in online chat rooms, blogs and other social media channels that accelerate the speed with which employee comments can reach a seemingly endless universe of potential recipients.

Key considerations that affect how the company interacts with its employees during the IPO period and beyond include the following:

- It is critical for employees to understand securities laws and SEC regulations prohibiting insider trading or tipping—particularly if they are given opportunities to participate in the offering. Employees need to

understand there will be a zero-tolerance policy on these issues.

- To maintain consistency in their communications with the market and avoid any inappropriate disclosure of material nonpublic information, the company should designate and train a very limited group of spokespersons, whose role is to discuss business and financial results with the public. Employees should be instructed to forward all external inquiries to these trained communicators and investor relations representatives.
- In compliance with Regulation FD, U.S. public companies must provide the financial community with equal and timely access to financial and operational data. The company will now issue quarterly and annual financial reports, and even more routine corporate announcements will assume increased importance. However, many companies can no longer provide employees with the same level of access to financial and operational data they might have received in the past. Employees need to understand this new reality, know they are still important and valued members of the team and have confidence that the company will continue communicating with them as openly and honestly as possible going forward.
- Sarbanes-Oxley regulations require public companies to maintain transparency and accountability in documenting financial controls. In many instances, these processes will be established well ahead of the IPO. The listing provides an opportunity to remind employees of their responsibility to protect sensitive data, including client/customer information, performance statistics and any other information not available to the general public.
- To be effective ambassadors of the company, employees must be given the right tools and resources to properly represent the company. In addition to training, the message platform should be adapted to address employees as well as investors to eliminate confusion and guarantee consistency.
- To help the company meet the expectations of investors, it is essential

that employees understand the company's priorities and how each area of the business drives success. Now more than ever, management needs to engage employees on the company's strategy and help clarify the overall vision. When a company elects to engage employees, research shows that the company will outperform its peers across several financial measures, including operating income, net income and earnings per share.¹

Business partners: Business partner communications can also be an important part of an IPO. Maintaining a consistent level of customer service is a priority during this process, and to the customer, a public listing should appear to be a nonevent.

In most instances, interactions with vendors, customers and other business partners will not change following the listing. However, a company may be required to disclose information about its top vendors or customers in its registration statement and subsequent filings with the SEC following the IPO. In these cases, outreach to inform partners of the required disclosure or to communicate any changes in interaction with them may be advisable. Additionally, management may want to consider communicating to business partners more generally around the listing or after the IPO to promote the message of "business as usual" or to reinforce the benefits (e.g., growth, investment, change in capital structure, etc.) of the transaction.

5.4 Legal framework for communications

Cleary Gottlieb Steen & Hamilton LLP

Following the IPO, the company will be required to produce a number of reports pursuant to SEC and stock exchange listing rules, as described in Section 6.1. In addition to those reports, however, the company will want to provide regular information to its security holders and

various market professionals such as financial analysts, investment advisors and broker-dealers to assist them in properly understanding the company's results and business trends. Open communication with the market is encouraged by stock exchange rules and will play a key role in the company's ability to effectively disseminate information into the market. These additional communications are not, however, legally required, and when provided voluntarily, should be carefully managed to comply with the legal framework and minimize potential legal risks.

Complete and accurate disclosure: The company's public disclosure must not contain misleading statements of material information and must include any additional information necessary to make the statements made not misleading.

Duty to update: If the company discovers that a public statement was materially inaccurate or misleading when made, it should promptly correct the statement to reduce its risk of liability. Even if it was accurate when made, a forward-looking statement may need to be updated if changed circumstances make it inaccurate or misleading. U.S. courts have reached conflicting conclusions on whether this kind of duty to update exists.

Research analysts: Management should not participate in the preparation of analysts' reports, because there is potential liability if company officials become so "entangled" with a report that the report can be attributed to the company.

Selective disclosure and Regulation FD (Fair Disclosure): When divulging material nonpublic information, company officials may not disclose it selectively—for example, exclusively to securities analysts or security holders—but rather must make the information available to the general public. Selective disclosure can lead to liability for the company and for company officials themselves for insider trading by persons receiving the disclosure.

U.S. public companies are subject to the requirements of Regulation FD,

which prohibits selective disclosure (for a discussion of this topic as it applies to foreign private issuers, see Section 9.6):

- Regulation FD focuses on what the SEC believes to be the core issue—selective disclosure to those that will foreseeably trade on that information or prompt others to do so. Accordingly, it applies to communications with market professionals (e.g., research analysts, broker-dealers, investment advisors and managers and investment companies) and with security holders that will reasonably foreseeably trade on the basis of the disclosed information. The regulation does not apply to communications with, among others, media representatives, advisors in a relationship of trust or confidence with the company (e.g., legal advisors and investment bankers), employees and government officials.
- The regulation applies to communications by senior officials and officers, employees or agents of the company who regularly communicate with market professionals or security holders.
- The regulation applies to selective disclosures of material nonpublic information. "Materiality" is not further defined in Regulation FD, but it is the subject of extensive case law and SEC guidance in other contexts.
- Whenever the company makes an "intentional" disclosure of material nonpublic information, simultaneous public disclosure is required. A disclosure is intentional if the company knows or is reckless in not knowing that the information being disclosed is both material and nonpublic. Whenever the company learns that it has made a nonintentional selective disclosure, it must make public disclosure of that information promptly (generally within 24 hours).
- Violations of Regulation FD are subject to SEC enforcement actions, but do not give rise to Rule 10b-5 liability or private causes of action. They also do not result in ineligibility for short-form registration or the Rule 144 safe harbor for resale of securities.

Public disclosure for purposes of Regulation FD can be made by filing or

¹Crush, Peter, —Employee Engagement ROI—Rules of Engagement. © 2008 Towers Perrin

furnishing a Current Report on Form 8-K or by disseminating the information through a method or combination of methods that is “reasonably designed to provide broad, non-exclusionary distribution of the information to the public.” The most common method is by press release. If the company wishes to make public disclosure of material nonpublic information by means of a conference call or webcast, it must give adequate public notice, including the date, time, subject matter and dial-in information for the call. Disclosure at a shareholders’ meeting, even one that is open to the public, is not sufficient if the meeting is not webcast or broadcast by electronic means, and the presence of the press at an otherwise nonpublic meeting does not render the meeting public. Posting information to the company website or use of social media is also permitted if the company regularly uses the website or other media for that purpose and the company alerts the market to the distribution channel it plans to use and the information it may disclose through the channel.

The SEC has aggressively investigated cases under Regulation FD, resulting in several enforcement proceedings. SEC personnel have indicated that they look for egregious violations involving the intentional or reckless disclosure of unquestionably material information. The enforcement actions also confirm that the SEC will look to market reaction as an indicator of the materiality of selective disclosure. One significant similarity among the enforcement actions is that visible and sometimes dramatic changes in stock trading price and volume occurred in the aftermath of the selective disclosures, and the SEC has stated that a very significant market reaction to selectively disclosed information requires public disclosure of that information.

Non-GAAP financial measures: Special disclosure rules apply when the company presents certain financial information in a way that is different from the financial statement presentation under GAAP. Use of non-GAAP financial measures in a public statement (whether written or oral)

is subject to Regulation G, which requires that the disclosure be accompanied by a presentation of the most directly comparable GAAP financial measure and a quantitative reconciliation (by schedule or other clearly understandable method) of the two measures. More stringent requirements apply if the company uses non-GAAP financial measures in a report filed with the SEC or in an earnings release, and some non-GAAP financial measures are not permitted in filed reports.

The following are some practical guidelines for a company’s communications with the market:

- Designate one company executive to communicate with analysts.
- Make each presentation to analysts on the basis of a prepared text that has been reviewed by senior executives and by counsel.
- Do not disclose material nonpublic information to analysts unless the information is disclosed to the public at the same time; this can be done by permitting the public, on reasonable advance notice, to participate in any call with analysts during which material nonpublic information may be discussed.
- Refrain from responding to analysts’ inquiries in a nonpublic forum unless the company is certain that the response does not include material nonpublic information.
- If asked about a matter that has not previously been disclosed, simply say, “No comment.”
- If requested by an analyst to review a research report, do not comment except to correct errors of fact. Do not comment in any way on an analyst’s forecasts or judgments, including by saying you are “comfortable” with them, that they are “in the ballpark” or other words to similar effect. To avoid entanglement, be cautious about distributing analysts’ reports or including hyperlinks to them on the company’s website
- Avoid favoring one analyst over another.
- Review public statements to identify any non-GAAP financial measures. To avoid the need to reconcile non-GAAP financial measures in presentations

given orally, telephonically, by webcast or broadcast or by other similar means, provide the most directly comparable GAAP financial measure, with the required reconciliation, on the company’s website and include the location of the website in the presentation. Written materials (whether distributed electronically or in hard copy) must include the most directly comparable GAAP measure and the required reconciliation.

- Do not make specific forward-looking statements, unless:
 - you set out the assumptions on which the forecast is based;
 - you indicate the factors that could prevent the forecast from being realized (both this and disclosure of the assumptions can be done by referring to a filed document that contains the relevant information);
 - you make the statements to the public at the same time; and
 - you are always prepared to evaluate the need to update the statement when circumstances change.

5.5 Market intelligence and surveillance

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Sections 5.5 through 5.8 cover a group of advisory services and tools that allow investor relations officers to stay informed of ongoing market activity and perceptions, access the most detailed information possible on investment community participants, effectively implement an investor relations strategy to prospect for new investors, manage interactions with the investment community efficiently and measure the success of their investor relations efforts. These services and tools are used widely by investor relations officers individually and collectively at listed companies around the world.

Once a company successfully completes the IPO process and begins trading in the secondary market, information regarding that trading and the ownership changes that result are difficult to come by in the absence of a market intelligence and surveillance program. A market intelligence and surveillance program should act as a company’s eyes and ears to the investment market and

serve as a fundamental service for investor relations officers at a majority of U.S.-listed companies. The type of information and support provided by this program on a regular basis include:

- day-of-trading feedback from active market participants that provides color and context on unusual volatility or trading volume;
- updates on material institutional ownership changes as they are uncovered and a systematic update of institutional ownership on a monthly basis;
- insights on the motivation behind institutional ownership changes and the strengths, weaknesses, opportunities and vulnerabilities of the structure of the shareholder base; and
- access to resources—human, data-oriented and technical—that an investor relations officer can leverage to extend the capabilities of the investor relations team.

Publicly traded companies in the United States are considered by the investment community to be among the most transparent in the world. The investor relations profession is well advanced and the quality of communication from companies to investors is second to none. The transparency provided to companies listed in the United States by the investment market, however, lacks timeliness and its opaqueness continually frustrates investor relations officers whose organizations are in continuous need of information regarding the trading and ownership of their equities.

The two principal areas of frustration in terms of information flow for publicly traded companies are:

1. the time lag in the disclosure of institutional ownership positions with the SEC; and
2. the fragmentation of equity trading in the United States and the resulting inability to get a clear signal from the market to determine drivers of trading on a daily basis.

Let's first address the time lag in the reporting of institutional ownership. SEC Rule 13f-1 mandates that institutional investment managers

with at least \$100 million in equity assets disclose to the SEC their entire portfolios of equity securities and some equivalents on a quarterly basis. These filings, commonly referred to as 13Fs, are to state the investment managers' complete equity portfolios as of the end of each calendar quarter. However, the SEC allows investment managers 45 days following the end of each quarter to submit the filing. For example, an investment manager's Form 13F stating its holdings as of June 30, 2013, would not need to be submitted to the SEC prior to August 15, 2013.

The second issue of fragmentation has been a steady topic of discussion at exchange operators, regulators, trading firms, institutional investors and publicly traded companies themselves. Equities in the United States now get traded on more than 50 venues, which include multiple exchanges, private alternative trading systems (commonly referred to as "dark pools") and internally at specific broker-dealers. Additionally, the size of the average trade in a U.S.-listed equity has been in steady decline over the past 10 years and has moved from an average size of more than 1,000 shares to less than 300 shares today. The fragmentation of the market overall and the fragmentation of the actual transactions have made understanding the drivers of day-to-day trading in equities challenging.

The role of a company's market intelligence and surveillance provider is to overcome the hurdles put in place by SEC regulations relating to institutional ownership and today's equity market structure. To do this, the market intelligence and surveillance provider undertakes a thorough research process that starts with a complete understanding of the registration of ownership of a company's security via the Depository Trust & Clearing Corporation (DTCC). The vast majority of investors, institutional and retail alike, hold equities in "street name" via banks and brokers that act as custodians of their assets. These custodians, in turn, have accounts at DTCC that allow for the electronic transfer of assets when equities are bought and sold. In the

United States, the settlement of a trade, the time at which a buyer delivers cash to the seller and the seller delivers shares to the buyer, occurs three days following a trade, which is known as T+3. This transfer of assets almost always occurs via DTCC. The issuer of the equity, the publicly listed company, has access to these DTCC records for a nominal annual fee. The market intelligence and surveillance provider, who will gain access to the DTCC settlement records with an issuer's permission, utilizes DTCC settlement records as a roadmap for the research process to uncover the ultimate buyers and sellers of the company's shares.

U.S.-listed companies are also at a disadvantage in that there is no regulation mandating that custodians holding the company's shares via DTCC disclose the identities of the investors behind their DTCC accounts. This means that the market intelligence and surveillance provider must utilize its expertise to understand the multitude of relationships between institutional investor portfolios and each DTCC nominee to get an initial understanding of who may be buying or selling shares. The inability to access information via custodians requires the market intelligence and surveillance provider to then engage in an outreach or survey process to the institutional community to gain information on the current holdings of their portfolios. Although institutions are not required to disclose this information, many are comfortable doing so to a credible and established market intelligence and surveillance provider who will also furnish a letter of authorization from the issuer stating its role in conducting this research.

Identifying the buyers and sellers of a U.S.-listed equity is an ongoing and iterative process for any market intelligence and surveillance provider. Given the lack of mandated disclosure rules in the United States outside of Rule 13f-1, an issuer should not expect that every institutional position reported by a market intelligence and surveillance provider is an exact accounting. However, the issuer should expect high-quality information. Most issuers define accuracy of market

intelligence and surveillance information as follows:

- Ownership trends are accurate (i.e., firms reported as purchasing shares are in fact buying the stock).
- Ownership positions are within a \pm range of 20% (i.e., a firm being reported as buying 900,000 shares when it actually bought 800,000 shares is acceptable).
- There is transparency and a conviction level with each position. A credible market intelligence and surveillance provider will give detailed background on material position changes in order for the issuer to understand its accuracy, as ownership information is often shared with senior management teams and the board of directors.

Identifying ownership changes, while important, is just one aspect of a market intelligence and surveillance program. The provider should be the company's connection to the capital markets and act as an extension of its investor relations team. Feedback from market participants, such as traders, sell-side analysts and buy-side portfolio managers and analysts, should be expected. This feedback should assist the company and its senior management team in understanding the primary drivers behind both short-term trading and longer-term institutional ownership trends. Additionally, a credible market intelligence and surveillance provider has a broad client base, a deep talent pool and access to a variety of data sources. Combined, this exposure, expertise and access to data will allow a company to leverage the team to understand and implement best practices across a variety of investor relations functions, such as internal and external communications as well as investor outreach, and will allow it to be at the forefront of market issues and developments.

5.6 Investor targeting and outreach

Ipree

Knowing the owners of the stock and their motivations, as described in the market intelligence and surveillance

section, are both fundamental to investor relations. Just as fundamental to investor relations is the strategy and execution of outreach to prospective institutional shareholders and the assessment of the investment opportunity and portfolio risk that is inherent in the company's current institutional shareholder base. Investment managers continue to place a high level of importance on gaining access to the senior management teams of publicly listed companies. These interactions play a critical role in the research process that could lead to investment (or divestment) in the stock or peer companies. Given the importance of these interactions to the investment community, the investor relations officer is often deluged with meeting requests directly from investment managers or through sell-side brokerage firms, which provide "corporate access" as a key service to its investment management clients. Of course, the investor relations officer's time and the senior management team's time are not unlimited (a business needs to be run!) and not all investment managers are equally worthy of time and attention.

An effective investor-targeting program requires five processes:

1. understanding the company as an investment;
2. evaluating the current shareholder base;
3. identifying potential investors;
4. communicating with current and potential investors; and
5. monitoring and measuring effectiveness of outreach.

Each of these is an ongoing process, and an effective provider will be able to contribute to the actions the IR team conducts in each step, as well as help to optimize the usage of scarce resources in maintaining communication with the investment community. The investor relations officer should look for a provider of services that can contribute by providing both information and advice at each step:

1. Understand the company as an investment: the flexibility to view the company's investment story in the same context as potential investors managing diverse strategies—relative to industry-specific fundamentals,

regional focus or even a global perspective—as well as transparency on the inputs to the process.

2. Evaluate the current shareholder base: helping to identify risk within existing positions, as well as opportunity available from current shareholders (either the ability to expand positions in existing portfolios or the ability to build new positions in new portfolios managed by the same firm).
3. Identify potential investors: delivering both qualitative and quantitative information describing not just the match between the company's investment story and the portfolio but also the communication conduits with the firm (who are the decision makers and how to approach them).
4. Communicate with current and potential investors: offering just-in-time information to support the company's interactions in any format (conferences, nondeal roadshows, analyst days, phone conversations).
5. Monitor and measure effectiveness of outreach: including both backward-looking and forward-looking advice on the communication process, including identifying "success stories" as well as those situations where your time may have been used better.

A provider of targeting and outreach advice will help guide a company to a plan that best utilizes the investor relations officer's and the management team's time and puts the officer in front of the most appropriate and impactful investment managers. The type of analysis and reporting provided generally includes:

- Top-down/Strategic:
 - Global analysis of the market-by-market opportunity for additional investment from prospective investors;
 - A view of positions within your current shareholder base potentially at risk.
- Bottom-up/Tactical:
 - Just-in-time money center analyses prior to any non-deal roadshows;
 - Analysis of attendees and meeting interest at brokerage-sponsored events to prioritize exposure to the best investors;

- Detailed premeeting briefing on current exposure and portfolio trends for each investor in advance of an interaction.

In concert with an effective investor-targeting provider, the investor relations officer will be able to confidently approach the investment community with the knowledge that time and resources are being used effectively.

5.7 Market perception feedback

Ipree

The market intelligence and surveillance and investor targeting and outreach functions provide critical data and insights on the current and potential states of the shareholder base, which are both imperative to running an impactful IR program. Perception feedback provides a largely qualitative complement that will enable an in-depth assessment of the investment community's view on various facets of the company. The key to gaining valuable feedback from investors and sell-side analysts is the utilization of a third party to conduct the research. Not only will a third party bring expertise to the design and execution of perception research but the indirect connection it has with the company will foster an environment that allows for the free exchange of thoughts and opinions. Perception feedback can be used in advance or after major events, such as an investor day or quarterly earnings announcement, to assess expectations or judge performance. Perception feedback can also be used on a more routine basis in order to keep a constant finger on the pulse of investor opinion. Regardless of the option chosen, expect the following from the market perception feedback providers:

- assistance and guidance on the topics that should be covered and the design of the questionnaire;
- consultation with regard to the participants most applicable for the study and the timing of the project;
- a comprehensive analysis of the study results that provides a synthesis of the feedback topic-by-topic and puts forth recommendations to address the concerns held by the investment community.

When conducting an initial perception study, a third party will host a series of conference calls with the investor relations officer to better understand the company's strategic direction, what was discussed during the pre-IPO roadshow, what has been accomplished since the IPO, as well as its current disclosure and communication practices. This understanding allows the perception feedback consultant to design an effective questionnaire and ask appropriate probing questions during the telephone interviews. The goal is to keep the questions open-ended to allow the participants to freely discuss the critical factors driving their investment or rating decisions. Themes to cover may include:

- Overall view as an investment: competitive strengths, weaknesses, risks, opportunities, reasons for a stock's discount, suggestions for achieving a premium, events that would cause a decrease/increase in position, fundamental metrics used to assess the stock, relative valuation;
- Business and capital allocation strategies: confidence in the current strategy and business model, strategic concerns, how investors would prefer the company to utilize their excess cash, what the potential growth areas are for the company;
- Earnings and guidance: reaction to latest earnings release, expectations for the full year, biggest challenges going forward from a results perspective, opinion on information presented;
- Peer and industry intelligence: preferred investment choice in the space, best-in-class disclosure and communication practices for the sector;
- Senior executive team: overall opinion of senior management's strategic vision, execution, credibility, capital management, corporate governance structure and expectations for shareholder interactions;
- IR efforts: overall satisfaction with IR's articulation of the company story, accessibility, credibility, frequency and content of communication and addressing misperceptions in the marketplace.

Equally important is choosing the appropriate study participants to ensure receiving unbiased, comprehensive feedback. Participants to be interviewed are typically dispersed among five segments: current buy-side institutional holders, potential buy-side institutional investors, recent buyers and sellers, current sell-side analysts and potential sell-side analysts. Global investors, focusing on North America, the United Kingdom, Continental Europe and Asia, should also be included, as participants' expectations often vary by region. When creating the participant list, those investors should be chosen that are familiar with the company as well as the management and IR teams. The optimal places to locate this information include the company's pre-IPO roadshow agenda, recent meeting schedules, conference call and webcast participant lists, as well as notes entered in the investment community database and CRM.

The consultant will also provide guidance on the most favorable times to conduct a study. Avoid launching the interviewing period if a major company announcement is expected to affect participants' opinions or during earnings season, major holidays or well-attended industry conferences.

Once the interviews are complete, expect the consultant to provide a comprehensive analysis of the study results that includes in-depth, topic-by-topic summaries, which are supported by verbatim comments from the participants. The final study will also identify any disconnects between what the company is communicating and what the investment community is hearing and include actionable, best-in-class communication recommendations to address the investment community's concerns. Based on these findings and recommendations, the company can tailor its disclosure and messages to shift perceptions closer to the preferred state.

Companies most commonly utilize large-scale perception studies annually in order to get an in-depth assessment of investor sentiment. These studies are a terrific benchmarking tool, and the results, in part or in their entirety, are

typically a component of the information reviewed by the company's board of directors.

5.8 Investment community database and CRM

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One of the biggest challenges faced by investor relations professionals is not only the amount of investor intelligence and data they are inundated with on a daily basis but also the challenge of obtaining the high-quality information that is required to plan and implement smart strategy and tactics. In order to navigate the sea of data effectively, a global investor community database and CRM are required. A global database system will provide access to a wide array of information from the desktop and from the road. Critical elements of a database system include:

- a secure web-based environment that allows for individual log-in credentials among team members along with the ability to share information and collaborate across the team;
- support of dedicated, knowledgeable and global account management team that provides 24/7/365 access;
- access to global investment community data and analytics including:
 - detailed contact and background information on investment staff at buy- and sell-side firms;
 - comprehensive information on the background, investment styles and investment approaches of buy-side institutions at the firm and fund levels;
 - complete portfolio information for every publicly listed equity around the world;
 - detailed, global fixed-income portfolio information;
 - advanced screening capabilities enabling access to the information required;
 - sell-side research reports and detailed earnings estimates;
 - calendar of investment community events as well as real-time and corrected transcripts of results and investor presentations;
 - real-time market data and news;
- a robust CRM system to manage and report on the team's interactions with all participants in the investment community, including:
 - ability to easily manage, input and track one-on-one meetings, group meetings, phone calls and e-mails;
 - ability to customize CRM data points to best fit the company's issues and requirements;
 - list management tools;
 - e-mail distribution;
 - one-click reporting to view items such as event itineraries, institutional and contact profiles and post-roadshow feedback reporting;
 - management-ready reports that highlight the effectiveness of IR and executive meetings with the investment community;
 - ability to export data and reports into Excel, Word, and PDF formats;
 - integration of proprietary CRM data with surveillance ownership information, investor targeting and perception feedback information.

The investment community database and CRM system are typically the central tool utilized by investor relations departments of any size to coordinate and manage activities on a daily basis. A database system has the ability to grow along with investor relations needs and requirements. At its core, a database system provides the user with a wealth of information that is critical and essential to any IR professional. For instance, when an incoming call or meeting request is received from an unfamiliar investor, the database user can quickly pull up the investment firm by name, review its background, investment philosophy, activist history, portfolio composition and metrics such as investment style and portfolio turnover. Additionally, the user can also view background information such as employment history, coverage details and educational background of the analyst or portfolio manager making the call. This data educates the user as to the investor's relevance and allows the user to make an informed decision about the amount of time he or she will provide to the investor. Is a phone call sufficient?

Should there be a one-on-one meeting with this investor? Should this investor be provided access to the CFO or CEO? These are all critical questions that need to be answered on an ongoing basis by investor relations professionals to properly manage their own time and the time of their management team.

For a company that has successfully completed the IPO process, the first step in using its investment community database is to seed historical investor activities with the itineraries from the IPO roadshow. Additionally, the notes from the IPO roadshow meetings should also be brought into the system. The IPO is a perfect opportunity to utilize the support of the database provider to understand best practices for managing the data, leveraging their tools to import the company's data and establishing customized views and data tags relevant to the company's story. The activity data from the IPO will provide a perfect foundation for future investment community interactions.

Another opportunity for getting immediate value from the database is to utilize the final share allocations provided by the investment banking team. The database provider will be able to map the investment firms on the allocation list with the investment firms in the database and import the number of shares that were purchased by each firm at the time of the IPO. This will allow tracking the progression of the shareholder base from day one of trading through to the time it is first updated by the surveillance provider or by ownership updated via public filings and beyond.

An investment community database also allows moving beyond the current ownership of stock to access the global portfolios of investment managers and funds from around the world. The owners of the company's peer group can be easily tracked and the strengths, weaknesses and opportunities of each company's ownership profile can be analyzed. The database will also allow the user to run detailed screens of investors by categories, such as location, investment style, portfolio turnover, or recent buying and selling activity in a particular stock or across a sector or peer group. Investor screening will enhance the user's ability

to make informed decisions on upcoming investor relations activities.

Nothing can replace the personal interactions that investor relations officers and management teams have with the investment community. However, e-mail communication and other methods of distribution to broad audiences are necessary. The database should allow the user to easily create and edit lists of investment staff so that regular distributions, such as quarterly results, and one-time events, such as investor days, can be easily managed. These investor lists can then be utilized to quickly send a uniform e-mail to a broad distribution group along with a personalized salutation, embedded links and graphics.

Tracking interactions with the investment community is certainly a worthwhile endeavor, as it will inform future interactions with that investor. Additionally, by closely tracking interactions, the ownership and other data available in the system can be utilized to run reports following investor relations activities in an effort to measure the success of an event through real-world metrics. A sell-side investor conference is an example.

Companies are often bombarded by requests from the sell-side to attend their conferences. If the company has accepted an invitation to a conference, a database user would be able to preview its series of meetings with investors not only from a qualitative perspective (Who are these firms and what are they all about? Is this firm a hedge fund?) but also from a quantitative perspective (How many shares of the company's stock do they own? What's their average turnover? What is their exposure to the company's sector?) Following the conference, as ownership data streams into the database, the user will be able to run reports to assess the impact of meetings from an ownership perspective (Did any potential investors initiate a position? How did the existing shareholders react?) The data from these reports can be used the following year to assist in investor relations planning, including decisions on which conferences to attend.

Another key attribute of an investment community database is the integration of information from the provider of

market intelligence and surveillance, investor targeting and market perception feedback. By employing one provider for all of these services, the user will be able to seamlessly integrate critical real-time and client-specific intelligence with the database information and CRM activity, allowing more powerful analysis and a deeper qualitative understanding of current and prospective investors.

The database should also allow quick access to sell-side research reports and earnings estimates for not only the company's stock but also for that of peer companies and others. The sell-side remains an important input into investor sentiment, and integrating this information into the investment community database is critical. Additionally, a calendar of events, such as investor conferences and the earnings calls of peer companies, is critical in that it enables better planning and management of the company's own events. Access to the verbatim transcripts of these events is also a standard requirement for a database tool.

An investment community database and CRM system are tools that are critical for a one-person IR department or a large IR team located in offices around the world. The one-person department can use the database to leverage limited resources and access critical information; the larger IR team can additionally use the database as a tool for collaboration and internal communication. Regardless of the size of the department, it is hard to imagine conducting investor relations in the absence of a global investment community database and integrated CRM. ●

6

Obligations of a public company

6.1 Reporting and compliance requirements

Cleary Gottlieb Steen & Hamilton LLP

(a) Periodic and other reports

After the IPO, the company must file regular “periodic” and other reports with the SEC in accordance with the requirements of the Exchange Act, which for U.S. companies include:

Periodic reporting:

- Annual report on Form 10-K
- Quarterly reports on Form 10-Q

Current reporting:

- Current reports on Form 8-K

Stockholder meetings and proxy solicitations:

- Proxy statements
- Rule 14a-3 “glossy” annual report

The periodic reports contemplate a system of “integrated disclosure,” in which portions of the various reports may be incorporated by reference into other reports to avoid repetition. This incorporation by reference is not required but is very common in U.S. company reports, particularly Form 10-K and the proxy statement. Incorporation by reference is also a concept that permits more streamlined disclosure for securities offerings, in particular after the company has been public for at least a year and is eligible to use a registration statement on Form S-3 for public offerings. Existing and future reports that the company files with the SEC will be incorporated into Form S-3, keeping the information current and eliminating the need to include detailed disclosure about the company in a prospectus for an offering.

The timing and some of the required content of these reports will depend on the company’s reporting category, which is largely based on the size of its worldwide “public float,” or the market value of the voting and nonvoting common equity held by nonaffiliates, as of the last business day of the most recent second fiscal quarter:

Reporting category	Public float
• Large accelerated filer	\$700 million or more
• Accelerated filer	\$75 million or more (but less than \$700 million)
• Nonaccelerated filer	All others

The large accelerated filer and accelerated filer categories also require at least 12 calendar months of reporting, including at least one Form 10-K, so that after the IPO, the company will be a nonaccelerated filer for the first year. In many cases a nonaccelerated filer will also qualify as a smaller reporting company, with scaled-back information requirements. The thresholds to enter and exit these reporting categories are different from those used for the initial determination. Emerging growth companies may also take advantage of scaled-back information requirements (see Chapter 4), and there are some differences for foreign private issuer reporting as well (see Section 9.6). The remainder of this chapter describes the reporting requirements for a U.S. domestic company that does not qualify as an emerging growth company.

The general legal framework for communications described in Section 5.5 also generally applies to the company’s required reporting, including the need for complete and accurate disclosure, the duty to update and the rules related to non-GAAP financial measures. For information about the financial statements that are required for the company’s various reports, see Section 2.2.

The SEC does not automatically review these regular reports, but it is required to review each company’s reports at least once every three years, and it may provide comments to improve disclosure or remedy noncompliance at any time.

Annual report on Form 10-K: A U.S. company must file an annual report on Form 10-K with the SEC after the end of

each fiscal year. A nonaccelerated filer must file Form 10-K no later than 90 days after the end of the fiscal year. This deadline shortens to 75 days for an accelerated filer and 60 days for a large accelerated filer.

The contents of Form 10-K are largely similar to the IPO prospectus, with several important differences:

- Internal control over financial reporting—Beginning with the second Form 10-K filed by the company, Form 10-K must include a management report on the effectiveness of internal control over financial reporting and a related auditors’ attestation, as described in more detail below.
- Disclosure controls and procedures—Disclosure about management’s evaluation of the effectiveness of disclosure controls and procedures, as described in more detail below, is also required, without any transition period.
- Certifications—The company’s CEO and CFO must certify Form 10-K, as described in more detail below.
- Unresolved SEC staff comments—An accelerated or large accelerated filer must include disclosure of any unresolved SEC staff comments on its periodic or current reports that the company received at least 180 days before the end of the fiscal year.
- Stock repurchases and use of proceeds—The company must disclose its stock repurchases (for more information, see Section 6.3), as well as the use of the proceeds from the IPO.
- Incorporation by reference from proxy statement—Most of the required disclosure about the company’s management and governance arrangements, including the detailed disclosure of executive compensation arrangements, is typically incorporated by reference from the proxy statement.
- XBRL—The financial statements contained in Form 10-K must also be filed in an exhibit using the XBRL interactive data format (see Section 2.2).
- Mine safety disclosure—A company with mining operations in the United States is required to include certain health- and safety-related disclosure about those operations.

- Sanctions-related disclosure—The company must disclose certain activities relating to Iran, materials likely to be used for human rights abuses and transactions with persons designated for their support of terrorist activity or the proliferation of weapons of mass destruction.

Proxy statement and “glossy” annual report: Following the IPO, a U.S. company will be subject to the proxy rules under the Exchange Act. The company must furnish a proxy statement to stockholders before soliciting voting authority for a matter submitted to stockholders’ vote. The stock exchange listing rules typically require a listed company to hold a regular annual stockholders’ meeting, for which the company will solicit proxies, so most companies prepare an annual proxy statement.

The proxy statement must contain information about the stockholders’ meeting, the matters to be considered (including stockholder proposals, if any) and voting procedures. The company should be sure to consider any requirements imposed by its charter, bylaws or state law, in addition to SEC and stock exchange requirements.

The most common item on the meeting agenda is the election of directors. In this case, the proxy statement will contain much of the same disclosure about the company’s management and governance arrangements that was included in the IPO prospectus, including the detailed disclosure of executive compensation arrangements and the compensation discussion and analysis. There are also several items that were not included in the IPO prospectus, including officer and director compliance with Section 16 filings (for more information, see Section 7.4) and information about code of ethics compliance and waivers.

Other typical agenda items include the approval or ratification of the company’s auditors, which requires disclosure about fees paid to the auditors, and the adoption or amendment of equity compensation plans, for which the material terms must be described together with a table

summarizing all of the company’s equity compensation plans. In addition, as described in Section 2.4, at the first annual meeting after the IPO and from time to time thereafter, the company must hold say-on-pay and say-on-pay frequency votes.

If the agenda includes the election of directors, the proxy statement must be accompanied or preceded by an annual report. This can be the Form 10-K but more typically is a separate “glossy” report with pictures and other investor-friendly information, which is also often used for other investor relations purposes. Some companies choose to combine the two, creating a “wrap” for Form 10-K to create the “glossy.”

For proxy solicitation purposes, the annual report (also known as the “Rule 14a-3 annual report”) must contain audited financial statements, MD&A, selected financial data and disclosure about market risk, stock prices and dividend payments, as well as a brief description of the company’s business, a stock performance graph and a list of the directors and executive officers.

Until recently, the proxy statement and annual report had to be mailed to all stockholders; however, the SEC “e-proxy” rules permit the company to post proxy materials on a publicly accessible website and mail only a notice to stockholders. This process is known as “notice and access.” The stock exchanges also used to require a physical mailing of an annual report to stockholders but now permit website posting, and the NYSE recently eliminated the need for a press release about the posting in most cases. Although e-proxy procedures are less expensive, many companies still choose to physically mail these documents to stockholders, primarily for investor relations purposes.

Quarterly reports on Form 10-Q: A U.S. company must file quarterly reports on Form 10-Q with the SEC after the end of each of the first three quarters of each fiscal year. A nonaccelerated filer must file Form 10-Q no later than 45 days after the end of the fiscal year. This deadline shortens to 40 days for accelerated and large accelerated filers.

Form 10-Q largely consists of unaudited interim financial statements and the related MD&A. It also includes disclosure about effectiveness of disclosure controls and procedures, changes in ICFR (but not a full assessment as in Form 10-K) and CEO and CFO certifications, as well as information about risk factors, legal proceedings and company stock repurchases, among other things. As for Form 10-K, the financial statements must also be included in XBRL format.

Current reports on Form 8-K: The U.S. securities laws generally do not require current reporting of all material company events, unlike in some other jurisdictions, unless the company is buying or selling securities or makes other disclosure for which information about the material event is needed to make that disclosure complete and accurate. Instead, a U.S. company must file a current report on Form 8-K with the SEC only for certain specified events and generally within four business days. The more common, day-to-day events that trigger this reporting include:

- an earnings release or other information about historical results of operations and financial condition;
- the entry into or amendment or termination of a material definitive agreement;
- a significant acquisition or disposition of assets (which may also require *pro forma* financial information);
- the creation of a material direct financial obligation or a contingent off-balance-sheet obligation or a related triggering event;
- costs associated with exit and disposal activities or material impairments;
- unregistered sales of equity securities or material modifications of the rights of security holders;
- a change in accountants;
- various governance items, such as the departure or election of directors and executive officers, results of stockholder votes, amendments to charter documents and amendments to or waivers of the code of ethics; and
- for mining companies, certain health- and safety-related disclosures.

Form 8-K is also used for information disclosed to ensure compliance with Regulation FD (discussed in Section 5.5), as well as for other information the company considers important for investors.

Form SD (Specialized Disclosure): As required by the Dodd-Frank Act, the SEC has adopted new rules that require specialized disclosure on a new Form SD beginning in May 2014 (but covering activity in 2013). There are two principal types of disclosure required by these rules. First, a company must file Form SD if certain “conflict minerals” or certain of their derivatives are necessary to the functionality or production of its products. Second, a company involved in the commercial development or extraction of oil, natural gas or minerals must file Form SD to disclose payments it makes to governments in connection with those activities.

Press releases: In addition to SEC reporting requirements, the stock exchanges impose reporting requirements on listed companies. It was these rules that in part drove the issuance of press releases to announce annual and quarterly results, which most companies do generally as a matter of good investor relations (see Section 5.2).

Stock exchange rules typically require timely disclosure of material events beyond those covered by Form 8-K. For example, under NYSE rules, a listed company is expected to:

- release quickly to the public any news or information that might reasonably be expected to materially affect the market for its securities; and
- act promptly to dispel unfounded rumors that result in unusual market activity or price variations.

Examples of events that the NYSE expects would result in prompt disclosure include annual and quarterly earnings, dividends, record dates, mergers, acquisitions, tender offers, stock splits, shareholder meetings, major management changes and any substantive items of an unusual or nonrecurrent nature. These announcements may be made by any

method that constitutes compliance with Regulation FD (discussed in Section 5.5), although the NYSE encourages use of a press release. The company may generally exercise judgment as to the timing of a public release on corporate developments where disclosure would endanger the company’s goals (e.g., in the MD&A context) or provide information helpful to a competitor.

These events generally also require notice to the NYSE. The NYSE also requires that the company submit an annual affirmation concerning compliance with the NYSE’s corporate governance listing standards within 30 days of a company’s annual shareholders’ meeting (or the filing of the annual report on Form 10-K), as well as interim affirmations in the event of certain governance changes and a notice if the company becomes aware of any noncompliance with the corporate governance listing requirements.

(b) Disclosure controls, internal controls and certifications

One of the most significant challenges for the company after going public is the required control framework and related disclosures. Perhaps the best-known element of that framework, often accompanied by considerable cost, is management’s report on the effectiveness of ICFR and a related auditors’ attestation. This requirement was imposed as a result of Section 404 of the Sarbanes-Oxley Act and is often referred to as “Section 404 reporting” or even “SOX reporting” (although SOX provided for much more than this). Separately, management is also required to report on the effectiveness of disclosure controls and procedures, and the CEO and CFO are required to certify the company’s periodic reports.

Internal control over financial reporting:

ICFR is a set of processes designed to provide reasonable assurance of the reliability of financial reporting and the preparation of financial statements in accordance with GAAP. These procedures must be designed by, or under the supervision of, the CEO and the CFO, who must include statements about them in their certifications (discussed below).

Once Section 404 reporting is required, the company’s Form 10-K must include a management report containing:

- a statement of management’s responsibility for establishing and maintaining adequate ICFR for the company;
- a statement identifying the framework used by management to evaluate the effectiveness of ICFR;
- an assessment by management of the effectiveness of ICFR as of the end of the most recent fiscal year, including a statement as to whether ICFR is effective; and
- a statement that the auditors of the financial statements included in the report have issued an audit report on the effectiveness of ICFR.

The auditors’ report must also be included in the Form 10-K. Any material weaknesses in ICFR must be disclosed, and management and the auditors may not conclude that ICFR is effective if there are one or more material weaknesses. U.S. companies must also disclose material changes in ICFR in the quarterly reports on Form 10-Q.

A newly public company typically need not comply with the Section 404 reporting requirements until its second Form 10-K after the IPO. In addition, a nonaccelerated filer need not provide the auditors’ attestation report.

Disclosure controls and procedures:

The company must also maintain “disclosure controls and procedures” designed to ensure that information required to be disclosed under the Exchange Act (discussed above) is recorded, processed, summarized and reported in a timely and accurate manner. They will overlap with ICFR, but disclosure controls and procedures cover both financial and nonfinancial information.

As for ICFR, disclosure controls and procedures must be designed by, or under the supervision of, the CEO and the CFO, who must include statements about them in their certifications (discussed below). Management must evaluate and disclose the effectiveness of disclosure controls and procedures quarterly.

Sample summary annual reporting cycle for U.S. large accelerated filer (calendar year-end)

<p>January</p> <ul style="list-style-type: none"> • Press release announcing Q4 earnings call/webcast (c. 1 week in advance). • Q4 earnings release and Form 8-K. • Q4 earnings call/webcast. 	<p>February</p> <ul style="list-style-type: none"> • Submit SEC no-action requests to exclude stockholder proposals from proxy (at least 80 calendar days before definitive proxy filed). • File Form 10-K (no later than 60 days after fiscal year end—i.e., by March 1 or 2). • File “glossy,” if incorporated by reference into Form 10-K, and print/post on website. 	<p>March</p> <ul style="list-style-type: none"> • File preliminary proxy with SEC (unless it contains only certain specified matters) at least 10 calendar days before definitive proxy filed, but review may take up to 30 days). • March 31—Q1 quarter end.
<p>April</p> <ul style="list-style-type: none"> • Press release announcing Q1 earnings call/webcast (c. 1 week in advance). • Q1 earnings release and Form 8-K. • Q1 earnings call/webcast. • File and post/mail definitive proxy (no later than 120 days after year-end if incorporated into 10-K; at least 40 days before annual meeting if using e-proxy “notice and access”). 	<p>May</p> <ul style="list-style-type: none"> • File Q1 Form 10-Q (no later than 40 days after quarter end—i.e., by May 10). • May 31—File Form SD (if applicable). 	<p>June</p> <ul style="list-style-type: none"> • Annual stockholders’ meeting. • June 30—Q2 quarter end.
<p>July</p> <ul style="list-style-type: none"> • Press release announcing Q2 earnings call/webcast (c. 1 week in advance). • Q2 earnings release and Form 8-K. • Q2 earnings call/webcast. 	<p>August</p> <ul style="list-style-type: none"> • File Q2 Form 10-Q (no later than 40 days after quarter end—i.e., by August 9). 	<p>September</p> <ul style="list-style-type: none"> • September 30—Q3 quarter end.
<p>October</p> <ul style="list-style-type: none"> • Press release announcing Q3 earnings call/webcast (c. 1 week in advance). • Q3 earnings release and Form 8-K. • Q3 earnings call/webcast. 	<p>November</p> <ul style="list-style-type: none"> • File Q3 Form 10-Q (no later than 40 days after quarter end—i.e., by November 9). • Notify stockholder proposal proponents of eligibility or procedural defects in proposal (within 14 days of receiving proposal). 	<p>December</p> <ul style="list-style-type: none"> • Deadline for stockholder proposals (120 days before date of prior year’s proxy statement). • Send directors’ and officers’ questionnaires to board members and executive officers (for proxy preparation). • December 31—year-end.

Disclosure controls and procedures should generally be documented in writing and tailored to reflect the operations of the company and its particular risk profile. The starting point for creating a system of disclosure controls and procedures should be an inventory of the company’s existing practices. The company should develop its disclosure controls and procedures in consultation with its auditors and outside counsel and ensure their compatibility with the company’s internal controls and other compliance policies and procedures.

Many companies choose to create a disclosure committee as part of their disclosure controls and procedures. This committee is responsible for considering the materiality of information and determining disclosure obligations on a timely basis and typically includes:

- the principal accounting officer or controller;
- the general counsel or other senior legal officer with responsibility for disclosure matters;
- the principal risk management officer; and
- the chief investor relations officer.

CEO and CFO certifications: As a result of SOX, the company’s periodic reports must include two types of certifications by the CEO and CFO: Section 302 certifications and Section 906 certifications. These certifications must reproduce the required statements exactly—they may not be changed in any respect, even if the change appears inconsequential in nature, although certain portions of the certifications will not be required until the company is subject to Section 404 reporting.

Under Section 302, each Form 10-K or Form 10-Q (but not Form 8-K) must

include statements by the CEO and CFO, or persons performing similar functions, certifying that:

- he or she has read the report;
- based on his or her knowledge, the report contains no material misstatements or omissions;
- based on his or her knowledge, the financial statements and other financial information fairly present in all material respects the financial condition, results of operations and cash flows of the company as of and for the periods presented in the report;
- the CEO and the CFO are responsible for establishing and maintaining disclosure controls and procedures and ICFR for the company, and have:
 - properly designed the disclosure controls and procedures or caused such disclosure controls and procedures to be designed under their supervision;
 - evaluated the effectiveness of the disclosure controls and procedures as of the end of the period covered by the report;
 - presented in the report their conclusions about the effectiveness of the controls and procedures based on that evaluation; and
 - disclosed in the report any change in the company's ICFR that occurred during its most recent fiscal quarter (the fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the company's ICFR; and
- the CEO and CFO, based on their most recent evaluation of ICFR, have disclosed to the audit committee and the company's auditors:
 - all significant deficiencies and material weaknesses in the design or operation of ICFR which are reasonably likely to adversely affect the company's ability to record, process, summarize and report financial information; and
 - any fraud (whether or not material) involving persons having a significant role in the ICFR of the company.

Under Section 906, each periodic report containing financial statements filed

by the company must be accompanied by a statement by the company's CEO and CFO (or equivalent thereof) certifying that:

- the report fully complies with the requirements of the Exchange Act; and
- the information contained fairly presents, in all material respects, the financial condition and results of operations of the company.

(c) Foreign Corrupt Practices Act

A significant source of new compliance requirements for the company following an IPO is the Foreign Corrupt Practices Act of 1977, as amended, and the International Anti-Bribery and Fair Competition Act of 1998 (collectively referred to as the FCPA). Two sets of provisions under the FCPA are applicable to a SEC-reporting company. One set, the accounting provisions, requires the company to keep accurate books and records and to maintain a system of internal accounting controls. These accounting provisions are in addition to the internal control requirements and disclosure controls and procedures described in Section 6.1(b) and are designed to eliminate the ability of companies to conceal unlawful payments (although the accounting provisions can be violated if no bribery is involved). The other set, the antibribery provisions, prohibits the bribery of non-U.S. government officials, who include:

- officers and employees of a foreign government, or of any government department, agency or instrumentality (e.g., a state-owned enterprise), or of a public international organization (e.g., the World Bank); or
- any person acting in an official capacity for or on behalf of any such government department, agency or instrumentality, or for or on behalf of any such public international organization.

Accounting provisions: The FCPA requires the company to maintain books, records and accounts that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company and to devise and maintain an adequate system of internal accounting controls. This system must be

sufficient to provide reasonable assurances that:

- transactions are executed in accordance with management's authorization and recorded as necessary to permit the preparation of financial statements in conformity with the applicable criteria and maintain accountability for assets;
- access to assets is permitted only in accordance with management's authorization; and
- recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences.

The SEC has adopted two rules intended to promote compliance with the FCPA. The first rule prohibits all persons from directly or indirectly falsifying any book, record or account of any company subject to the FCPA. The second rule generally bars the company's directors and officers from making material misstatements, or omitting material facts from statements they make, to accountants in connection with audits of the company or examinations of the company's financial statements or SEC filings and bars directors, officers and persons acting under their control from coercing, manipulating, misleading or fraudulently influencing the auditors if the person engaging in the conduct knew or should have known that doing so could render the company's financial statements materially misleading.

The accounting provisions also apply to subsidiaries when the company owns or controls more than 50% of the voting power of the subsidiary.

Antibribery provisions: The FCPA prohibits the company from using the mails or any means or instrumentality of U.S. interstate commerce (including between the United States and any foreign country) to corruptly make an offer, pay, promise to pay or authorize the payment of any money, gift or anything of value to a foreign official, a foreign political party or an official thereof. It further prohibits candidates for foreign office from doing any of the following to obtain or retain business for or with, or directing business to, any person:

- influence any official act or decision;
- fail to perform their official duties or secure any improper advantage (e.g., a tax rate lower than one allowed by law); or
- use their influence with a foreign government or instrumentality thereof to influence any act or decision of that government or instrumentality.

The types of payments described above cannot be made or offered through a third party if the payor knows that all or a portion of the payment would be made or offered to a non-U.S. official. The company may be deemed to “know” of improper payments to intermediaries even without actual knowledge of a bribe. A person is considered to “know” of improper payments if circumstances exist, or if the person has a firm belief that they exist, indicating that the prohibited conduct is substantially certain to occur. Conscious disregard or deliberate ignorance of known circumstances that should reasonably alert one to the high probability of a bribe can lead to liability. If the company ignores warnings or “red flags” indicating that its funds were being used to bribe foreign officials, the company may be subject to prosecution. The nature of those red flags varies depending on the circumstances, but enforcement authorities likely will expect companies to be particularly vigilant when active in industries (e.g., the oil business) or geographical areas (e.g., certain countries in Africa) known for corruption, or with parties that have a history of ethical problems.

The antibribery provisions apply to any acts of the company involving U.S. interstate commerce. If the company is located or has its principal place of business in the United States, it is subject to the antibribery provisions regardless of any other tie to the United States. Individual directors or employees of the company who are U.S. citizens or residents are subject to the antibribery provisions regardless of any other connection with the United States.

Exclusions from FCPA: The FCPA contains an important exception: it permits so-called “grease” payments. A grease payment is a payment whose purpose is to facilitate or expedite “routine governmental action.”

Examples of such actions include obtaining permits, processing visas and providing police protection. “Routine government action” does not include a decision by a non-U.S. official to award new business or to continue business with a particular company.

The FCPA also has two affirmative defenses:

- The payment at issue was lawful under the written laws of the foreign country; or
- The payment was made for a reasonable, *bona fide* business purpose, such as travel and lodging expenses, for the promotion, demonstrations or explanation of a product (e.g., paying the reasonable expenses of a non-U.S. official who comes to the United States for a demonstration of a company product).

Enforcement and penalties: The FCPA is enforced by the U.S. Department of Justice and the SEC. Penalties can be severe, and enforcement has been aggressively expanded in recent years:

- Accounting provisions—If convicted of knowing violations, individuals may be sentenced to up to 20 years’ imprisonment and fined up to \$5 million for each violation, while companies may be fined up to \$25 million for each violation.
- Antibribery provisions—Convicted individuals may be sentenced to up to five years’ imprisonment and up to a \$250,000 fine for each violation. The company employing the individual may not pay this fine on the employee’s behalf. Convicted companies may be fined \$2 million or twice the applicable gross gain or loss, whichever is greater, for each violation.

When settling FCPA cases in recent years, the U.S. Department of Justice has frequently required companies to hire an FCPA compliance monitor that periodically reports to the government on the company’s efforts to improve its anticorruption policies.

In the past few years, the size of the penalties imposed for FCPA violations has significantly increased, including a \$800 million penalty against Siemens in 2008, \$579 million against KBR and

Halliburton in 2009, \$400 million against BAE Systems in 2010, \$219 million against JGC Corporation in 2011 and \$60 million against Pfizer Inc. in 2012.

6.2 Listing standards

NYSE

When a company’s shares are listed on the NYSE or NYSE MKT, investors generally expect compliance with ongoing financial standards, disclosure policies and corporate governance practices designed to promote integrity and accountability.

(a) Financial and distribution standards

The NYSE and NYSE MKT have established quantitative and qualitative standards for initial listing of U.S. and non-U.S. companies. The financial standards for operating companies listing on the NYSE or NYSE MKT are summarized in the appendices. Standards reflect the different types of issues and issuers. Listed companies must meet continued listing standards on an ongoing basis. These too are summarized in the appendices. If companies fall below continued listing standards, generally they are afforded a period of time to return to compliance. Please see the appendices for more details.

(b) Governance requirements

In addition to these quantitative listing standards, the company must meet NYSE or NYSE MKT corporate governance listing standards, as applicable. The company must comply with corporate governance requirements at the time of listing and throughout the life of its listing. As with the quantitative standards, different standards are applicable to different types of issuers. In addition, for a company listing in conjunction with an IPO, certain of the corporate governance requirements can be phased in. Governance requirements for NYSE MKT listed companies, designed to accommodate smaller companies, differ from NYSE requirements.

To learn more about the NYSE and NYSE MKT financial, distribution and governance requirements, please refer to the complete requirements outlined in the *New York Stock Exchange Listed Company Manual*, the comprehensive rulebook for listed companies, which can

be accessed online at <http://nysemanual.nyse.com/LCM/Sections/>, or to the *NYSE MKT Company Guide*, which can be referenced at <http://wallstreet.cch.com/MKT/CompanyGuide/>. Alternatively, contact the NYSE or NYSE MKT directly.

6.3 Trading and repurchases

Cleary Gottlieb Steen & Hamilton LLP

Many public companies repurchase their shares from time to time—for example, to offset dilution from stock option exercises or generally to return value to stockholders. These repurchases, as well as sales of the company’s stock by directors, officers and other affiliates, should be carefully structured so as not to give rise to potential liability under the U.S. securities laws.

(a) Tender offers

Any tender offer by the company for its equity securities is subject to Section 13(e) of the Exchange Act and Rule 13e-4 thereunder. Whether a stock repurchase constitutes a tender offer depends on a complex, fact-specific inquiry. If the company does conduct a tender offer, it must comply with extensive disclosure and other obligations, including opening the tender to all holders of the class of the securities sought in the offer and paying the same price to all holders whose securities are purchased. The company can avoid the tender offer rules by conducting repurchases of its equity securities either through customary market transactions or in individually negotiated private transactions (in either case, in accordance with the provisions of Rule 10b-18, discussed below).

(b) Stock repurchase programs

Another concern when the company repurchases its stock is that this will be viewed as market manipulation (see Section 8.1 for further discussion about market manipulation and related liability). Rule 10b-18 under the Exchange Act provides a safe harbor from this liability. As a result, companies generally adhere to the provisions of Rule 10b-18 when repurchasing stock and in particular when conducting a program of repurchases over a period of time. Rule 10b-18 requires the following:

- Single broker or dealer—On a given day, the company must make all repurchases either through one broker or from one dealer.
- Timing—No repurchase should be effected at the opening of the stock exchange on which the stock lists or within the last half-hour of trading on that stock exchange.
- Maximum price—No repurchase should occur at a price exceeding the higher of the last sale price for the securities and the current bid price for the securities.
- Volume—The total volume of repurchases by the company or any affiliated purchaser on any given day must not exceed 25% of the trading volume for the security. However, once each week, the company may instead effect a single purchase of a “block” of securities.

The safe harbor provided by Rule 10b-18 is not available at any time during which the company is engaged in a “distribution” of its securities in the United States and does not protect against liability under Rule 10b-5 if the company repurchases its securities while in possession of material nonpublic information.

The company will often disclose planned repurchase activity in its periodic reports or earnings releases and may be required to disclose significant repurchase transactions by press release. The company’s periodic reports must also include specific disclosure about all of its stock repurchases over the period covered by the report.

Accelerated share repurchase plans:

The company may use accelerated share repurchase plans to buy back shares from the market. A typical accelerated share repurchase involves the combination of a buyback of common stock from an investment bank, which typically borrows the shares from investors, and a forward contract with the investment bank on the company’s common stock. Settlement of the forward contract is indexed to the company’s common stock. Accelerated share repurchase plans allow the company to exchange a fixed amount of money for shares of its stock immediately,

transferring the risk of changes in the share price to the investment bank and generally permitting immediate accounting recognition of the repurchase for earnings per share purposes.

The company cannot benefit from the Rule 10b-18 safe harbor when using accelerated share repurchase plans, because the rule protects only traditional open-market stock repurchases and not the forward contracts upon which such plans are based.

(c) Rule 10b5-1 plans

As discussed in Section 8.1, insider trading liability is triggered by the sale or repurchase of a company’s shares by a party that trades while aware of material nonpublic information about the company. This liability could apply to a transaction by the company or its officers, directors or other insiders. One way to conduct trades in the company’s securities during a “blackout” window (e.g., in advance of the company’s earnings release), without risking violation of the prohibition against insider trading, is to enter into a Rule 10b5-1 plan.

A Rule 10b5-1 plan is a contract to purchase or sell securities established prior to any trades. The plan must have been adopted in good faith during an open trading window and without knowledge of material nonpublic information. It may also be modified only at those times, although it can be terminated at any time. The insider may not influence the person or entity responsible for executing the plan, which is generally an investment bank.

Anyone that is routinely exposed to material nonpublic information that a reasonable investor would use to buy, sell or hold shares of company stock is a candidate for a Rule 10b5-1 plan. This includes the company itself, directors, officers and other employees and large shareholders.

(d) Resales by affiliates

Company securities held by affiliates, including officers, directors and large stockholders that are treated as having the ability to directly or indirectly control management or policies of the company, are considered “restricted,” and resales must either be registered with the SEC or be effected pursuant to an exemption.

Securities acquired by a nonaffiliate in a private transaction are also considered restricted securities for a period of up to one year.

Rule 144 under the Securities Act is a common exemption used by affiliates to resell their company securities, with the following requirements:

- **Holding period**—The affiliate must hold the shares for at least six months before resale. One exception is for shares obtained pursuant to a written compensatory plan or contract. In that case, Rule 701 under the Securities Act allows resale under Rule 144 without any holding period. This resale must occur at least 90 days after the effective date of the IPO.
- **Volume limitation**—In any three-month period, sales by the affiliate may not exceed the greater of 1% of the company’s total outstanding shares or the average weekly reported volume in the securities on the exchange during the four weeks preceding the sale.
- **Current public information**—The company must have filed all required reports with the SEC on time.
- **Manner of sale**—The sale must be made through a broker-dealer or in certain other specified transactions through a stock exchange.

In some cases when using Rule 144, an affiliate must file Form 144 with the SEC and the stock exchange on which the securities trade.

6.4 Ongoing compliance obligations

NYSE Governance Services

The IPO is not the end of the story with respect to ethics and compliance—in fact, it is only the beginning. Once listed, a company will experience far greater public scrutiny and will have a range of continuing obligations with which to comply. Any weakness in its systems or failure to comply with regulations could cause public embarrassment to management, reputational damage and potential fines for the company and individuals involved in the failure.

During the last two decades, the role that directors play with respect to oversight of a company’s ethics and compliance program has expanded. The

expansion of director responsibility has arisen from several key events, including the enactment of the FSG. The implementation of the FSG, however, was only the start of the rapid development of director oversight responsibility of ethics and compliance programs. The decisions in *In re Caremark International Inc. Derivative Litigation*¹ and *Stone v. Ritter*,² two rounds of amendments to the FSG, the widespread acceptance and application of Department of Justice (DOJ) guidance for the prosecution of organizations and expanded application of the responsible corporate officer doctrine all provide that directors must now exercise greater oversight and control of compliance than ever before.

Despite these fundamental changes, organizations often fail to adequately support directors with the vital resources and expertise they need to exercise effective, ongoing oversight of an ethics and compliance program. Even if an organization has robust ethics and compliance practices below the director level, failure to retain directors who are knowledgeable about the content of the program, and who exercise reasonable oversight of the implementation and effectiveness of the program, will render the program “ineffective” in the eyes of regulators, prosecutors and federal judges.

Boards should periodically receive information about:

- the structure and resourcing of the compliance program and whether the compliance officer has sufficient authority to implement the program;
- the structure of the company’s reporting system and the company’s policies regarding responding to suspected misconduct;
- the types of compliance training that employees and others are required to complete and any modifications to those training requirements;
- the company’s risk assessment process and results and the methods developed by the company to prioritize and address the risks identified therein;

- the way in which the company audits for implementation of the compliance program and for substantive violations, especially in high-risk areas; and
- employees’ perception of the company’s culture of compliance, including fear of retaliation for reporting suspected misconduct, and whether employees believe that management is committed to compliance.

Just as vital is providing adequate resources and authority to the person or persons responsible for the day-to-day operations of the program. While the FSG and general best practices do not dictate a particular structure or level of authority for the person or persons responsible for compliance, at a minimum such individuals must have access to the board of directors and be of sufficient rank to effectively carry out their duties.

An organization’s code of conduct is the cornerstone of any successful program. But the code, along with any stand-alone compliance policies, is a living document that must be regularly reviewed and periodically updated. The code must speak to the culture of the organization and be accessible to all employees in their native language and at their appropriate reading level.

The FSG state that an effective compliance and ethics program should take reasonable steps to periodically communicate its standards, procedures and other guidelines by utilizing thorough training programs and other communication tools. Efficient, yet comprehensive, training is essential for any ethics and compliance program and is the most effective way for organizations to ensure their employees understand the standards to which they are held. Training must be periodically evaluated and reviewed to ensure the content and presentation is accurate and produces results. Organizations must establish comprehensive, risk-based training plans that take into account changing demographics and operational and legal factors. It is equally essential that organizations regularly communicate a message of ethics and compliance to employees at all levels of the organization. Employees take their cues on culture and compliance from their managers, so

¹698 A.2d 959 (Del. Ch. 1996).

²911 A.2d 362 (Del. 2006).

it is vital that managers and supervisors be involved in the communication of compliance standards and discussion of ethical culture.

Organizations should undertake a data-driven approach to monitoring and auditing their compliance program. A company should be collecting data on the program that includes, but is not limited to, training, reporting, culture assessment and knowledge assessment and should utilize appropriate external benchmarking tools to assess performance. The FSG require that organizations provide an anonymous reporting mechanism; additionally, organizations must ensure that open-door reporting—and a commitment to nonretaliation—is encouraged and properly communicated.

All organizations must ensure that investigations and discipline are consistent and as transparent as possible; this reinforces organizational justice and encourages reporting. Organizations should also seek creative and objective measures for performance and incentivize ethics and compliance at their organizations, as recommended by the FSG.

Corporate compliance practices have undergone enormous change in a relatively short period of time and best practices are continually developing. The level of scrutiny of a board's monitoring—or failing to monitor—the activities of a corporation has increased dramatically. The challenge for boards, executive officers and compliance officers now is to view the increased scrutiny and enhanced standards not merely as a host of new legal requirements but as an opportunity to review and enhance their corporate governance and compliance practices, setting a true “tone from the top.” ●

7

A public company and its shareholders

7.1 Proxy statement and annual meeting

Morrow & Co., LLC

(a) Annual meeting requirements

Every public company in the United States is required to have an annual meeting, at which shareholders can cast their vote, either in person at the meeting or by proxy beforehand. At a minimum, shareholders are given the opportunity to vote on the election of directors of the corporation and are also given the opportunity to provide their advisory vote on executive compensation for the previous year (commonly referred to as “Say on Pay”).

Most annual meetings are fairly formal affairs, well scripted and planned in advance. Generally, the venue for the meeting is chosen by the company and is usually suited to the number of holders expected to attend the meeting. Some companies hold the meeting at the same place every year, and others choose to rotate the meeting site to accommodate shareholders; the choice is up to management and the board of directors. There has been some movement toward holding “virtual” annual meetings, with no physical site for holders to attend; instead, it all takes place on the Internet. Most companies have chosen not to take this option; they use the once-a-year opportunity to meet shareholders in person, and many shareholders seem to prefer it that way.

(b) Timeline

The timing of the annual meeting is generally determined by the company’s fiscal year-end, and meetings are typically held at the same time each year. A number of important events in the preparation for, and lead-up to, the annual meeting require compliance with state laws, government regulations and other regulatory agency policies, as well as stock exchange listing requirements, if applicable.

(c) Preparation

Determine agenda and dates: Management and the board of directors, working together, will determine any other items to be presented to shareholders in addition to the usual items and determine the timing for the annual meeting. The board will set the record date (the date of stock ownership that determines

eligibility to vote) and the meeting date, and management will communicate this information to all appropriate parties. The length of time between the record date and meeting date is set by state law (in Delaware, for example, the record date can be no more than 60 days prior to the meeting and no less than 10 days prior to the meeting).

Communication: To ensure that the process runs smoothly, all parties involved need to work closely together to achieve the common goal. Parties involved include the issuer, the company’s transfer agent, the proxy solicitor (if one is used) and outside counsel.

Notification of record date and meeting date (broker search): SEC rules require that all street name holders (brokers, banks and other custodians) be given advance notice of the record date and meeting date, and this notice must be given a minimum of 20 business days prior to the record date. The notice sets forth the name of the company, the Cusip number of the security(ies) entitled to vote, the record date and the annual meeting date; it is sent to brokers, banks and their agents, as applicable, and affords them the opportunity to respond with the number of sets of material they will need to forward to their beneficial holders to allow them to vote at the meeting. This also gives the issuer the opportunity to determine the total number of copies of material that will be needed to be printed. If the company retains a proxy solicitor, the solicitor will take care of the broker search. In the absence of a proxy solicitor, the transfer agent will generally handle the search notice.

Analyze the need for a proxy solicitor: Recent changes to NYSE regulations (which govern member firms, such as brokers, and not just listed companies) have changed the voting landscape for public companies. The most important change involves the election of directors; previously, member firms (brokerage firms) were permitted to vote on the election of directors in the absence of instructions from the underlying owners of the shares. However, since January 1, 2010, brokers are no longer permitted to vote on the election of directors

without specific instructions from their clients. Usually, member firms are permitted to vote on the ratification of auditors without specific shareholder instructions. A professional proxy solicitation firm not only can help with timing and mechanical requirements for the meeting but can also provide advice on the presentation of items to shareholders for optimal readability and the likelihood of achieving the requisite vote for the proposal to pass. The recent addition of the requirement to include a shareholder vote on executive compensation (Say on Pay) has added another level of complexity to annual meetings. Other issues, such as increasing support for certain shareholder proposals, the increasing influence of institutional and activist investors, and the views of proxy advisory firms have made planning for the annual meeting a more complex and longer process than it has been in the past. Companies with nonroutine ballot items (such as equity plans or shareholder proposals), and even those with “ordinary” agenda items, should consider retaining a professional proxy solicitation firm to help navigate the proxy process.

7.2 Providing shareholders with proxy material

Morrow & Co., LLC

(a) Material preparation

Materials to be provided to holders: In order to solicit votes from shareholders for the annual meeting, the issuer is required to provide holders with a proxy statement and form of proxy that allows holders to vote. In addition, the annual meeting materials must either be accompanied by, or preceded by, an annual report. These documents must be filed with the SEC concurrently with the mailing. In some cases (which can be discussed with counsel), the proxy may need to be filed in preliminary form, depending on the proposals to be presented to shareholders. The proxy statement, in addition to meeting applicable legal requirements, is also an advocacy piece for management’s position. Clarity of presentation and ease of reading are key to ensuring that holders take the time to read the material that is being sent to them.

In addition to the proxy statement and annual report, the issuer will need to provide shareholders with a form of proxy (generally referred to as a proxy card) to allow holders the ability to cast their vote. The format of the proxy is generally coordinated with the issuer's transfer agent to ensure that returned proxies will be readable by the transfer agent's computer systems. In-house counsel will also generally ensure that the form of proxy meets applicable legal requirements.

(b) Material distribution

Web hosting of materials: Since January 2009 all companies soliciting proxies under SEC rules are required to post annual meeting material to the Internet and notify shareholders of availability. However, the issuer cannot merely link to the SEC's EDGAR website—a link must be provided to a site that is cookie-free and may be hosted either by the issuer or by an outside party. Whoever is chosen to host the site, it is important that all requirements for accessibility and privacy protection are met.

Electronic distribution of materials: SEC rules allow issuers to distribute proxy material electronically to shareholders that have already consented to such delivery. Shareholders are offered the opportunity to access their documents electronically, which offers printing and postage cost savings. Consents may be promoted via hard-copy communications such as the proxy card, proxy statement and annual report. Shareholders can also sign up for electronic delivery of material for future mailings when they vote online.

Notice and Access: The SEC allows issuers to send holders a simple notice providing information on how to access their proxy materials—without prior consent for electronic delivery. If an issuer chooses to use Notice and Access, the form to be used in mailing is prescribed by the SEC and must include the issuer's name, date of meeting and a brief description of items to be voted on, among other items. A link to the proxy material and voting site is included in the notice, along with a control number specific to the holder to access the site, and an issuer may NOT include a proxy card with the mailing. Shareholders must also be given the

opportunity to request a printed copy of the proxy materials, and instructions on how to do so must be included with the Notice. The issuer is obligated to honor requests for paper copies of the material for up to one year after the meeting. Use of notice and access requires that the notice be sent at least 40 days prior to the meeting date, and the site hosting the material must be live and available at the time the Notice is mailed. Failure to meet the 40-day time frame would cause the company to revert to its normal delivery procedure. Issuers may use Notice and Access, or they may choose to use Notice and Access for certain holders and mail full packages to other holders. This determination can be made in coordination with the proxy solicitor and will include consideration of the items on the ballot, the vote requirements for each proposal and the number of shareholders to be affected.

Householding: To further reduce the number of printed annual reports and proxy statements required, the SEC permits issuers to mail one set of materials when two or more shareholders with the same last name live at the same address. Separate proxy cards are included for each registration, however.

Full-set mailing: An issuer may also choose to mail a full package to all holders; the package includes the annual report, proxy statement, proxy card and return envelope. The choice can be made to mail all packages by one class of mail (typically, either first class mail or standard (formerly bulk) mail). The choice will, as with Notice and Access, depend on the size of the shareholder base, share distribution of holders and the ballot items to be voted on.

(c) Phase three: solicitation and voting

Generally, less than 30% of retail (noninstitutional) shareholders vote in response to the initial proxy material distribution; institutional holders have a much higher rate, with U.S. institutional investors typically voting over 90% of their positions. In cases where contentious or high-vote proposals are on the ballot, it may be helpful to achieve higher turnout from retail holders. In general, retail holders support management more often than not and can provide an additional margin of support for a management proposal.

Three methods of voting are typically offered to shareholders to make their choices known: (1) traditional mail-in, where a holder signs a card and mails it in a postage-paid return envelope; (2) telephone voting, whereby a holder calls a toll-free number and enters the control number that appears on the proxy form and specifies his or her choice; and (3) Internet voting, whereby a holder goes to a specified site and enters the control number and specifies the voting choice. The holder will also have the option to sign up for electronic delivery of material for future meetings.

Professional proxy solicitation firm versus in-house solicitation:

A large number of public companies in the United States hire a professional proxy solicitation firm to help them with all aspects of their annual meeting. A proxy solicitor can handle the mechanical aspects of the solicitation (such as overseeing the distribution and mailing of material), provide guidance on the presentation of information in the proxy statement and work to ensure that all shareholders are afforded the opportunity to vote. A solicitor can also provide advice on the likely voting outcomes on many proposals to be presented to shareholders and will work closely with management to coordinate solicitation efforts. The solicitor will also provide daily voting reports to keep the company apprised of the status of the voting on a real-time basis, so there will be no surprises at the time of the meeting.

Proxy solicitation team: At most public companies, the conduct of the annual meeting is the responsibility of the corporate secretary's office, working in conjunction with the general counsel and legal staff. In addition, the investor relations department may also be involved, to assist in garnering support from institutional investors with whom it has a close working relationship. With the current requirement to provide shareholders with an advisory vote on executive compensation, it is not uncommon for the human resources department to also be involved. The proxy solicitor will work closely with the company in coordinating outreach to shareholders, both institutional and retail.

To determine whether an issue is controversial or to obtain a vote, the corporate secretary and corporate legal counsel should retain a proxy solicitation firm. With recent changes to regulations and the growing influence of proxy advisory firms, achieving successful voting percentages is becoming a more challenging task.

Shareholder profile: In order to conduct an efficient and effective proxy solicitation, it is important to know the composition of the shareholder base. A proxy solicitor can determine the amount of shares held by institutional holders, retail holders and insiders (including shares held in company plans). With this information, a determination can be made on the nature and extent of the solicitation needed and also whether an outreach campaign to retail holders is necessary and beneficial.

Executing an effective campaign: With knowledge of the shareholder base, the corporate secretary and staff can position the messaging in the proxy statement. The proxy statement is not just a means to satisfy SEC and state law disclosure requirements but is also a public company's most broad and direct investor relations tool.

Corporate governance practices are important for many shareholders, and this is a trend that continues to grow in importance. A company's governance practices should be presented in the best possible light, since many investors will take these practices into account when making their voting decisions. The board of directors is responsible for deciding what practices are best for the company as a whole, while also taking into account the views of their shareholders. Meeting with investors regularly, and understanding their concerns as well as those of the proxy advisory firms, will help address potential conflicts before the annual meeting.

Third-party proxy advisory firms: The two major proxy advisory firms are Institutional Shareholder Services (ISS) and Glass, Lewis & Co. These third-party proxy advisory firms provide analysis and voting recommendations on virtually

all U.S.-listed companies, and many foreign ones, to institutional investors. While the views and recommendations of these firms are influential, they are not necessarily dispositive, and most major institutions have their own voting policies and guidelines in place that govern how they will vote on specific issues. Many will also subscribe to one or more of the proxy advisory firms proxy analysis services and use them as a guide in helping to make their voting decisions. Most institutional investors are required to publicly disclose their voting record once a year, on Form NP-X, with the SEC. Some institutional investors will also have one of the advisory firms vote their proxies, based on the advisory firm's recommendations.

7.3 Ownership reporting by shareholders

Cleary Gottlieb Steen & Hamilton LLP

After the IPO, the company's major shareholders (or groups of shareholders acting together) will be required to comply with certain reporting requirements under the Exchange Act. These requirements are in addition to those applicable to officers, directors and 10% shareholders under Section 16 of the Exchange Act. The company's management usually encounters these requirements in two ways. First, a company with a controlling or principal shareholder will often monitor that shareholder's compliance with these requirements. Second, filings under these requirements occasionally provide important information about transactions by major shareholders.

Schedule 13D filers: Pursuant to Sections 13(d) and 13(g) of the Exchange Act and the related SEC regulations, each person (or group of persons acting together) acquiring any voting equity securities registered under the Exchange Act as a result of which such person or group beneficially owns more than 5% of such securities, within 10 days of the 5% threshold being crossed, must file a report on Schedule 13D with the SEC and send copies to the company and relevant stock exchanges. As discussed below, some shareholders may be able to file instead on Schedule 13G, which requires less information.

Schedule 13D requires disclosure of:

- the identity of the acquirer (or each member of the group), including its management, directors and controlling entities;
- the source and amount of funds used to acquire the securities;
- the purpose of the acquisition, including any plans or proposals the acquirer may have for future purchases or sales of target stock or for any changes in the target management or board of directors, or any major corporate transaction affecting control of the target, such as a tender offer or business combination;
- the amount and percentage of target securities held by the acquirer and details about transactions in such securities during the 60 days prior to filing of the Schedule 13D (or, if shorter, for the period since the most recent Schedule 13D filing); and
- the nature of any arrangements to which the acquirer is a party relating to the target's securities.

Documents relating to the financing of the acquisition and any contemplated extraordinary transaction involving the company must be filed as exhibits to the Schedule 13D filing.

Schedule 13D filings can be quite long and complex. In the event of a contest for control, there can be litigation challenging the accuracy of the filing, and especially of statements describing the acquirer's purpose and plans. Filers often try to preserve as much flexibility as possible by describing a wide variety of options.

A report on Schedule 13D must be amended "promptly" (which can mean almost immediately in some circumstances) in the event of a material change in the information disclosed in the schedule, including a change in—or, in the view of the SEC, the selection of one particular purpose from—the previously disclosed plans. Any acquisition or disposition of 1% or more of the relevant class of securities is deemed material for this purpose, while a lesser change in holdings may be material, depending on the circumstances.

Schedule 13G filers: An existing shareholder that already owns more than

5% of the company at the time of the IPO is required to file a report on Schedule 13G within 45 days of the end of that calendar year. Thereafter, the shareholder must amend its report within 45 days of the end of each calendar year to reflect any changes, as of that year-end, in the reported information. It must convert to reporting on Schedule 13D within 10 days of its ownership percentage increasing by more than 2% in any 12-month period, but it need not amend its Schedule 13G or file a Schedule 13D merely by reason of a change in its intentions or plans.

There are two other types of investors that may report on Schedule 13G instead of Schedule 13D, provided that they have acquired shares in the ordinary course of business without the purpose or effect of changing or influencing control of the company:

- a “qualified institutional investor” that falls with certain specified categories of institutions; and
- a “non-qualified passive investor” that does not fall with the specified categories but beneficially owns less than 20% of the shares.

Schedule 13G requires much more limited information than Schedule 13D. The principal disclosures required by Schedule 13G include:

- the identity of the holder;
- the basis for its eligibility to use Schedule 13G;
- the amount and percentage of target securities that it holds; and
- the identity of the persons on whose behalf it owns the securities or that compose an acquiring group.

A qualified institutional investor generally need not file its Schedule 13G until 45 days after the end of the calendar year in which the acquisition occurred, and only if it remains above the 5% threshold at the end of the calendar year. Thereafter, the filing must generally be amended annually. It must also be amended within 10 days of the end of the first month in which the qualified institutional investor’s direct or indirect beneficial ownership interest exceeds 10% of the class and thereafter within 10 days of the end of any month in which its interest increases or decreases by more than 5% of the class.

A nonqualified passive investor must file its Schedule 13G within 10 calendar days of crossing the 5% threshold. It must also amend its filing “promptly” if it acquires beneficial ownership of more than 10% of the subject class of securities. After it exceeds the 10% threshold and so long as its percentage of beneficial ownership remains below 20%, an additional amendment to the nonqualified passive investor’s report on Schedule 13G must also be filed “promptly” to reflect any increase or decrease in beneficial ownership of more than 5% of the class of subject securities.

If a nonqualified passive investor increases its ownership above 20%, it must file a Schedule 13D within 10 days and is prohibited from purchasing any additional shares or voting the securities subject to the Schedule 13D filing until 10 days after the filing. Similarly, both a qualified institutional investor and a nonqualified passive investor must convert to a Schedule 13D within 10 days of their intentions being no longer passive and are prohibited from purchasing any additional shares or voting the securities subject to the Schedule 13D filing until 10 days after the filing.

Comparable non-U.S. institutions may be permitted to report their beneficial ownership on a short-form Schedule 13G to the same extent as their U.S. counterparts, subject to certain conditions.

7.4 Reporting by insiders

RR Donnelley

Certain “insiders,” including executive officers, directors and investors owning over 10% of the shares of the company, will generally be required to file disclosure reports under Section 16(a) of the Exchange Act regarding changes in their beneficial ownership of the company’s shares within two days of the transaction on the SEC’s EDGAR system. The reports must also be available on the company website. They will also be subject to the “short-swing profit recapture” provisions under Section 16(b) of the Exchange Act designed to limit insiders’ ability to reap profits from any purchases and sales within six months of each other. Section 16(c) of the Exchange Act and the rules

thereunder generally prohibit such insiders from effecting short sales and taking short positions in derivative securities with respect to the company’s shares. In connection with the IPO, the company should determine who, in its view, are its “executive officers” for Section 16 and proxy purposes.

It can be challenging to manage all of the moving parts included in filing Forms 3, 4 and 5 with the SEC. The company can take complete control of the filing process by utilizing a web-based filing solution, which allows it to file the forms directly from its own computers. Alternatively, it can outsource the filings to a financial printer that has the resources and experience necessary to ensure that these filings meet the tight SEC deadlines.

Summary of Section 16 for foreign private issuers:

Directors and officers of a U.S. company with a class of equity securities registered under the Exchange Act, and beneficial holders (whether or not U.S. holders) of more than 10% of any class of equity securities of such company, generally must file reports regarding their ownership of such securities. They are also subject to short-swing profit recapture provisions designed to recapture for the benefit of the company profits realized on purchases and sales of equity securities registered under the Exchange Act within any six-month period. These requirements do not apply to directors, officers and large shareholders of foreign private issuers.

Excerpts on other Section 16 information:

A number of transactions in securities in which an insider has a pecuniary interest are exempt from reporting under Section 16(a). For example, an increase or decrease in the number of securities held as a result of a stock split or stock dividend applying equally to all securities of a class and an acquisition of securities pursuant to a dividend or interest reinvestment plan are exempt from reporting under Section 16(a), subject to certain conditions. In addition, changes in beneficial ownership pursuant to transactions that are exempt from short-swing profit recapture under Section 16(b) are generally reportable on Form 5 rather than Form 4

(although certain of such transactions must be reported on Form 4, pursuant to Rule 16a-3(f)).

To the extent that an exemption exists from the reporting requirements of Section 16(a) in respect of any transaction in a security, the short-swing profit recapture provisions of Section 16(b) likewise do not apply to such transaction (see Rule 16a-10). Rule 16a-10 does not apply in the reverse; an exemption from the short-swing profit recapture provisions of Section 16(b) does not automatically provide an exemption from the reporting requirements of Section 16(a).

An insider must file Form 4 with the SEC and with each national securities exchange on which any security of the company is listed within 10 days of the end of each month in which any reportable change in position occurs with respect to any security as to which it has a direct or indirect pecuniary interest. Every transaction during such month must be reported, even if acquisitions and dispositions during such month even out.

For purposes of beneficial ownership, a person can be deemed to own beneficially not only securities owned directly by such person but also securities underlying derivative instruments convertible into or exchangeable for securities. For example, the holder of an option convertible into securities within 60 days will be deemed, for the purposes of Section 13(d) (and determining a person's status as an insider under Section 16(a)), to indirectly beneficially own the underlying securities, whether or not the option has been exercised. Thus, derivative securities owned by an insider that are, within 60 days, convertible into or exercisable for more than 5% of a security will create a reporting obligation under Section 13(d) with respect to the underlying securities. If such derivative securities are, within 60 days, convertible into or exercisable for more than 10% of a security, such holder will also be deemed an insider of the company of such security subject to the reporting obligations under Section 16(a).

7.5 Related party transactions

Cleary Gottlieb Steen & Hamilton LLP

It is not uncommon, pre-IPO, for the company to do business informally with family members or without giving due consideration to whether certain transactions are done on an arm's-length basis. Once the company conducts its IPO, however, it needs to be careful about so-called "related party transactions" because they can present potential or actual conflicts of interest and create the appearance that decisions are based on considerations other than the best interests of the company and its stockholders.

Definition: The SEC defines a "related party transaction" as:

- any individual or series of transactions, including any financial transaction, arrangement or relationship;
- in which the company participates;
- where the amount involved exceeds \$120,000; and
- in which any related person had or will have a direct or indirect material interest.

A "related person" includes:

- any director or executive officer of the company;
- any nominee for director, if the information is being provided in a proxy statement;
- any beneficial owner of more than 5% of any class of the company's voting securities; and
- any immediate family member of the people listed above (i.e., any child, stepchild, parent, stepparent, spouse, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law or sister-in-law of such people) and any person, other than a tenant or employee, sharing the household of such people.

Reasons for concern: The company should care about related party transactions for a number of reasons:

- It makes good business sense—Related party transactions may involve terms that are not as competitive as might otherwise be achieved, preventing the

company from best accomplishing its financial or strategic goals.

- Some related party transactions are prohibited—Under the securities laws, the company is prohibited from making loans to directors or executive officers. Any such loans would have to be unwound prior to the company's IPO. Other related party transactions can cause a director not to be considered independent for service on the company's compensation or audit committee for tax or securities law purposes.
- Stockholders care—Related party transactions signal a possible conflict of interest to investors. They can call into question whether the company puts the best interests of the company and its stockholders first, tarnishing the legitimacy of management and damaging valuation of the company's securities.
- The SEC cares—The SEC considers disclosure regarding related party transactions as integral to a materially complete picture of financial relationships with the company. As a result, securities regulations require detailed disclosure on these transactions in proxy statements, annual reports and registration statements, including Form S-1. The disclosure must cover such information as the name of the related person and the basis on which the person is a related person, the related person's interest in the transaction with the company, the approximate dollar value of the transaction and any other information regarding the transaction that is material to investors in light of the circumstances of the particular transaction.
- Stock exchanges care—The listing rules of the various stock exchanges require the company to think carefully about related party transactions. For example, under NASDAQ rules, an independent body of the company's board of directors must conduct ongoing review and oversight of all related party transactions for potential conflict-of-interest situations. Similarly, the NYSE recommends a similar process and also

requires listed companies to adopt a code of business conduct and ethics for directors, officers and employees that address conflicts of interest.

- Auditors care—Auditors are obligated to have sufficient understanding of the company’s business activities to assess whether the company’s disclosures on related party transactions are adequate. Accounting requirements dictate certain disclosures about related party transactions. Audit rules set forth specific auditing procedures on how to determine the existence of related parties and transactions with them, how to examine identified related party transactions and how to respond to management’s representations that a transaction was consummated at arm’s length. These audit procedures are quite detailed and can involve a review of the company’s board minutes, proxy information and other material filed with the SEC, stockholder listings and other potential sources of information.

How to deal with the issue: The company should develop policies and procedures for the review, approval or ratification of related party transactions. Clear policies are essential to provide directors and officers with guidance on related party transactions and how the company will deal with them. Although the securities laws do not mandate the specific features of the policy, they require disclosure of it in certain filings and suggest that it may be appropriate to include the following:

- Types of transactions covered by the policies and procedures—The company should consider what makes most sense given its business requirements, corporate structure and operating style. Also, it pays to be aware of “hot-button” issues when describing the types of transactions covered. For example, the SEC is especially sensitive about transactions involving family members, so the company may consider developing a nepotism policy.
- Standards to be applied pursuant to the policies and procedures—Policies should hold all related parties to the same standards as third parties.

Although there may be situations where a limited market makes it difficult to establish what the terms and manner of settlement of a particular transaction would be with a third party, the company should nevertheless attempt to set forth objective business criteria against which the related party transaction can be reviewed.

- The persons (or groups of persons on the board of directors or otherwise) who are responsible for applying such policies and procedures—The company should consider the board committee responsible for administering the policy. Usually the audit committee is charged with this task, but it may also make sense for the nominating and corporate governance committee to be responsible for matters relating to directors. Also, the company should establish when the responsible persons will review related party transactions. Although subsequent review may be acceptable, best practice mandates prior review.

In order to enable board members or delegates to make informed advance decisions on related party transactions, company procedures need to ensure that the information presented to them is sufficient in scope and quality:

- Sources of information—The first source of information should be the related parties themselves. For example, an annual questionnaire distributed to directors and officers should capture basic information about transactions between directors and officers, their family members and the company. Furthermore, directors and officers should have an ongoing obligation to inform the company in advance of any potential related party transaction and to provide updates of parties related to them, their employment and relationships with charitable organizations. The company may also consider instituting independent information-gathering procedures, which may include periodic review of news articles or Internet searches.
- Application of information—The company may consider developing

a related party master list to be distributed, with any updates, to the relevant members of management such as the CFO and business unit and department leaders responsible for purchasing or selling. The company may also develop a “watch list” of potentially related persons, using the sources of information described above to check whether their status changes.

Tasks: In preparing for the IPO, the company and its lawyers should do the following:

- Review both existing related party arrangements and any plans for new ones as soon as possible. Consider the impact of such arrangements on disclosure and governance standards.
- Identify arrangements between officers, insiders and their close relatives on the one hand, and the company on the other; these arrangements will generally have to be disclosed.
- Confirm that the compensation committee approves all elements of compensation paid to executive officers. Compensation exceeding \$120,000 paid to executive officers must be disclosed if not approved (or recommended for approval) by the compensation committee or a group of independent directors performing that function.
- Unwind loans to directors and officers before the initial IPO registration statement is filed with the SEC.
- Develop written related party transaction policies and procedures. If the company already has a code of conduct or other policies addressing this issue, it may be preferable to integrate related party transactions policies with such existing policies. Although the securities laws do not require that policies and procedures be in writing, best practice mandates written policies.

7.6 Share ownership mechanics

Morrow & Co., LLC

(a) Types of share ownership

Shareholders can be divided into two broad groups: “registered” holders and “beneficial” holders. A registered holder

is one who owns shares directly in his own name and whose identity and share ownership appears on the company register (a registered holder may be an individual, a group or other entity). Evidence of share ownership may be by physical stock certificate or by electronic entry on the company's records. Typically, the register of shareholders is maintained by the company's transfer agent, which keeps track of ownership and transfer of shares.

A beneficial holder is one who chooses not to keep the stock in his own name; ownership is retained by a broker, bank or other custodian. A beneficial holder does not appear on the company's records as a shareholder but retains beneficial ownership of the shares. Holding in this manner is often referred to as holding in "street name."

Companies know who their registered holders are and can communicate with them directly. Beneficial holders are not known directly by the company and may choose not to have their identity disclosed. Beneficial owners can either be nonobjecting beneficial owners (NOBOs) or objecting beneficial owners (OBOs). OBOs will not allow their identity to be disclosed to the company, and the only way to communicate with them is through their broker, bank or custodian. NOBO holders, however, have waived the right to remain anonymous, and an issuer can request a NOBO listing of such holders, upon payment of a charge for the list. The NOBO list will contain the name, address and shareholding amount of the holders but will not indicate which custodian holds the shares for the owner. Issuers can then communicate directly with these holders, if they choose. A shareholder has the right, when opening a brokerage account, to decide whether they choose to have their identity disclosed in this manner (i.e., whether to be a NOBO or OBO).

"Book entry" and printed share certificates: Registered holders have their ownership evidenced either by a printed share certificate (the traditional method) or by book entry. With book entry, the holder's ownership is recorded on the transfer agent's register of shareholders, but no physical certificate is issued. The main advantages of book entry ownership

are the ease of transfer or sale (no certificates need to be presented at the time) and a more secure environment. The risk of losing a certificate is mitigated with book entry ownership and it also eliminates the need for posting a bond to replace a lost certificate. The SEC is a strong proponent of the reduction in the use of physical certificates.

All beneficial holders are book entry holders—their ownership is recorded on the records of their custodian and there is no physical certificate for the owner.

(b) Recordkeeping

The transfer agent, retained by the issuer, maintains a record of the ownership of the company's shares, including the holder's name and address. Brokers and banks maintain their own record of ownership of shares held in their name for the benefit of others.

The transfer agent, in addition to maintaining the ownership record, is also responsible for the transfer, issuance and cancellation of shares. A list of all registered holders can be produced upon request of the issuer. The most common request for a registered holder list comes at the time of the record date for an annual meeting (or special meeting) to determine those holders eligible to vote. Most commonly, the transfer agent is the custodian of the list of common stock holders, but they can also serve as record keepers for other types of securities, such as preferred stock or bonds.

Transfer agent's duties also include:

- payment of dividends;
- tax reporting;
- dividend reinvestment plan (DRIP) administration;
- escheatment and lost shareholder reporting;
- stock option issuance;
- restricted stock transfers; and
- annual and special meeting services, including the mailing of proxy material to all registered holders and the tabulation of returned votes.

Transfer agents generally provide online access to holders accounts. The transfer agent also usually acts as registrar of the shares of an issuer as well, ensuring that shares issued do not exceed the number of shares authorized in the company's charter.

Transfer agents are subject to regulation, both by the SEC and by the state of incorporation. These regulations govern, among other things:

- processing time for transfers;
- responsiveness to inquiries;
- accuracy of recordkeeping, and retention of records;
- secure handling of stock certificates;
- safeguarding of funds and securities; and
- searching for and tracking lost shareholders.

States have rules regarding lost shareholders and the process for turning over securities in inactive or abandoned accounts (escheatment). In addition, the Internal Revenue Service requires transfer agents to report the payment of dividends and shares sales by means of Form 1099. The IRS also may instruct a transfer agent to either begin, or cease, tax withholding, which the transfer agent must comply with.

(c) Transfer of shares and voting

As described above, transfer of shares for registered holders are handled by the transfer agent; mailing of material and vote tabulation is also usually handled by the transfer agent as well.

For "street name" shares, the procedure differs. A beneficial holder in street name does not appear directly on the share register; shares are held by the broker or bank that acts as custodian for those shares. Most brokers and banks do not hold their shares directly on the register; instead, the shares are held by The Depository Trust & Clearing Corporation, which through its DTC subsidiary appears on the share register as owner of the shares (showing, in the name of its nominee, CEDE & Co.).

DTC was established to alleviate the volume of transfers of physical stock certificates necessary for trading of securities. Rather than transferring certificates, shares are transferred electronically, and DTC will then allocate the shares to their participants (brokers and banks) for whom they are holding the shares. Since the shares held in DTC's name are not owned by Depository Trust, it maintains a list of participants for whom it is holding shares and the number of

shares owned by each participant. The participating brokers and banks also maintain their own records, as well as keep the contact information for the beneficial holders of the shares (clients of the broker or bank).

Dividends paid by an issuer are paid by the transfer agent directly to registered holders. Similarly, one payment is made to CEDE & Co. (DTC's nominee); DTC will then allocate the payment to each of its participants. The participants will, in turn, allocate the dividend payment to the account of the beneficial holder.

When an issuer needs to mail information to its shareholders, whether for a shareholder meeting or for some other reason, the process is generally done in two parts. The transfer agent, since it has the identity of all registered holders, will generally mail the requisite information to all holders on the registered list. If the mailing is for a meeting at which voting will take place, the mailing will include a form of proxy that the holder can use to give voting instructions and return it to the transfer agent for tabulation.

The transfer agent does not have the identity of the beneficial holders in street name and cannot mail directly to those holders. DTC disclaims beneficial ownership of the shares and will not vote on behalf of its participants directly. However, it does provide, as of the voting record date, an omnibus proxy and participants' listing for the security subject to the meeting. The omnibus proxy formally assigns the voting rights for shares held in its name to each of their participants; the participants' listing provides the name and number of shares held by each of the brokers and banks held in the DTC account. It is up to each participant to mail material to their beneficial holders, seeking voting instructions. They will provide a form of proxy to their holders, to be returned to the broker or bank, and the participant will then execute the vote and return it to the transfer agent for inclusion in the tabulation.

In practice, almost all brokers and banks outsource the mailing of proxy material to their beneficial owners in the interests of efficiency and cost savings. They will use an intermediary who will mail and tabulate votes on their behalf,

and the intermediary will return the votes directly to the transfer agent. The most commonly used intermediary is Broadridge Financial Solutions. The intermediary will receive information on each participants' holders (including name, address and share amount) and compile that into a master list to complete the mailing of the issuer's material. In addition to meeting materials, it can also distribute other information to beneficial holders (such as newsletters) without a proxy voting form.

(d) Lost shareholders

Since all 50 states and the U.S. territories require financial institutions, issuers and their transfer agents to report property that is unclaimed or abandoned, it is imperative that complete and accurate records be kept on all activity in an account. Property may be considered unclaimed or abandoned based on uncashed dividend checks or on a certain number of pieces of returned mail (a "lost" shareholder). Inactivity or abandonment leads to escheatment—the process of transferring abandoned property to the state or territory.

In each case, property can be escheated only after a certain period of inactivity passes on the account (referred to as the "dormancy period"). Each state has its own regulations on the amount of time that constitutes the dormancy period, as well as what types of shareholder action constitutes a valid action to avoid dormancy. The SEC also requires a company and its transfer agent to conduct due diligence, including mailings and database searches before the property is escheated (SEC Rule 17ad-17). After all due diligence is completed, the company and its transfer agent must file unclaimed property reports with the states, and the property is turned over to the state.

Accurate records must be kept to make sure that all lost shareholder and escheatment regulations are adhered to. This serves to ensure that all required escheatment of property is completed on a timely basis, and also that assets are not escheated improperly. States may, and often do, perform audits on a company and its transfer agent to ensure that the escheatment process is handled appropriately.

Finally, records must also be maintained after the property is turned over to the states, in the event that a shareholder whose property has been escheated attempts to retrieve the property at a later date. The assets can be reclaimed by the shareholder by directly contacting the individual state. •

8

Managing risk

8.1 Liability standards

Cleary Gottlieb Steen & Hamilton LLP

Sources of liability: The main potential sources of liability for public companies and their officers, directors and other employees are the federal securities laws, state securities laws and state corporate law of fiduciary duty.

The principal areas under which liability may arise under the federal securities laws are as follows:

- **Disclosure liability provisions**—Several specific provisions of the federal securities laws impose liability for written or oral statements about the company or its securities that contain a material misstatement or make a material omission. Certain of these provisions apply to registration statements and prospectuses (including the IPO registration statement and prospectus); others apply to the company’s periodic and other reports filed with the SEC. The precise liability standard and burdens of proof vary among statutes, as do the available defenses based on the defendant’s exercise of reasonable care or the plaintiff’s nonreliance on the disclosure. Depending on the specific provision, the SEC may bring criminal or civil penalties against the company, its directors and officers; and in some cases, private parties may also rely on these laws to assert claims for damages or rescission.
- **Antifraud provisions**—The company and others may face liability under broadly worded statutes and regulations addressing fraud in the securities markets. The most important of these are Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which apply in connection with purchases and sales of securities. Rule 10b-5 broadly prohibits fraudulent and deceptive practices and untrue statements or omissions, both written and oral, of material fact in connection with the purchase and sale of any security. Under Rule 10b-5, the issuer and its employees or agents may be liable whether or not any of them actually purchased or sold any securities. Liability requires proof that the defendant engaged in willful

misconduct or at least acted recklessly and can be based on information contained in a document filed with the SEC (including a registration statement or a periodic or other report), as well as any information released to the public by the company, including press releases and annual reports to shareholders. This catchall antifraud provision has been widely used in securities litigation by private parties and the SEC alike. The geographic reach of liability under Rule 10b-5 has been the subject of extensive litigation and some legislative changes in recent years, as discussed in Section 9.8.

- **Failure to register**—As described in Section 3.2, the U.S. securities laws establish a framework for public offerings of securities. This framework requires the registration of every offer and sale of a security with the SEC unless a specific exemption from registration applies. As discussed in Section 3.2, the terms *offer* and *sale* have been very broadly construed. Both private parties and the SEC may bring suit against the company or other offering participants for violations of these rules.
- **“Books and records” requirements**—Under the Exchange Act, the company is required to make and keep books, records and accounts that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of its assets. The SEC regularly uses this as a basis for enforcement proceedings, and the company, its officers and directors and other parties who control the company may be subject to civil or criminal penalties, including fines and imprisonment, if they are found to have violated this provision.
- **Market manipulation**—Transactions in the company’s own securities could raise concerns about the possible manipulation of the market price. Manipulation would expose the company to a variety of civil and potentially criminal liabilities.

The individual states have securities statutes that are analogous to the federal securities law statutes. Federal law preempts state law to a degree in certain

areas (e.g., registration of offers and sales, class actions) but generally not with regard to securities fraud or misrepresentation. All U.S. states (other than New York) have statutes that allow investors to sue to rescind transactions or recover damages when securities are sold by means of materially misleading offering documents. In approximately 35 states, including a number with a significant investor base, sellers must show they exercised reasonable care to avoid liability. However, state securities laws are unlikely to provide a basis for the nationwide class actions or other large-scale proceedings that have marked securities litigation under the federal securities laws.

Finally, the corporate laws of the individual states impose basic “fiduciary” duties on directors and officers of companies organized under those laws, with these duties being owed to the company itself and its shareholders. Directors have two fundamental fiduciary duties: the duty of care and the duty of loyalty. Directors must act in good faith, with the care of a prudent person, and in the best interest of the company. They must refrain from self-dealing, usurping corporate opportunities and receiving improper personal benefits. Decisions made on an informed basis, in good faith and in the honest belief that the action was taken in the best interests of the company, will be protected by the “business judgment rule.” Generally, officers owe fiduciary duties similar to those of directors. Officers also may owe a duty to keep the board informed. Officers with greater knowledge and involvement may be subject to a higher standard of scrutiny and liability.

Directors and officers can be held liable to the company for violations of these duties. The shareholder derivative suit provides a means by which a private litigant can enforce duties on behalf of the company.

Types of proceedings: Remedies and sanctions for improper securities activities can be sought in three basic ways:

- **Civil** (including class actions and derivative suits)—Private parties seek to recover losses allegedly suffered as a result of the defendant’s conduct or request relief to compel or to stop

certain actions. Government agencies, such as the SEC, may also bring civil actions to force the defendant to give up illegally obtained profits or pay monetary penalties or to compel or stop certain actions.

- **Administrative**—Government agencies bring administrative proceedings before administrative judges, who follow the rules promulgated by the applicable agency. For certain violations of the federal securities laws, the SEC may bring administrative proceedings to impose civil penalties or an order to bring immediate halt to allegedly improper conduct.
- **Criminal**—Only the U.S. Department of Justice can institute federal criminal proceedings. Defendants who are convicted in criminal proceedings face substantial fines and, in the case of individuals, terms of imprisonment.

None of these mechanisms is exclusive and a party may be forced to defend against more than one type of proceeding.

Liability for corporate disclosures: The securities laws do not impose a general duty to disclose material information about the company. Rather, such disclosure is required only when there is a legal duty to do so. This duty arises in connection with the purchase and sale of securities, whether in registered or private offerings or in secondary market trading. The company and its directors and officers can be liable for material misstatements and omissions in public disclosures. This liability risk is mitigated by conducting appropriate due diligence prior to the IPO and establishing robust internal reporting and disclosure controls and procedures in connection with ongoing reporting obligations.

Liability relating to insider trading:

Insider trading liability arises under Rule 10b-5 when a party trades the company's securities (or "tips" others to do so) while aware of material nonpublic information. The number of insider trading enforcement actions by the SEC has increased steadily over the last five years, and it is expected that this aggressive enforcement trend will continue. To reduce the risk that trading by those parties in its securities may be

claimed to violate the prohibition against insider trading, the company should observe the following guidelines:

- Only trade during "window periods" tied to the release of the company's interim and annual earnings reports and other material information and the public filing of such information with the SEC and the relevant securities exchange.
- Develop and promote a written policy and code of ethics with clear guidelines prohibiting insider trading and addressing general standards of conduct, protection of confidential information and whistleblowing.
- Develop robust compliance programs.
- Conduct periodic training on contemporary regulations, requirements and developments for all employees, including directors, officers and other management.

Meanwhile, directors, officers and employees should observe the following guidelines:

- Do not trade when aware that a material event or trend is developing or will occur but is not yet ripe for disclosure.
- Do not selectively disclose material nonpublic information to others.
- Trade only in "window periods" in compliance with any internal procedures, after all important corporate developments have been disclosed to the market.
- Trade pursuant to a Rule 10b5-1 plan (see Section 6.3).

Sarbanes-Oxley provisions: The Sarbanes-Oxley Act enhanced the SEC's enforcement powers, expanded areas of personal exposure for directors and executive officers and created new criminal provisions. These provisions include:

- giving the SEC the authority to freeze possible "extraordinary payments" to directors, officers, agents and employees during the course of an investigation involving "possible" violations of the federal securities laws;
- mandating forfeiture of certain CEO and CFO bonuses and profits in connection with restatements;
- giving the SEC the authority to seek equitable relief for the benefit of

investors, which it has invoked to seek disgorgement of all compensation received after alleged occurrence of fraud, not just bonuses and incentive compensation;

- giving the SEC the authority to bar persons from serving as directors or officers of public companies in cease and desist proceedings; and
- creating civil and criminal penalties for false certifications by officers of periodic reports.

Corporate compliance programs: A corporate compliance program is a written and operational commitment to company-wide compliance with all applicable laws. A compliance program protects the company and management in three major ways:

- It reduces the chance that employees will engage in criminal misconduct.
- If employees do break the law, it can help mitigate the consequences for the company. The U.S. Department of Justice, the SEC and many other agencies are more lenient on companies with effective compliance programs when making charging decisions and assessing penalties.
- It establishes behavioral and professional expectations for employees, allowing the company to set standards in advance and facilitating termination of employees for misconduct when rules are not followed.

8.2 Class action and derivative lawsuits

Marsh

Imagine the shock if the newly public company were to be served with a federal securities class action lawsuit within three days following the IPO. This happened to a significant new issuer in 2012. In fact, most securities claims are filed within three years of an IPO and there is a significantly higher probability that a securities class action will arise if an IPO is involved. As such, when managing risk in a newly public company, it is critical to understand the primary civil liability exposures faced by directors and officers.

Direct class actions: The primary exposure for directors and officers of U.S.-listed companies continues to come from federal

securities laws—in particular, sections of the Securities Act, the Exchange Act and SOX. Claims made against directors and officers under these statutes are frequently brought as class action litigation, where damage awards and settlement proceeds go directly to shareholders allegedly harmed. There are also statutes that may have industry-specific application.

The Securities Act is designed to prevent fraud in securities offerings and to assure that investors receive full disclosure in connection with the offer and sale of securities by the company. As such, the Act imposes a high standard of conduct on directors and officers of the company. Section 11(a) of the Act states that a person who purchased a security covered by a registration statement (e.g., an IPO and secondary public offering of equity or debt) may recover damages from, among others, the company and its directors and officers who sign the registration statement if the registration statement:

- contained a misstatement of material fact; or
- omitted to state a material fact that either was required to be stated or was necessary in order for the registration statement not to be misleading (this includes anyone who has consented to be a director of the company and is named as a director in the registration statement, not just those who have signed the registration statement)

While the company is strictly liable for violations of Section 11, directors and officers may avoid liability if they are successful in establishing their own defense. If the misstatement or omission occurred in a part of the registration statement not passed upon by an expert (e.g., an auditor's report), the director or officer must demonstrate that he or she had, after reasonable investigation, sufficient grounds to believe that the disclosure statements were true or that material statements were not omitted. If the misstatement or omission occurred in a part of the registration statement passed upon by an expert, a director or officer need only show that he or she had no reasonable grounds to believe that that portion was materially untrue or omitted

to state a material fact. There is no requirement under Section 11 to show that directors and officers intended to defraud investors.

A series of related court decisions have been the subject of controversy and discussion related to whether a directors and officers (D&O) liability insurance policy covers certain losses as a result of violations of Section 11 (Level 3 Communications, Inc v Federal Insurance Co, 272 F3d 908 (7th Cir 2001); Consec, Inc v National Union Fire Insurance Company, Case No 49D130202CP000348, Marion Circuit Court, Marion County, Indiana (December 31 2002)). Taken together, the decisions have generally been interpreted by some practitioners of D&O liability to distinguish between coverage for the company (or issuer) and coverage for individual directors and officers. D&O insurance coverage for individual defendant officers and directors is generally viewed not to be endangered by these decisions; however, the effect of the collective decisions may affect the nature and breadth of D&O insurance coverage afforded to the company, and modifications to such coverage may be appropriate to assure affirmative coverage for potential violations of Sections 11 and 12.

A related but separate issue is whether D&O insurance policies should also include affirmative coverage for violations of Section 15 of the Securities Act. Section 15 provides that any person who is deemed to control any person found liable under Section 11 or 12 will share liability for the damages imposed on the controlled person. Companies undergoing an initial public offering might seek such affirmative coverage, particularly companies whose directors and officers might be deemed to be control persons following the IPO.

Turning to the Exchange Act, the objective of this legislation is to increase the information available to public company investors through the implementation of disclosure requirements and to prevent unfair practices in U.S. securities markets. As discussed earlier, Rule 10b-5 has broad application and includes statements or omissions in the company's Exchange Act filings (e.g., Forms 10-K, 10-Q and 8-K). The rule prohibits any practice

to defraud investors, including making any untrue statement of material fact or omitting a material fact in the company's filings. Actions may be brought against the company and/or its officers or directors by private parties, the SEC or the Department of Justice. In general, Rule 10b-5 liability is broader than Section 11 liability as applied to the directors and officers of the company. Moreover, plaintiffs' lawyers must demonstrate "scienter," which is an intention by a defendant director or officer to defraud.

Shareholder derivative suits: Another frequent source of potential liability and expense is what is commonly called a "derivative suit." These are lawsuits brought by shareholders on behalf of the company against individual directors and officers and typically allege violations of state and common law fiduciary duties owed to the company or other wrongdoing. Most shareholder derivative suits are resolved through payment of fees to plaintiff's counsel and by the company's adoption of certain corporate governance and management reforms negotiated between the company and the plaintiffs, the purposes of which are to strengthen protections for investors and enhance shareholder value.

Until recently, derivative actions had rarely resulted in substantial monetary recoveries. But within the last four years there have been a number of derivative actions with settlements exceeding \$50 million. When monetary settlements or damages are involved, such awards generally go to the benefit of the company itself and not directly to shareholders. Shareholder derivative lawsuits, which have been increasing in frequency, usually settle in tandem with outstanding class action litigation and are often called "companion" or "tagalong" cases. These suits are now often brought in multiple jurisdictions and can sometimes involve inconsistent outcomes (In Re Oracle Corp Derivative Litigation, 2003 WL 21396449 (Del Ch June 17 2003)).

Two common bases of liability in shareholder derivative actions include violations of the duty of care and the duty of loyalty, discussed in more detail below, but may also include excessive officer compensation, proxy violations, option

plan violations, related party transactions, misappropriation of corporate opportunities and corporate waste:

- **Duty of care**—Directors and officers owe the company and its stockholders a duty of care. They must act on an informed basis and in a manner that they reasonably believe to be in the company’s best interests, exercising the degree of care that an ordinarily prudent person in a similar position would exercise. The duty of care focuses on the decision-making process. When directors or officers are accused of breaching their duty of care, generally the “business judgment rule” shields their decision by presuming that in making the decision, the directors and officers were informed, acted in good faith and honestly believed that the decision was in the best interests of the company and its stockholders. To support application of the business judgment rule, directors and officers generally should be proactive and attentive, regularly attend board meetings, meaningfully evaluate alternatives and deliberate as a board with adequate and complete information. Where appropriate, the board of directors should also consider retaining financial advisors, counsel and other experts to provide input and guidance.
- **Duty of loyalty**—Directors and officers owe the company and its stockholders a duty of loyalty. Again, they must act in good faith and in the reasonable belief that their actions are in the best interests of the company. Loyalty issues arise when a director or officer has a conflict of interest or lacks independence with regard to a particular business decision or personally profits from an opportunity at the expense of the company. In evaluating claims for breaches of the duty of loyalty, courts generally will examine the decision-making process but may also evaluate the substance of the business decision to determine fairness to the company and its stockholders. To help avoid liability, interested directors should disclose potential conflicts and opportunities to other directors and abstain from deliberations and voting on any

decisions where an actual conflict exists and consider abstaining where the appearance of a conflict exists.

Frequency and severity of securities class action suits: The average public company faces a 6.4% probability that it will face a securities class action lawsuit in a given five-year period. And if an IPO is involved, class action lawsuits settlements are on average 35% higher.

It is important to recognize recent trends in securities class action litigation. An understanding of these trends can impact decisions concerning directors and officers liability (D&O) insurance, including limits purchased, coverage selection and premium trends. (Note: The information that follows is taken from *Recent Trends in Securities Class Action Litigation: 2012 Full-Year Review*, a publication by NERA Economic Consulting, a unit of Oliver Wyman Group. Marsh and Oliver Wyman are both wholly owned subsidiaries of Marsh & McLennan Companies.)

In 2012, there were 207 federal securities class action filings, the lowest level since 2007, with a notable slowdown in filings in the second half of 2012. Filings from 2010 to 2012 were driven in large measure by a spike in merger objection suits, which comprised, on average, 28% of

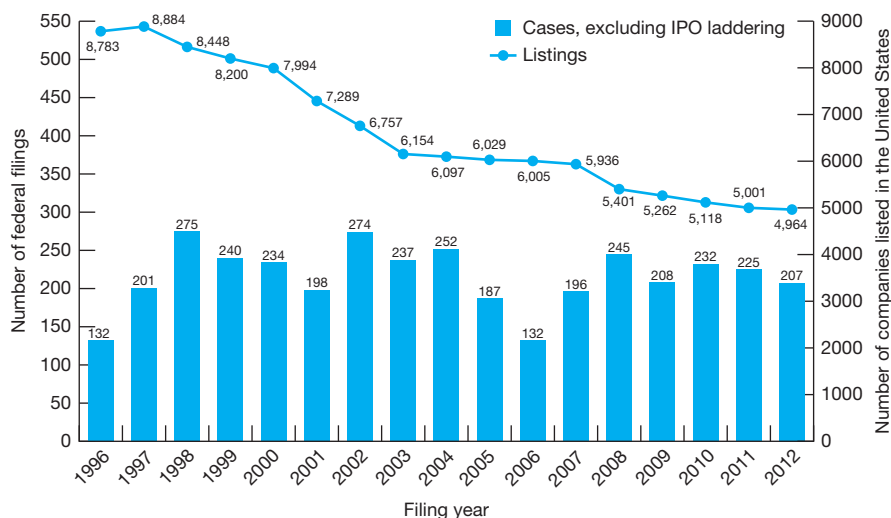
total filings during this period. While the number of filings has fluctuated, the number of publicly listed companies in the United States has continued to decrease. The result is that the average listed company in the United States was 68% more likely to be the target of a securities class action lawsuit in the last five years (2008 to 2012) than it was from 1996 to 2000.

The average cost of resolving these lawsuits has also increased. In 2012, the average settlement value (excluding settlements over \$1 billion) was \$36 million, up from \$35 million from 2007 to 2011. Typically, plaintiffs’ attorneys’ fees and expenses make up approximately one-third of settlement values.

8.3 Indemnification
Marsh

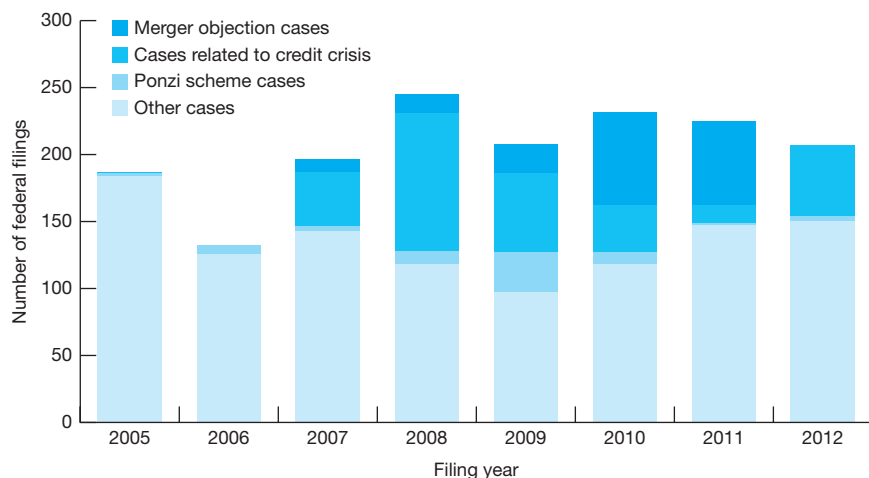
Generally, indemnification of officers and directors is governed by the law of the state of incorporation. All 50 states provide for corporate indemnification and address situations where the company may indemnify its officers and directors and situations where the company must indemnify its officers and directors. To understand when indemnification is permitted by the company, look to the company bylaws or charter.

Federal securities filings and number of companies listed in the United States (January 1996–June 2012)



Note: Number of companies listed in the United States is from Meridian Securities Markets; 1996–2011 values are year-end; 2012 is as of June.

Federal securities filings by type (January 2005–December 2012)



In Delaware, for example, the statute merely authorizes indemnification where not considered mandatory by statute (as further discussed below), meaning a director or officer is not necessarily entitled to indemnification unless the company charter or bylaws contain necessary authorizing language to permit indemnification. Delaware corporations may structure their certificates of incorporation to limit the liability of their directors to situations involving:

- breaches of their duty of loyalty (including improper personal benefit) to the company and its stockholders; and
- acts or omissions not in good faith or that involve intentional misconduct or a knowing violation of the law.

It is important for directors and officers of public and nonpublic companies to seek counsel on and understand the indemnification provisions of company bylaws and/or indemnification agreements to which they will be subject. Review of the provisions and/or agreements should occur not simply prior to an initial public offering, but on a periodic basis as well.

Be mindful of features (or absence of features) in the company bylaws, charter or corporate indemnification agreements that could impair one’s ability to seek indemnification. Two examples of such provisions include:

- a provision that fails to obligate the company to reimburse a director’s or

officer’s claim for costs and expenses for enforcing the company’s obligation to indemnify;

- a provision that forces a director or officer to bear the burden of proof to demonstrate entitlement to indemnification.

Several common questions that arise regarding indemnification follow.

When must the company indemnify its directors and officers? Section 145(c) of the Delaware General Corporation Law requires a corporation to indemnify a director or officer when the person to be indemnified has been successful on the merits with respect to a claim against him or her. In other words, if the director or officer defends the claim on the merits and is vindicated of any wrongdoing, it is mandatory that the company indemnify that individual for the costs and expenses, including attorneys’ fees, incurred in connection with the claim. As a practical note, a recent Delaware Chancery court decision in early 2012 has cast some uncertainty around whether an officer or director has been “successful on the merits” of a claim against him or her (see *Hermelin v. K-V Pharmaceutical Company*, C.A. No. 6936-VCG (Del.Ch. Feb. 7, 2012).

What is the nature of the conduct required for the company to indemnify its directors and officers? Under Section 145(a) of the Delaware General

Corporation Law, a corporation may (but need not) indemnify a director or officer only “if such person acted in good faith and in a manner reasonably believed to be in or not opposed to the best interest of the corporation.” In the criminal context, a director or officer must also have had no reason to believe his or her conduct was unlawful in order to be indemnified. Outside of the mandatory indemnification discussed in the prior paragraph, companies frequently provide broader indemnification protections in recognition that only a small proportion of situations may require a company to indemnify with a larger proportion of situations permitting a company to indemnify.

Even if a director’s or officer’s conduct is of the type that can be indemnified, the company’s ability to indemnify him or her may be limited or prohibited by state statute. For example, the Delaware statute authorizes the company to indemnify directors and officers only for expenses incurred by them in defending shareholder derivative suits brought by or on behalf of the company. The Delaware statute does not authorize indemnification of settlements or judgments in such actions. The rationale is that if the company indemnified the directors or officers for amounts they owed to the company, the result would be a return of funds back from the company, rendering the debt owed to the company meaningless.

To what extent is an individual’s liability limited as a matter of law? The state in which the company is incorporated will determine the extent to which a director’s or officer’s liability to the company is limited as a matter of law. Almost all states have adopted statutes that limit the liability of directors—and, in some instances, officers—under state law. Like Delaware, many states allow companies in their charters to limit or eliminate the personal liability of directors for damages in claims by the company and its shareholders (Section 102(b)(7) of the Delaware General Corporation Law). Notably, the Delaware statute does not eliminate liability for conduct not taken in good faith or for breach of a director’s duty of loyalty.

From whom does a director or officer seek indemnification? In short, it depends.

Indemnification is not self-executing. The company bylaws, charter and any corporate indemnification agreement between a director or officer and the company will determine:

- who evaluates and approves requests for indemnification; and
- whether a director or officer may be indemnified in a particular case and, if so, whether the director or officer may receive an advancement from the company to pay for expenses incurred in connection with the matter.

In the absence of specific provisions related to who evaluates and approves requests for indemnification, the decision is generally made by a majority vote of disinterested (nondefendant) directors, a committee of disinterested (nondefendant) directors or upon the recommendation of independent legal counsel in a written opinion.

If the company is either unwilling or unable to indemnify a director or officer for expenses, damages or settlement amounts, the director or officer may be able to seek payment directly from insurers, depending on the nature and breadth of insurance coverage under insuring agreement A of the company's directors and officers liability insurance policy (commonly called "Side A"). Notably, the ability of a director or officer to seek timely reimbursement directly from insurers may differ significantly, depending on the exact terms, conditions, exclusions and limits that are purchased by the company. Today, most Side A policies are poised to begin responding to a loss on behalf of a director or officer within 60 days if the director or officer has not received a response from his or her company regarding whether it will indemnify the director or officer for the matter in question.

Does the company have to advance the costs and expenses incurred in defending against a claim made against a director or officer? The ability of the company to advance defense costs in a timely manner to its directors and officers can be critical in attracting independent directors because the cost of defending a lawsuit can be immediate and substantial and may directly influence both the nature

and quality of the defense presented by directors and officers.

Rights to advancement are governed under a combination of state law, corporate bylaws and corporate indemnification agreements of the company and are separate and distinct from the obligation of indemnification. For example, a right to advancement of defense costs may be broader and less restrictive than an individual's right to indemnification. Because the determination as to whether an officer's or director's conduct is indemnifiable generally cannot be made until the end of a claim or proceeding, Section 145(e) of the Delaware General Corporation Code permits (but does not require) a corporation to advance defense costs, including attorneys' fees, to defend against a claim for something that, if true, would be an indemnifiable claim; but only if the claimant submits to the company a written undertaking to repay the amounts advanced if it is ultimately determined that he or she is not entitled to indemnification. Specific attention also should be paid to other conditions that may have to be met in order to receive timely advancement.

A note of caution: in light of a 2008 Delaware court decision in *Schoon v Troy Corp* (948 A 2d 1157 (Del Ch 2008)), directors and officers relying on indemnification provisions in company bylaws should understand whether:

- the bylaws include language stating that the rights of directors and officers to advancement of legal expenses vest upon commencement of services;
- these rights are contract rights; and
- the bylaws state that they cannot be amended retroactively to impair those rights.

Although Delaware has since amended its corporations code to reverse the effect of *Schoon v Troy Corp*, it serves to highlight the potential importance for directors and officers to consider separate indemnification agreements with the company that specifically address advancement of expenses, including provisions that prohibit modifications to such an agreement without the written consent of the director or officer.

8.4 D&O liability insurance

Marsh

It is clear that companies and their boards of directors may well face lawsuits at some point. While most boards take their responsibilities seriously and try to execute them properly, that intent does not confer immunity. Shareholders and other stakeholders—often prompted by an aggressive plaintiffs' bar—can be expected to sue when they see themselves as having been wronged. Thus, in addition to doing everything possible to execute their responsibilities properly and effectively, those charged with corporate governance should also protect themselves with D&O insurance.

Most D&O insurance policies for public companies provide financial protection to more than just individual directors and officers. They also afford a significant degree of protection for certain financial obligations of the company. As a result of this dual protection, directors and officers must be aware that, at certain times, their interests and those of the company may diverge, particularly if claims are made that may approach or exceed the shared limits of liability for all the insureds taken as a whole. Directors and officers should understand the basic coverage and limits of their particular policies.

D&O policies are generally written on a "claims-made" basis. Under such policies, the making of a claim against the insured during the term of the policy—not the occurrence of injury or damage—is the operative threshold event to which the policy responds. Some policies also require that the insured report the claim to the insurer within the policy period (or within a brief window of time thereafter).

Most D&O insurance policies have one or more of the following three basic insuring agreements (see chart below):

- Side A: Personal asset protection for officers and directors—Insuring Agreement A, commonly referred to as "Side A," covers a loss incurred by individual directors and officers resulting from claims for which the company has not indemnified them. A director or officer need not pay a retention or deductible in the event Side A insurance proceeds are sought

if the company is unable or unwilling to indemnify the individual director or officer directly.

- Side B: Corporate reimbursement insurance—Insuring Agreement B, also called “Side B,” protects the company against a loss incurred by the company in indemnifying an officer or director for claims made against them. Side B coverage is commonly referred to as balance sheet protection. A deductible or retention applies for claims made under Side B.
- Side C: Corporate coverage against securities claims—Insurance Agreement C, also called “Side C,” protects the company against a loss resulting from securities claims made directly against it. A deductible or retention also applies for claims made under Side C.

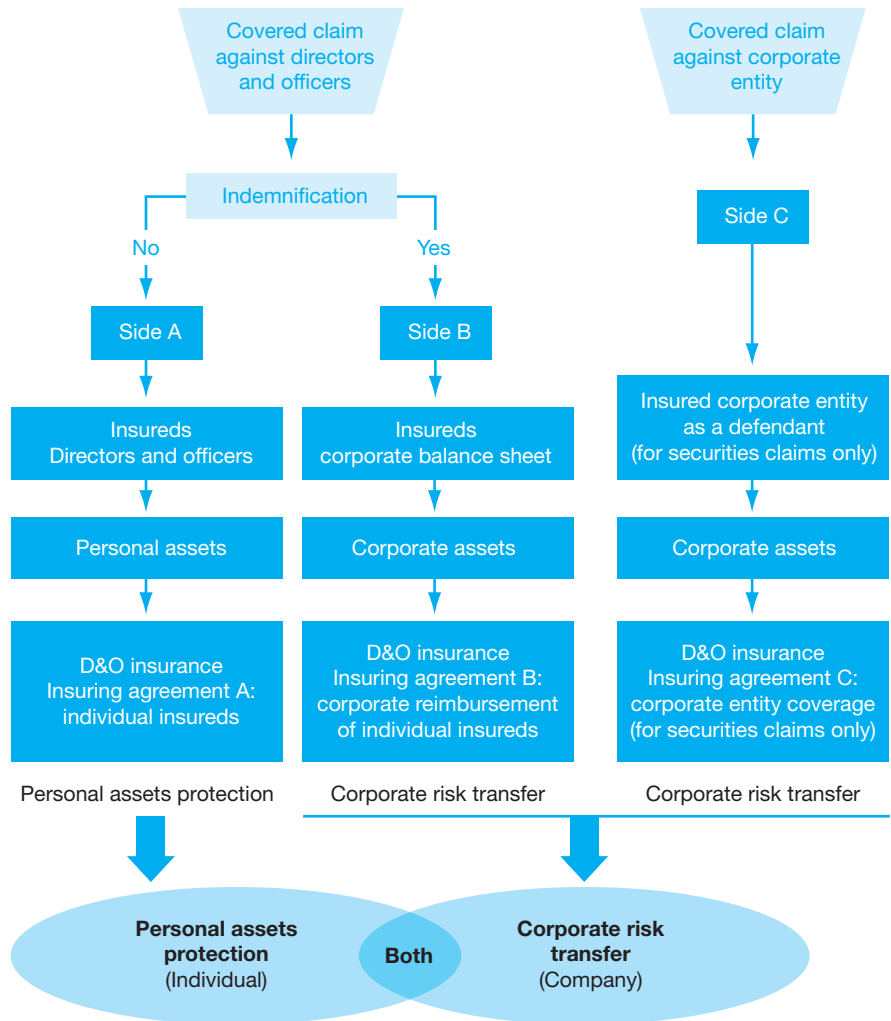
A D&O insurance program can be customized to meet the particular demands of a public company and its officers and directors. Many companies, however, commonly purchase a D&O insurance policy in which a single limit of liability is shared equally among all three insuring agreements. The effect of this is that a single policy limit protects both the personal assets of directors and officers and certain financial obligations of the company. Companies also frequently purchase additional, dedicated limits of Side A coverage, with broad policy terms and conditions, and a DIC or difference in conditions feature (see discussion in (b) D&O Insurance and indemnification). Companies purchase these additional limits for a number of reasons, including considerations related to premium pricing, philosophical predispositions, balance sheet strength and the broader protection afforded individual officers and directors in such Side A policies.

(a) D&O policy provisions

Certain provisions in a D&O policy may affect the extent to which the policy responds favorably. Some of the key concepts are discussed below.

Rescission: Material misrepresentations or nondisclosure of material information in the course of the application process for a D&O insurance policy may result in

What is the structure of the D&O policy post-IPO – typical “ABC” policy example



the insurer seeking the drastic remedy of policy rescission or avoidance. Through rescission, an insurer voids coverage under the policy for all insureds and returns the premium paid by the company. Rescission of an insurance policy by an insurer may result in severe consequences for the company and its directors and officers. A successful rescission results in all or a portion of the D&O insurance policy being null and void and, ultimately, can result in a loss of coverage for all named insureds on the policy, including innocent directors and officers. Certain D&O policies today can be negotiated to make some or all insuring agreements nonrescindable.

Severability of the application: Rescission raises the concept of severability. In this context, severability simply relates to the question of whether the knowledge of one or a limited number of covered officers or directors will be imputed to (and potentially result in a loss of coverage for) all the insureds named in a policy (including the company itself). Severability imposes a limit on the extent to which the knowledge of one individual insured is imputed to the company and other insured individuals. As a result, nearly all D&O insurance policies contain provisions which state that no insured person’s knowledge will be imputed to any other insured and which limit the identified

individuals—usually the CEO and CFO—whose knowledge will be imputed to the company (as an insured itself). As another—and perhaps better—alternative, the company may seek a policy that is not rescindable for any reason. Obtaining a fully nonrescindable policy may involve trade-offs in other coverage or additional premium.

Frequently, the company’s periodic securities filings and financial statements under the Exchange Act and registration statements under the Securities Act are expressly made part of the application for D&O insurance. Claims of inaccurate or incomplete disclosure in such filings incorporated into the application for insurance may be the basis for claims made by insurers that the application was materially false or misleading. As a result, accounting restatements—depending on their nature, scope and magnitude—may provide insurers with an additional basis to rescind a D&O insurance policy.

Conduct exclusion: Almost all D&O policies contain exclusions barring coverage for certain “bad conduct” by directors or officers. Generally, they include:

- intentionally dishonest acts or omissions;
- fraudulent acts or omissions;
- criminal acts;
- willful violations of any statute, rule or law;
- an insured’s obtaining an illegal profit; and
- an insured’s obtaining an illegal remuneration.

From an insured’s perspective, each of these exclusions should be limited as much as possible. For example, as noted above, it is important to consider enhancements to a policy so that the conduct of any one insured director or officer will not be imputed to any other insured. This should limit the exclusion of coverage to the individual directors or officers who actually committed the excluded conduct, while maintaining coverage for other insureds.

It is also important to clarify the point at which coverage exclusions apply or are triggered. Certain policies state that the exclusions apply if the excluded conduct “in fact” occurred.

This can be troublesome because of the ambiguity involved in interpreting what “in fact” actually means. Insureds should consider seeking a more clearly defined parameter for determining when a conduct exclusion may apply. Policies stating that the exclusions apply only if the excluded conduct was established in connection with a “final adjudication” of the underlying claim generally better protect directors and officers. However, although “pure” final adjudication language provides broad protection for individual directors and officers, it could result in the depletion of limits, leaving less in available limits to protect nondefendant directors and officers.

Priority of payment provisions: Unlike many other types of commercial insurance, traditional D&O policies protect two distinct sets of beneficiaries: the company’s individual directors and officers and the company. Because there is a limit of liability for D&O insurance programs, situations may arise in which insurance proceeds may have to be prioritized among the insured parties. Typically, a priority of payments provision requires that the claims against the individual directors and officers be satisfied first, before claims against the company are satisfied.

However, sometimes this provision may have unintended consequences. For example, a situation may arise in which a number of concurrent claims are made against the company and its individual directors and officers. This could include shareholder derivative suits (settlements of which may not be indemnifiable by the company) and securities class actions (settlements of which are indemnifiable). If the securities class action suits are settled before the settlement of the shareholder derivative actions, insurers may delay payment of any proceeds under the policy for a securities claim until settlement of the shareholder derivative action. A delay in such a settlement payment may adversely affect timing or funding of a proposed settlement of such a claim.

“Entity v Insured” exclusion: Many D&O policies contain a so-called entity v insured exclusion, which bars coverage for a claim brought by an insured company against an insured director or officer or

another insured corporate entity. This exclusion has historically been broader than it is today, so many of the concerns about the overreaching nature of this exclusion have been eliminated. However, there remain certain exceptions to this exclusion that should be considered, most of which relate to situations in which a company finds itself in insolvency or bankruptcy.

(b) D&O insurance and indemnification

Directors and officers no doubt find it especially troubling when the company is financially able to indemnify or advance defense costs to them but chooses not to or simply ignores their requests. Many directors and officers assume that in such a circumstance, the company’s D&O insurance policy would respond. But that might not be the case. In a traditional D&O policy, if the company is permitted to indemnify an officer or director but chooses not to, the insurer often will first seek the application of a “self-insured retention” (in other words, a deductible) that under ordinary circumstances would not apply. This is sometimes called a “presumptive indemnification” requirement. Under this circumstance, the self-insured retention would have to be paid by an officer or director prior to accessing any proceeds of a D&O policy. In some cases, the self-insured retention may be substantial. Directors and officers should seek clarification from their insurance brokers and counsel on the extent to which their D&O insurance policies allow directors and officers to access the policy proceeds in the event the company is able but unwilling to indemnify or advance defense costs to them. In fact, most traditional primary D&O policies, similar to Side A D&O policies, are now responding to a loss on behalf of a director or officer within 60 days if the director or officer has not received a response from his or her company regarding whether it will indemnify the director or officer for the matter in question. This has significantly reduced the punitive aspect of presumptive indemnification.

A properly constructed D&O policy generally is meant to provide a level of protection for individual directors and officers in the event the company’s indemnification or advancement obligation

inadequately protects them. Outlined below are some specific circumstances where an individual officer or director may expect such protection.

Derivative suit judgments or settlements:

The ability of the company to indemnify its officers and directors for judgments or settlements resulting from a shareholder derivative action may be significantly limited or prohibited by statute in a company's state of incorporation. For example, Delaware generally does not allow indemnification of settlements or judgments in an action brought by or on behalf of the company unless the court permits such action. In such circumstances, Side A coverage may apply as long as the conduct of individual directors and officers also complies with the limitations and exclusions of the insurance policy.

Public policy prohibition against indemnification:

Indemnification for claims related to registration of securities and antifraud provisions of the federal securities laws (and other federal statutes, such as the Racketeer Influenced and Corrupt Organizations Act and antitrust laws) may be precluded by public policy. The SEC's view is that such indemnification is against public policy because it undermines the securities laws' deterrent effect. However, the SEC does not regard the maintenance of D&O insurance as against public policy, even where the company pays the premium. As a result, it may be possible for insurance to respond to protect individual directors and officers in such circumstances where indemnification from the company is prohibited as a matter of public policy.

Conduct not in "good faith" and "reasonable belief":

The company may indemnify a director or officer only if such person acted in good faith and in a manner that he or she reasonably believed to be in, or not opposed to, the best interests of the company. As a result, acts that do not satisfy the "good faith" and "reasonable belief" standard may not be indemnified by the company. In such circumstances, claims made against an individual director or officer may be insurable so long as the

conduct of such individual also complies with the limitations and exclusions of the insurance policy.

Refusal by board to indemnify: If the board or other authorized designee either declines in writing to indemnify an individual or fails to make or initiate a determination to indemnify an individual, insurance may respond to protect individual directors and officers, but it may be subject to a retention or deductible depending on the structure of the program.

To avoid a circumstance where an individual insured might be personally responsible to pay a retention, many public companies today purchase a variation of Side A insurance often referred to as Side A DIC (the "DIC" refers to the "difference in conditions" provisions that are contained in this type of insurance policy). Side A DIC insurance provides broader coverage and is often purchased in addition to and in excess of the traditional D&O (Sides A, B and C) insurance described above. In a circumstance where the board or other authorized designee declines to indemnify an individual as described above, Side A DIC insurance could be called upon to provide directors and officers coverage at the primary level of the program (no retention).

Near insolvency: Should the company approach insolvency, it will approach the "zone of insolvency," where officers and directors may be deemed to owe certain fiduciary duties to creditors of the company. Although not yet insolvent, the company might choose not to indemnify a particular director or officer for fear that such act may be a breach of fiduciary duty owed to creditors of the company or may be the subject of an order by a bankruptcy trustee to return those proceeds. Insurance may respond if limits of the policy are not otherwise eroded.

Actual insolvency or bankruptcy: The company either may be insolvent or, in the context of U.S. bankruptcy laws, may be unable or unwilling to indemnify an officer or director if the bankruptcy trustee determines that such indemnification is

either unwarranted or improper. Moreover, assuming that such indemnification of an officer or director was warranted and proper, the proceeds of the policy might be deemed an asset of the "estate" and subject to an automatic stay. The obligation to indemnify may be deemed an unsecured obligation, placing the affected officer's or director's interest behind the interests of secured creditors and on par with other unsecured creditors awaiting payment or settlement.

If there is some risk that the company may avail itself of the protection of U.S. bankruptcy laws, it may be useful to seek an explanation from the company's insurance advisor and counsel as to how the company's D&O insurance policy may respond to a number of potential issues. Key issues to understand would include identifying any issues related to:

- how limits in the policy are either allocated or prioritized to coverage other than coverage of claims made against a director's or officer's personal assets;
- whether the design of the company's D&O insurance program is such that directors or officers will not be subject to a retention or deductible if the company is permitted to but fails to indemnify such an individual; and
- what—if any—language exists in the policy to waive an automatic stay as regards the company's policy.

Choosing a D&O policy structure, limits, retention and insurers:

The company should consider several questions before selecting the limits and structure of its D&O policy, including the following:

- How susceptible is the company to a class action lawsuit or government enforcement action?
- If the company suffers a class action lawsuit, what might it cost to defend and settle?
- What limits, structures and retentions do the company's peers purchase?
- How can the balance between coverage, limit, retention and price be optimized?
- What is the overall financial stability of each insurer on the program?
- How can the program most cost-effectively address exposure for foreign directors and officers?

Constructing a D&O liability program leading into an IPO is a dynamic process. The goal is to understand the choices and trade-offs and to achieve an optimal balance that properly reflects the values of the company and its directors and officers. For example, many companies purchase policies that protect both the company and the individual directors and officers for nonindemnifiable claims. This structure involves a shared limit of liability that protects the company and its directors and officers. If a very large claim is made against the company, it may exhaust the limits made available to individual directors and officers. One potential solution is to purchase additional limits of coverage dedicated solely to protect individual directors and officers. Alternatively, dedicated coverage may also be purchased solely for independent directors of the board, excluding nonindependent board members and officers.

Selecting an appropriate level of limits is now more science than art. Peer benchmarking data is only one element to consider in choosing the right amount of insurance and retention. Analysis of a particular company's susceptibility to securities class actions and projections of realistic settlement amounts can provide greater confidence in limit decisions.

Turbulence affecting the financial condition of insurers several years ago has raised concerns regarding insurer stability, making the decisions on which insurers to partner with more challenging. An in-depth comparative analysis of an insurer's creditworthiness and financial strength is a precursor to an assessment of the company's counterparty risk. Just as important is the ongoing monitoring of the financial condition of the company's partner insurers.

One of the more complex and evolving areas of D&O coverage involves subsidiaries located outside the United States. It is important to understand the tax, regulatory and coverage issues associated with D&O exposures outside the United States to ascertain whether exposure exists. There are a number of solutions to address such exposure, depending on location and magnitude, some of which may impact the company's choice of primary insurer.

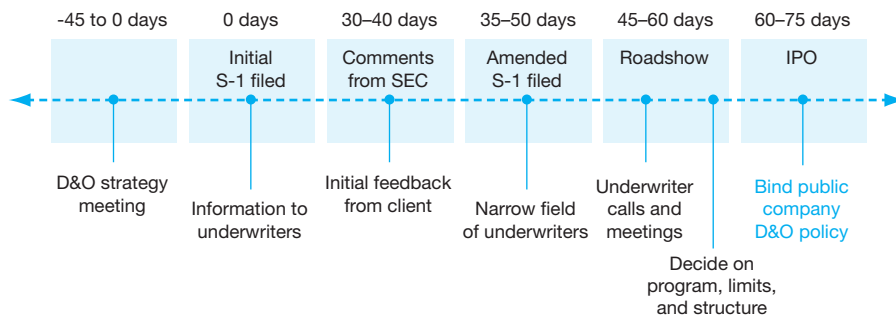
(c) Timing the D&O liability insurance purchase for an IPO

A D&O policy for a newly public company generally becomes effective on the date the company's registration statement covering the traded securities becomes effective. The process and timeline leading up to the commencement of the policy period differ depending on the situation and can be tailored to meet the specific needs of the company. The following is a suggested timeline for meeting key milestones in the process of obtaining D&O coverage.

D&O strategy meeting: In the month leading into filing of Form S-1, it is recommended that the company meet with its insurance brokers and outside counsel, if needed, to strategize on D&O program design options, selection of carriers, coverage issues, limit analysis, timeline and cost. Being beneficiaries of D&O insurance, the entire board of directors or certain key members may need to be engaged.

Filing of Form S-1: Once the company's registration statement is filed, a submission can be made to the underwriters, which would include the draft Form S-1. Given the passage of the JOBS Act in 2012, a draft registration statement might be filed confidentially with the SEC. In such event, additional time and consideration should be given to obtaining nondisclosure agreements with insurers from which a company wishes to solicit a quote. The submission, combined with calls and/or face-to-face meetings with the underwriters, will allow the insurers to assess the company's D&O risk profile.

Timeline



Meetings with underwriters: It is generally expected that senior representatives of the company will meet with the underwriters, either in person or by teleconference, before a premium quotation will be given for a D&O policy. It is an opportunity for the insurers to better understand the company's financial and operating condition and its prospects and to speak directly with management about corporate governance issues and concerns. These meetings typically take place during the roadshow detailed in Chapter 3.

Analysis: Once quotes have been submitted to the insurers, insurance advisors—sometimes working in concert with outside counsel—provide the company's management and/or board with detailed comparative analysis to allow the company to ultimately make a number of decisions on the nature of its D&O program, including the appropriate structure, limits, retentions, coverage and insurers.

Binding of insurance: Once decisions have been made by the company, insurance advisors will execute those decisions to build the D&O program and bind the insurers in time for the effectiveness of the registration statement.

8.5 Personal risk management

Marsh

An IPO will certainly have an impact on your professional life, but it will also have a considerable effect on your personal lifestyle. The complexity of a high net worth lifestyle requires a new way of thinking about risk and

customized solutions to help address it. Many ultrawealthy individuals and families find they benefit by working with a personal risk manager that can provide comprehensive resources to properly align protection for their property, liability, family and lifestyle. And because you and your company will now be more prominent, it is imperative to have total coordination between your business estate plans.

(a) Protecting yourself and your assets

Personal liability: Entertaining guests at your home, letting your teenage child drive your car and serving on a board of directors are among everyday activities that can expose you to legal liability. Your increased public prominence may lead some to believe you have “deep pockets,” making you a target for expensive lawsuits.

A personal excess liability insurance policy is designed to protect against multimillion-dollar settlements resulting from personal injury, bodily injury or property damage lawsuits. Consider a recent example, in which the teenage son of a wealthy business owner was involved in an automobile accident with a bicyclist. Although there was no indication that the driver acted irresponsibly, the court awarded a \$20 million judgment to the bicyclist. The insured carried only \$5 million in excess liability insurance, meaning his family’s financial situation may be severely harmed for years to come. Consulting with a personal risk management expert can help you set appropriate liability limits for your lifestyle.

Personal property: As you acquire wealth, it’s likely you will acquire high-end property and assets. Key areas of risk to consider include the following:

- Homeowners—High-value homes are often built with unique materials and features. Not all insurance policies provide for appropriate replacement costs in their loss settlement provisions.
- Automobiles—Luxury, exotic or collector vehicles may require specialized insurance.

- Valuables—Most standard insurance policies have low dollar limitations for loss of high-value items such as jewelry, art and other collectibles.

Specialized coverage can help properly protect these assets and investments.

Benefits of a broker: When wealthy individuals accumulate new property and nonliquid assets, protection for each is often purchased as needed with a local agent. However, working with various agents or brokers in different states can lead to gaps or overlaps in coverage. Additionally, the distinctive aspects of high-value items can require specialized solutions that often are not available through local agents. By working with a broker that specializes in addressing the risks associated with the high net worth lifestyle, you will benefit from expertise, comprehensive coverage, innovative solutions and access to broad, customized coverage.

Protecting yourself and your business:

There’s no doubt that you are now looking to the future with the anticipation that your business and family will long benefit from all of your hard work. Now is the time, however, to consider the effects that events beyond your control—such as death and disability—may have on your business. It is critical to evaluate the risks inherent in your business and in your estate plan. Coordination of the two will help protect the business and ensure continuity of the legacy you have created.

Wealth transfer: It is important to evaluate the IPO’s impact on your estate plan, including the risks in transferring wealth to succeeding generations. Those potential risks can include:

- significant taxes at your death; and/or
- unwise dissipation by heirs, their divorcing spouses and creditors.

Properly drafted and executed wills and trusts can protect your assets from taxes and creditors. Many wealthy individuals choose to fund trusts with assets as well as with life insurance. Owned by a trust outside the estate, life insurance has the

potential to supply an income-tax-free benefit to the trust free of estate tax. Careful planning in this manner with your tax and/or legal advisors can allow wealth and assets you’ve created to pass to your family intact.

Key person: You may be the “brains behind the business,” but you also may have irreplaceable employees. If something unexpected happened to a key employee, would your business suffer? Key person insurance helps you cover additional costs when such a situation arises. You even may be able to combine protection for your business with an agreement designed to reward a vital employee for continued employment.

These are just some of the concerns that may arise as a result of your new wealth. Again, you may benefit greatly by working with a personal risk manager to design the right protection for your family and your business.

8.6 Managing compliance risk

NYSE Governance Services

Compliance and ethics programs are designed to prevent and address corporate risk—such as SEC enforcement actions and other government prosecutions against directors, officers and other employees of public companies in connection with regulatory violations. In order to minimize the risk of these lawsuits and enforcement actions, it is in the interest of the company, its board and its management to design and maintain robust controls and procedures designed to prevent misconduct and ensure regulatory compliance. A corporate ethics and compliance program is a written and operational commitment to company-wide compliance with all applicable laws and, therefore, provides protection to the company and management in three major ways:

- It reduces the chance that employees will engage in criminal misconduct.
- If employees do break the law, it can help mitigate the consequences for the company. The DOJ, the SEC, and many other agencies are more lenient on companies with effective ethics and

compliance programs when making charging decisions and assessing penalties.

- It establishes behavioral and professional expectations for employees, allowing the company to set standards in advance and facilitating termination of employees for misconduct when rules are not followed.

Assuming a corporate ethics and compliance program exists, an organization must still perform incremental compliance activities, as risks can and do change over time. Engaging in an ethics and compliance risk assessment is one way a company is able to analyze the effect that ever-changing risks have on the organization, prioritize these risks and develop options and actions to reduce the threat they pose.

Organizations often confuse an ethics and compliance risk assessment with a general corporate-wide risk assessment and are uncertain as to the scope, frequency and structure of such an assessment. As an increasing number of organizations have begun to institute ethics and compliance risk assessments, leading practices have started to emerge. They are as follows:

- Examine all major areas of misconduct—A common mistake organizations make when conducting an ethics and compliance risk assessment is to limit the potential risk universe to a preconceived list of likely high-impact risks. Rather, a proper ethics and compliance risk assessment encompasses all potential risks, including both those that are systemic to the average organization and those that are unique to the industry in which the specific organization operates.
- Examine risk contextually—To be effective, the ethics and compliance risk assessment must take into account the ability of the organization to plan for, prevent or mitigate each risk area. This focus entails examining the controls, processes and procedures designed to prevent compliance failures, as well as assessing the effectiveness of the individuals in

positions of substantial authority in recognizing and preventing a compliance breakdown.

- Address current and potential risks—An effective ethics and compliance risk assessment should take into consideration risks that presently exist, as well as those activities that are currently legal but could reasonably be called into question in the future.
- Review internal and external information—Ethics and compliance risk assessments should include an examination of internal corporate documents, as well as industry information and historical incidence reports. To be adequately predictive, the ethics and compliance risk assessment should include not only compliance breakdowns and failures but also near-misses.
- Include participants from all levels of the organization—When collecting and assessing potential risk areas, ethics and compliance risk assessments should involve personnel across various disciplines and seniority levels. This can be accomplished through workshops, focus groups, surveys and interviews.
- Consider impact and likelihood of occurrence—Ethics and compliance risk assessments should weigh risk areas to account for impact and likelihood of occurrence. By assigning quantifiable weights or ratings to each relevant risk area, organizations will be able to rank them appropriately.
- Document the outcome—The outcome of the ethics and compliance risk assessment should be documented in a defensible action plan. This plan should include not only a description of the process that was followed but also the actions that were taken to design, implement or modify the compliance program.
- Be defensively objective—The ethics and compliance risk assessment process should fairly assess the full universe of the organization’s potential risks, including existing acceptable industry practices. Resist the temptation to ignore or deemphasize risks because they could be costly to

address from a financial or internal political perspective.

- Quantify each risk area—The ethics and compliance risk assessment process should allow for quantification of each risk area. An assessment that goes beyond “likelihood” and “impact” can be more useful in prioritizing compliance budget spending and activities, as well as in justifying any incremental controls, policies, processes or spending that must be implemented. Furthermore, if executed correctly, such quantification can be used to measure program effectiveness, a U.S. Federal Sentencing Guidelines criterion of an effective ethics and compliance program.
- Conduct ethics and compliance risk assessments periodically—The frequency with which an organization chooses to conduct ethics and compliance risk assessments and schedule follow-up risk reviews may depend on the nature of the organization’s industry. However, if the methodology and process is adequately defined, it can reasonably be conducted on an annual basis, and year-over-year results can be appropriately compared. Since operating environments, regulations and government enforcement priorities routinely change, it is inadvisable to conduct ethics and compliance risk assessments on a less frequent basis than every two years.
- Measure employee knowledge—The ethics and compliance risk assessment should include a measurement of employee knowledge, as well as awareness of the compliance program and supporting controls. Doing so can help pinpoint where training and communications programs need to be improved.
- Benchmark—When possible, the ethics and compliance risk assessment should benchmark against peer organizations. In addition to industry peers, consider those organizations that are peers in terms of size and geographic scope. This is particularly important as it ensures that the organization meets

“accepted or applicable industry practice,” as outlined in the FSG.

- Coordinate with internal analysts—It is helpful to coordinate ethics and compliance risk assessments with internal audits. Completing an ethics and compliance risk assessment aligns company focus and resources to address areas of greatest significance to the organization and allows the auditor to design a program that tests the most important internal controls.

At the end of the risk assessment process, an organization should be armed with extensive documentation of identified and prioritized risk areas. Failing to act upon this information could subject an organization to exposure in the event the information is disclosed during litigation or in connection with a government investigation. Therefore, with this information in mind, the organization should revise its compliance program, review its code of conduct, modify its training plan, shape its compliance communication program and appropriately staff its ethics and compliance department. •

9

Foreign private issuers

9.1 American depositary receipts

J.P. Morgan (Depositary Receipts Group)

The tranche of shares that foreign issuers sell to U.S. investors when going public typically takes the form of American depositary shares, commonly known as ADRs. These instruments subsequently trade just like ordinary shares on the NYSE, another U.S. stock exchange or in the over-the-counter market.

(a) Advantages for issuers

For foreign issuers, going public in the United States has numerous advantages beyond an initial capital raising.

Ready access to world’s largest equity market: A U.S. listing affords ready access to the world’s largest equity market, facilitating future capital raising through follow-on, secondary and rights offerings.

Diversification of shareholder base and valuation support: By going public in the United States and maintaining a listing there, U.S. investors can more easily invest in a foreign issuer. For some foreign issuers, a U.S. listing results in higher corporate governance standards, further increasing its appeal. Attracting U.S. investors helps broaden and diversify a foreign issuer’s shareholder base, reducing the issuer’s dependence on investors in its home market for its capital needs. Moreover, the incremental demand that U.S. investors can bring to bear on a foreign issuer’s shares helps drive its market valuation—and hence lowers its cost of capital—over the long term.

U.S. acquisition currency: Because the ADRs used to raise capital in the United States are dollar denominated, they can eventually be used to make stock-based acquisitions of U.S. companies. Generally, U.S. shareholders are more likely to accept ADRs than foreign shares.

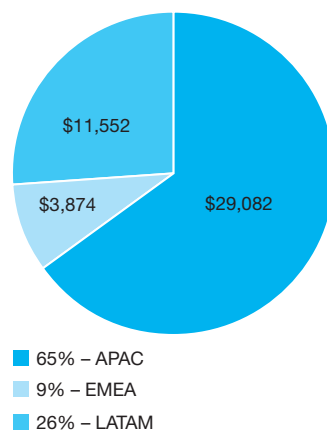
Stock-based compensation for U.S. employees: Being dollar denominated, ADRs allow foreign issuers to establish stock purchase and option plans for U.S.-based employees. Absent these plans,

foreign issuers can be at a significant disadvantage when competing for talent in the U.S. labor market. ADRs also allow for the creation of direct purchase and dividend reinvestment plans, which can enhance the investment appeal of a foreign issuer.

Enhanced corporate visibility in the United States: Finally, by going public in the United States, a foreign issuer can increase its visibility not just in the U.S. investment community, but in the commercial and consumer markets that make up the world’s largest economy. Many U.S. citizens own equities and tend to follow publicly traded companies. Consequently, a U.S. listing can raise a foreign issuer’s corporate profile as well as capital.

The effectiveness of ADRs is why 162 foreign issuers have used this instrument to raise over \$44 billion in capital (IPOs only) in the United States during the past decade alone.¹ As of December 31, 2012, 262 foreign issuers had ADRs listed on the NYSE.¹

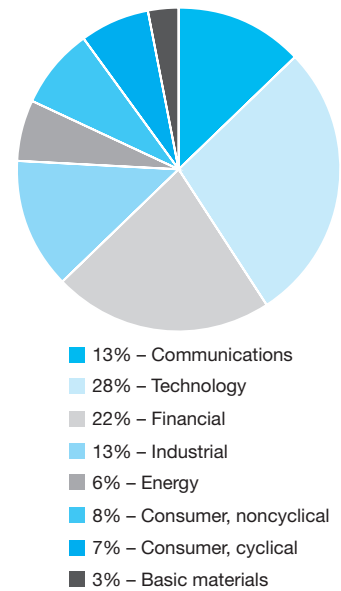
Capital raised using ADRs, by region—2002 to 2012 (\$MM)



Source: J.P. Morgan, Bloomberg, other depositary banks, stock exchanges, January 2013

¹Source: J.P. Morgan, Bloomberg, other depositary banks, stock exchanges, January 2013.

Capital raised using ADRs, by sector—2002 to 2012



Source: J.P. Morgan, Bloomberg, other depositary banks, stock exchanges, January 2013

(b) Advantages for investors

The effectiveness of ADRs for raising capital in the United States is due to their appeal to investors—these instruments are a convenient way to directly invest in international companies while avoiding many of the risks typically associated with securities held in other countries. For U.S. investors, ADRs:

- are easier to purchase and hold than a foreign issuer’s underlying ordinary shares;
- trade easily and conveniently in U.S. dollars and settle through established clearinghouses;
- pay dividends in U.S. dollars;
- eliminate local custody arrangements; and
- provide notifications of corporate actions in English.

(c) Establishing an ADR program

ADR structures: A Level III ADR program listed on the NYSE (or on another U.S. stock exchange) allows a foreign issuer to realize all of the aforementioned benefits of ADRs, including raising capital from

individual investors. Alternatively, capital can be raised from qualified institutional investors only via a private placement, known as a Rule 144A offering.

A Level II ADR program allows a foreign issuer to list on a U.S. stock exchange, but not raise capital. Under a Level I program, the ADRs are not listed, trading instead in the over-the-counter market.

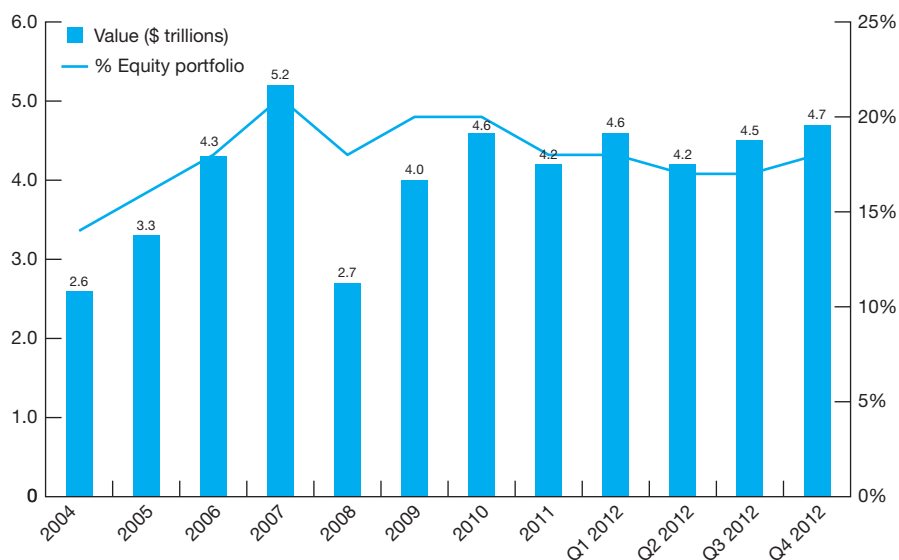
How ADRs are created: ADRs are normally created when the shares of a foreign issuer—either those currently trading in its local market or newly issued shares in connection with an offering of securities—are deposited with a depository bank’s custodian in the issuer’s home market. The depository then issues to investors ADRs representing those shares. At any time thereafter, an investor can sell these ADRs in the secondary market (e.g., the NYSE) or have the sponsoring depository bank cancel the ADRs and receive the underlying ordinary shares that can be sold in the foreign issuer’s local market.

Setting up an ADR program: Once a foreign issuer has chosen an ADR structure, it will work closely with a depository bank to establish and maintain the ADR program. Time frames and requirements for launching a program will vary. However, certain characteristics are common to any ADR structure.

Setting the ADR-to-share ratio: Each ADR issued will represent a certain number of underlying ordinary shares held in custody in the foreign issuer’s home market. There is no official rule for setting the ratio for ADRs. However, the share prices of sector peers should be taken into consideration in order to establish a ratio that will result in an initial price per ADR that investors will perceive to be “attractive.”

The ratio initially selected may affect the transaction costs that a foreign issuer’s investors will pay. For instance, since fees for issuance (and cancellation) are assessed in cents per ADR, an ADR that is priced “too low” can add incremental transaction costs for investors.

U.S. investment in foreign equities



Source: Federal Reserve, March 2013

Parties that work with the foreign issuer:

Establishing an ADR program requires close coordination between the foreign issuer, its chosen depository bank and each firm’s legal counsel. When raising capital in the United States, the issuer also relies on other advisors, such as accountants, investment bankers and investor relations firms. The chart on page 100 summarizes the roles and responsibilities of each party involved. On page 101 is a sample timetable for the establishment of a Level III ADR program.

The deposit agreement: As a first step toward establishing an ADR program, the foreign issuer and its chosen depository bank negotiate a deposit agreement. This contract details the legal relationship and obligations of the depository bank and the issuer, describes the services the depository and issuer will provide and sets forth the rights of ADR holders and the fees they must pay the depository bank. Some terms are standard, but deposit agreement provisions may vary from program to program depending on the legal requirements of the foreign issuer’s home market, the objectives of the depository bank and individual issuer specifications.

The deposit agreement includes provisions relating to the following:

- deposit of the issuer’s shares;
- execution and delivery of the ADRs;
- issuance of additional shares by the issuer in compliance with applicable securities laws;
- transfer and surrender of the ADRs;
- setting of record dates by the depository;
- voting of the foreign issuer’s underlying shares (i.e., the shares evidenced by the ADRs);
- obligations and rights of the depository bank and the holders of the ADRs;
- distribution by the depository of cash dividends, stock dividends, rights to acquire additional shares of the issuer and other distributions made by the issuer;
- circumstances in which reports and proxies are to be made available to ADR holders;
- tax obligations of depository receipt holders;
- fees and expenses to be incurred by the issuer, the depository and ADR holders;
- prerelease of ADRs; and
- protections for the depository and the issuer (i.e., limitations on liabilities)

SEC registration: As a U.S.-listed company, a foreign issuer must comply with the registration provisions and continued reporting requirements of the Securities Exchange Act, as amended, as well as certain registration provisions of this act. For more information about the SEC registration and reporting requirements, please refer to Chapter 5.

Establishing an ADR program: roles and responsibilities of foreign issuer, depositary bank and other parties

Custodian

- Receive local shares in issuer’s home country.
- Confirm deposit of underlying shares.
- Hold shares in custody for the account of depositary in the home market.

Depositary

- Provide advice/perspective on type of program, exchange or market on which to list or quote.
- Advise on ratio of depositary shares to ordinary shares.
- Appoint custodian.
- File Form F-6 if Level one, 2 or 3 program.
- Review draft registration statement or offering memorandum, depending on type of program to be established.
- Coordinate with all partners to complete program implementation steps on schedule.
- Coordinate with legal counsel on Deposit Agreement and securities law matters.
- Prepare and issue certificates and/or direct registration statements.
- Announce DR program to market (brokers, traders, media, retail/ institutional investors via news releases and internet.

Issuer

- Provide depositary and custodian with notices of dividends, rights offerings and other corporate actions, including notices of annual and special shareholder meetings.
- Ongoing compliance with stock exchange and SEC regulations, including disclosure and reporting (coordinating with legal counsel/accountants).
- Executes U.S. focused investor relations plan.

Legal counsel (depositary’s and issuer’s)

- Prepare draft deposit agreement (depositary bank’s counsel) and file required registration statements with the SEC.
- Manage compliance with U.S. securities laws, rules and regulations and perfect any securities law exemptions (if Rule 144A/Reg S program) (issuer counsel).

Accountants (Level II/III ADRs only)

- Prepare issuer’s financial statements in accordance with, or reconcile to, U.S. GAAP or accepted IFRS standard.
- Review registration statement or offering circular and provide requisite opinions.

Investor relations advisor/firm

- Develop long-term plan to raise awareness of issuer’s program in the United States.
- Develop communications plan and information materials for launch activities (roadshow and presentations to investors, launch day promotion, meetings with financial media).
- Coordinate with issuer’s advertising and public relations teams on specific program plans to support and develop company image in the United States.

Investment banks/Underwriters (Level II/III/Rule 144A/Regulation S ADRs only)

- Advise on type of program to launch and exchange or market on which to list or quote.
 - Advise on ratio of depositary shares to ordinary shares.
 - Cover issuer through research reports/promote DRs to investors.
 - Advise on roadshows, investor meetings, investors to target.
 - Advise on capital market issues.
 - Where applicable, advise on potential merger/acquisition candidates, and other matters such as rights offerings, stock distributions, spin-offs, proxy contests, etc.
- If concurrent public offering:
- Advise on size, pricing and marketing of offering.
 - Act as placement agent or underwriter in offering.
 - Conduct roadshows with management/introduce issuer to institutional and other investors.
 - Line up selected dealers and co-underwriters for offering.

Level III ADR program—Sample timetable

Action	Parties involved						Weeks															
	I	D	L	A	IB	IR	1	2	3	4	5	6	7	8	9	10	11	12	13	14	Ongoing	
Establish and organize transaction team.	•	•	•	•	•	•																
Begin U.S. roadshow and ongoing investor relations program: create communications materials, target institutional investors, organize direct purchase programs for retail investors and establish employee ownership plans. Select ratio.	•	•			•	•																
Underwriter conducts preliminary due diligence.					•																	
Prepare and submit to SEC offering circular/prospectus and Form F-1. Commit to file Form 20-F within 12 months (if not already being filed in conjunction with an existing Level II ADR). Resolve any and all matters involving registration and disclosure.	•	•	•	•	•																	
Negotiate Deposit Agreement.	•	•	•																			
Submit exchange listing or NASDAQ quotation application and agreement. Receive approval.	•	•	•																			
Prepare Form F-6 and submit to SEC with Deposit Agreement.	•	•	•																			
Receive SEC comments on Form F-1 and other forms. Amend if necessary.	•	•	•																			
Complete requirements for trading and settlement: obtain DTC eligibility, CUSIP number and ticker symbol; and prepare ADR certificates.	•	•	•		•																	
Receive SEC declarations of effectiveness on Forms F-1 and F-6. Execute DA.	•	•	•																			
Conduct roadshow meetings with U.S. investors (group and one-on-one).	•	•			•																	
Print final prospectus, price offering and sell ADRs. ADRs are listed and begin trading.	•				•																	
Closing. Underwriter delivers cash proceeds to issuer, depository's custodian receives underlying shares and depository delivers ADRs to syndicate for forward delivery to investors.	•	•			•																	
Distribute press release and broker announcements to media and investment community.	•	•	•		•	•																
Place tombstone advertisement.	•	•	•		•	•																

Time frames provided are indicative. Regulator's involvement and issuers' program specifics may vary and can materially affect timing. The SEC generally provides comments on Form F-1 registration statements within 30 days of the date filed.

Key to parties involved: I = Issuer; D = Depository Bank; L = Legal Counsel (for depository and/or issuer); A = Accountant; IB = Investment Bank; IR = Investor Relations firm

9.2 Direct equity share listing

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As discussed in Section 9.1, most foreign issuers that list equity in the United States do so using ADRs. ADRs were developed to facilitate custody and settlement for U.S. investors and the U.S. clearing system.

A foreign private issuer may also list its shares directly on the NYSE without employing ADRs. This is common for Canadian companies, and major Dutch, German and Israeli issuers have also done so. An issuer that lists shares directly needs to establish a share registry system that effectively permits its shares to be quoted, traded and settled in the United States in U.S. dollars. To allow U.S. clearing and settlement without the intermediation of a depository, the usual approach is to appoint a U.S. registrar that coordinates with the home country registrar using a continuously updated two-way electronic link between clearing systems. The mechanics can be complex, and the cost and time required to work them out can be a deterrent, especially for the first issuer to make these arrangements from a given jurisdiction.

9.3 Description of IPO process timeline

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Every IPO is different, but most follow a broad pattern that breaks down into four phases. An aggressive but reasonable timeline might take 20 weeks: eight weeks to prepare materials for submission to the SEC, eight weeks to complete SEC review and then make a public filing, three weeks for marketing and a week to price and close the IPO.

Several factors typically affect the length of the timeline. If the issuer will be dual-listed, the most important of these factors is the coordination of non-U.S. requirements with U.S. requirements, although with most non-U.S. regulators and exchanges there is ample precedent for managing this coordination. Another important factor is how much time the issuer and its auditors take to develop the information required by U.S. rules, especially financial statements that meet SEC requirements and an audit report that meets PCAOB standards. This can extend the first phase substantially.

(a) Phase one—preparation

During the first phase, the principal task is to prepare a draft registration statement on Form F-1. This includes the preliminary prospectus, which will be the principal document used to market the offering to investors. If the issuer is already listed in its home jurisdiction, the prospectus can draw on material the issuer already prepares for home-country reporting purposes, but the U.S. prospectus often will be quite different from what the issuer has previously published. If the issuer is going public in two jurisdictions at the same time, the coordination of the preparation process to address requirements in both jurisdictions, and sometimes in two languages, can be challenging.

Unlike authorities in many other jurisdictions, the SEC requires an issuer to file its material contracts and certain other documents as exhibits to the registration statement, and these exhibits are publicly available. One priority for the first phase is to identify required exhibits and determine whether making them public presents any difficulties.

The issuer should also use the preparation period to familiarize itself with the ongoing requirements applicable to companies registered with the SEC and to confirm the readiness of its reporting and compliance systems.

The underwriters will typically use this period to conduct much of their due diligence, which includes management presentations, review of documentation and often other steps as well.

Other items of documentation can be addressed during the preparation phase or later. These include working with the NYSE on listing qualifications, selecting a depository and negotiating arrangements with it, preparing the separate registration statement on Form F-6 for the ADRs and negotiating the underwriting agreement.

(b) Phase two—SEC review

Following the preparatory phase, the issuer submits its substantially complete registration statement to the SEC for review and then responds to SEC comments, with the assistance of its U.S. counsel and its auditors. The SEC comment process can involve extensive back-and-forth discussion between the issuer and the SEC staff and the

submission of successive amended registration statements. For a domestic U.S. issuer other than an emerging growth company, the successive versions of the registration statement are publicly filed. Most foreign issuers, however, go through the SEC review process on a confidential basis, without making the registration statement public at that time or disclosing that it has been submitted. (Confidential review is discussed in Section 9.5(a), below.) For a foreign private issuer that pursues a confidential review, the initial public filing usually occurs after the resolution of most or all SEC comments.

During the SEC review period, the issuer and the underwriters also prepare for the roadshow, developing a roadshow presentation and itinerary. If the issuer qualifies as an emerging growth company under the JOBS Act (see Chapter 4), limited premarketing (often called “testing the waters”) is permitted before the registration statement is filed, although this has not yet become common practice. Otherwise, marketing does not begin until after the initial public filing of the registration statement.

(c) Phase three—marketing

The marketing period begins after the registration statement has been publicly filed, which is ordinarily after SEC comments have been resolved. If the issuer’s shares are not already trading (in its home market, for example), a price range for the offering must also be established before full marketing begins.

The marketing phase often takes two or three weeks. It involves distributing the preliminary prospectus and conducting a roadshow with prospective investors based on an elaborate roadshow presentation. As marketing proceeds, the underwriters gather nonbinding indications of interest from investors—a process known as “bookbuilding.” After the conclusion of the roadshow, the issuer and the underwriters ask the SEC to declare the registration statement effective, which is required before the shares can be sold to investors.

(d) Phase four—pricing and closing

The bookbuilding process culminates in the pricing of the IPO, when the issuer (and any selling shareholder) agrees with the underwriters on the offering price and

the underwriters agree to purchase the securities. The underwriters promptly begin confirming sales to investors, and in a successful offering the securities are all sold within hours. Typically, ADRs begin trading on the NYSE the morning after pricing. Closing usually occurs three to five business days after pricing of the IPO.

This process—pricing, selling to investors, commencement of trading and closing—is more complex in a dual-listed offering, which requires coordination of one or more regulatory regimes, markets, currencies and exchanges. See Section 3.1 for more detail on the IPO process for U.S. issuers, which is similar in many respects to the process for foreign private issuers.

9.4 Publicity

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Publicity in connection with an IPO is subject to strict regulation under U.S. law, as discussed in Section 3.2. The statutory framework under Section 5 of the Securities Act regulates *offers* of securities, and it particularly regulates *written* offers. Because of the broad definitions given to the terms *offer* and *written*, offering participants must be careful to distinguish between permissible communications and illegal offers and to avoid any conduct or communications that could be construed as impermissibly conditioning the market for the securities to be offered.

The specific limitations on publicity turn on whether the registration statement has been filed and then on whether it has been declared effective. Before the registration statement is filed there is a “quiet period,” when no offers are permitted. Between public filing and effectiveness of the registration statement, there is a “waiting period,” when offers may be made, but written offers are subject to content regulation and filing requirements. After the registration statement is effective, offers and sales are permitted, but there are still restrictions on written offers.

The SEC has established a number of safe harbors that allow communications that might otherwise be prohibited offers or impermissible written offers. One of them is specifically designed for foreign private issuers. In addition to the safe harbors available to U.S. issuers, a foreign private issuer may hold offshore

press conferences or issue press releases offshore, and that publicity will not be an illegal offer, provided that:

- there is a bona fide intent to conduct at least part of the offering outside the United States;
- access to the offshore press activities is provided to both U.S. and foreign journalists; and
- any written offering-related materials provided to the press must contain a prescribed cautionary legend and may not contain any form of purchase order or coupon that may be returned to express interest in the offering.

Issuers should be cautious when they rely on this safe harbor, since a statement in reliance on the safe harbor may still give rise to U.S. liability if it is false or misleading. Moreover, the SEC may require that the content of offshore communications, particularly forward-looking statements, be included in the registration statement and prospectus if the SEC views those statements as material.

If a foreign private issuer qualifies as an emerging growth company under the JOBS Act, it may elect to benefit from eased restrictions on publicity and offers in its IPO. Specifically, in connection with an IPO of an emerging growth company, the JOBS Act permits oral or written communications with certain sophisticated investors (qualified institutional buyers as defined under Rule 144A under the Securities Act or accredited investors as defined in Regulation D under the Securities Act) before the filing of a registration statement to determine whether the investors have an interest in the IPO. These “testing-the-waters” communications are not subject to the restrictions on all forms of communication during the “quiet” period or the requirements imposed on written communications during the “waiting” period of the IPO process. See Chapter 4 for a more complete discussion of the JOBS Act, including eased publicity restrictions.

9.5 Registration

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(a) Registration statement

The registration statement requirements are similar for foreign private issuers and

U.S. issuers. The registration statement is composed of two parts: Part I consists of the prospectus (described below) and Part II contains information that must be publicly filed with the SEC, but need not be provided to prospective investors. (See Section 3.2 for a more complete description of the different parts of the registration statement.)

However, there are several important distinctions between registration statements for foreign private issuers and for U.S. issuers. A foreign private issuer will register its IPO using Form F-1 (or, in the case of Canadian issuers, Form F-10), rather than Form S-1 used by a domestic issuer. A foreign private issuer that chooses to establish an ADR program must file an additional short-form registration statement on Form F-6, which requires certain information concerning the depositary arrangement and consists principally of the deposit agreement and a sample ADR certificate.

One important difference concerns the availability of confidential SEC review of a draft registration statement. A registration statement is available to the public as soon as it is formally filed with the SEC, and the SEC staff generally will not review a registration statement before it is filed. Consequently, a domestic issuer conducting an IPO files successive publicly available versions of its registration statement. To avoid this, the JOBS Act established a confidential review process for an IPO registration statement of an emerging growth company. (See Chapter 4.)

Confidential review under the JOBS Act is available for a foreign issuer, but the SEC also has a separate policy under which it will review a draft registration statement for a first-time foreign registrant on a confidential basis where (1) the issuer is already listed or is concurrently listing its securities on a non-U.S. securities exchange, (2) the issuer is being privatized by a foreign government or (3) the issuer demonstrates that the public filing of its registration statement would conflict with the law of a relevant foreign jurisdiction. If an issuer proceeds under this policy, the SEC may still require it to publicly file its draft registration statements in certain circumstances, such as where there is publicity about a proposed offering or listing. Otherwise, a foreign private issuer often waits until shortly

before the roadshow to make its first public filing—in contrast, an emerging growth company proceeding under the JOBS Act confidential review process must make a public filing at least 21 days in advance of the roadshow. The issuer must resubmit all previously submitted draft registration statements, SEC staff comment letters and issuer response letters at the time of the public filing of its registration statement, and these will be posted publicly on the SEC's EDGAR system.

For a discussion of SEC fees associated with the filing of a registration statement, see Section 3.2(f).

(b) Prospectus

The prospectus will be distributed to prospective investors in preliminary form during the “waiting” period in order to market the IPO. The disclosures included in the prospectus are described in more detail in Section 3.3(a), but they generally include a description of the issuer's business, its operating and financial history and a description of the securities being offered.

Foreign private issuers should pay particularly close attention to the requirements concerning the financial statements that must be included in the prospectus. If the issuer's financial statements are not presented under U.S. GAAP or IFRS as approved by the IASB, they must include a reconciliation of certain items to U.S. GAAP. For further information concerning the particular rules that apply to foreign private issuers.

9.6 Reporting requirements

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(a) Ongoing reporting-related requirements

After the initial public offering, an issuer must file regular periodic and other reports with the SEC in accordance with the requirements of the Exchange Act. The reports required for a foreign private issuer differ from those required for a U.S. issuer described in Section 6.1(a).

Annual reports: The primary report for a foreign private issuer is the annual report on Form 20-F. (A Canadian company may

use Form 40-F.) Form 20-F must be filed with the SEC within four months of the end of each fiscal year. The contents of Form 20-F are similar to the IPO prospectus, including with respect to the required audited financial statements. There are, however, some differences, including disclosures about controls and officer certifications, as well as information about stock repurchases and the use of IPO proceeds.

The SEC does not automatically review the annual report on Form 20-F, but it is required to review each issuer's annual report on Form 20-F at least once every three years and may provide comments to improve disclosure or remedy noncompliance at any time. Unlike Form 10-K, which requires detailed information on an issuer's compensation of its directors and executive officers, a foreign private issuer may provide an aggregate amount for director and officer compensation, and individual employment contracts and compensatory plans need not be filed as exhibits to the Form 20-F so long as the issuer has not made such data, contracts or plans public elsewhere. A foreign private issuer is required to disclose in the Form 20-F fees to investors associated with its ADR facility and any payments to the issuer by the ADR depository.

A foreign private issuer is not subject to the U.S. proxy rules and so need not prepare a U.S.-style proxy statement, although many choose to prepare a “glossy” annual report in addition to the annual report on Form 20-F. A foreign private issuer whose shares or ADRs are listed on the NYSE is, however, required to solicit proxies from U.S. shareholders for shareholder meetings.

Current reports: Unlike U.S. issuers, foreign private issuers are not required to file quarterly financial information on Form 10-Q or to disclose the items specified on Form 8-K within four business days. Instead, a foreign private issuer is required to furnish material information “promptly” to the SEC on Form 6-K if the information is otherwise disclosed because it (1) must be made public in the foreign private issuer's country of domicile or incorporation pursuant to the law of that country, (2) is filed with any foreign stock

exchange on which its securities are listed and made public by such exchange or (3) is distributed to the foreign private issuer's security holders. Form 6-K specifies that the information required to be furnished is information that is material with respect to the issuer and its subsidiaries concerning:

- changes in business;
- changes in management or control;
- acquisitions or dispositions of assets;
- bankruptcy or receivership;
- changes in certifying accountants;
- financial condition and the results of operations;
- changes in securities or in the security for registered securities;
- defaults upon senior securities;
- material increases or decreases in the amount outstanding of securities or indebtedness;
- the results of submission of matters to a vote of security holders;
- transactions with directors, officers, or principal security holders;
- the granting of options or payment of other consideration to directors or officers; and
- any other information which the issuer deems of material importance to security holders.

Form 6-K is very simple, consisting of a cover and signature pages to which the relevant information is attached. The form must be signed by an authorized officer, but no certification by the CEO or CFO is required. The information submitted need not be in English, but a full English translation is required for press releases, annual or interim financial information and information sent directly to security holders. For other information, an English summary will suffice.

The SEC reportedly has considered revising Form 6-K because of the number of foreign private issuers using the United States as their sole listing jurisdiction. The SEC staff is concerned that these issuers may make limited disclosures as a result of not having obligations to make information public under home country laws.

Foreign private issuers are generally required to comply with stock exchange rules requiring prompt disclosure of material events as discussed in Section 6.1(a).

Other specialized disclosure requirements:

A foreign private issuer must comply with the SEC's specialized disclosure rules adopted under the Dodd-Frank Act. There are two principal types of disclosure, each of which will be made on a new Form SD beginning in 2014. First, an issuer must file Form SD if certain "conflict minerals" or certain of their derivatives are necessary to the functionality or production of its products. Second, an issuer involved in the commercial development or extraction of oil, natural gas or minerals must file Form SD to disclose payments it makes to governments in connection with those activities.

A foreign private issuer is also required to disclose in its annual reports on Form 20-F certain activities relating to Iran, materials likely to be used for human rights abuses and transactions with persons designated for their support of terrorist activity or the proliferation of weapons of mass destruction.

A foreign private issuer that operates mines in the United States may be subject to disclosure requirements concerning health and safety violations at those mines.

Duty to correct and update: If an issuer discovers that a public statement was materially inaccurate or misleading when made, it should promptly correct the statement to reduce its risk of liability. Even if it was accurate when made, a forward-looking statement may need to be updated if changed circumstances make it inaccurate or misleading. U.S. courts have reached conflicting conclusions on whether this kind of duty to update exists.

Selective disclosure and Regulation

FD: Under Regulation FD, if an issuer discloses material nonpublic information to market professionals (e.g., research analysts) or to investors under circumstances in which it is reasonably foreseeable that the recipient will trade on the basis of the information, it must make general public disclosure of that information at the same time. Selective disclosure can also lead to insider trading liability in some circumstances. Regulation FD does not apply to foreign private issuers, but many comply voluntarily or look to it for guidance as a "best practice" and to

avoid potential liability. A foreign private issuer seeking to comply voluntarily with Regulation FD may make the general public disclosure by filing a Form 6-K, distributing a press release, conducting a public webcast (announced in advance) or other means designed to provide broad, nonexclusionary access to the information. See Section 5.5 for a more detailed discussion of Regulation FD.

Use of non-GAAP financial measures: As noted in Section 5.5, special disclosure rules apply when an issuer presents certain financial information in a way that is different from its financial statement presentation based on GAAP. A financial measure that triggers these SEC rules is referred to as a "non-GAAP financial measure" (even if the issuer uses IFRS or another body of accounting principles rather than U.S. GAAP). Use of non-GAAP financial measures in a public statement (whether written or oral) is subject to Regulation G, which requires that the non-GAAP measure be accompanied by a presentation of the most directly comparable GAAP financial measure and a quantitative reconciliation of the two measures. A foreign private issuer, however, is exempt from the requirements of Regulation G if (1) its securities are listed or quoted on a securities exchange or inter-dealer quotation system outside the United States, (2) the non-GAAP financial measure is not derived from or based on a U.S. GAAP measure and (3) the disclosure is made outside the United States or included in a written communication released outside the United States.

When a foreign private issuer includes non-GAAP financial measures in a report filed with the SEC, it must comply with more stringent disclosure requirements and consider whether the measure comes within a category of non-GAAP financial measures not permitted in filed materials. Generally speaking, materials submitted to the SEC on Form 6-K are not considered "filed" with the SEC, so those materials are not subject to these more stringent rules—except that if the Form 6-K is incorporated by reference into a securities registration statement, it is treated as filed. For further information on the rules

concerning non-GAAP financial measures, see Section 5.5.

Stock exchange notifications and affirmations:

A NYSE listed foreign private issuer must comply with requirements to notify the exchange on an ongoing basis with regard to, among other things, record dates, dividends, shareholder meetings, changes in listed securities and certain corporate actions. Beyond the notice requirements, NYSE requires that a listed foreign private issuer submit an annual affirmation concerning compliance with NYSE's audit committee and corporate governance-related requirements within 30 days after the filing of a Form 20-F (or 40-F). NYSE also requires that, on an interim basis, a foreign private issuer submit an affirmation in the event of certain changes to its audit committee or the loss of foreign private issuer status.

(b) Disclosure controls, internal controls, and certifications**Internal control over financial reporting:**

As of the end of each fiscal year, a foreign private issuer, like a U.S. issuer, is required to evaluate its internal control over financial reporting. ICFR is a set of processes designed to provide reasonable assurance of the reliability of financial reporting and preparation of financial statements in accordance with GAAP. Even though the evaluation of ICFR is based on the issuer's primary financial statements, it should take into account controls related to U.S. GAAP reconciliation (if reconciliation is required).

An internal control report must be included in the foreign private issuer's annual report on Form 20-F. The report must contain:

- a statement of management's responsibility for establishing and maintaining adequate ICFR for the issuer;
- a statement identifying the framework used by management to evaluate the effectiveness of ICFR;
- an assessment by management of the effectiveness of ICFR as of the end of the most recent fiscal year, including a statement as to whether ICFR is effective; and

- a statement that the auditors of the financial statements included in the report have issued an audit report on the effectiveness of ICFR.

The auditors' report on the effectiveness of ICFR must also be included in the Form 20-F. A first-time registrant is exempt from these rules until its second annual report is filed with the SEC. For a more in-depth discussion of the ICFR requirements, see Section 6.1(b).

Disclosure controls and procedures: A foreign private issuer is also required to maintain "disclosure controls and procedures" designed to ensure that financial and nonfinancial information required to be disclosed under the Exchange Act is recorded, processed, summarized and reported in a timely and accurate manner. They must include procedures to accumulate and communicate information to top management to allow for timely decisions regarding required disclosure, including reports on Form 6-K.

CEO and CFO certifications: The CEO and CFO of a foreign private issuer provide two separate certifications in annual reports on Form 20-F (or Form 40-F, though not in any Form 6-K). The substance of these certification requirements is discussed in Section 6.1(b).

(c) Beneficial ownership reporting by investors

After the IPO, the issuer's major shareholders will be required to comply with certain reporting requirements under the Exchange Act. Specifically, any person who is directly or indirectly the beneficial owner of more than 5% of any listed class of voting equity securities of the issuer will be required to file reports under Sections 13(d) and 13(g) of the Exchange Act. Regulation 13D-G under that act generally requires each such person (or group of persons acting together), within 10 days after the 5% threshold is crossed, to file a report on Schedule 13D with the SEC and send copies to the issuer and relevant stock exchanges. Schedule 13D requires substantial disclosure regarding the identity of the acquirer, the source and amount of funds used to acquire the securities, the purpose of the acquisition,

the amount and percentage of securities held by the acquirer and related details about the acquirer's involvement with the securities. A shareholder who holds more than 5% of an issuer's securities at the time of an issuer's IPO is entitled to file a report on less demanding Schedule 13G, but changes in the shareholder's holdings may require the holder to switch over to filing reports on Schedule 13D.

Section 7.3 contains additional information on the required disclosures under Regulation 13D-G and timing of disclosures.

The directors, officers and large shareholders of a U.S. company are subject to certain reporting and short-swing profits requirements under Section 16 of the Exchange Act, as described in Section 7.4. Foreign private issuers are not subject to these rules.

9.7 Corporate governance

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(a) Stock exchange corporate governance requirements

For a foreign private issuer, most—but not all—corporate governance matters will be determined by home country laws and practices. Issuers listed on the NYSE are subject to governance requirements set forth in the *NYSE Listed Company Manual*. The *Manual* provides that a foreign private issuer may follow home country practice rather than the *Manual's* corporate governance provisions, but with some important exceptions. A listed foreign private issuer must maintain an audit committee compliant with the independence requirement of SEC Rule 10A-3 and is also subject to the requirement that the CEO promptly notify the NYSE if he or she becomes aware of noncompliance with the applicable provisions and the requirement to submit annual (and under some circumstances, interim) written compliance affirmations. The NYSE also requires that a listed foreign private issuer disclose in its annual report on Form 20-F any significant ways in which its corporate governance practices differ from those followed by U.S. issuers under NYSE standards, including with respect to audit and compensation committee requirements. As noted earlier, a foreign

private issuer with shares or ADRs listed on the NYSE is required to solicit proxies from U.S. holders for shareholder meetings.

(b) Audit committee

Any issuer listed on a U.S. exchange must have an audit committee to oversee accounting, financial reporting and audit services. There are no size requirements for the audit committee of a listed foreign private issuer, so the committee may consist of a single member.

The members of the audit committee must be independent within the meaning of SEC Rule 10A-3. The SEC defines the term *independent* in this context to mean that a member of the audit committee (1) may not be an "affiliated person" of the issuer or any of its subsidiaries and (2) may not accept any consulting, advisory or other "compensatory fee" directly or indirectly from the issuer or any of its subsidiaries, other than in his or her capacity as a member of the board of directors or any board committee (including the audit committee).

There are two general exemptions from the independence requirements. First, although all audit committee members must be fully independent within a year of listing in the United States, only one member of the audit committee must be fully independent at the time of the initial listing and only a majority of the members must be fully independent within 90 days of listing. Second, an audit committee member may sit on the board of directors of both a listed issuer and an affiliate of the listed issuer if the member otherwise meets the independence requirements for each entity.

For a foreign private issuer, three additional exemptions from the independence requirements are available to permit the following persons to sit on the audit committee:

- any employee who is not an executive officer, if that employee is elected or named to the board of directors or audit committee pursuant to the issuer's governing law or constitutive documents, an employee collective bargaining or similar agreement or other home country legal or listing requirements;
- a person who is an affiliate or a representative of an affiliate (including

a controlling shareholder) as a nonvoting observer, if that person is not the chair of the audit committee or an executive officer of the issuer and does not receive any compensation prohibited by the independence requirements; and

- a representative of a foreign government that is an affiliate of the issuer, if that representative is not an executive officer of the issuer and does not receive any compensation prohibited by the independence requirements.

A foreign private issuer is exempt from the audit committee requirements if it has an alternative mechanism for overseeing the independent auditor, such as a board of auditors or statutory auditors, that is separate from the issuer's board of directors.

There are also accommodations for foreign private issuers operating under a dual holding company structure and for foreign private issuers with two-tier board structures. If an issuer relies on any of the exemptions for foreign private issuers under the audit committee rules, it must disclose that in its annual report on Form 20-F.

(c) Compensation committee

A foreign private issuer is exempt from the requirements concerning compensation committees that apply to U.S. issuers, but if it relies on the exemption with respect to member independence, it must in its annual report on Form 20-F, if listed on the NYSE, include a description of any significant differences of home country rule from the NYSE rules regarding the composition of compensation committees.

(d) Ethics code

A foreign private issuer must disclose in its annual report on Form 20-F whether it has adopted a code of ethics that applies to its CEO, CFO, principal accounting officer or controller and persons performing similar functions. If the issuer has not adopted a code of ethics governing its CEO and senior financial officers, it must disclose that fact. A "code of ethics" means written standards that are reasonably designed to deter wrongdoing and to promote (1) honest and ethical conduct; (2) full, fair, accurate,

timely and understandable disclosure in documents filed with the SEC and in other public communications; (3) compliance with applicable laws, rules and regulations; (4) the prompt internal reporting of violations of the code to an appropriate person or persons; and (5) accountability for adherence to the code. The code of ethics (if one exists) must be filed with the SEC and posted on the issuer's website or otherwise made available to any person requesting a copy without charge. The issuer must also disclose, on an annual basis, any waiver (including any implicit waiver) granted to its CEO or any of the senior financial officers subject to the code and any amendments that may be made to the code.

(e) Prohibitions on arranging credit

A foreign private issuer planning a U.S. IPO should review any arrangements that may be considered direct or indirect loans or other extensions of credit by it or its subsidiaries to any of its executive officers or directors, as these generally must be terminated prior to the effectiveness of the IPO registration statement to comply with SOX.

(f) Clawback requirements

The Dodd-Frank Act requires the SEC to establish final rules under which the stock exchanges will amend their listing standards to require listed companies to adopt and disclose compensation clawback policies as set forth in the statute and implementing regulations. The SEC has yet to issue final rules, however, and it remains to be seen whether it will establish an exemption for foreign private issuers from the clawback policy requirement as it has for other corporate governance requirements. For further information concerning clawback requirements, see Section 2.4.

(g) Foreign Corrupt Practices Act

As described in more detail in Section 6.1(c), a foreign private issuer that conducts an IPO in the United States will be subject to the FCPA. Two sets of provisions under the FCPA are applicable to SEC-reporting companies. One set, the accounting provisions, requires issuers to keep accurate books and records and to maintain a system of internal accounting controls. These accounting provisions are in addition to the internal control requirements and disclosure controls and procedures

described in Section 9.6(b). The other set, the antibribery provisions, prohibits the bribery of non-U.S. government officials. An issuer will violate the antibribery provisions if it uses the mails or any means or instrumentality of interstate commerce (including communication between the United States and any foreign country) to, for example, make payments to foreign officials for the purpose of corruptly influencing actions or decisions by them in order to assist the issuer in obtaining business. The SEC and the U.S. Department of Justice have aggressively expanded FCPA enforcement in recent years.

9.8 Managing risk

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Once a foreign private issuer is listed on a U.S. stock exchange, it and its directors, officers and certain other employees are subject to the federal and state securities laws with respect to their registration statements, reports filed with the SEC, other public statements and trading activities, as discussed in Section 8.1. For example, Rule 10b-5 broadly prohibits fraudulent and deceptive practices and untrue statements or omissions, both written and oral, of material fact in connection with the purchase and sale of any security. Under Rule 10b-5, the issuer and its employees or agents may be liable for making false or misleading statements about the issuer, whether or not any of them actually purchased or sold any securities. Liability requires proof that the defendant engaged in willful misconduct or at least acted recklessly and can be based on information contained in a document filed with the SEC (including a registration statement, the Form 20-F or a Form 6-K), as well as other information released to the public by the issuer, including press releases.

The geographic reach of liability under Rule 10b-5 has been the subject of extensive litigation and some legislative changes in recent years. A private plaintiff can only sue under Rule 10b-5 with respect to securities transactions that occur in the United States or transactions in securities that are listed on a securities exchange in the United States. The SEC and other U.S. government agencies, however, can enforce Rule 10b-5 against wrongful conduct even

if it occurred outside the United States if it had a substantial effect in the United States or on its citizens.

9.9 Executive and employee compensation programs

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Having a class of listed equity securities generally facilitates using equity-linked compensation programs for U.S. executives and employees. For further information concerning considerations relevant to compensation programs, see Section 2.4.

The U.S. “say on pay” rules that require U.S. domestic issuers to seek periodic nonbinding shareholder votes to approve executive compensation (see Section 2.4) do not apply to foreign private issuers.

Early in the U.S. IPO planning process, a foreign private issuer should review its executive and employee compensation programs with its advisers to ensure that the U.S. disclosure and other requirements relevant to them will not pose issues for the company.

9.10 Financial information

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The financial statement requirements for an initial registration statement of a foreign private issuer is found in Items 3, 8, 17 and 18 of Form 20-F and in Regulation S-X. The financial statement requirements differ in a number of significant ways from those of domestic US issuers. Some of the key differences in the requirements are as follows:

- Audited financial statements generally must cover each of the latest three fiscal years, with certain exceptions:
 - if the issuer has been in existence less than the required three years,

financial information covering the issuer’s predecessor entities (if any) may need to be provided;

- if a jurisdiction outside the United States does not require a balance sheet for the earliest year of the three-year period, that balance sheet may be omitted; and
- audited financial statements are required only for the most recent two years if the financial statements presented are prepared in accordance with US GAAP.
- Foreign private issuers may use GAAP other than US GAAP, but may need to reconcile to US GAAP. This reconciliation is not required if the company uses IFRS as issued by the IASB.
- Regardless of the basis of presentation, the audited financial statements must be accompanied by an audit report issued by independent accountants that are registered with the PCAOB and audited in accordance with PCAOB standards. Financial statements audited under the International Auditing Standards or other local country GAAS would not be considered “audited” financial statements for SEC purposes. The accountants must meet SEC and PCAOB standards for independence. The SEC Staff will not object if the audit report states that the audit was also conducted in accordance with home-country generally accepted accounting standards.
- The latest audited annual financial statements included in the registration statement must be as of a date not older than 12 months prior to the date the registration statement is filed. The SEC will waive this requirement in cases where the company can represent

adequately that it is not required to comply with this requirement in any other jurisdiction outside the United States, and that complying with the requirement is impracticable or involves undue hardship. Regardless, the latest audited annual financial statements included in the filing cannot be more than 15 months old as of the date the registration statement becomes effective.

- If a registration statement becomes effective more than nine months after the end of the last audited fiscal year, the company must provide unaudited interim financial statements in accordance with, or reconciled to, US GAAP (this reconciliation is not required if the company uses IFRS as issued by the IASB) covering at least the first six months of the year.
- Foreign private issuers may report in any currency.
- Financial statements of an acquired foreign business need not be reconciled from local GAAP to US GAAP when the acquired business is below 30% for any of the Rule S-X 1-02(w) significance tests. This reconciliation is not required if the acquired business uses IFRS as issued by the IASB.
- Financial statements of a significant equity method investment meeting the significance threshold of Rule 3-09 of Regulation S-X need not be reconciled to US GAAP (or, if applicable, IFRS as issued by the IASB), unless either of the two tests is greater than 30% as calculated on a US GAAP (or, if applicable, IFRS as issued by the IASB) basis. A description of the differences in accounting methods is required, however, regardless of the significance levels.●

Appendices

Appendix I: NYSE original listing standards, U.S. operating companies, REITs, and funds

U.S. domestic companies must qualify for listing under the domestic listing standards. Foreign private issuers may list under either the domestic listing standards or the listing standards for non-U.S. companies set forth in Appendix II.

Domestic listing requirements call for minimum distribution of the company’s shares within the United States, as well as minimum financial criteria. This chart is to be used for an initial evaluation only. For a more complete discussion of the minimum numerical standards applicable to U.S. companies, see Section 102.00 of the *Listed Company Manual*, which can be accessed at <http://nysemanual.nyse.com/LCM/Sections/>.

Distribution and size criteria <i>Must meet all three of the following:</i>		Alternative #3—Affiliated company <i>For new entities with a parent or affiliated company listed on the NYSE</i>	
Round-lot holders ^(a)	400	Global market capitalization ^(c)	\$500 million
Publicly held shares ^(b)	1,100,000	Operating history	12 months
Market value of publicly held shares: ^(b)		Parent or affiliate is a listed company in good standing Company’s parent or affiliated company retains control of the entity or is under common control with the entity	
IPOs, spinoffs, carveouts, affiliates	\$40 million	Alternative #4—Assets and equity	
All other listings	\$100 million	Global market capitalization ^(c)	\$150 million
Stock price criteria <i>All issuers must have a \$4 stock price at the time of listing</i>		Total assets	\$75 million
Financial criteria <i>Must meet one of the following standards:</i>		Stockholders’ equity	\$50 million
Alternative #1—Earnings^(d)		Real estate investment trusts (REITs)^(e)	
Aggregate pre-tax income for the last three years ^(d)	\$10 million	Stockholders’ equity	\$60 million
Minimum in each of the two most recent years Positive amounts in all years	\$2 million	Closed-end funds and business development companies (BDCs)	
Or		Market value of publicly held shares ^(b)	\$60 million (also require a total market cap of \$75 million for BDCs)
Aggregate pre-tax income for the last three years ^(d)	\$12 million		
Minimum in the most recent year	\$5 million		
Minimum in the next most recent year	\$2 million		
Alternative #2a—Valuation/revenue with cash flow^(d)			
Global market capitalization ^(c)	\$500 million		
Revenues (most recent 12-month period)	\$100 million		
Adjusted cash flow: Aggregate for the last three years All three years must be positive	\$25 million		
Alternative #2b—Pure valuation/revenue			
Global market capitalization ^(c)	\$750 million		
Revenues (most recent fiscal year)	\$75 million		

(Continued opposite)

(a) The number of beneficial holders of stock held in “street name” will be considered in addition to the holders of record.
 (b) Shares held by directors, officers or their immediate families and other concentrated holding of 10% or more are excluded in calculating the number of publicly held shares and market value of publicly held shares.
 (c) Global market capitalization for existing public companies is the average of the most recent three months of trading history in the case of the pure valuation/revenue test. For all other standards, the measurement is at a “point in time” for an existing public company though trends are considered. For IPOs, spinoffs and carveouts, it is represented by the valuation of the company as represented by, in the case of a spinoff, the distribution ratio as priced, or, in the case of an IPO/carveout, the as-priced offering in relation to the total company’s capitalization.
 (d) The NYSE may consider two full fiscal years and the current nine months in certain limited circumstances. For emerging growth companies presenting two fiscal years and qualifying under Alternative #1, pre-tax income must total at least \$10 million in the aggregate for the last two fiscal years together with a minimum of \$2 million in both years. For emerging growth companies presenting two fiscal years and qualifying under Alternative #2a, aggregate cash flow must total \$25 million for the last two fiscal years, with positive amounts in both years.
 (e) REITs with more than 3 years of operating history must qualify under one of Alternatives 1-4.

Appendix I continued**Additional considerations**

In addition to meeting the minimum numerical standards listed above, other factors must necessarily be considered. The company must be a going concern or be the successor to a going concern.

The NYSE has broad discretion regarding the listing of a company. The NYSE is committed to listing only those companies

that are suitable for auction market trading and that are eligible for trading on the NYSE. Thus, the NYSE may deny listing or apply additional or more stringent criteria based on any event, condition, or circumstance that makes the listing of the company inadvisable or unwarranted in the opinion of the NYSE. Such determination can be made even if the company meets the quantitative standards set forth above.

Appendix II: NYSE original listing standards, non-U.S. operating companies

The NYSE offers two sets of standards—worldwide and domestic—under which non-U.S. companies may qualify for listing. Both standards include distribution and financial criteria. A company must qualify for both the distribution and financial criteria within that particular standard. The domestic standards are summarized at Appendix I.

This chart is to be used for an initial evaluation only. The NYSE will work with each company to determine which standards are best suited to that entity.

For a more complete discussion of the minimum numerical standards applicable to non-U.S. companies, see Section 103.01 of the *Listed Company Manual*, which can be accessed at <http://nysemanual.nyse.com/lcm>.

Criteria	Requirements	Worldwide
Distribution	Round-lot holders Total stockholders^(a)	
		5,000
	Publicly held shares ^(b)	2.5 million
	Market value of publicly held shares ^(b)	\$100 million
	IPOs, carveouts and spinoffs	n/a
	All other listings	n/a
Financial Criteria		
<i>Must meet one of the following standards:</i>		
Alternative 1 Earnings^(c)	Aggregate pre-tax income for last three fiscal years	\$100 million
	Minimum pre-tax income in each of two most recent fiscal years	\$25 million
Alternative 2a Valuation/revenue with cash flow^(d)	Global market capitalization ^(c)	\$500 million
	Revenues (most recent 12-month period)	\$100 million
	Aggregate cash flow for last three fiscal years	\$100 million
	Minimum cash flow in each of two most recent fiscal years	\$25 million

(Continued opposite)

Appendix II continued

Criteria	Requirements	Worldwide
Alternative 2b Pure valuation/ revenue	Global market capitalization ^(c)	\$750 million
	Revenues (most recent fiscal year)	\$75 million
Alternative 3 Affiliated company For new entities with a parent or affiliated company listed on the NYSE	Global market capitalization ^(c)	\$500 million
	At least 12 months of operating history	Yes
	Affiliated listed company is in good standing	Yes
	Affiliated listed company retains control of the entity	Yes

(a) The number of beneficial holders of stock held in “street name” will be considered in addition to the holders of record.

(b) Shares held by directors, officers or their immediate families and other concentrated holding of 10% or more are excluded in calculating the number of publicly held shares and market value of publicly held shares.

(c) Global market capitalization for existing public companies is the average of the most recent six months of trading history in the case of the pure valuation/revenue test. For all other standards, the measurement is at a “point in time” for an existing public company though trends are considered. For IPOs, spinoffs and carveouts, it is represented by the valuation of the company as represented by, in the case of a spinoff, the distribution ratio as priced, or, in the case of an IPO/carveout, the as-priced offering in relation to the total company’s capitalization.

(d) The NYSE may consider two full fiscal years and the current six months and qualifying under Alternative 1 in certain limited circumstances. For emerging growth companies presenting two fiscal years pre-tax income and qualifying under Alternative 1, pre-tax income must total at least \$100 million in the aggregate for the last two fiscal years with a minimum of \$25 million in each year. For emerging growth companies presenting two fiscal years and qualifying under Alternative 2a, aggregate cash flow must total at least \$100 million for the last two fiscal years with a minimum of \$25 million in each year.

Appendix III: NYSE MKT original listing standards

NYSE MKT has established certain quantitative and qualitative standards for initial listing of U.S. and foreign companies, as follows.

To learn more about NYSE MKT quantitative, distribution and governance requirements, please refer to the complete requirements outlined in the *NYSE MKT Company Guide*, which can be referenced at <http://wallstreet.cch.com/MKT/CompanyGuide/>.

Criteria	Original listing standards			
	Standard 1	Standard 2	Standard 3	Standard 4
Pre-tax income ^(a)	\$750,000	n/a	n/a	n/a
Market capitalization	n/a	n/a	\$50 million	\$75 million OR At least \$75 million in total assets and \$75 million in revenues
Market value of publicly held shares	\$3 million	\$15 million	\$15 million	\$20 million
Minimum stock price	\$3	\$3	\$2	\$3
Operating history	n/a	2 years	n/a	n/a
Stockholders' equity	\$4 million	\$4 million	\$4 million	n/a
Distribution ^(b)	800 public shareholders and 500,000 shares publicly held; OR 400 public shareholders and 1 million shares publicly held; OR 400 public shareholders, 500,000 shares publicly held and average daily trading volume of 2,000 shares for previous six months.			

(a) Required in the latest fiscal year or two of the three most recent fiscal years.

(b) The shares of foreign companies may be considered for listing under Section 101. Companies which do not meet the share distribution requirements under Section 102 may be considered for listing under the alternate requirements set forth below:

Share distribution	
Round-lot public shareholders	800 worldwide
Publicly held shares	1,000,000 worldwide
Aggregate market value of publicly held shares	\$3,000,000 worldwide

Appendix IV: NYSE financial continued listing standards, U.S. companies

The NYSE has both quantitative and qualitative continued listing criteria. When a company falls below any criterion, the NYSE will review the appropriateness of continued listing. The following is a summary of the NYSE’s quantitative continued listing standards. For a more complete discussion of the NYSE’s continued listing standards, as well as the procedures followed when a company falls below any of the continued listing criteria, see Section 802.00 of the *Listed Company Manual*, which can be accessed at <http://nysemanual.nyse.com/lcm>.

Price criteria		For companies that listed under the “pure valuation/revenue” standard	
Average closing price of a security is less than \$1.00 over a consecutive 30 trading-day period		Average global market capitalization over a consecutive 30 trading-day period is less than	\$375 million
Numerical criteria for capital and common stock		and	
For companies that listed under the “Earnings” standard or “Assets and equity” standard		Total revenues for the most recent fiscal year are less than	\$15 million
Average global market capitalization over a consecutive 30 trading-day period is less than	\$50 million	or	
and		Average global market capitalization over a consecutive 30 trading-day period is less than	\$100 million
Total stockholders’ equity is less than	\$50 million	For companies that listed under the “Affiliated company” standard	
or		The listed company’s parent/affiliated company ceases to control the listed company or such parent/affiliated company itself falls below the numerical criteria; and average global market capitalization over a 30-day trading period is less than \$75 million.	
Average global market capitalization over a consecutive 30 trading-day period is less than	\$15 million		
For companies that listed under the “Valuation/revenue with cash flow” standard			
Average global market capitalization over a consecutive 30 trading-day period is less than	\$250 million		
and			
Total revenues for the most recent 12 months	\$20 million		
or			
Average global market capitalization over a consecutive 30 trading-day period is less than	\$75 million		

The NYSE has separate criteria for closed-end funds, real estate investment trusts, special-purpose acquisition companies, bonds and preferred stocks. See Section 802.01B of the *Listed Company Manual*.

Appendix V: NYSE MKT continued listing standards^(a)

NYSE MKT has both quantitative and qualitative continued listing criteria. When a company falls below any criterion, NYSE MKT will review the appropriateness of continued listing. The following is a summary of NYSE MKT's quantitative continued listing standards. For a more complete discussion of NYSE MKT's continued listing standards, as well as the procedures followed when a company falls below any of the continued listing criteria, see Section 1003 and Section 1009 of the Company Guide, which can be accessed at <http://wallstreet.cch.com/MKT/CompanyGuide/>.

A company falls below compliance if its stockholders' equity is less than:

- \$2 million and the company has two out of three years of losses from continuing operations and/or net losses.
- \$4 million and the company has three out of four years of losses from continuing operations and/or net losses.
- \$6 million and the company has five consecutive years of losses from continuing operations and/or net losses.

A company is not subject to stockholders' equity continued listing requirements if it has:

- Market capitalization of \$50 million; OR
- Total assets AND total revenue of \$50 million each (in last fiscal year or two of the last three); AND (in each case)
- Distribution: 1.1 million shares publicly held, \$15 million market value of public float, and 400 round-lot shareholders.

Distribution

A company falls below compliance if:

- The number of publicly held shares is less than 200,000; OR
- It has fewer than 300 Shareholders; OR
- The market value of publicly held shares is less than \$1 million (if below for 90 consecutive days).

(a) In addition to the financial and distribution standards shown above, NYSE MKT has requirements relating to: 1. disposal of assets/reduction of operations; 2. failure to comply with the Listing Agreement and/or SEC requirements; 3. low selling price; 4. failure to pay listing fees; 5. maintenance of sufficient liquidity; and 6. public interest concerns.

Appendix VI: Summary of filing and other requirements based on issuer category

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The following table summarizes some of the most common financial statement filing requirements, Regulation S-K disclosure requirements, and other rules for nonaccelerated filers, smaller reporting companies, emerging growth companies and foreign private issuers.

Requirement	Nonaccelerated reporting company	Categories with modified reporting requirements		
		Smaller reporting company	Emerging growth company	Foreign private issuer
Audited financial statements in initial registration statement				
Balance sheet	Most recent two fiscal year-ends	Most recent two fiscal year-ends	Most recent two fiscal year-ends	Most recent two fiscal year-ends if financial statements are presented in accordance with U.S. GAAP. Most recent three fiscal year-ends if presented in accordance with IFRS as issued by the IASB ^(a)
Income statement, comprehensive income, cash flows, changes in shareholders' equity	Most recent three fiscal years	Most recent two fiscal years	Most recent two fiscal years	Most recent three fiscal years ^(b)
Financial statements of a significant acquired business	Up to three years may be required, depending upon level of significance	Limited to up to two years, depending upon significance ^(c)	Limited to up to two years, depending upon significance	Up to three years may be required, depending upon level of significance ^(d)
Initial Sarbanes-Oxley Act compliance after an IPO				
Quarterly section 302/906 certifications	First periodic filing (10-Q/10-K) after the IPO	First periodic filing (10-Q/10-K) after the IPO	First periodic filing (10-Q/10-K) after the IPO ^(e)	First Form 20-F filed after the IPO
Section 404(a) management report	Second 10-K filed after the IPO	Second 10-K filed after the IPO	Second 10-K filed after the IPO	Second 20-F filed after the IPO
Section 404(b) auditor attestation ^(f)	Second 10-K filed after the IPO if an accelerated filer	Not required	Transition period of up to five years	Second 20-F filed after the IPO ^(g)
Select Regulation S-K disclosure requirements				
Selected financial information	Last five fiscal years and interim periods presented	Not required	Last two fiscal years and interim periods presented ^(h)	Last five fiscal years and interim periods presented

(Continued opposite)

Appendix VI: continued

Requirement	Nonaccelerated reporting company	Categories with modified reporting requirements		
		Smaller reporting company	Emerging growth company	Foreign private issuer
Select Regulation S-K disclosure requirements				
MD&A	3 years	2 years	2 years	3 years
Initial compliance with XBRL	First 10-Q filed after the IPO	First 10-Q filed after the IPO	First 10-Q filed after the IPO	First 20-F filed after the IPO

(a) IFRS requires a first-time adopter to present an opening IFRS statement of financial position at the date of transition to IFRS, which results in the presentation of three statements of financial position. An FPI that is not a first-time adopter of IFRS is also required to provide three statements of financial position if it makes retrospective revisions to its financial statements, which is required upon adoption of a new accounting policy, a restatement or a reclassification in the financial statements. Even if an FPI is an EGC, it would still be required to provide three statements of financial position in these instances to assert that its financial statements are prepared in compliance with IFRS as issued by the IASB.

(b) In an initial registration statement, if the financial statements are presented in accordance with U.S. GAAP (rather than reconciled to U.S. GAAP), the earliest of the three years of financial statements may be omitted if that information has not previously been included in a filing made under the Securities Act or the Exchange Act. This accommodation does not apply to financial statements presented in accordance with IFRS as issued by the IASB, unless the issuer is applying IFRS as issued by the IASB for the first time. Instruction G to Form 20-F provides for an accommodation that permits a foreign private issuer in its first year of reporting under IFRS as issued by the IASB to file two years rather than three years of statements of income, changes in shareholders' equity and cash flows prepared in accordance IFRS as issued by the IASB.

(c) A third year is required if the acquisition is greater than 50% significant and the acquired business had revenues of at least \$50 million in its most recent fiscal year.

(d) An FPI is required to comply with the reporting requirements of Rule 3-05 for material acquisitions when registering securities. An FPI is not subject to the ongoing reporting filing requirements of Rule 3-05 for a material acquisition (FPIs are not subject to the reporting filing requirements of Form 8-K).

(e) If an FPI qualifies as an EGC, this is required with the first Form 20-F filed after the IPO.

(f) Under existing SEC rules and regulations, newly public entities, other than nonaccelerated filers, begin complying with Section 404(b) auditor attestation of the Sarbanes-Oxley Act with their second annual report filed with the SEC. An EGC will be exempt from this requirement as long as it qualifies as an EGC; however, management's reporting on internal control is still required.

(g) On April 8, 2011, the SEC staff advised that foreign private issuers, who prepare their financial statements in accordance with IFRS as issued by the IASB, are not required to submit to the SEC and post on their corporate website XBRL reporting until the SEC specifies a taxonomy for use in preparing their XBRL exhibit.

(h) After going public, an EGC will file annual, quarterly and periodic reports under existing SEC rules and regulations. An EGC filing that includes selected financial data in a filing is not required to provide this information for periods earlier than those presented in the EGC's initial registration statement.

Contributor profiles



NYSE
11 Wall Street
New York, NY 10005
United States
Tel +1 212 656 3000
www.nyx.com

Scott R. Cutler
Executive Vice President, Head of Global Listings

Scott Cutler is executive vice president and head of global listings at NYSE, where he is responsible for managing the Exchange's relationship with over 2,100 companies listed at the NYSE from Canada, Latin America, United States and Asia, as well as over 2,000 companies listed at the European domestic markets. In addition, Mr. Cutler is responsible for the Exchange's relationship with the investment banking, private equity, venture capital, and legal communities to attract new listings and also oversees the capital markets business, including, initial public offerings for operating companies, structured products, closed-end funds, and REITs listing on the NYSE or NYSE MKT. He also oversees strategic development and M&A for the global listings business.

Mr. Cutler has been involved in over \$130 billion in initial public offering transactions since 2008, leading the NYSE to its #1 ranking globally among exchanges over the past four years, and 75% of the domestic U.S. market. He has managed some of the largest capital markets transactions in history, such as General Motors, Visa, Petrobras, HCA and Banco Santander Brazil, and led the NYSE's transition in technology IPOs, with deals including AOL, AVG, Freescale, Fusion i-o, LinkedIn, Netsuite, Pandora, VMWare and Yelp!

He is a regular commentator on CNBC and Bloomberg TV and is frequently quoted in financial publications such as *The Wall Street Journal*, *Financial Times*, *Reuters*, *Bloomberg*, *New York Times*, *Exame (Brazil)* and *Caijing Magazine* (China) on topics including capital markets, regulation and corporate governance.

Mr. Cutler has an extensive background in investment banking and corporate securities law. Before joining NYSE, he was an investment banker focused

on technology at SG Cowen & Co. and Thomas Weisel Partners. He was also a corporate securities lawyer at Cooley Godward, focused on M&A, IPOs, venture fund formation and venture capital representation.



Cleary Gottlieb Steen & Hamilton LLP
One Liberty Plaza
New York, NY 10006
United States
Tel + 1 212 225 2000
www.clearygottlieb.com

Nicolas Grabar
Partner
ngrabar@cgsh.com

Nicolas Grabar's practice focuses on international capital markets and securities regulation, as well as the representation of large reporting companies, leading Mexican and Brazilian companies, Fortune 100 companies and global investment banks. He has extensive experience in international financings in public and private markets, including U.S. securities law applicable to foreign issuers, and in the regulation of financial reporting. He specializes in the telecommunications and natural resource sectors and has advised on acquisitions, joint ventures, privatizations and debt restructurings. Mr. Grabar was honored in 2011 as a "Dealmaker of the Year" and in 2010 as a "Dealmaker in the Spotlight," each by *The American Lawyer*. IFLR, Chambers, *The Legal 500*, Latin Lawyer, *The International Who's Who of Lawyers* and *The Best Lawyers in America* repeatedly recognize him as one of the world's best capital markets lawyers. From 2002 to 2010, Mr. Grabar chaired the annual PLI program on foreign issuers and U.S. securities regulation. He is a co-author of *U.S. Regulation of the International Securities and Derivatives Markets* (published by Wolters Kluwer, 10th edition, 2012) and is currently a member of the TriBar Committee on Legal Opinions. Based in the New York office, Mr. Grabar became a partner in 1991. Mr. Grabar is a member of the Bar in New York and has been admitted to practice in France.

Sandra L. Flow
Partner
sflow@cgsh.com

Sandra Flow's practice focuses on capital markets transactions and corporate governance, including the representation of both U.S. and international issuers, as well as underwriters, in a variety of Securities and Exchange Commission

Fenwick

FENWICK & WEST LLP

Fenwick & West LLP
Silicon Valley Center
801 California Street
Mountain View, CA 94041
United States
Tel + 1 650 988 8500
www.fenwick.com

Jeffrey R. Vetter

Partner

jvetter@fenwick.com

Jeffrey Vetter's practice concentrates on public and private offerings of securities, mergers and acquisitions, counseling public and late-stage private companies and other securities law matters.

Mr. Vetter's recent public offerings include Tableau Software, Workday, Facebook, Proofpoint, Fusion-io, Jive Software, Responsys, SuccessFactors and ShoreTel. He has worked on more than 45 IPOs during his career. Mr. Vetter also represents underwriters of numerous initial public offerings, including the initial public offerings of Marin Software, Model N, Jive Software, Fusion-io, Salesforce.com and Omniture, and has experience with other public and private offerings of debt and equity securities and stock exchange listings, including the listing of SuccessFactors on the NYSE and Frankfurt Stock Exchange, corporate governance matters and joint ventures.

Mr. Vetter has also advised companies with respect to corporate governance and SEC matters, activist stockholders and joint ventures. He also advises a variety of late-stage private companies.

Mr. Vetter was named a 2012 Attorney of the Year by The Recorder and is listed in Chambers USA for capital markets: debt & equity, U.S. News–Best Lawyers® for securities and capital markets law and is repeatedly selected as a Northern California Super Lawyer by Super Lawyers, a Thomson Reuters publication.

William L. Hughes

Partner

whughes@fenwick.com

William Hughes's practice focuses on securities offerings, counseling public companies and securities law compliance. His experience encompasses initial public offerings, follow-on equity offerings, investment-grade debt offerings,

(SEC) registered and private securities offerings and domestic and cross-border listings. Her corporate governance practice includes advising companies on their disclosure obligations and governance matters, including compliance with SEC requirements, the Sarbanes-Oxley Act and listing standards of the NYSE and NASDAQ. She has also advised a number of companies on issues relating to financial statement restatements. Ms. Flow has been recognized as a "leading lawyer" for capital markets by the IFLR 1000 Guide to the World's Leading Law Firms and distinguished for her capital markets practice by The U.S. Legal 500. Ms. Flow is currently Chair of the Committee on Securities Regulation of the New York City Bar Association. Based in the New York office, Ms. Flow became a partner in 2004. She is a member of the Bar in New York.

John Palenberg

Partner

jpalenberg@cgsh.com

John Palenberg's practice focuses on international capital markets transactions, particularly matters related to Japan and German-speaking Europe, and corporate governance issues. He has extensive experience with international debt and equity financings, restructurings, recapitalizations and refinancings involving obligors in the United States, Europe, Africa and the Commonwealth of Independent States. Chambers Global, Chambers Europe, The Legal 500 UK and The Legal 500 U.S. recognize him as one of the world's best capital markets lawyers. Mr. Palenberg was resident in the Frankfurt office from 1996 to 2000 and in the London office from 2000 to 2010, and from 2004 to 2010, he divided his time between the London and Cologne offices. Prior to his return to the United States, JUVE ranked him as among the leading seven attorneys in Germany for debt offerings. Currently based in the New York office, Mr. Palenberg became a partner in 1991. He is a member of the Bar in New York.

Mary E. Alcock, a counsel in the Cleary Gottlieb New York office, provided executive compensation and employee benefits expertise for this guide. In addition, Cleary Gottlieb associates Alex Speyer, Craig Fischer and Fred Martin, all of whom focus on corporate and financial matters, provided invaluable assistance, as did Cleary Gottlieb associates Lilliane Diaba, who focuses on executive compensation and employee benefits, Brynn Lyerly, who focuses on litigation, and Julie Yip-Williams, who focuses on M&A and corporate governance. Cleary Gottlieb senior attorney Elizabeth Chang provided expertise in the area of Blue Sky law. We also thank Cleary Gottlieb associates Catherine Skulan and Nicole Puppieni, and former associates Femi Austin, Colleen Harp and Carsten Fiege, for their assistance on the first edition of this guide.



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FTI Consulting
 88 Pine Street, 32nd Floor
 New York, NY, 10005
 United States
 Tel + 212 742 8964
www.fticonsulting.com

convertible debt offerings and going-private transactions. Mr. Hughes's recent initial public offerings include Infoblox, Green Dot and ShoreTel. He has also represented Cisco Systems and Symantec on numerous public and private offerings of debt securities. Mr. Hughes regularly advises companies on disclosure and reporting obligations under U.S. federal securities laws, corporate governance issues and stock exchange listing obligations. He also advises a variety of late-stage private companies.

Elizabeth Saunders
 Chairman, Americas—Strategic Communications
elizabeth.saunders@fticonsulting.com

Elizabeth Saunders is Americas Chairman of the Strategic Communications segment at FTI Consulting, and is based in Chicago and New York.

The Strategic Communications segment at FTI Consulting is a global, financial and corporate communications firm with in-depth expertise in investor relations (IR), capital markets communications, and transaction and crisis communications. It is consistently ranked by Mergermarket as one of the top M&A firms globally, and was named the 2012 "Corporate Agency of the Year" by The Holmes Report.

Ms. Saunders also leads the Americas Financial Communications practice, and specializes in building best-practice financial communications programs across a wide spectrum of clients. She serves as senior counsel for business transformation assignments, and has actively worked on post-merger communications, CEO transitions and restructurings for Fortune 500 companies, including the Coca-Cola acquisition of its largest North American bottler, CCE; the Dow Chemical acquisition of Rohm & Haas; the merger of Knight Capital Group and GETCO; and various activism contests, defending companies from Carl Icahn, Janna Partners and Relational Advisors.

Renowned for her expertise in the area of corporate governance, Ms. Saunders has published numerous articles; lectured throughout the U.S. on shareholder activism strategies; and been quoted in Board & Directors Magazine, The New York Times and The Wall Street Journal. She was also named to the Crain's Chicago Business "40 Under 40" list, and has spoken to the National Association of Corporate Directors (NACD) and WomenCorporateDirectors (WCD).

Prior to this, Ms. Saunders was a co-founder of Ashton Partners, one of the top-15 independent IR firms in the U.S. FTI Consulting acquired Ashton partners in 2001.

Ms. Saunders holds a law degree from DePaul University with a concentration in securities law, and a BBA in finance from the University of Notre Dame. She is a member of National Investor Relations Institute (NIRI) Senior Roundtable, and is a former NIRI board member and Emerging Issues subcommittee chair. Ms. Saunders is also actively involved with Catholic Charities and The Cradle.

Leigh Parrish
 Senior Managing Director—Strategic Communications
leigh.parrish@fticonsulting.com

Leigh Parrish is a Senior Managing Director and the Retail & Consumer Sector Leader in the Strategic Communications practice of FTI Consulting. She is based in the Company's New York office.

As a senior communications consultant with more than 15 years of experience, she has a proven track record in directing critical communications campaigns and devising multi-stakeholder strategic communications programs.

Ms. Parrish's client engagements have ranged from innovative capital markets and business media relations programs to advising clients on communications issues including corporate positioning, key message development, management transitions and terminations, financial results and related disclosures, and employee communications. She has extensive experience in event-driven, crisis and financial situations that includes initial public offerings, mergers and acquisitions, bankruptcy or restructuring, regulatory probes, litigation, product recalls and other reputational issues.

Ms. Parrish's client experience is varied having worked across industries spanning retail, consumer, education, real estate, media, and financial services. Her recent IPOs include Taylor Morrison, Restoration Hardware and Dollar General while crisis and issues management work has included clients such as Orchard Supply Hardware, American Suzuki Corporation, Fairfield Residential, Phillips Foods, Circuit City,

IPREO

Ipreo
1359 Broadway,
2nd Floor
New York, NY 10018
United States
Tel + 1 212 849 5000
www.ipreo.com

Chris Taylor
EVP & Managing Director, Global Investor
Relations, New York
chris.taylor@ipreo.com

Chris Taylor heads up the Global Investor Relations division for Ipreo, a leading provider of market intelligence and IR technology to publicly traded companies around the world. Ipreo's extensive suite of IR services includes cross-asset class surveillance, investor targeting, perception studies and custom analytics, as well as the BD Corporate platform, which offers the most comprehensive database covering global institutional contacts, investor profiles and ownership data.

Mr. Taylor came to Ipreo through the acquisition of CapitalBridge in February 2008, where he served as managing director, responsible for the global operations of the firm. During his 15-year tenure there, he was a key orchestrator of the firm's growth and transformation into one of the preeminent brands in market intelligence. Mr. Taylor has been an active speaker on relevant investor relations topics at the National Investor Relations Institute (NIRI) Annual Conference, local NIRI chapters and other industry events.

J.P.Morgan

J.P. Morgan & Co.
Global Equity Capital Markets
383 Madison Avenue, Floor 28
New York, NY 10179
Tel + 1 212 622 5628
www.jpmorgan.com

Elizabeth Myers
Managing Director, Head of Global Equity
Capital Markets, New York

Elizabeth Myers is a Managing Director and Head of the Global Equity Capital Markets (ECM) group at J.P. Morgan. Ms. Myers joined J.P. Morgan 21 years ago. Over the past 16 years in ECM she has executed numerous IPOs, follow-ons and convertible transactions for clients across the globe, spanning a range of industries including financials, technology, real estate, industrials, health care, natural resources and consumer products. Prior to joining ECM, she worked for several years in J.P. Morgan's Mergers & Acquisitions group and focused on transactions across a range of industries. Ms. Myers has an MBA from Harvard Business School and a BA in Economics from Princeton University.

Bill Contente
Managing Director, Vice Chairman of
Equity Capital Markets, New York

Bill Contente is a Managing Director and Vice Chairman of Equity Capital Markets at J.P. Morgan's Investment Bank, based in New York. Prior to that Mr. Contente was Co-Head of Equity Capital Markets for the Americas. Mr. Contente has worked on numerous high profile IPOs and major capital raisings since joining J.P. Morgan in 1991. Amongst notable deals, Mr. Contente led the \$23.1bn IPO for General Motors, the largest equity capital raise ever, and the \$19.7bn IPO for Visa. Mr. Contente has extensive experience working with clients in Diversified Industrials, Technology Services, Transportation, Aerospace and Defense industries, and with Financial Sponsors clients. Previously, Mr. Contente worked extensively in Europe and Latin America, particularly in Brazil. Mr. Contente holds a B.A. in Economics from Yale University.

The Children's Place and Kid Brands. She has led ongoing programs for a variety of retailers such as OfficeMax, Aeropostale, Guitar Center, Talbots, Dollar General, Lumber Liquidators and consumer companies such as International Flavors & Fragrances, Hanesbrands, Movado Group, and Jarden.

Ms. Parrish began her career at Robertson, Stephens and managed investor relations at Ivanhoe Mines Inc. prior to joining Morgen-Walke Associates, which later merged with Financial Dynamics./FTI.

Ms. Parrish graduated with a BA in History from San Diego State University.

Sharrafah T. Al-Salem, CFA
Director—Strategic Communications
sharrafah.al-salem@fticonsulting.com

Sharrafah Al-Salem is a director in the FTI Consulting Strategic Communications practice and is based in San Francisco.

Ms. Al-Salem joined the firm as an analyst in November 2006. She has experience with financial communications across various sectors, including Energy, Technology and Retail; current and past clients include Transocean, Cloud Peak Energy, PetroLogistics, Polycorn, Juniper Networks and Restoration Hardware.

Ms. Al-Salem maintains a dynamic relationship with sell-side analysts and buy-side institutions and specializes in advising on strategic messaging, driven by market awareness and perceptions work. Additionally, she has done extensive shareholder base analyses, including benchmarking movements among top buyers/sellers as well as assessing risk and capacity of top holders. More recently, she played a significant role in building out communications platforms for Restoration Hardware, PetroLogistics and Gogo around their initial public offerings.

Prior to joining FTI Consulting, Ms. Al-Salem was with Equilar, Inc., an executive and board compensation research firm. She received a BS in management science at University of California, San Diego. Ms. Al-Salem is a CFA charterholder.

J.P. Morgan & Co.
Global Equity Capital Markets
560 Mission Street, Floor 20
San Francisco, CA 94105
Tel + 1 415 315 5000
www.jpmorgan.com

J.P. Morgan Depository Receipts
Group
1 Chase Manhattan Plaza, Floor 58
New York, NY 10005
Tel + 1 212 552 3739
www.jpmorgan.com

Michael Millman

Managing Director, Global Head of Technology, Media and Telecom Equity Capital Markets, San Francisco

Michael Millman is a Managing Director and Global Head of J.P. Morgan's Technology, Media and Telecom (TMT) Equity Capital Markets Group. In his role, Michael spearheads the firm's strategic advisory and equity capital raising services for TMT clients around the world. He is also responsible for coverage of U.S. western region equity mandates. Mr. Millman began his career at J.P. Morgan in 1997 and currently oversees a wide variety of equity mandates ranging from structuring and executing initial public offerings, follow-on offerings and specialized capital raising alternatives such as convertible security offerings and equity private placements. His client coverage includes a range of emerging and established companies in the TMT sector and he has managed many of J.P. Morgan's most important and high profile equity financing mandates. Michael's work has led him to interact with a variety of clients across the globe, and develop strategic relationships with key buy-side institutions, financial sponsors and venture firms. Mr. Millman holds a BA in Economics/Statistics from Rutgers University and an MBA from Columbia University.

Christopher Roberts
Managing Director, Head of Equity Execution, Technology, Media and Telecom Equity Capital Markets, San Francisco

Christopher Roberts is a Managing Director and Head of Equity Execution for J.P. Morgan's Technology, Media and Telecom (TMT) Equity Capital Markets Group. In this role, he oversees the structuring and execution of TMT equity offerings bookrun by J.P. Morgan with the aim of ensuring efficiency of process and consistency of execution standards. Mr Roberts has been

with J.P. Morgan for six years and has 16 years of experience in investment banking and legal practice. Prior to his current role, he worked in J.P. Morgan's EMEA ECM Execution Group based in London, with responsibility for the execution of numerous initial public offerings and follow-on offerings across a broad range of sectors and geographies. He began his career in 1997 as a corporate and securities lawyer and practiced in London and Paris advising clients on a wide range of financing transactions, including in particular public and private equity capital raisings. Mr. Roberts holds a BA Hons (First Class) from University College London, as well as postgraduate law qualifications from UEA Law School and The College of Law, London.

Ivan M. Peill

Vice President, Global Head of IR Advisory, New York
ivan.m.peill@jpmorgan.com

Ivan Peill is a Vice President in the IR Advisory Services team of J.P. Morgan's Depository Receipts Group. He has 15 years of investor relations experience. Before joining J.P. Morgan, he was an advisor at Georgeson & Co., Thomson Financial and Capital MS&L, where he counseled small- to large-cap clients in Asia, Europe, the United States and Latin America. In addition to his extensive IR experience, Mr. Peill has expertise in financial media relations.

Mr. Peill advises J.P. Morgan DR clients on various aspects of investor relations: formulating an IR strategy; building an effective IR infrastructure; training executives new to investor relations; creating effective investor communications materials, such as roadshow presentations; developing disclosure policies; analyzing changes in institutional ownership; and using the financial media to raise visibility in the capital markets.

Mr. Peill is the editor of J.P. Morgan's DR Advisor Quarterly, a publication focused on investor relations and other issues important to DR issuers. He also writes papers on SEC regulatory developments and serves as an expert speaker at IR conferences around the world. He holds an MBA with honors from Fordham University and is a member of the National Investor Relations Institute.



KPMG
 345 Park Avenue
 New York, NY 10154-0102
 United States
 Tel + 1 212 758 9700
www.kpmg.com

Aamir Husain
 Partner, New York
ahusain@kpmg.com

Aamir Husain is a partner at KPMG in the firm's New York office where he is the national leader of the IPO Advisory practice. He has more than 19 years of experience providing capital markets advisory services to global private equity funds, investment banks and other strategic investors. Mr. Husain advises clients with technical and project management advice on complex accounting and finance reporting issues associated with the SEC registration process, IPOs, 144a debt offerings, carve-outs and conversions to and from IFRS and U.S. GAAP. He has extensive experience in cross-border transactions and has assisted major international institutions in the United States, Europe and Asia to list on the New York Stock Exchange as well as on exchanges in London, Hong Kong and Toronto. During his career, Mr. Husain has worked on over 30 IPOs. He received his BA degree from Boston University and is a member of the American Institute of Certified Public Accountants (AICPA) and the Institute of Chartered Accountants in England and Wales (ICAEW).

Kevin Bogle
 Managing Director, New York
kevinbogle@kpmg.com

Kevin Bogle is a member of KPMG's Accounting Advisory Services group and a managing director in the firm's New York office. Mr. Bogle provides clients with accounting, financial reporting and project management support for equity and debt offerings (including initial public offerings), mergers and acquisitions, accounting conversions and divestitures. This includes assisting clients with SEC and foreign filings, U.S. GAAP and International Financial Reporting Standards (IFRS) technical accounting issues and financial integrations. During his career, Mr. Bogle has assisted clients with their IPOs in the

United States, Canada and Hong Kong that have also included strategic sales efforts and carveouts.

Shari Mager
 Managing Director, Silicon Valley
smager@kpmg.com

Shari Mager is a managing director at KPMG in the firm's Accounting Advisory practice. She is based in the Silicon Valley office, providing capital markets advisory services to private equity and venture-backed companies. Ms. Mager provides clients with accounting, financial reporting and project management advice for both public and private equity and debt offerings, as well as mergers, acquisitions and divestitures. This includes assisting clients with SEC filings and reporting matters, sell-side assistance including carveouts, U.S. GAAP technical accounting issues and postmerger financial integrations, including accounting conversion and business combination issues.

G. Anthony Lopez
 Director, Denver
galopez@kpmg.com

Tony Lopez is a member of KPMG's Accounting Advisory Services group and a director in the firm's Denver office. Mr. Lopez specializes in transaction or special-event-based advisory services, including IPOs, business combinations, spin-offs, financial restatement assistance, IFRS conversions and technical on-call accounting. Mr. Lopez advises companies on a variety of SEC reporting matters. He formerly was a FASB staff member, SEC Associate Chief Accountant and Deputy Chief Auditor with the PCAOB. Mr. Lopez also spent five years in the national office of another Big 4 firm consulting on complex accounting matters.

Mike Meara
 Director, New York
mmeara@kpmg.com

Mike Meara is a member of KPMG's Accounting Advisory Services group and a director in the firm's New York office. He has worked on a variety of equity offerings, including IPOs and other SEC-registered offerings. Mr. Meara regularly advises public companies on financial reporting and regulatory issues, including SEC filings, restatements, IFRS conversions and postmerger integration. Prior to joining Accounting Advisory Services, he held financial management positions in Fortune 1000 companies, where he was responsible for SEC reporting and corporate financial reporting areas. Mr. Meara received his MBA and BBA degrees from Thunderbird and the University of Texas at Austin, respectively.



Marsh
1166 Avenue of the Americas
New York, NY 10036-2774
United States
Tel + 1 212 345 6000
www.marsh.com

99 High St
Boston, MA 02116
United States
Tel + 1 617 385 0200

345 California Street,
Suite 1300
San Francisco,
CA 94104-2679
United States
Tel +1 415 743 8000

Dennis Kearns
Managing Director, Financial &
Professional Liability Practice
dennis.kearns@marsh.com

Dennis Kearns is a managing director and manager of the Claims Advocacy Group for Marsh's Financial and Professional Liability Practice, specializing in complex coverage and claims issues concerning directors and officers liability, employment practices liability, fiduciary liability, and professional liability insurance. Dennis leads a team of 11 lawyers serving as claims advocates for Marsh clients and works extensively with advisory brokers and clients on policy language, manuscript endorsements, and other legal issues regarding the structure and placement of management liability insurance. Prior to joining Marsh in 2011, Dennis spent 11 years at Chubb, serving as an executive underwriter, underwriting counsel, and coverage counsel. He also served as a senior attorney in Chubb's claims department, providing insurance coverage advice on personal and commercial insurance policies and monitoring coverage litigation. Dennis previously served as underwriting counsel and held several positions in the claims department at AIG, where he was responsible for adjusting high-end exposure claims under multimedia, corporate, miscellaneous, and Internet professional liability policies. Admitted to practice law in 1993, Dennis has also held positions in private and public legal practice and has served as an adjunct professor. He has served as a speaker and panelist at several seminars on directors and officers liability insurance topics, including events sponsored by RIMS and the American Conference Institute.

David Hong
Managing Director, Financial &
Professional Liability Practice
New York, NY
david.hong@marsh.com

David Hong is the U.S. Placement leader and a senior advisor in Marsh's Financial and Professional Liability Practice. In his role as an advisor, he assists clients on the evaluation and design of risk-transfer solutions that address financial and professional exposures, including directors and officers, errors and omissions, employment practices and fiduciary- and crime-related products. Mr. Hong is recognized for his technical expertise in risk-profile evaluation, coverage analysis and related securities compliance and corporate governance issues. He advises a variety of publicly traded U.S. and multinational companies that have D&O insurance programs supported in the U.S., European and Bermuda marketplace. Prior to joining Marsh in 2004, he was a securities attorney for nine years in New York and San Francisco, focusing on mergers and acquisitions, public and private debt and equity placements, corporate governance and securities compliance. In his nine years as a securities lawyer, Mr. Hong has been the general counsel for a software and communications company and was an attorney with Morrison & Foerster LLP. He has represented a broad base of clients in industries including technology, aerospace and defense, mining, consumer products, transportation and power and energy. He holds a JD degree from Georgetown University Law Center and a BA from Columbia University.

Susan Ott
Vice President, Private Client Services
San Francisco
susan.ott@marsh.com

Susan Ott directs asset protection consulting and insurance services offered to affluent individuals and families. Her 25 years of extensive risk management experience provides her with unique insight into delivering tailored client solutions that help protect wealth as well as physical assets. Prior to rejoining Marsh in 2011, Susan worked as the managing director of Personal Insurance for another Bay Area brokerage. She has been a featured speaker at several industry conferences and wealth management events, including the Risk & Insurance Management Society (RIMS), the Family Firm Institute (FFI) and the Family Office Exchange (FOX). Ms. Ott is a graduate of the University of San Francisco with a BS in business administration and a master's in human resources and organization development. She also holds the designation of Associate in Risk Management (ARM) from the Insurance Institute of America.

MORROW & CO., LLC
SINCE 1972

Morrow & Co., LLC
470 West Avenue
Stamford, CT 06902
United States
Tel + 1 203 658 9400
www.morrowco.com

Frederick J. Marquardt
Senior Managing Director
fmarquardt@morrowco.com

Fred Marquardt is a senior managing director of Morrow & Co., LLC, a prominent proxy solicitation and corporate governance consulting firm. Mr. Marquardt has over 35 years of experience in the industry and regularly works with both domestic U.S. and foreign corporations on annual and special shareholder meetings, consent solicitation, tender and exchange offers and governance consulting work. He works closely with a team of experienced individuals in providing clients with the timely information on strategic engagement with investors and corporate governance advice.

Before joining Morrow in 1991, Mr. Marquardt was senior vice president at The Carter Organization, Inc., having served as the head of the Proxy Solicitation Group.

Mr. Marquardt is a frequent speaker on proxy solicitation and governance topics to industry groups, law firms and professional organizations, both in the United States and abroad. He earned a BA from Queens College of the City University of New York and an MBA in finance from St. John's University.

RR DONNELLEY

RR Donnelley
111 South Wacker Drive
Chicago, IL 60606-4301
United States
Tel + 1 312 326 8000
www.rrdonnelley.com

Mr. Thomas F. Juhase
President, Financial Services Group

Tom Juhase was named president of RR Donnelley's Financial Services Group in 2004. The Financial Services Group consists of Global Document Solutions, Business Communication Solutions, Global Investment Markets, Global Capital Markets, Global Real Estate Services, Global Translations and Multilingual Communications Services, Global Outsourcing Services and Legacy EDGR Data and Analytics Business, now RRD Data and Analytics.

Mr. Juhase joined RR Donnelley & Sons in 1991 as managing director of European Capital Markets based in London. In 1996, he became managing director of International Sales and Operations for the business unit until 1999, when he became managing director and vice president of sales for RR Donnelley Financial in the United States. He later served as RR Donnelley Financial Services Group senior vice president of sales and service delivery until 2004. He is based in New York City.

Prior to joining RR Donnelley, Mr. Juhase spent several years in a variety of sales and general management positions within the financial printing and document services industry.

He earned a BS degree from Seton Hall University and a MBA from the University of Miami.

Publisher

Timothy Dempsey

Consulting publisher

Brian Curran, NYSE

Editorial and Production Services

PreMediaGlobal

Consulting editors

Nicolas Grabar, Sandra L. Flow

and John Palenberg

Cleary Gottlieb Steen & Hamilton LLP

**NYSE IPO Guide, Second Edition,
is published by**

Caxton Business & Legal, Inc

27 N Wacker Drive, Suite 601

Chicago, IL 60606

United States

Tel +1 312 361 0821

Fax +1 312 278 0821

www.caxtoninc.com

Printed by RR Donnelley

ISBN 978-0-615-84229-5

NYSE IPO Guide, Second Edition,

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