SEC AMENDS RULE 701 TO EASE DISCLOSURE BURDENS FOR CERTAIN SHARE OFFERINGS TO US EMPLOYEES

The US Securities and Exchange Commission ("SEC") has issued a final rule release (available here) to amend Rule 701 under the Securities Act of 1933, as amended (the "Securities Act") – an exemption commonly relied on by companies not listed in the United States to offer shares to their US employees. Specifically, the SEC has increased a threshold amount that triggers additional disclosure obligations pursuant to Rule 701 pursuant to a mandate contained in the recently enacted Economic Growth, Regulatory Relief, and Consumer Protection Act. At the time the SEC adopted this rule change, it also issued a concept release (available here) to solicit comments on possible ways to modernize rules related to compensatory arrangements in light of the significant evolution in both the types of compensatory offerings and the composition of the workforce.

Offers and sales of securities to persons in the United States must either be registered with the SEC under the Securities Act or be made pursuant to a valid exemption from US registration requirements. Rule 701 allows eligible companies to sell securities to their employees without the need to register the offer and sale of such securities. An issuer is eligible for the exemptive relief provided by Rule 701 when it is not subject to the periodic public reporting requirements of the Securities Exchange Act of 1934, as amended (the "**Exchange Act**") – which would include foreign private issuers who are only listed in their home country as well as non-public domestic US companies.

Rule 701 specifically applies to offers and sales under a written compensatory benefit plan or a written compensatory contract established by any of the following entities:

- the issuer of the securities;
- the issuer's parent company;
- any of the issuer's majority-owned subsidiaries; or
- any majority-owned subsidiaries of the issuer's parent company.

For all sales under Rule 701, the issuer must deliver to each relevant US employee a copy of the applicable plan document or contract.

This exemption limits the types of persons to whom the issuer's securities may be offered and sold in reliance to Rule 701 to those who are, at the time of the offer and sale of the securities:

- employees;
- directors;
- general partners;
- trustees;
- officers;
- consultants;
- advisors who are natural persons; and
- their family members through gifts or domestic relations orders.

The SEC's concept release solicits comments on whether to broaden the range of individuals permitted to participate in offerings under Rule 701.

The amount of securities that may be issued in reliance on Rule 701 is limited. The aggregate sales price of all securities sold into the United States during any consecutive 12-month period in reliance on Rule 701 may not exceed the greatest of the following:

- $1,000,000;
- 15% of the issuer's total assets measured at its most recent balance sheet date; or
- 15% of the outstanding amount of the issuer's securities of the same class measured at its most recent balance sheet date.

The SEC's concept release also seeks public comment on whether this annual limit should be increased or even eliminated.

Prior to the recent amendment to Rule 701, if the aggregate sales price of all securities sold during any consecutive 12-month period in reliance on Rule 701 exceeded $5 million, the issuer was required to deliver specified additional disclosures (including risk factors and financial statements) to the relevant US employees within a reasonable period of time before the actual sale date. This particular $5 million threshold has been increased to $10 million, at the direction of the US Congress pursuant to the Economic Growth, Regulatory Relief, and Consumer Protection Act. Because the amendment was directed by Congress, this rulemaking was not subject to the usual public comment process and became effective immediately upon publication in the Federal Register, which occurred on July 24, 2018. These additional disclosure requirements have been seen as especially burdensome for companies that report their financial results using accounting principles other than IFRS (as adopted by IASB) or US GAAP, because they would require financial statement reconciliation to US GAAP.

Employee share offerings made in reliance on the Rule 701 exemption sometimes include a $5 million maximum offering amount. When such a maximum is put in place, if the total amount subscribed for by US employees exceeds this maximum, US employee subscriptions would be subject to proration. By including this maximum offering amount, employers have been able to avoid triggering Rule 701's additional disclosure requirements. If a company offers shares to its US employees and has this type of limitation in their employee share offering documentation, they can now consider raising the maximum to $10 million.

The SEC's amendment to Rule 701's disclosure threshold represents a step toward decreasing burdens on employers relying on this rule. As discussed above, the concept release that the SEC published on the same day that it approved the amendment seeks public comment on other possible amendments to Rule 701 that would further decrease compliance burdens on non-reporting employers.

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