

**SECURITIES AND EXCHANGE COMMISSION**

**17 CFR Part 230**

**[Release No. 33-10520; File No. S7-17-18]**

**RIN 3235-AM39**

**Exempt Offerings Pursuant to Compensatory Arrangements**

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Final rule.

**SUMMARY:** The Securities and Exchange Commission is adopting an amendment to its regulations under the Securities Act of 1933 (the “Securities Act”), which provide an exemption from registration for securities issued by non-reporting companies pursuant to compensatory arrangements. As mandated by the Economic Growth, Regulatory Relief, and Consumer Protection Act (the “Act”), the amendment revises a rule to increase from \$5 million to \$10 million the aggregate sales price or amount of securities sold during any consecutive 12-month period in excess of which the issuer is required to deliver additional disclosures to investors.

**DATES:** *Effective date:* July 23, 2018.

*Comment date:* Comments regarding the collection of information requirements within the meaning of the Paperwork Reduction Act of 1995 should be received on or before August 23, 2018.

**ADDRESSES:** Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission’s Internet comment form (<http://www.sec.gov/rules/final.shtml>); or

- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number S7-xx-18 on the subject line; or
- Use the Federal eRulemaking Portal (<http://www.regulations.gov>). Follow the instructions for submitting comments.

Paper comments:

- Send paper comments in triplicate to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number S7- 17-18. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/final.shtml>). Comments are also available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

**FOR FURTHER INFORMATION CONTACT:** Anne M. Krauskopf, Senior Special Counsel, and Adam F. Turk, Special Counsel, Office of Chief Counsel, Division of Corporation Finance, at (202) 551-3500.

**SUPPLEMENTARY INFORMATION:** We are adopting an amendment to 17 CFR 230.701 (Rule 701)<sup>1</sup> under the Securities Act.<sup>2</sup>

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<sup>1</sup> Unless otherwise noted, all references to statutory sections are to the Securities Act, and all references to rules under the Securities Act are to title 17, part 230 of the Code of Federal Regulations [17 CFR part 230].

<sup>2</sup> 15 U.S.C. 77a et seq.

## I. BACKGROUND

Rule 701 provides an exemption from the registration requirements of the Securities Act for offers and sales of securities under certain compensatory benefit plans or written agreements relating to compensation. The exemption covers securities offered or sold under a plan or agreement between a non-reporting company<sup>3</sup> and the company's employees, officers, directors, partners, trustees, consultants, and advisors.<sup>4</sup>

## II. RULE AMENDMENT

As mandated by Section 507 of the Act,<sup>5</sup> we are amending Rule 701(e)<sup>6</sup> to increase from \$5 million to \$10 million<sup>7</sup> the aggregate sales price or amount of securities sold during any consecutive 12-month period in excess of which the issuer is required to deliver additional disclosure to investors. As amended, Rule 701(e) will otherwise continue to operate in the same manner as it currently does.<sup>8</sup> Specifically, the additional disclosures required by Rule 701(e)<sup>9</sup>

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<sup>3</sup> Only issuers that are not subject to the reporting requirements of Section 13 [15 U.S.C. 78m] or 15(d) [15 U.S.C. 78o(d)] of the Securities Exchange Act of 1934 ("Exchange Act") and are not investment companies registered or required to be registered under the Investment Company Act of 1940 [15 U.S.C. 80a-1 et seq.] are eligible to rely on Rule 701.

<sup>4</sup> The rule applies to compensatory arrangements established by the issuer, its parents, its majority-owned subsidiaries and majority-owned subsidiaries of the issuer's parent.

<sup>5</sup> Pub. L. 115-174, 132 Stat. 1296 (2018).

<sup>6</sup> 17 CFR 230.701(e).

<sup>7</sup> Section 507 of the Act also requires that every five years we index for inflation such aggregate sales price or amount of securities sold to reflect the change in the Consumer Price Index for All Urban Consumers published by the Bureau of Labor Statistics, rounding to the nearest \$1 million.

<sup>8</sup> Concurrent with the adoption of this amendment to Rule 701, we are issuing a concept release requesting public comment on various other issues relating to Rule 701. See Release No. 33-10521 (Jul. 18, 2018).

<sup>9</sup> These disclosures consist of:

- a copy of the summary plan description required by the Employee Retirement Income Security Act of 1974 ("ERISA") [29 U.S.C. 1104-1107] or, if the plan is not subject to ERISA, a summary of the plan's material terms;
- risk factors associated with investment in the securities under the plan or agreement; and
- the financial statements required in an offering statement on Form 1-A [17 CFR 239.90] under Regulation A [17 CFR 230.251 through 230.263].

will not be required for sales up to \$10 million in the 12-month period. If aggregate sales during that period exceed \$10 million, however, the issuer must deliver those additional disclosures a reasonable period of time before the date of sale to all investors in the 12-month period. Issuers that have commenced an offering in the current 12-month period will be able to apply the new \$10 million disclosure threshold immediately upon effectiveness of the amendment.

### **III. PROCEDURAL MATTERS**

The Administrative Procedure Act (“APA”) generally requires an agency to publish notice of a proposed rulemaking in the Federal Register and provide an opportunity for public comment.<sup>10</sup> This requirement does not apply, however, if the agency “for good cause finds . . . that notice and public procedure are impracticable, unnecessary, or contrary to the public interest.”<sup>11</sup>

As discussed above, Section 507 of the Act directs the Commission, not later than 60 days after the date of enactment, to amend Rule 701(e) to increase from \$5 million to \$10 million the aggregate sales price or amount of securities sold during any consecutive 12-month period in excess of which the issuer is required to deliver additional disclosures to investors. Because the amendment is necessary to conform Rule 701(e) to the requirements of the Act, and involves no exercise of agency discretion, we find that notice and public comment are unnecessary.<sup>12</sup>

The APA also generally requires that an agency publish an adopted rule in the Federal

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<sup>10</sup> See 5 U.S.C. 553(b).

<sup>11</sup> Id.

<sup>12</sup> This finding also satisfies the requirements of 5 U.S.C. 808(2), allowing the amendment to become effective notwithstanding the requirement of 5 U.S.C. 801 (if a federal agency finds that notice and public comment are impractical, unnecessary, or contrary to the public interest, a rule shall take effect at such time as the federal agency promulgating the rule determines). The amendment also does not require analysis under the Regulatory Flexibility Act. See 5 U.S.C. 604(a) (requiring a final regulatory flexibility analysis only for rules required by the APA or other law to undergo notice and comment).

Register 30 days before it becomes effective.<sup>13</sup> This requirement, however, does not apply if the agency finds good cause for making the rule effective sooner.<sup>14</sup> For the same reasons as we are forgoing notice and comment, we find good cause to make the rules effective immediately upon publication in the Federal Register. In addition, we find that the amendment relieves a restriction in our rules.<sup>15</sup>

#### **IV. ECONOMIC ANALYSIS**

We are mindful of the costs imposed by and the benefits obtained from our rules and amendments.<sup>16</sup> The discussion below addresses the potential economic effects of the amendment, including the likely benefits and costs. The Commission is adopting an amendment to implement the specific statutory mandate of Section 507 of the Act. The legislative history suggests that Section 507 of the Act was intended to address two concerns with the existing \$5 million threshold for requiring additional disclosure. Namely, that the additional disclosure makes it more expensive for companies to compensate their employees with the company's stock and that this disclosure puts non-reporting companies at risk of disclosing confidential financial information.<sup>17</sup> By increasing the threshold from \$5 million to \$10 million, we believe that Congress intended to alleviate some of these concerns. The costs and benefits of this amendment

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<sup>13</sup> See 5 U.S.C. 553(d).

<sup>14</sup> Id.

<sup>15</sup> Id.

<sup>16</sup> Section 2(b) of the Securities Act [15 U.S.C. 77b(b)] requires the Commission, when engaging in rulemaking where it is required to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition and capital formation.

<sup>17</sup> See, e.g., Report of the Financial Services Committee of the House of Representatives to H.R. 1343 ("These exemptions assist privately-held companies that want to provide their employees with the option to purchase the company's securities to increase employee ownership. . . . Rule 701 should be updated by raising the \$5 million threshold requirement because the disclosures make it more expensive for companies to compensate their employees with the company's stock. In addition, these disclosure requirements put private companies at risk of disclosing confidential financial information.").

stem entirely from the statutory mandate of Section 507.<sup>18</sup> In addition, given that the amendment implements a statutory mandate and involves no exercise of agency discretion, we believe there are no reasonable alternatives to the amendment.<sup>19</sup>

#### **A. Baseline**

The baseline for our economic analysis is the disclosure requirement of Item 701(e) prior to the amendment being adopted, which required an issuer to deliver additional disclosures to investors if the aggregate sales price or amount of securities sold during any consecutive 12-month period exceeded \$5 million. The amendment will affect non-reporting companies that rely on Rule 701 to offer securities to plan participants pursuant to compensatory benefit plans. In particular, the amendment will affect non-reporting companies that issue, or seek to issue, between \$5 million and \$10 million in a 12-month period. Non-reporting companies that issue less than \$5 million or more than \$10 million in a 12-month period will not be affected by the amendment. The Commission lacks data on non-reporting companies that rely on, or seek to rely on, Rule 701 to offer securities pursuant to compensatory benefit plans. We can approximate the number of growth companies with external financing needs using data on companies conducting exempt securities offerings under Regulation D, Regulation A, and Regulation Crowdfunding. This group may be likely to rely on Rule 701 for the purpose of offering competitive compensation packages to attract and retain key individuals. Based on filings in 2017, we estimate there are approximately 16,491 non-reporting companies conducting exempt offerings of unregistered securities under the aforementioned exemptions.<sup>20</sup> Some of

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<sup>18</sup> As the intent of this rulemaking is to implement the specific regulatory change mandated by Congress, this analysis focuses on the economic effects arising from that change.

<sup>19</sup> As noted above, concurrent with the adoption of this amendment, we are issuing a concept release requesting public comment on various other issues relating to Rule 701.

<sup>20</sup> Based on staff analysis of EDGAR filings in calendar year 2017, there were approximately 15,960 non-reporting operating companies conducting Regulation D offerings. In addition, there were 88 newly qualified

these companies may currently be too small to offer securities in compensatory benefit plans that would fall in the \$5 million to \$10 million range over a 12-month period, but could potentially be able to do so in the future if they successfully grow their businesses. We do not have access to equivalent data for non-reporting foreign private issuers, who also can rely on Rule 701 to offer securities pursuant to compensatory benefit plans.

Plan participants who make use of issuer disclosures will also be affected by the amendment mandated by the Act. To the extent a company issues more than \$5 million but less than \$10 million in aggregate sales price of securities under the rule in a 12-month period, the company will not be required to deliver the Rule 701(e) disclosures to plan participants.

#### **B. Economic Effects of the Amendment**

The statutory mandate requires the Commission to raise the threshold for requiring issuers to deliver additional disclosure to plan participants in Rule 701 offerings from \$5 million to \$10 million in any consecutive 12-month period. This will lower the regulatory burden in terms of required disclosures and thereby reduce the cost of securities offerings in this range pursuant to compensatory benefit plans by affected non-reporting companies. In addition, if the regulatory burden under the baseline currently deters some non-reporting companies from using this form of compensation arrangement to an extent that otherwise would be desired, such companies may be able to improve the efficiency of their employee compensation plans or contracts under the amendment and thereby improve company performance (e.g., through improved incentive provisions). Such increases in efficiency may permit these companies to deploy resources more productively. Further, these efficiency gains may be passed through to

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offerings under Regulation A during calendar year 2017, excluding post-qualification amendments and withdrawn offerings. Finally, 443 non-reporting companies conducted offerings solely under Regulation Crowdfunding in 2017 (companies conducting both Regulation D and Regulation Crowdfunding offerings in 2017 are included in the number for Regulation D offerings).

some plan participants through increases in the value of securities offered by non-reporting companies as these companies are able to avail themselves of the Rule 701 exemption without having to provide the previously required disclosure.

The amendment may reduce the amount of information available to plan participants, as issuers conducting offerings in the \$5 million to \$10 million range will not be required to provide Rule 701(e) disclosures to investors a reasonable period of time before the date of sale. Less information to plan participants may in turn make it harder for them to accurately value the offerings, and may partially offset the efficiency gains noted above. To the extent non-reporting issuers have issued securities in reliance on Regulation A and made available the information required by Rule 701(e) or have issued securities in excess of \$5 million in reliance on Rule 701 in the current 12-month period, and, at their option, continue to provide the disclosures required by Rule 701(e), there may be no loss of information to participants.<sup>21</sup>

We expect the amendment to make compliance burdens the same between companies seeking to use Rule 701 to offer amounts up to \$5 million and companies seeking to use Rule 701 to offer amounts between \$5 million and \$10 million. By doubling the amount of securities that can be offered to employees without requiring the additional disclosure under Rule 701(e) from \$5 million to \$10 million, the amendment to Rule 701 may have competitive effects for non-reporting companies that offer or sell securities as compensation. Although the Commission does not anticipate that the amendment will have substantial competitive effects among firms that currently rely on Rule 701, the amendment may permit some smaller companies to compete

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<sup>21</sup> Based on a review of Regulation A offering statements, irrespective of the offering amount sought, the staff identified approximately seven cases of companies that disclosed unregistered securities sold in reliance upon Rule 701 in the past twelve months in Part I of Form 1-A; however, this would not account for companies that have conducted a Regulation A offering and subsequently have relied upon Rule 701 for unregistered sales.



with larger companies to recruit and retain employees by increasing the offering amount threshold for additional disclosure from \$5 million to \$10 million.

Relatedly, companies seeking to offer amounts between \$5 million and \$10 million will experience a reduction in regulatory burden compared to companies wishing to offer amounts over \$10 million. As discussed below in Section V.A, for the purposes of the Paperwork Reduction Act, the Commission estimates that approximately 10% of the 16,149 non-reporting companies, or 1,600 issuers, provide information under Rule 701, and that approximately one-half of those issuers (800) will sell securities in compensatory benefit plans between \$5 million to \$10 million over a 12-month period. Using these estimates, we further estimate that the amendment will reduce the regulatory burden associated with Rule 701 by 400 hours of company personnel time and \$480,000 in professional costs per year.

Finally, to the extent compensatory benefit plans are used by non-reporting companies to attract and retain persons that are in demand internationally, a reduction in regulatory burden due to the amendment of Rule 701(e) may also increase the international competitiveness of the companies affected by the amendment.

## **V. PAPERWORK REDUCTION ACT**

### **A. Background and Summary**

Certain provisions of Rule 701 that will be affected by the amendment contain “collection of information” requirements within the meaning of the Paperwork Reduction Act of 1995 (“PRA”).<sup>22</sup> The Commission is submitting the amendment to the Office of Management

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<sup>22</sup> 44 U.S.C. 3501 et seq.

and Budget (“OMB”) for review in accordance with the PRA.<sup>23</sup> The title for the affected collection of information is:

Rule 701 (OMB Control No. 3235-0522).

Rule 701 provides an exemption from registration for offers and sales of securities pursuant to certain compensatory benefit plans and contracts relating to compensation. Issuers conducting employee benefit plan offerings in excess of \$5 million in reliance on Rule 701 are required to provide plan participants with certain disclosures, including financial statement disclosures. This disclosure constitutes a collection of information. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information requirement unless it displays a currently valid OMB control number. Compliance with the information collection is mandatory. Responses to the information collection are not kept confidential and there is no mandatory retention period for the information disclosed.

We estimate that currently approximately 1,600 issuers<sup>24</sup> provide information under Rule 701, and that the estimated number of burden hours per respondent is two.<sup>25</sup> Therefore, we estimate an aggregate of 3,200 burden hours per year. The portion of the burden carried by outside professionals is reflected as a cost, while the portion of the burden carried by the issuer internally is reflected in hours. We estimate that 25% of the burden per response is completed by the issuer internally and the other 75% of burden per response is attributed to outside cost, using

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<sup>23</sup> 44 U.S.C. 3507(d) and 5 CFR 1320.11.

<sup>24</sup> See Section IV.A, above. While we estimate that there are 16,491 non-reporting companies conducting exempt offerings of unregistered securities under Regulation A, Regulation Crowdfunding and Regulation D, some of these issuers may currently be too small to offer securities in compensatory benefit plans in excess of \$5 million over a 12-month period. For purposes of this PRA analysis, we estimate that approximately 10% of those issuers currently provide information under Rule 701.

<sup>25</sup> Issuers are required to provide information that is similar to, but not as extensive as, the information required by Form 1-SA [17 CFR 239.90], the semiannual report required to be filed with the Commission under Regulation A [17 CFR 230.251 through 230.263]. We believe, however, that many of these issuers already prepare the same types of disclosure in their normal course of business, such as for using other exemptions, so we estimate that the burden is two hours.

\$400 as the professional cost per burden hour.<sup>26</sup> We believe the amendment will reduce the current burden estimates associated with Rule 701 for issuers that sell securities in compensatory benefit plans in the \$5 million to \$10 million range over a 12-month period, especially for issuers that do not otherwise prepare the same types of disclosure in their normal course of business. We estimate this will impact one-half of the issuers that currently provide information under Rule 701, or 800 issuers.

We therefore estimate the total annual decrease in the paperwork burden for all affected companies to comply with the collection of information requirements of Rule 701, as amended, will be approximately 1,600 hours, allocated as a decrease of 400 hours (800 issuers x 0.5 burden hour) of company personnel time and a decrease of \$480,000 of professional costs (800 issuers x 1.5 hours x \$400 per hour).

Table 1. Decrease in Paperwork Burden under the final amendment.

	Estimated number of affected responses (A)	Decrease in burden hours per response (B)	Total decrease in burden hours (C)=(A)*(B)	25% Company (E)=(C)*0.25	75% Professional (E)=(C)*0.75	Professional Costs (F)=(E)*\$400
Rule 701(e) disclosure	800	2	(1,600)	(400)	(1,200)	(\$480,000)

<sup>26</sup> We recognize that the costs of retaining outside professionals may vary depending on the nature of the professional services, but for purposes of this PRA analysis we estimate that such costs will be an average of \$400 per hour. This estimate is based on consultations with several registrants, law firms and other persons who regularly assist registrants in preparing and filing periodic reports with the Commission.

## **B. Request for Comment**

We request comments in order to evaluate: (1) Whether the collection of information is necessary for the proper performance of the functions of the agency, including whether the information would have practical utility; (2) the accuracy of our estimate of the burden of the collection of information; (3) whether there are ways to enhance the quality, utility and clarity of the information to be collected; and (4) whether there are ways to minimize the burden of the collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

Any member of the public may direct to us any comments concerning the accuracy of these burden estimates and any suggestions for reducing the burdens. Persons who desire to submit comments on the collection of information requirements should direct their comments to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and send a copy of the comments to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090, with reference to File No. S7- 17-18. Requests for materials submitted to the OMB by us with regard to these collections of information should be in writing, refer to File No. S7-17-18 and be submitted to the Securities and Exchange Commission, Office of FOIA Services, 100 F Street NE, Washington DC 20549-0213. Interested persons are encouraged to send comments to the OMB by August 23, 2018.

## VI. STATUTORY AUTHORITY

The amendment contained in this release is adopted under the authority set forth in sections 3(b), 19(a), and 28 of the Securities Act and section 507 of the Economic Growth, Regulatory Relief, and Consumer Protection Act.

### List of Subjects in 17 CFR Part 230

Reporting and recordkeeping requirements, Securities.

### TEXT OF AMENDMENT

For the reasons set out in the preamble, title 17 chapter II of the Code of Federal Regulations is amended as follows:

#### **PART 230 – GENERAL RULES AND REGULATIONS, SECURITIES ACT OF 1933**

1. The authority citation for part 230 continues to read in part as follows:

Authority: 15 U.S.C. 77b, 77b note, 77c, 77d, 77f, 77g, 77h, 77j, 77r, 77s, 77z-3, 77sss, 78c, 78d, 78j, 78l, 78m, 78n, 78o, 78o-7 note, 78t, 78w, 78ll(d), 78mm, 80a-8, 80a-24, 80a-28, 80a-29, 80a-30, and 80a-37, and Pub. L. 112-106, sec. 201(a), sec. 401, 126 Stat. 313 (2012), and Pub. L. 115-174, sec. 507, 132 Stat. 1296 (2018), unless otherwise noted.

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2. Section 230.701 is amended by revising the introductory text of paragraph (e) to read as follows:

**§230.701 Exemption for offers and sales of securities pursuant to certain compensatory benefit plans and contracts relating to compensation.**

\* \* \* \* \*

(e) *Disclosure that must be provided.* The issuer must deliver to investors a copy of the compensatory benefit plan or the contract, as applicable. In addition, if the aggregate sales price or amount of securities sold during any consecutive 12-month period exceeds \$10 million, the

issuer must deliver the following disclosure to investors a reasonable period of time before the date of sale:

\* \* \* \* \*

By the Commission.

Dated: July 18, 2018

Brent J. Fields,  
Secretary.