

Public Statement

Statement on Amendment to Securities Act Rule 701(e) and Concept Release on Potential Revisions to Securities Act Rule 701 and Securities Act Form S-8



Commissioner Kara M. Stein

I would like to join Chairman Clayton in thanking the staff for their hard work on these releases. In particular, I would like to thank Anne Krauskopf and Adam Turk.

Today's rulemaking and concept release are both about expanding the use of stock compensation by companies. Both rule 701^[1] and Form S-8^[2] allow companies to more easily pay their employees in stock while still complying with federal securities laws. The recommendations before us ask whether these tools should be expanded so that more companies can use them. After all, we have all heard how stock compensation can help align employee incentives with company success, or help a company recruit and retain talent. But we also have heard how stock compensation may not ultimately provide the right incentives, or may not help a company or its employees in the long run.^[3] A corollary to the question presented, then, is whether more companies *should* be able to use these tools.

Currently, under the federal securities laws, every offer and sale of securities must be registered or be subject to an exemption from registration. These requirements apply even when a company decides to issue stock to its own employees. However, the Commission has long recognized that these sorts of stock issuances present different issues than capital-raising issuances. So, rather than requiring a private company^[4] to register employee stock offerings,^[5] or requiring a public company to go through the traditional registration process for these types of offerings, the Commission adopted rule 701 and Form S-8. Rule 701 and Form S-8 provide companies with an accommodation from certain liability, as well as from certain disclosures that they would otherwise be obligated to provide their shareholders under the federal securities laws.

Like the Commission's other regulatory accommodations, rule 701 and Form S-8 require that certain conditions be met in order for a company to use them. For example, rule 701 states that if a company issues more than \$5 million in securities in a 12-month period, it is required to provide greater investor protections in the form of certain financial and other disclosure to the persons that received the securities during that period.^[6] This is true even if those who received the stock are employees. This requirement was borne out of the Commission's concern that the larger the offering—even in the context of employee compensation—the greater the possibility of investor harm if there isn't accompanying investor protections, like financial disclosure.^[7] Earlier this year, however, Congress mandated that the Commission increase this threshold to \$10 million.^[8] And that is what today's first recommendation does. While I am still uncertain of all of the costs and benefits of such an increase, Congress did not give us discretion. Accordingly, I will support this recommendation.

Today's second recommendation goes a step further. It seeks comment on other aspects of the current exemption from registration. Given changes in both how companies pay their employees, and the evolving relationships between companies and the individuals who work for them, should the Commission expand a company's ability to issue stock without having to register the offering? In effect, the release asks whether the rule's definition of employee should be broadened in light of the so-called "gig economy." For example, some companies now enter into contractual arrangements with people that may be short-term, part-time, or freelance in nature. Other companies allow individuals to use their Internet "platforms." These individuals may provide services or products to end users, such as ride-sharing, food delivery, or hand-made crafts. But they do not necessarily enter into traditional employer-employee relationships. As a result, companies may not be able to pay them in stock using the current exemption under rule 701, which would require that the individual be an employee.^[9] That is because, while the Commission recognized that these types of stock issuances present issues that are different from capital-raising issuances, it also wanted to avoid potential abuse of the exemption. First and foremost, the Commission wanted to maintain appropriate protections for shareholders. Accordingly, the Commission has focused, in part, on the nature of a company's relationship with its employees to help determine the appropriate parameters of the exemption.

The main question we are asking commenters to weigh in on today is whether companies should be allowed to issue stock compensation to even more people without having to register the offering with the Commission. In particular, would allowing companies to issue stock to workers with whom they have short-term contractual arrangements be consistent with the rule's underlying goals? What parameters should be set around the relationship between a company and its workers? Would broadening the existing parameters result in companies hiring more independent contractors instead of full-time employees? Does the existing rule already cover such relationships? And how often do companies that have these sorts of arrangements actually want or need to issue securities to these types of workers in the first instance?

With respect to Form S-8, the release seeks comment on a host of issues. One, in particular, relates to the potential costs associated with filing the form. The Commission has over the years made efforts to reduce these costs.^[10] Despite this, the release is investigating ways in which to further reduce these costs. I would like to hear from commenters on what exactly the costs relate to, and what they are in real numbers. Do they relate to the registration fee, the cost of obtaining an auditor's consent, or other matters? Reducing costs can be a good thing, but we must remember, as I stated earlier, that Form S-8 is an accommodation from what companies would otherwise be required to do under the law at even greater cost. Form S-8 provides clear benefits to companies and their employees alike. It allows companies a simpler way to register offerings of stock that are made just to their employees. This, in turn, allows their employees to freely trade this stock, which may provide the company with increased liquidity. In this regard, we should remember that Form S-8 already attempts to reduce costs for those who provide stock compensation to their employees.

Ultimately, I will support today's recommendations. But I would like to hear commenters' best thoughts on the topics I highlighted, as well as the various requests for comment contained in the release.

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In conclusion, I'd like to highlight one final point. As we move forward, we should continue to be mindful of what effect any changes to our rules will have on incentivizing companies and investors to access the public markets. Put simply, we must ask ourselves whether any particular change would incentivize a company to become public, or whether it might actually encourage the company to remain private. If the Commission's current agenda is to encourage more investment in the public markets, while increasing Main Street investors' participation in these markets, we must be sure that the actions we take are consistent with this goal and do not inadvertently undermine the quality and transparency that instills investor confidence.

Thank you.

^[1] 17 CFR 230.701.

^[2] 17 CFR 239.16b.

[3] See, e.g., Financial Crisis Inquiry Commission, Financial Crisis Inquiry Report (Jan. 2011).

[4] 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 Exchange Act and are not investment companies registered or required to be registered under the Investment Company Act are eligible to rely on rule 701.

[5] The exemption covers securities offered or sold under a plan or agreement between a non-reporting company and the company's employees, officers, directors, partners, trustees, consultants and advisors.

[6] 17 CFR 230.701(e). In addition, a company can sell at least \$1 million of securities under rule 701 regardless of its size. A company can sell even more if it satisfies certain formulas based on its assets or on the number of its outstanding securities. Securities issued under rule 701 are "restricted securities" and may not be freely traded unless the securities are registered or the holders can rely on an exemption.

[7] Rule 701—Exempt Offerings Pursuant to Compensatory Arrangements, Securities Act Release No. 7645 (Feb. 25, 1999) [64 FR 11095 (Mar. 8, 1999)], at section II.B.

[8] Economic Growth, Regulatory Relief and Consumer Protection Act, Pub. L. 115-174, 132 Stat. 1296 (2018), section 507.

[9] See *supra* note 5.

[10] For example, by: allowing Form S-8 to go effective automatically without review by the staff or other action by the Commission; allowing the incorporation by reference of certain past and future reports required to be filed by the issuer under section 13 or 15(d) of the Exchange Act; adopting an abbreviated disclosure format that eliminated the need to file a separate prospectus and permitting the delivery of regularly prepared materials to advise employees about benefit plans to satisfy prospectus delivery requirements; providing for registration of an indeterminate amount of plan interests and providing that there is no separate fee calculation for registration of plan interests; and providing a procedure for the filing of a simplified registration statement covering additional securities of the same class to be issued pursuant to the same employee benefit plan.