

# A Reminder to Track Rule 701 Equity Awards to U.S. Residents

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Canadian companies relying on Rule 701 under the Securities Act of 1933 to exempt their U.S. awards of stock options and other types of compensatory equity (such as RSUs and PSUs), need to track on an ongoing basis the amount of grants being made in the United States. If they anticipate that the aggregate dollar amount of the awards, calculated under Rule 701, will exceed US\$5 million in any 12-month period, they must also prepare and deliver Rule 701-mandated disclosure documents.

Just this month, the SEC announced a financial settlement with a privately-held fintech company, Credit Karma, Inc., relating to Credit Karma's failure to provide stock option holders with the financial statements, risk factors, and other disclosures required by Rule 701 when its stock option awards exceeded US\$5 million over 12 months. In the settlement, Credit Karma agreed that due to these disclosure failures, there was no valid securities exemption, and the company had violated the registration requirements of the Securities Act. This, notwithstanding that only a small fraction of the stock options were actually exercised. Failure to comply with Rule 701 can also subject a company to additional consequences, including state enforcement actions, rescission offers to investors, and, in extreme cases, criminal prosecution.

While a company should always obtain advice from a knowledgeable securities lawyer, some key facts to know about calculating Rule 701 limits include:

- In the case of options, the sale is deemed to have been made at the time of the grant of the options, and the value is determined based on the exercise price of the options;
- In the case of other securities, the calculation is made at the time of sale, or in the case of a deferred compensation plan when the irrevocable election to defer is made, and the value is determined based on all of the consideration received or to be received by the company for the sale of the securities; and
- The SEC has taken the position that disclosure requirements are triggered by a company's expectation that it will exceed US\$5 million in a 12-month period, even if it has not yet exceeded US\$5 million.

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Rule 701 imposes further restrictions on which advice should be obtained by companies making equity awards in the United States, including limits on the types of companies that can make an award, the types of persons who can receive an award, resale restrictions, and the aggregate maximum amount that can be awarded even if Rule 701 disclosures are provided.