



Certified Equity Professional Institute

L1 Exam Overview Webinar Corporate and Securities Law

The information presented herein is of a general nature and has been simplified for presentation to a large audience. It is not a complete discussion of all aspects the laws, rules, regulations, standards, and principles that govern equity compensation plans. The contents are neither designed nor intended to be relied upon, and should not be considered, as legal, tax or accounting advice. Your specific situation may involve circumstances that cause the laws, rules, regulations, standards and principles described herein to apply differently. You should consult your own advisors before deciding what, if any, course of action to take in your own particular situation.

Exam Focus and Scope

- **Level 1 Subject Matter**
 - 25% Corporate & Securities Law



Corporate & Securities Law

● Financing

- Debt: borrowed funds
 - loans, bonds
- Equity: ownership
 - common stock: basic ownership interest
 - preferred stock: preferred status for distributions via dividends or liquidation
 - may have different rights (additional or no voting rights, transferability restrictions, conversion features etc.)

● Administering stock plans

- Board of directors or committee appointed by the board is responsible for approving the stock plan and option grants
- Shareholders also approve stock plans

● Reporting obligations

- Annual and special meetings of shareholders
 - Record date



Corporate and Securities Law

● Board of directors

- Make major policy decisions
- Appoint and remove officers
- Adopt equity plans
- Standards of conduct
 - The board's decisions must be in good faith and in the exercise of reasonable business judgment
- Conflicts of interest
 - Board members must have a disinterested view when approving matters.
 - Most companies establish a committee of outside directors to approve equity plans so as not to have any conflict of interest if an officer was on the board



Corporate and Securities Law

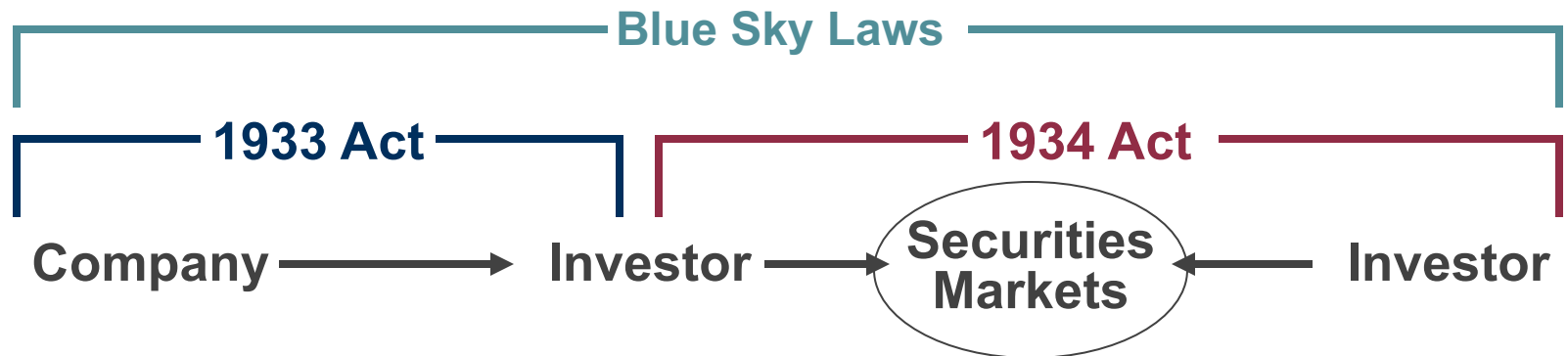
- **Corporate governance**

- Shareholder approval of equity plans required if company listed on a stock exchanges
- NYSE requires:
 - Compensation committee make recommendations to board about compensation of Section 16 officers
 - Compensation committee determines and approves CEO's compensation
- Internal approvals: Document, document, document



Governing Law

- **Securities Act of 1933:** Regulates the process by which companies sell stock to the investors
- **Securities Exchange Act of 1934:** Regulates the securities markets and the entities that participant in those markets
- **Blue Sky Laws**



Securities Act of 1933

- **Stock sold by a company to investors must be registered with the SEC**
 - Form S-1 is used to register shares sold in an IPO
 - Form S-8 is used to register shares sold pursuant to a stock plan
 - Prohibits fraud, misstatements and material omissions in the registration statement
- **Includes a number of registration exemptions**
 - Rule 701 exempts shares sold by a privately held company through a compensatory arrangement
 - Shares issued pursuant to an exemption are considered “restricted securities” and must be resold under an exemption
 - Rule 144



Registration Requirements

● Rule 701

- Exempts shares sold by a privately held company through a compensatory arrangement
 - Only available to privately held companies for stock sold via compensatory arrangements
 - Limits the amount of stock that can be sold in a 12-month period to whichever of the following is highest:
 - \$1 million
 - 15% of outstanding stock
 - 15% of assets
 - Requires additional disclosures if sales within a year exceed \$5 million
- Shares are “restricted securities” since not registered
- Shares are freely saleable 90 days after IPO
 - Only broker requirement applies
 - Blanket opinion letter



Registration Requirements

- Rule 144
- Exemption for resale of two types of securities:
 - Restricted securities
 - shares acquired in unregistered offering
 - cannot be resold unless registered or sold pursuant to an exemption
 - Control securities
 - shares owned by affiliates
 - persons considered to be in control of the company
 - officers, directors, and principal shareholders
 - can be registered or unregistered shares
 - affiliates never own “freely tradable” shares



Registration Requirements

- **Rule 144 requirements**

- Company must be current in reporting
- Shares to be resold must have been held for six months
- Shares resold in three-month period may not exceed the greater of:
 - 1% of the company's outstanding stock
 - average trading volume of preceding four weeks
- Shares must be sold through registered stock broker or market maker
- Form 144 filed with SEC at sale (or prior)



Section 16

- **Applies to**

- Officers

- CEO and president
- CFO, CAO, and possibly controller
- Vice presidents
- Other persons with significant policy-making function

- Directors

- 10% shareholders

- **Beneficial ownership**

- Relatives sharing the same household

- Children living away from home while attending college



Section 16(a) reporting

- **Requires holdings and transactions to be reported to the SEC**
 - Form 3
 - Holdings
 - File within ten calendar days of becoming an insider
 - Form 4
 - Open market purchases and sales
 - Grants, exercises, restricted stock purchases, sales of stock to the company
 - File within 2 business days after the transaction occurs
 - Form 5:
 - Gifts to anyone
 - Transfers due to inheritance
 - Small acquisitions that don't exceed \$10,000
 - File within 45 calendar days after fiscal year-end
 - Year-end statement that no Form 5 is required



Form 4

- **Reportable transactions**

- Grants of options, SARs, restricted stock
- Exercises and withholding of shares to cover taxes upon exercise
- Delivery of shares to company to pay exercise price
- Material amendment of option or SAR
- Sales and purchases
- Cancellation where money is received
- Trades under a Section 10b5-1 plan
- Transactions by a household relative



Section 16(a) reporting

● Exempt transactions

- Expiration or cancellation for no consideration
- Nonmaterial amendment to a stock options
- Vesting of an option, SAR, or RSA (RSUs depend on how they were initially reported)
- Transfer pursuant to divorce decree
- Dividend reinvestment plans
- ESPP purchases
- Stock splits



Section 16(b) matching

- **Short-swing profits recovery period**

- Opposite-way: Purchase and sale or sale and purchase
- Non-exempt: Exempt transactions are not subject to this rule. Many stock plan transactions are exempt.
- Within a period of less than six months.

- **Strict liability statute**

- Proof of inside information is not required for profits recovery
- Proof of economic profits are not necessary for recovery
 - Profits are determined by subtracting the lowest purchase price from the highest sale price



Section 16

- **Post-termination**

- Form 4 reporting required until six months after last transaction while still a Section 16 insider
- Transactions are matchable under Section 16(b) during that time



Insider Trading Regulation

- **Section 10(b) of the Securities Exchange Act of 1934**

- unlawful for any person, directly or indirectly, to use manipulative or deceptive device that contravenes any rule that the SEC may adopt
- Rule 10b-5
- Rule 10b5-1 trading plans
 - Allows participant to enter into a trading “plan” that provides for future, scheduled transactions
 - Contract entered into when no “material non-public” information
 - Defense against later trades

- **Other laws and considerations**

- Sarbanes-Oxley Act of 2002
- Dodd-Frank Act of 2010



Insider Trading Regulation

- **Material non-public information**

- Information that would affect market price of company's stock
- Information that would affect the decision of an investor
- Information not widely disseminated

- **Prohibited actions**

- Trading securities based on material non-public information
- "Tipping" other parties



Company Trading Policies and Practices

- **Company trading policies and practices**

- Window periods
- Blackout periods
- Compliance officer
- Employee education

- **Scope of application**

- All insiders, at a minimum
- Management-level employees
- Employees with access to confidential information
- All employees



Sarbanes-Oxley Act of 2002

- **Prohibits loans to executive officers and directors**
 - Applies to public companies
- **Internal Controls**
 - Section 404 requires annual report on controls for financial reporting
 - Management and auditors review controls
 - Review includes
 - Third-party administrators
 - Stock-plan tracking systems
 - Segregation of duties
 - Approvals
 - Communications
 - Financial expense calculations
 - SEC reporting



Corporate and Securities Law

● Blue Sky Laws

- State laws regulating transactions in securities
- Similar to 33 Act: prohibits the sale of stock unless registered with state securities commission or fits under an exemption
- Requirements for registration of securities to be sold in the state
 - Offer and sale of stock may make it subject to two different states' regulation
 - Determine jurisdictions and research filing requirements
- Non-public companies must comply with blue sky laws for any states in which the company issues equity awards
- Public companies are eligible for stock exchange-related exemptions from state blue sky laws (state securities laws and regulations)



Corporate and Securities Law

- **Blue Sky Laws (cont.)**

- Federal pre-emption

- Public companies are eligible for stock exchange-related exemptions from state blue sky laws (state securities laws and regulations)
- Non-public companies must comply with blue sky laws for any states in which the company issues equity awards
- Federal pre-emption for securities applies only to state registration and qualification but does not prevent states from imposing requirements to file notices and pay fees.
- May apply only to underlying securities, not award itself.



Broker Issues

- **Same-day sale transactions**

- Regulation T

- Allows brokers to finance the SDS exercise
- Employee benefit plan
- Shares registered on Form S-8
- Don't have to charge margin interest
- Requires irrevocable notice authorizing funds to go to company and shares to go to broker.

- **Registration**

- Registered shareholder
- Street name



Educational Courses to Assist In Exam Preparation

- NASPP
 - <https://www.nasppuniversity.com>
- NCEO
 - <http://www.nceo.org/training/cepstudy.html>

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