Frequently asked questions on Equity Compensation Plans

Section A. Is this an equity compensation plan subject to the rule?

A-1. A plan under which the company "matches" employee contributions using company stock:

Yes; the matching feature is an equity compensation plan that requires shareholder approval, unless an exemption applies (such matching features are common in Section 401(k) plans, which would be covered by the exemption for Section 401(a) plans). This is because the employee does not have the discretion to take the company match in cash, but must take that match in company stock. Note that the existence of a matching provision will not cause other provisions of a compensation plan to be considered subject to our rule if they would not be subject to our rule standing alone.

A-2. A plan providing for de minimis issuances of shares to non-officer employees:

Yes. The rule does not provide for any de minimis exception; if they are issued to employees and are in fact shares in the company they will be subject to this rule.

Clarified August 18, 2016.

A-3. A plan for directors with a mandatory deferral of some percentage of the company's annual retainer payment into an equity account for the director:

Yes. Any plan that has a mandatory payment in company stock is considered an equity compensation plan. On the other hand, if the director has the choice of accepting cash or stock at fair market value, this will not be considered an equity compensation plan, regardless of whether the stock is delivered currently or after a deferral period.

A-4. An arrangement whereby employees (but not shareholders generally) may elect to purchase shares at fair market value, and the company makes cash payments to employees who do elect to make such a purchase (for example, a cash payment of 10% of the purchase price):

Yes; this arrangement is in effect a discount purchase plan for employees.

A-5. An arrangement whereby a company makes cash payments to a Trustee, which uses the cash to purchase shares in the open market, at fair market value, for current or future delivery to the employees:

If the employees have no choice to receive the cash rather than have it paid to the Trustee, yes, this is an equity compensation plan under our rule. Whether the equity is provided from newly issued shares, existing treasury shares or new purchases in the open market, and whether those purchases are made by the company or by a directed trustee, is not relevant to this answer.

Section B. Material Revision issues (Previously Section C):

B-1. What is considered a material revision to an equity compensation plan?

Below are some examples of material revisions to an equity compensation plan:

- An expansion of the types of awards available under the plan;

- A material increase in the number of shares available under the plan;
- A material expansion of the classes of persons eligible under the plan;
- A material extension of the term of the plan;
- A material change in the method of determining the strike price of options;
- A deletion or limitation of any provision prohibiting repricing

B-2. If a revision does not fall into one of the listed examples, how do you determine if it is a "material revision" under the rule?

If the revision would have the effect of materially increasing the potential dilution of shareholders over the lifetime of the plan, it is considered material. Also, if the revision has an effect similar to one of the listed examples, it is considered material.

B-3. If a plan provides for the grant of restricted stock, is an amendment to permit the award of restricted stock units a material revision?

No. Options, stock-settled stock appreciation rights and similar awards that provide for equity compensation based upon the appreciation in value of stock over an exercise or base price are considered to be one "type" of award; restricted stock, restricted stock units and similar awards that provide for equity compensation without any exercise or base price are considered a second "type." Because restricted stock units and restricted stock are considered to be the same "type" of award, this revision is not material.

B-4. Consider an existing plan that provides for the grant of stock options and restricted stock, subject to an overall limit of 10 million shares that may be delivered pursuant to options and restricted stock grants together, and a further limit of 1 million shares available for restricted stock. Will an amendment to materially increase the restricted stock limit, but not the aggregate 10 million share limit, be a material revision?

Yes. This revision materially increases the shares available for one type of award. It is therefore similar to two of the listed examples of material revisions: an expansion of the types of awards available under the plan, and a material increase in the number of shares available under the plan.

B-5. If an existing plan allows grants of options and restricted stock to employees, and restricted stock to directors, would an amendment to allow options to be granted to directors be a material revision?

Yes. This revision expands the types of awards available to a particular class of persons eligible for the plan. It is therefore similar to two of the listed examples of material revisions: an expansion of the types of awards available under the plan, and a material expansion of the classes of persons eligible under the plan.

B-6. If a plan with a fixed maximum number of shares, out of which certain grants are made pursuant to a formula is amended to change the formula, is that a material revision?

Generally, no, if the shares granted pursuant to the formula continue to count against the maximum number and the maximum number remains unchanged.

B-7. Would an anti-dilution adjustment of option prices and/or numbers of shares to reflect a stock dividend, stock split, extraordinary cash dividend or spinoff be considered a material revision in the plan under the repricing rules?

No. An anti-dilution adjustment is neither a material amendment nor a repricing. See also question B-13.

B-8. If outstanding options, restricted stock or other equity awards are amended in ways that do not require a plan amendment, can the amendments ever be considered material revisions?

Generally, no. For example, consider a plan that allows the compensation committee to grant options with terms of up to ten years. If the committee grants an option with a term of six years, then later decides to amend the option to extend its term to ten years from the original grant date, the amendment to the option would not be considered to involve a revision to the plan. Hence, it would not be a material revision to the plan.

B-9. Is a plan amendment to extend the period within which an option holder is permitted to exercise options following termination of employment considered to be a material revision?

Not if the amendment does not extend the maximum possible term of options beyond what was already permitted by the plan. For example, if a plan allows options to have terms of up to 10 years from the date of grant, an amendment to extend the period for exercise after retirement from one year to two years (but in no event more than 10 years after the date of grant) would not be a material revision. By contrast, if the maximum possible term of options under the plan is materially extended, that amendment is similar to a material extension of the term of the plan itself, and would be considered a material revision.

B-10. If a company enters into an agreement with an executive that provides that on a change of control, all of the executive's unvested options (whether granted before or after the agreement was entered into) would be automatically be vested, is there a material revision of the executive's options or of the plan under which they are granted?

No. Changes to the vesting schedule of options under a plan are not material revisions, whether or not the change requires an amendment to the plan under which the options were granted.

B-11. What constitutes a material expansion of the classes of persons covered under a plan?

Each circumstance needs to be considered individually, based on the facts and circumstances of the plan and the specific proposal to add additional classes of individuals to the plan. For example, extending the plan to similar level and compensated individuals in the company may not be considered material. However, an amendment of a plan that originally covered only directors to extend it to cover executive officers of the company would be considered material. Similarly, expanding a plan that previously covered non-executive-officer employees only to cover executive officers as well is material.

B-12. When will an amendment to a Section 401(k) plan be considered a material revision?

Only if it affects the company stock aspects of the plan in a way that is otherwise a material revision. For example, adding to or changing investment funds – other than a company stock fund – to such a plan would not be considered a material revision.

Section 401(k) plans are exempt from the shareholder approval requirement of the rule, but the Exchange does require listed companies to seek and obtain approval by their independent compensation committee or a majority of their independent directors for any material revision to an exempt plan. In addition, the Exchange must be notified when a listed company utilizes an exemption (see questions D-1 and D-5).

B-13. Would any of the following types of adjustments to options in a spinoff be considered to result in either a material revision or a repricing?

Facts: Parent company ("P") distributes all of the stock of Subsidiary ("S") to its shareholders. Any or all of the following types of adjustments may be made to options held by current and former employees of P and S:

(a) Options remain P options, with anti-dilution adjustment to reflect the spinoff of S in an antidilution adjustment.

(b) Options are converted into options to acquire S stock.

(c) Each option is adjusted to consist of two options, one to acquire P stock and one to acquire S stock.

In each case, the number of shares subject to the options is based upon the trading price of P stock immediately before giving effect to the spinoff and the trading prices of P and S immediately after giving effect to the spinoff. In other words, the adjustments are done in a manner designed to ensure that the difference between the aggregate fair market value of the shares subject to the options and the aggregate exercise price of the options (whether positive or negative), as well as the ratio of the per-share fair market value of the shares to the per-share exercise price of the options, remain the same.

None of these types of adjustments would be considered to be a repricing or a material revision of the options.

Clarified August 18, 2016.

B-14. Section 423 plans are exempt from the shareholder approval requirements of the Exchange, but still must be approved by shareholders under the Internal Revenue Code. When this approval for Internal Revenue Code purposes is sought, does Rule 452 apply? If it does apply, what is the benefit of the exemption for Section 423 plans?

Yes. Under Rule 452, the Exchange precludes its member organizations from giving a proxy to vote on equity compensation plans unless the beneficial owner of the shares has given voting instructions. Section 423 plans are considered equity compensation plans and thus this rule applies when shareholders are asked to approve them.

Under the Internal Revenue Code, shareholder approval of a Section 423 plan can be obtained up to one year after the plan is adopted, which in many cases would be later than the Exchange would otherwise require (see question E-2). The exemption therefore avoids the imposition of a second, earlier deadline for shareholder approval of Section 423 plans.

Section C. Formula Plans (Previously Section D):

C-1. How do the rules apply to a plan that provides for adding shares back to the pool of available shares in various situations? In some cases, increasing the pool of available shares by adding back shares may be considered a "formula" that implicates the formula plan rules.

A rule to add back shares that have never in fact been issued is not a "formula." Examples of this include (1) shares that are subject to an option that expires without being exercised, or another award that is forfeited without the shares having been issued, (2) shares that are held back upon exercise of an option to cover the exercise price and (3) shares that are held back to satisfy income tax obligations. By extension, an amendment to a plan to provide for the withholding of shares based on an award recipient's maximum tax obligation rather than the statutory minimum tax rate is not a material revision if the withheld shares are never issued, even if the withheld shares are added back to the plan.

On the other hand, a rule to add back shares that have actually been issued generally is considered a formula. For example, adding back shares that a grantee already owns that are tendered to pay the exercise price of an option or satisfy a tax obligation is a "formula," as is adding back shares that are repurchased by the company using the cash paid upon exercise of options. The only exception to this rule is that the adding back of shares of restricted stock that are forfeited rather than vesting is not a formula, even though technically the restricted stock is issued upon grant. However, consistent with the preceding paragraph, a rule to add back shares that are withheld from restricted stock upon vesting to cover taxes is a formula unless the withheld shares are immediately cancelled upon vesting. If a plan has a fixed number of shares available, but for one or more formula addback rules, the latter may be treated as separate from the fixed share pool for purposes of our rules. Thus, if a "formula" rule is included in a plan, the term during which the formula may be operative must be limited to 10 years from the last shareholder approval of the plan, but that term need not be applied to the fixed share pool itself. Similarly, if such a plan was in effect as of the effective date of our rules but had not been approved by shareholders, the company may continue to use the fixed share pool after expiration of the limited transition period without seeking shareholder approval, even though it will not be able to continue to use the formula addback rules without shareholder approval.

Clarified August 18, 2016.

C-2. Consider a pre-June 30, 2003 formula plan that is being amended to add a 10-year term limit. If after the plan was originally adopted and approved by shareholders, it was amended to add performance goals meeting the requirements of Section 162(m) of the Internal Revenue Code, may the 10-year term limit be measured from the date on which shareholders approved the Section 162(m) goals?

Generally, no. Such a shareholder vote would typically be limited to approval of the goals, without asking shareholders to re-approve the plan as a whole; this limited approval does not re-start the period for the 10-year term limit.

Section D. Issues Relating to Use of Exemptions (Previously Section E):

D-1. What are the procedures for providing the Exchange with written notification of reliance on an exemption to Rule 303A(8)?

The written notice is to be filed with the issuer's listing representative, and may be filed in electronic form. It must describe the exempt action and the exemption relied upon in sufficient detail so that the Exchange can verify that the exemption applies. The notice should be filed as promptly as practicable following the exempt action, and if not filed before, must be included with the first supplemental listing application filed with respect to shares issued pursuant to the exempt action.

D-2. What is the Exchange's policy with regard to press release disclosure when a company utilizes the provided exemption from shareholder approval for inducement for employment?

When a company utilizes the exemption from seeking and obtaining shareholder approval of equity compensation under the inducement provision of the rule, an immediate press release is required if the grant is specifically negotiated or approved for the employee involved. This will typically involve a higher compensated employee.

If a company has a program in which equity is granted routinely to each new hire without individual negotiation, the company may as an alternative aggregate information about new hires made over a brief

period, not less frequently than every two weeks, and issue a press release summarizing the number of employees hired in that period and the equity awards granted them in connection with their hire. This aggregated disclosure would not suffice, however, for any separately negotiated awards made by the company to new hires during the period, which, as noted above, must be covered by an immediate press release containing specific details about the individual grant. Individual and not aggregated disclosure must also be provided for inducement grants to a person hired as an executive officer of the company, whether or not separately negotiated.

If a company grants equity as an inducement to sign on broad classes of employees of a company with which the listed company has merged, the disclosure of this inducement may be made in one release announcing the program and giving the maximum number of employees involved and the maximum amount of equity that will be granted if all the employees accept. However, individual and not aggregated disclosure must be provided for any such grants to a person who will be an executive officer of the post-merger company.

The Exchange encourages companies who anticipate use of inducement options for all new hires to adopt a shareholder-approved plan for that purpose, rather than relying on the "inducement grant" exemption. No press release is required for grants to newly hired employees under shareholder-approved plans (see question D-4).

D-3. Can an equity grant to a new non-employee member of a company's board of directors qualify as an exempt inducement grant?

No. The exemption for inducement grants applies only to employees.

D-4. If a company makes an equity grant to a newly hired employee as an inducement for employment, but the grant comes out of a shareholder-approved plan, do the press release and notice requirements apply?

No. In such a case, the company is not relying on the exemption for inducement grants, so these requirements are inapplicable.

D-5. **A company ("Target") that is acquired by another company ("Acquiror") has shares available for grant under a pre-existing plan that was previously approved by Target's shareholders. The listing standard states that these shares may be used for post-transaction grants of options and other awards with respect to equity of Acquiror, either under the pre-existing plan or another plan, without shareholder approval. This exemption from the shareholder approval requirement is subject to certain limitations, including that the exemption is not available for grants to individuals who were employed, immediately before the transaction, by the post-transaction listed company or entities that were its subsidiaries immediately before the transaction. Would this exemption be available for grants to persons who were non-employee directors or consultants to Acquiror and the companies that were its subsidiaries before it acquired Target?**

No. The reference in the exemption to "employees" is not intended to be construed narrowly. Rather, for purposes of this exemption, an individual is treated as "employed" by an entity to which he or she renders services, whether as a non-employee director, a consultant or an employee. (Compare question D-3.)

<u>Section E: Miscellaneous (Previously Section F):</u>

E-1. **Who is considered a consultant under the rule?**

Anyone for whom the company uses or would be permitted to use a Form S-8 registration statement to register the equity granted. In contrast, the use of equity as consideration under a contract for the provision of goods or services will not constitute equity compensation subject to the rule. For example, the issuance of stock as payment for media advertising provided by a media outlet or an advertising agency would not constitute equity compensation subject to the rule.

E-2. **If shareholder approval of a new equity compensation plan is required, may grants be made before the approval is obtained, so long as the grants are forfeited if the shareholder approval is not in fact obtained?**

No *shares* may be *issued* until the approval is obtained. Grants may be made before shareholder approval, provided that no shares can actually be issued pursuant to the grants until it is obtained. For example, a listed company could grant stock options that would not become exercisable until after shareholder approval is obtained. On the other hand, restricted stock could not be issued before shareholder approval, because restricted stock is issued upon grant. Note, however, that the company could promise to issue restricted stock at a future date after shareholder approval is obtained.

Clarified August 18, 2016.

<u>Section F. Foreign Plans Generally (Previously Section G):</u>

F-1. **In order to rely on the exemption from shareholder approval for an equity compensation plan that provides non-U.S. employees with substantially the same benefits as a comparable Section 401(a) plan, Section 423 plan or parallel excess plan (the "Foreign Plan Exemption"), does the company have to have such a plan for U.S. employees?**

Yes; the Foreign Plan Exemption covers plans that are in essence part of, or parallel to, an existing comparable U.S. plan.

F-2. In order for the Foreign Plan Exemption to apply to a plan, must it be identical to the comparable U.S. plan?

No. The foreign plan may differ from the U.S. plan in two ways. First, it may provide benefits that are different in nonsubstantial ways. (See Sections G and H below for related questions.) Second, it may differ in ways that are "substantial" if the differences are necessary to comply with foreign tax laws.

F-3. What if there are differences that arise because of other local law (non-tax) concerns?

Such differences must be considered on a case-by-case basis, but the foreign plan exemption will not be available if the differences are substantial.

F-4. What if there are differences that arise because of differing local practices (not tax law)?

If the differences mean that the benefits are not substantially the same as the comparable U.S. plan's benefits, the Foreign Plan Exemption does not apply.

Section G. Foreign Plans Comparable to Section 401(a) Plans (Previously Section H):

G-1. What is required in order for a foreign plan to be eligible for the Foreign Plan Exemption based on comparability to a Section 401(a) plan?

The following characteristics generally would need to be present for substantial comparability to exist:

- The plan is designed primarily to provide savings for retirement via employer and/or employee contributions, as evidenced by such provisions as vesting requirements, limitations on withdrawal of savings, and the like.

- Employer contributions to the plan result in compensation expenses for financial accounting purposes.

- The plan is subject to tax and/or other regulatory regimes that ensure broad coverage and limits on contributions.

Other characteristics may be relevant depending on the particular plan design. The source of the issuer stock (newly issued shares, treasury shares, or open-market purchases) is irrelevant.

G-2. If the issuer has a Section 401(k) plan and a similar foreign plan, but under the Section 401(k) plan there are investment choices in addition to the issuer stock fund, while only issuer stock is available under the foreign plan, is the Foreign Plans Exemption available?

This is not a difference that would prevent the two plans from being considered substantially comparable, if the reason for the difference in investment choices does not undermine the general comparability. For example, the foreign plan may be designed to replicate an ESOP portion of the Section 401(k) plan, while the other portions of the Section 401(k) plan are replicated by another arrangement (such as a government-mandated savings program). By contrast, a foreign plan that is in essence a discount stock purchase program, under which tax advantages accrue to participants if they hold the stock for a particular holding period, but which is not designed to encourage maintaining the investment until termination of employment or retirement, would not generally be considered "comparable" to a Section 401(a) plan. Such a plan might, however, be comparable to a Section 423 plan (see Section H below).

G-3. What if a foreign plan is like a Section 401(k) plan, but only employee contributions – not employer contributions – are made, and any purchases of issuer stock are made at fair market value, and at the employee's choice?

Such a plan is not an "equity compensation plan," so no shareholder approval is required regardless of whether the Foreign Plan Exemption would otherwise apply.

Section H. Foreign Plans Comparable to Section 423 Plans (Previously Section I):

H-1. What is required in order for a foreign plan to be eligible for the Foreign Plan Exemption based on comparability to a Section 423 plan?

The following characteristics generally would need to be present for substantial comparability to exist:

- The plan provides employees an opportunity to purchase stock at a discount (or an analogous opportunity, such as purchase at fair market value with a company matching contribution).
- Tax-favored treatment is available if the relevant requirements are met.
- The plan allows broad participation on the same terms and conditions for all participants.
- The total number of shares or contributions per participant is limited.
- Applicable law or regulations other than the Exchange's listing standards (such as Internal Revenue Code Section 423) require the plan to be approved by shareholders.

Other characteristics may be relevant depending on the particular plan design. The source of the issuer stock (newly issued shares, treasury shares, or open-market purchases) is irrelevant.

H-2. Can a foreign plan that does not receive shareholder approval qualify for the Foreign Plan Exemption if it is otherwise comparable to a Section 423 Plan?

No. The Exchange's requirement for shareholder approval does not apply to Section 423 plans because the Internal Revenue Code imposes its own shareholder approval requirement. (See question B-14.) Therefore, this is an essential characteristic that must be present for the Foreign Plan Exemption to apply to a foreign plan. For example, the Exchange understands that a Share Incentive Plan under the laws of the United Kingdom has many characteristics in common with Section 423 plans, but is not required to be approved by shareholders if the shares are purchased on the open market by a trustee. The Foreign Plans Exemption does not apply to such a plan. (See question H-3.)

H-3. What if employer and/or employee contributions are made to a trust and the trustee uses the contributions to purchase the shares on the open market?

This mechanism does not make a difference to the analysis. If the employees have no choice about taking the stock, or if the purchase is subsidized by the employer, the plan is an "equity compensation plan," and shareholder approval is required unless the Foreign Plan Exemption applies. (See question A-5.)