

(a) “*Acquired in Connection with Service or Employment as a Director or Executive Officer*”.

As adopted, new Rule 100(a) of Regulation BTR⁵⁶ defines the term “acquired such equity security in connection with service or employment as a director or executive officer” to include equity securities acquired by a director or executive officer:

- At a time when he or she was a director or executive officer under a compensatory plan, contract, authorization or arrangement,⁵⁷ including, but not limited to, plans relating to options, warrants or rights, pension, retirement or deferred compensation or bonus, incentive or profit-sharing (whether or not set forth in any formal plan document), including a compensatory plan, contract, authorization or arrangement with a parent, subsidiary or affiliate;

- At a time when he or she was a director or executive officer as a result of any transaction or business relationship described in paragraph (a) or (b) of Item 404 of Regulation S-K⁵⁸ or, in the case of a foreign private issuer, Item 7.B of Form 20-F (but without application of the disclosure thresholds of such provisions), to the extent that he or she has a pecuniary interest⁵⁹ in the equity securities;

- At a time when he or she was a director or executive officer, as “director’s qualifying shares” or other securities that he or she must hold to satisfy minimum ownership requirements or guidelines for directors or executive officers;

- Prior to becoming, or while, a director or executive officer where the equity security was acquired as a direct or indirect inducement to service or employment as a director or executive officer; or

- Prior to becoming, or while, a director or executive officer where the equity security was received as a result of a business combination in respect of an equity security of an entity involved in the business combination that he or she had acquired in connection with service or employment as a director or executive officer of that entity.

Several commenters expressed concern that, as proposed, the definition was overly broad.⁶⁰ One commenter objected to treating equity securities acquired in an arms-length, commercial transaction that is subject to disclosure under Item 404(a) or (b) of Regulation S-K as “acquired in connection with service or employment as a director or executive officer.”⁶¹ While this aspect of the definition may reach equity securities that were, in fact, acquired in arms-length, commercial transactions, we believe that it is necessary to prevent evasion of the trading prohibition of Section 306(a) of the Act.

Some commenters opposed treating equity securities acquired to satisfy minimum ownership requirements or guidelines as subject to the Section 306(a) trading prohibition, arguing that securities purchased in the open market are not “acquired in connection with service or employment as a director or executive officer,” regardless of the extrinsic motivation, and that the proposed definition was contrary to the statutory language and the intent of Section 306(a).⁶² They also asserted that requiring a director or executive officer subject to minimum ownership requirements or guidelines to identify and track equity securities purchased in the open market to satisfy such requirements or guidelines would impose an unjustified administrative burden.

We agree that equity securities purchased in the open market before an individual becomes a director or executive officer (and, thus, before the minimum ownership requirements or guidelines apply) should not be subject to the Section 306(a) trading prohibition even if they are used to satisfy the ownership requirements or guidelines after the individual becomes a director or executive officer. We, therefore, revised this aspect of the definition to indicate that equity securities used as directors’ qualifying shares or to satisfy an issuer’s minimum security ownership requirements or guidelines will be considered “acquired in connection with service or employment as a director or executive officer” only where an individual acquires the equity securities at a time when he or she is a director or executive officer of the issuer. Since these equity securities are clearly “acquired in connection with service or employment as a director or

executive officer,” we do not believe that it is overly burdensome to require directors and executive officers to identify and track these securities for purposes of Section 306(a).

Some commenters objected to treating equity securities acquired by an individual before becoming a director or executive officer as “acquired in connection with service or employment as a director or executive officer” if the equity securities were awarded to induce the individual to become an employee or non-executive officer of the issuer.⁶³ These commenters argued that subjecting these equity securities to the statutory trading prohibition at the time an employee or non-executive officer is promoted to director or executive officer status was contrary to the statutory language and did not serve the goals of Section 306(a). They suggested that inducement awards be treated as “acquired in connection with service or employment as a director or executive officer” only if they are directly related to an individual becoming a director or executive officer. Because, in some situations, an equity securities award to an individual joining an issuer as an employee or non-executive officer may be an inducement related to subsequent service or employment as a director or executive officer, we chose not to exclude inducement awards related to becoming an employee or non-executive officer from the definition. Instead, to ensure that this type of inducement award is not used to evade the statutory trading prohibition, we revised the definition to make it clear that an award acquired as a direct or indirect inducement to service or employment as a director or executive officer will be considered “acquired in connection with service or employment as a director or executive officer.” Awards that are an inducement to becoming an employee or non-executive officer, but are not a direct or indirect inducement to service or employment as a director or executive officer, will not be considered “acquired in connection with service or employment as a director or executive officer.”

Finally, commenters requested clarification on one other aspect of the definition. New Rule 100(a)(5) of Regulation BTR⁶⁴ makes clear that, in the case of equity securities acquired in connection with a merger, consolidation or other business combination by an individual who was a director or executive officer of the target entity and is to become a director or executive officer of the acquiring entity at the time

⁵⁶ 17 CFR 245.100(a).

⁵⁷ The scope of the phrase “compensatory plan, contract, authorization or arrangement” includes a “plan” as defined in Item 402(a)(7)(ii) of Regulation S-K [17 CFR 229.402(a)(7)(ii)], as well as an “employee benefit plan” as defined in Securities Act Rule 405 [17 CFR 230.405].

⁵⁸ 17 CFR 229.404(a) or (b). The descriptions in Item 404(a) and (b) of Regulation S-K are to be used without regard to whether the issuer is a “small business issuer” subject to the disclosure requirements of Regulation S-B [17 CFR 228.10 *et seq.*].

⁵⁹ See n. 53 above.

⁶⁰ See the ABA Letter, the ACB Letter, the PSCA Letter, the PWC Letter and the Letter dated December 16, 2002 of Sullivan & Cromwell (the “S&C Letter”).

⁶¹ See the ACB Letter.

⁶² See the ABA Letter, the PSCA Letter and the S&C Letter.

⁶³ See the ACB Letter and the S&C Letter.

⁶⁴ 17 CFR 245.100(a)(5).