equitybee

Counterparty Risk Management

Funding employee stock options

In the startup ecosystem, it's not uncommon for employees to miss out on the opportunity to become shareholders in the companies that they've helped build. One of the main reasons this occurs is because many startup employees cannot come up with the capital required to fund the exercise of their employee stock options.

At the same time, well-funded, successful startups are staying private much longer - this means much of the growth is taking place while they are still private and inaccessible to most investors.

Equitybee seeks to resolve these issues by unlocking accredited investor access to these high-growth, VC-backed startups by allowing them to fund employee stock options. We match these employees with our investor network, who in turn help fund their options in exchange for a predetermined percentage of their shares upon a successful liquidity event.

That said, funding employee stock options inherently carries a counterparty risk of the employee breaching their contract. As the intermediary connecting employees with investors, Equitybee addresses these risks in several ways:

Funding Options: The Mechanics

Before any offer is added to our platform, the employee is required to sign the Private Financing Contract, known as the PFC. By signing this contract, the employee agrees to receive funding from our investor network with the sole purpose of exercising their options and paying the associated taxes.
In exchange for receiving this funding, the employee must deliver a settlement amount upon a liquidity event to the investor, as stipulated in the PFC. As the investor, you have the rights to a predetermined percentage of the share value, return of principal, and annual compounded interest on the initial investment. These three items can be delivered in cash or in shares at the sole discretion of the employee.

Due Diligence

All offers on the Equitybee platform are reviewed and approved by a registered principal of Equitybee Securities, an SEC registered broker-dealer and member of FINRA. Equitybee Securities follows comprehensive due diligence procedures, including:

1. Prior to adding an offer to our platform, a thorough credit and background check is conducted on the participating employee. If we identify certain red flags on the employee's record, such as financial trouble or criminal convictions, Equitybee will reject the offer.
    a. Equitybee maintains a set of criteria that all participating employees must meet before their PFC is accepted and offered to investors. The criteria includes, but is not limited to: credit scores, past due payments, liens, and criminal charges or convictions.
    b. The credit check and financial criteria help us identify potential default risk, which would lead to an offer rejection.
    c. Equitybee further screens for potential red flags and verifies that the employee is not disqualified as a "bad actor" under U.S. securities laws.
2. Verification of the employee's options grants, including grant prices and vesting schedules.

Ongoing Engagement

Once an employee receives funding, they have two business days to use the investment capital to exercise their options.
Equitybee requires that they send a copy of their subsequent share certificate, verifying that they have indeed exercised their options.

Equitybee maintains regular communications with Employees after they receive funding to ensure we are always up to date on any important changes (such as residence, contact information, etc). This communication allows Equitybee to swiftly act on behalf of the investor in any event of liquidity and promptly work to enforce the terms of the offer.

Liquidity Event

If a liquidity event occurs, Equitybee will walk the employee through the process of working with our team to provide the designated settlement amount to you as the investor.
The settlement amount is based on the terms of the liquidity event, as well as the original investment amount.

This settlement amount is broken into three components:

1. Return of your original investment capital
2. The predetermined agreed upon share percentage
3. Accrued interest rate on the original capital

Please keep in mind that the settlement proceeds can be distributed in either cash or shares, depending on which option the employee chooses.

The settlement will only occur when the employee can freely access the shares, for example, either post IPO and/or post any lock-up period. This is dependent on when the employee's company allows access to the shares.

We will collect the settlement amount on your behalf from the fund of the respective employee. Once received by the fund, we distribute the cash and/or shares to you.

The PFC: Structural Risk Mitigation

As a private financing contract, the PFC includes several protective clauses intended to protect the investors:

Sale of assets: Anytime the employee would like the opportunity to sell their shares, they must communicate this with Equitybee and gain investor approval first. For the first four years following the effective date of the PFC, if the employee has the opportunity to sell their shares prior to an IPO, both the employee and the investor need to agree on the participation. If the investor does not want the employee to sell their shares at this time, the employee is contractually restricted from doing so. After the first four years of the agreement, the investor has full discretion to direct the employee's participation in a liquidity event.

Spousal consent: The employee consents that the shares cannot be included in any separation or divorce agreement. The employee's spouse is obligated to sign a spousal consent form, acknowledging that in the event of a separation, the shares will not be included in the settlement.

Settlement amounts: In any liquidity scenario, the investor has first priority to any receivables from a liquidity event. This means that the employee will not receive any proceeds until your principal is returned, with the intention of your investment being paid back in full before the employee receives any proceeds.

If the original investment amount exceeds the proceeds, the employee will pay 100% of the proceeds they receive. However, the employee will not be liable to cover the remaining amount of funding that they initially received.

Breach + Power of Attorney: If the employee refuses to distribute the investor proceeds, the fund can exercise its power of attorney to inform the issuer to transfer the remaining covered securities into the name of the investor. The fund may also compel the employee to arbitration and request specific performance, including the delivery of the settlement amount and any other measures necessary in order to register the covered securities and transfer to the investor, as necessary.

The PFC contains additional clauses intended to mitigate counterparty risk.

Equitybee executes private financing contracts (PFCs), private placements which are speculative, illiquid, contain substantial risk and may result in 100% loss of capital to the investor. Risks are greater during extreme market conditions. PFCs do not grant or transfer ownership of startup company stock. Review the private placement memorandum carefully before investing. For accredited investors only.

There is no guarantee of a liquidity event. Each investor should carefully review and understand the details of any investment and only make an investment decision based on a complete understanding of the investments. Consult your tax accountant as there may be tax considerations on profit amounts. Results may vary with each use and over time. A successful liquidity event is defined as an event that results in proceeds from the sale of the employee's equity that was purchased via the funded employee stock options exceeding the initial investment amount by an amount that allows the employee to pay investors the original investment amount, any accrued interest, and the Share Incentive Percentage. For the purpose of calculating proceeds following a liquidity event, the volume weighted average price from the first five (5) trading days following the conclusion of the blackout period is used. This amount may be more than, less than, or equity to the share price at the time of the liquidity event.
Investor proceeds upon liquidity event may be distributed in cash or shares. Distributions in shares will be subject to market volatility risk. The actual value of shares received will fluctuate between the liquidity trigger event date and the distribution date.
Securities offered through EquityBee Securities, LLC, member FINRA.