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News & Insights

SEC Amendments to Rule 10b5-1

Alert
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On December 14th, 2022, the U.S. Securities and Exchange Commission (SEC) adopted a series of amendments to Rule 10b5-1 under the Securities Exchange Act of 1934. In sum, the amendments accomplish the following:

1. Establish "cooling-off periods" between Rule 10b5-1 plan adoption and the commencement of trading on the plan
2. Require directors and officers to include in their Rule 10b5-1 plans a written certification as a pre-condition to using the Rule 10b5-1 affirmative defense
3. Limit the quantity of Rule 10b5-1 plans an insider may have at one time, with exceptions
4. Limit the quantity of single-trade plans a person may effectuate in any 12-month period
5. Establish additional requirements for using the Rule 10b5-1(c)(1) affirmative defense
6. Establish a variety of mandatory disclosure and reporting requirements on Rule 10b5-1 plans, insider trading policies, and use of option grants (and similar equity instruments)
7. Require issuers to tag the mandatory disclosure information in Inline XBRL
8. Add a mandatory check box to Forms 4 and 5
9. Require insiders to report bona fide gifts on Form 4 rather than Form 5

According to the SEC, these amendments "are designed to address concerns about opportunistic abuse of Rule 10b5-1." (cleaned up). Following its adoption in 2000, Rule 10b5-1 became a popular vehicle for insiders to make routine sales of company shares while avoiding suspicion of insider trading. In recent years, however, courts, members of Congress, and commenters to the SEC grew concerned that insiders were manipulating Rule 10b5-1 plans to the detriment of investors. The SEC noted, for example, that "some academic studies have found that corporate insiders trading pursuant to Rule 10b5-1 plans consistently outperform the trading of corporate insiders that is not conducted under such plans." Motivated by these

concerns, the SEC adopted these amendments to curtail the harmful impact of insider trading by making Rule 10b5-1 plans more difficult to exploit and increasing transparency regarding their use.

Cooling-Off Periods

There will be mandatory waiting or "cooling-off" periods between the date of a Rule 10b5-1 plan's adoption and the date when trading on the plan may begin. Previously, the adoption and trading of a plan could occur on the same day. Now, however, there will be minimum waiting periods between those two events. According to the SEC, these choreographed delays will "reduce the risk that corporate insiders could benefit from any material nonpublic information of which they may have been aware when adopting the plan. Issuers, for the time being, are excluded from this requirement, though the SEC "believes that further consideration of potential cooling-off periods for issuers is warranted." The length of the cooling-off period depends on the category of person intending to rely on Rule 10b5-1 as an affirmative defense.

Directors and Officers

Directors and officers must wait for the later of (a) 90 days after the adoption of the plan, or (b) 2 business days following the disclosure of the issuer's financial results in a Form 10-Q or Form 10-K for the fiscal quarter (or, for foreign private issuers, in a Form 20-F or Form 6-K that discloses the issuer's financial results). This cooling-off period, however, may last at most 120 days after adoption of the plan.

Other Persons

Persons other than directors, officers or issuers must wait 30 days after the adoption of the plan before beginning trading on the plan.

Written Certification

For directors and officers to benefit from the Rule 10b5-1 affirmative defense, they must now include a written certification "in the Rule 10b5-1 plan as a representation" at the time of the plan's adoption. The written certification must certify that they (a) "are not aware of material nonpublic information about the issuer or its securities" and (b) "are adopting the plan in good faith and not as part of a scheme to evade the prohibitions of Exchange Act Section 10(b) and Exchange Act Rule 10b-5."

Limitations on Quantity of Plans

Subject to some exceptions, no person intending to rely on Rule 10b5-1 as an affirmative defense may have multiple overlapping plans "of any class of securities of the issuer on the open market during the same period." This limitation does not apply to issuers.

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Exceptions

"A series of formally distinct plans with multiple brokers may be treated as a single plan where, taken together, the plans would otherwise satisfy the conditions of the multiple overlapping plans restriction rule above. Simply put, if multiple plans behave as a single plan when taken as a whole, the restriction does not apply."

Persons may also have staggered Rule 10b5-1 plans provided the "later-commencing plan is not authorized to begin (a) until after all trades under the earlier-commencing plan are completed or expire without execution, and (b) until the applicable cooling-off period of the later-commencing plan expires, which is deemed to begin tolling on the date the earlier-commencing plan expires." This means a person can still have multiple plans without violating the new rule, provided trading on the later plans are appropriately delayed pursuant to these rules.

Insiders, lastly, "will not lose the benefit of the Rule 10b5-1 affirmative defense" by having multiple overlapping plans, provided the "additional plan or plans only authorize qualified sell-to-cover transactions." Sell-to-cover transactions are plans that "(a) authorize an agent to sell only such securities as are necessary to satisfy tax withholding obligations incident to the vesting of a compensatory award, such as restricted stock or stock appreciation rights, and (b) the insider does not otherwise exercise control over the timing of sales."

Single-Trade Plans

"A single-trade plan will not receive the benefit of the Rule 10b5-1 affirmative defense" if the person entering the plan has also adopted another single-trade plan in the preceding 12-month period. In other words, "a person will be able to rely on the Rule 10b5-1 affirmative defense for only one single-trade plan during any 12-month period." This limitation does not apply to issuers.

Additional Affirmative Defense Requirement

Previously, the Rule 10b5-1 affirmative defense required a person to demonstrate only that the "plan was entered into in good faith and not as part of a scheme to evade the prohibitions of the rule." The amendments impose an additional requirement on top of this. A person will also need to demonstrate they "have acted in good faith with respect to [the plan]." In short, the good faith imperative now extends through the life of the plan, not just its adoption.

According to the SEC, this expansion of the good faith requirement targets, among other things, "corporate insiders who try to improperly influence the timing of corporate disclosures to benefit their trades under Rule 10b5-1 by delaying or accelerating the release of material nonpublic information and cancelling or modifying Rule 10b5-1 plans in an attempt to evade the prohibitions of the rule."

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Mandatory Disclosure and Reporting Requirements

The amendments establish a variety of mandatory disclosure and reporting requirements where, before, no such requirements existed.

Quarterly Disclosure

New Item 408(a) of Regulation S-K establishes quarterly reporting requirements for issuers regarding the use of Rule 10b5-1 plans. On Forms 10-Q and 10-K, as applicable, issuers must "disclose whether, during the last fiscal quarter, any director or officer has adopted or terminated any Rule 10b5-1 plan and/or any *non*-Rule 10b5-1 plan." Non-Rule 10b5-1 plans are defined in New Item 408(c) of Regulation S-K. To be a non-Rule 10b5-1 plan, first, the directors or officers must have adopted the plan "at a time when they were not aware of material nonpublic information about the security or the issuer." Second, the plan must have specified the amount, price and date of the securities to be purchased or sold. Third, the plan must have "included a written formula or algorithm, or computer program, for determining the amount" and price of the securities to be purchased or sold. Fourth, the plan must not have "permitted the covered person to exercise any subsequent influence over how, when, or whether to effect purchases or sales." Lastly, "any other person who, pursuant to the plan did exercise such influence must not have been aware of material nonpublic information when doing so."

Issuers must also "provide a description of the material terms of the Rule 10b5-1 plan or non-Rule 10b5-1 plan, other than terms with respect to the price." Material terms include "(a) the name and title of the director or officer; (b) date of adoption or termination of the plan; (c) duration of the plan; and (d) aggregate number of securities to be sold or purchased under the plan." SRCs and emerging growth companies (EGCs) are included in this requirement.

Annual Disclosure

New Item 408(b) of Regulation S-K establishes annual reporting requirements for issuers regarding their insider trading policies. On Form 10-K (Form 20-F for foreign private issuers) and on proxy or information statements, issuers must "disclose whether they have adopted insider trading policies governing the disposition of their securities or, if they have not adopted such policies, explain why; and, if they have adopted insider trading policies, file a copy of their insider trading policies and procedures as an exhibit to Forms 10-K and 20-F, respectively." "Under General Instruction G to Form 10-K, issuers can incorporate by reference the information required above from a definitive proxy or information statement involving the election of directors, if the proxy or information statement is filed within 120 days of the end of the fiscal year." SRCs and EGCs are included in this requirement.

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Option Grants

Item 402(x) establishes reporting requirements for issuers regarding the use of option grants. This item has two basic components: a narrative disclosure and a tabular disclosure.

Regarding the narrative disclosure, issuers must "discuss their policies and practices on the timing of awards of option grants in relation to the issuer's disclosure of material nonpublic information, including how the board determines when to grant such awards, whether and how the board or compensation committee takes material nonpublic information into account when determining the timing and terms of an award, and whether the issuer has timed the disclosure of material nonpublic information for the purpose of affecting the value of executive compensation." In short, issuers must produce a relatively detailed account of their option grant practices.

Regarding the tabular disclosure, "if, during the last completed fiscal year, option grants were awarded to named executive officers (NEOs) within specific time periods, the issuer must provide the following information concerning each such award for the NEO on an aggregated basis in the tabular format set forth in the rule: (a) name of the NEO; (b) grant date of the award; (c) number of securities underlying the award; (d) per-share exercise price; (e) grant date fair value of each award computed using the same methodology as used for the registrant's financial statements under generally accepted accounting principles; and (f) percentage change in the market price of the underlying securities between the closing market price of the security one trading day prior to and one trading day following the disclosure of material nonpublic information." The expectation is that disclosing this information will "highlight for investors options award grants that may be more likely than most to have been made at a time that the board of directors was aware of material nonpublic information affecting the value of the award." SRCs and EGCs are included in this requirement.

Tagging Requirements

For issuers subject to the above disclosure requirements, they will also be "required to tag the information specified by new Items 402(x), 408(a), and 408(b)(1) of Regulation S-K, (and Form 20-F), in Inline XBRL in accordance with Rule 405 and the EDGAR Filer Manual." In other words, the SEC's tagging requirements will apply to all the new mandatory disclosures.

Checkboxes on Forms 4 and 5

There will be an additional, mandatory checkbox on Forms 4 and 5 which requires reporting persons to indicate whether "a reported transaction is pursuant to a plan that is intended to satisfy the affirmative defense conditions of Rule 10b5-1(c)." If the reporting person checks the box, they "will also be required to provide the date of adoption of the Rule 10b5-1 plan, and will have the option to provide additional relevant information about the reported transaction."

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Reporting Gifts

Whereas reporting persons previously used Form 5 to report any "bona fide gift of equity securities registered under…Section 12," which allowed for a delay of more than a year between the date of the gift and date of reporting, reporting persons will now be required to "report dispositions of bona fide gifts of equity securities on Form 4 in accordance with Form 4's filing deadline (that is, before the end of the second business day following the date of execution of the transaction)," a significantly shorter turnaround.

Important Dates

These amendments will take effect 60 days following their publication in the *Federal Register*, which will likely occur in early 2023. "The amendments will not affect existing Rule 10b5-1 plans that were entered into prior to the effective date, except to the extent that such a plan is modified or changed after the effective date." In other words, existing Rule 10b5-1 plans and those adopted before the amendments take effect in early 2023 will be exempt from the amendments, provided the plans do not change after the amendments take effect.

For Forms 4 and 5 specifically, reporting persons must "comply with the amendments to Forms 4 and 5 for beneficial ownership reports filed on or after April 1, 2023."

Lastly, regarding disclosure and tagging requirements in particular, "issuers that are SRCs must comply with the new requirements in the first filing that covers the first full fiscal period that begins on or after October 1, 2023." All other issuers will be required to comply with the new requirements in the first filing that covers the first full fiscal period that begins on or after April 1, 2023."

Final Considerations

In the light of these amendments, issuers and in-house counsel may need to evaluate whether existing company procedures require modification in order to facilitate compliance with the various mandatory disclosures, the new checkboxes, and the reporting of gifts. Moreover, companies may need to consider revising their insider trading policies to account for the new quantity limitations on plans, cooling-off periods, and certification requirements. Thinking proactively about aligning company practices with the SEC's amendments can help safeguard the availability of the Rule 10b5-1 affirmative defense for company insiders going forward.

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