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SEC Proposes Limitations on Use of Rule 10b5-1 Trading Plans and Increased Disclosure About Insider Trading Policies

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Securities and Capital Markets

After years of public concern around the potential misuse of Rule 10b5-1 trading plans by public company insiders, on December 15, 2021 the SEC proposed rules[1] that would limit the availability and use of Rule 10b5-1 trading plans, as well as increasing disclosure around such plans and public companies' insider trading policies.[2] The SEC's proposed rules would, among other things:

- Require a 120-day cooling off period between the adoption of a Rule 10b5-1 trading plan by officers and directors and the commencement of trades under such plan; a 30-day cooling off period would be required for Rule 10b5-1 trading plans adopted by issuers;
- Require domestic issuers to disclose on a quarterly basis information regarding the adoption and termination of Rule 10b5-1 trading plans by the issuer or its officers and directors, including the identity of the relevant officers or directors, the duration of newly adopted plans and the aggregate amount of securities to be sold or purchased under such plans;
- Require officers and directors adopting a Rule 10b5-1 trading plan to certify in writing to the issuer that they are not aware of material nonpublic information about the issuer or its securities;
- Limit the availability of the affirmative defense under Rule 10b5-1 to one single-transaction trading plan during any consecutive 12-month period, and provide that the affirmative defense does not apply to multiple overlapping Rule 10b5-1 trading arrangements for open market trades in the same class of securities; and
- Require domestic issuers and foreign private issuers to disclose on an annual basis whether or not (and, if not, why not) the issuer has adopted insider trading policies and procedures and to disclose such policies and procedures.

[1] See Rule 10b5-1 and Insider Trading Proposed Rule, https://www.sec.gov/rules/proposed/2021/33-11013.pdf.

[2] In a separate release, also on December 15, 2021, the SEC proposed new rules governing disclosure about issuer share repurchases. See Share Repurchase Disclosure Modernization Proposed Rule, https://www.sec.gov/rules/proposed/2021/34-93783.pdf. We plan to issue an alert on this proposal in the coming days.

The SEC did not address whether existing Rule 10b5-1 plans will have to be modified or readopted in order to comply with the proposed rule changes. The proposed rule is subject to a 45 day public comment period, which is historically shorter than the 60 to 90 day period typically adopted by the SEC.

Background

Rule 10b5-1 was adopted in 2000 to clarify unsettled case law under Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act") and Rule 10b-5 promulgated thereunder as to the causal connection that must be shown between a trader's possession of insider information and his or her trading. Rule 10b5-1 provides that trading in a security is "on the basis of material non-public information" if the person making the purchase or sale was aware of the material non-public information when the person made the purchase or sale.

Rule 10b5-1(c)(1) provides an affirmative defense to counter the presumption under the rule that any trade by an insider is "on the basis of" any material non-public information of which the insider was aware at the time of the trade. The rule provides that a person does not trade on the basis of material non-public information if such trade occurs under a contract, instruction or written plan to trade the security, so long as such contract, instruction or plan was entered into at a time when the person was not aware of any material non-public information and no discretion is exerted around specific trades.

To establish the defense provided by Rule 10b5-1(c)(1), a person (including an issuer engaged in stock repurchases) who is not then aware of material non-public information, may in good faith and not as a means to evade the securities laws, enter into a binding contract and give instructions to a broker to buy or sell company securities pursuant to a written plan. The contract, instructions or plan must: (i) specify the amount of securities to be bought or sold, as well as the price and date for the transaction; (ii) include a written formula or algorithm for determining the amount, price and date of the purchase or sale; and (iii) not permit the exercise of any subsequent influence over how, when or whether to effect purchases or sales while aware of material non-public information.

Cooling-Off Period

Currently Rule 10b5-1 does not require any cooling off period between the date a trading plan is adopted and the date trades under the plan commence, although, in practice many trading plans do include a cooling off period. The SEC has proposed amending Rule 10b5-1 to require, as a condition of satisfying the safe harbor, that trading plans for officers and directors include a period of 120 days between the date the plan is adopted and the start of trading under the plan. For trading plans adopted by issuers, a 30-day cooling off period would be required. Notably, the proposed rules would require another cooling off period if an existing Rule 10b5-1 plan is amended or modified. The SEC indicated that requiring a 120-day cooling off period will provide sufficient time for any material nonpublic information to be disclosed in a quarterly earnings release before trades can be made.

New Disclosures

Currently there are no disclosure requirements concerning the adoption of Rule 10b5-1 trading plans. Proposed new disclosure requirements include:

- Quarterly disclosure by domestic companies about the adoption or termination of a Rule 10b5-1 trading plan by the issuer or by any officer or director, including the date of such adoption or termination, the duration of any new plan and the aggregate amount of securities to be sold or purchased pursuant to each such plan;
- Annual disclosure by both domestic companies and foreign private issuers of the existence or absence (and the reasons for such absence) of insider trading policies and procedures governing the purchase, sale and other disposition of the company's securities by directors, officers and employees or the company itself and disclosure of such policies and procedures[3]; and
- A new requirement on Forms 4 and 5 for insiders to identify through a checkbox whether a reported transaction was executed pursuant to a Rule 10b5-1(c) trading arrangement.[4]

These new disclosures would also be tagged in Inline XBRL.

Director and Officer Certifications When Adopting a Rule 10b5-1 Trading Plan

In order to reinforce to directors and officers their responsibility not to trade based on material nonpublic information and to act in good faith when setting up Rule 10b5-1 trading plans, the proposed rules would require an officer or director to furnish the issuer a written certification at the time of adoption or modification of a Rule 10b5-1 trading plan, stating:

- That they are not aware of material nonpublic information about the issuer or its securities; and
- That they are adopting the contract, instruction, or plan in good faith and not as part of a plan or scheme to evade the prohibitions of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.[5]

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[3] In the proposing release the SEC stresses that companies should endeavor to provide detailed and meaningful information from which investors can assess the sufficiency of their insider trading policies and procedures. As examples, the SEC stated that investors may find it useful to include a description of the issuer's process for analyzing whether directors, officers and employees, when conducting open market purchases, have material nonpublic information; the issuer's process for documenting such analyses and approving requests to purchase or sell its securities; or how the issuer enforces compliance with any such policies and procedures it may have.

[4] Many Section 16 filers already note in Forms 4 and 5 whether reported transactions have been made pursuant to 10b5-1 trading plans.

[5] The proposed rules would also require Rule 10b5-1 plans to be operated in good faith in order to take advantage of the safe harbor. The SEC indicated that canceling or modifying a plan may indicate a lack of ongoing good faith if the purpose of those actions is to evade the prohibitions of the rule.

It is important to note that the proposed certification would not be required to be filed publicly and would not be an independent basis of liability for directors and officers under the federal securities laws.

Limits on Specific Trading Plan Practices

Another concern the SEC has voiced is the use of more than one Rule 10b5-1 trading plan at a time, where each individual plan seemingly complies with the requirements of the safe harbor but the aggregate behavior aims to capitalize on material nonpublic information.

The proposed rules aim to address this concern with two new limitations. First, the proposed rule would limit the use of any plan designed to effect the purchase or sale of the total amount of securities covered by such plan in a single transaction to one in any 12-month period. Second, the proposed rules would condition the availability of the Rule 10b5-1(c)(1) affirmative defense on the absence of multiple overlapping trading arrangements for open market purchases or sales of the same class of securities. This latter proposed amendment aims to prevent traders from exploiting inside information by setting up trades timed to occur around dates when they expect the issuer will likely release material nonpublic information or from trying to evade the proposed cooling off period.

New Executive Compensation Disclosure Requirements

The proposing release also proposes an amendment to the executive compensation disclosure rules in Item 402 of Regulation S-K to require companies to disclose in a new table any option awards, stock appreciation rights or similar awards to named executive officers or directors that are made within a certain time proximate to the release of material nonpublic information such as earnings announcements. More specifically, companies would be required to disclose in the new table each option award, stock appreciation right or similar award granted within 14 calendar days before or after the filing of a periodic report, an issuer share repurchase, or the filing or furnishing of a current report on Form 8-K that contains material nonpublic information; the market price of the underlying securities the trading day before the disclosure of the material nonpublic information; and the market price of the underlying securities the trading day after disclosure of the material nonpublic information.

Interestingly, the SEC does not propose to exempt smaller reporting companies and emerging growth companies from this proposed new tabular disclosure requirement (though the individuals for whom disclosure is required would track the current reduced universe applicable to these companies) as it believes the information to be disclosed is material to investors in companies of all sizes and stages of maturity.

Reporting of Gifts on Form 4

To address concerns around insiders making stock gifts while in possession of material nonpublic information, the proposed rules would require all “bona fide” gifts of stock to be reported on Form 4 before the end of the second business day following the date of such gift.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our Securities and Capital Markets practice:

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