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SEC Tightens Rule 10b5-1 and Creates New Disclosure Requirements

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Securities and Capital Markets

On December 14, 2022, the Securities and Exchange Commission ("SEC") adopted amendments to Rule 10b5-1 under the Securities Exchange Act of 1934 (the "Exchange Act") and created several new disclosure requirements. The amendments to Rule 10b5-1 impose a number of new conditions on the ability of company officers and directors to purchase or sell securities under a binding contract, specific instruction or written plan (a "trading plan") under Rule 10b5-1.[1] Although the significant changes to Rule 10b5-1 will likely generate the biggest headlines, other aspects of this rulemaking will impose important new disclosure obligations on public companies and their insiders.

The final rules will become effective 60 days following publication of the adopting release in the Federal Register. All 10b5-1 trading plans adopted after the effective date of the final rules, as well as any 10b5-1 trading plans that are modified or amended as to key terms after the effective date, must comply with the new requirements. An appendix detailing the compliance dates can be found here.

I. Summary

The SEC's action includes the following items, which are discussed in greater detail below:

- **Amends Rule 10b5-1** to impose additional conditions on trading plans intended to rely on the rule's affirmative defense to insider trading, including:
  - mandatory cooling-off periods before trades commence under 10b5-1 trading plans adopted by individuals and a lengthy cooling-off period for officers and directors;
  - a requirement that officers and directors sign a new certification at the time a 10b5-1 trading plan is adopted;
  - restrictions on the ability of persons other than issuers to use multiple overlapping 10b5-1 trading plans, subject to certain exceptions; and
  - limitations on the ability of persons other than the issuer to rely on Rule 10b5-1 for more than one single-trade plan during any 12-month period.

[1] A trading plan that meets the conditions of Rule 10b5-1 is referred to as a "10b5-1 trading plan."

- **Enacts new Item 408 of Regulation S-K** to require:
  - quarterly disclosure by a company regarding the adoption or termination of 10b5-1 trading plans and certain other trading arrangements, on an individualized basis, by a company's officers and directors;
  - annual narrative disclosure regarding a company's insider trading policies and procedures; and
  - the filing of insider trading policies and procedures as an exhibit to the company's annual report.
- **Enacts new Item 402(x) of Regulation S-K** and Item 16J of Form 20-F to require narrative and tabular disclosures regarding a company's award of options, stock appreciation rights ("SARs") and similar instruments with option-like features to insiders shortly before and immediately after the release of material nonpublic information.
- **Changes Forms 4 and 5** to add a checkbox to denote transactions intended to satisfy the requirements of Rule 10b5-1 and to require the reporting of dispositions of equity securities by gifts within two business days on Form 4, rather than on a deferred basis on Form 5.

II. Background on Rule 10b5-1

In 2000, the SEC adopted Rule 10b5-1 to resolve conflicting case law pertaining to the prohibition on insider trading under Exchange Act Rule 10b-5. For years, courts had been split on whether insider trading liability required proof that a trader actually "used" material nonpublic information ("MNPI") or whether "knowing possession" of MNPI at the time of a trade was sufficient. Rule 10b5-1 resolved this conflict by clarifying that trading "on the basis of" MNPI for purposes of insider trading liability means that a person has traded while "aware" of MNPI.

Rule 10b5-1 established two affirmative defenses to insider trading liability under Rule 10b-5, one of which involves purchasing or selling a security under a trading plan put into place before the trader became aware of the MNPI.[2]

Under this affirmative defense, a trading plan must meet one of the following conditions: (i) it specifies the amount of securities to be purchased or sold and the price and date at which the securities are to be purchased or sold; (ii) it includes a written formula, algorithm or computer program for determining the amount of securities to be purchased or sold and the price and date at which the securities are to be purchased or sold; or (iii) it does not permit the person to exercise any subsequent influence over how, when or whether to effect purchases or sales, provided, in addition, that any other person who, under the trading plan, did exercise such influence must not have been aware of the MNPI when doing so.

[2] The other affirmative defense is available to entities and requires that (i) the person making the investment decision on behalf of the entity was not aware of the MNPI and (ii) the entity has adopted reasonable policies and procedures to ensure those persons responsible for investment decisions do not violate insider trading laws.

A 10b5-1 trading plan is available only to a person who is not in possession of MNPI at the time of its adoption and that enters into the trading plan in good faith and not with the intent to evade insider trading prohibitions. A 10b5-1 trading plan provides an insider with the opportunity to trade in securities with confidence that the insider will not violate federal insider trading rules, even if the insider is aware of MNPI at the time an actual trade is executed under the plan.

In the years since its adoption, Rule 10b5-1 has been criticized for containing certain weaknesses and loopholes that could permit opportunistic trading on the basis of MNPI by corporate insiders. The SEC's recent amendments are intended to address these criticisms. The new requirements follow various academic studies, media reports and a 2013 rulemaking petition by the Council of Institutional Investors that have called into question trading activity under 10b5-1 trading plans and practices related to the adoption, modification and termination of such plans.

III. New Requirements for 10b5-1 Trading Plans

New Conditions

The SEC's amendments add four new conditions that must be satisfied in order to rely on the affirmative defense provided by Rule 10b5-1(c). These are summarized below.

***Cooling-off Periods*.** 10b5-1 trading plans for all persons other than issuers must include a cooling-off period between the time the plan is adopted and the time that trades under the plan may start. For officers[3] and directors, the duration of the cooling-off period is the longer of: (1) 90 days following the adoption of a 10b5-1 trading plan; or (2) two business days following the disclosure of the company's financial results in a Form 10-Q or Form 10-K for the completed fiscal quarter in which the 10b5-1 trading plan was adopted, and, for foreign private issuers, in a Form 20-F or Form 6-K. In all events, the maximum cooling-off period need not exceed 120 days. As described below, certain modifications to a 10b5-1 trading plan will be deemed to constitute the termination of the plan and the adoption of a new trading plan that would need to include the requisite cooling-off period.

For individuals other than officers and directors, the cooling-off period is 30 days following the adoption of a 10b5-1 trading plan. Notably, the SEC decided not to impose any cooling-off period for 10b5-1 trading plans adopted by issuers, pointing out that market practice in this area varies widely and that it may revisit this issue in the future.

Certification. Any officer[2] or director adopting a 10b5-1 trading plan must certify in writing at the time of adoption that he or she (i) is not in possession of MNPI and (ii) is adopting the trading plan in good faith and not as part of a plan or scheme to evade the prohibitions of Rule 10b-5.

***Limitation on Multiple and Overlapping 10b5-1 Trading Plans*.** Any person (other than an issuer) adopting a new 10b5-1 trading plan may not have another outstanding 10b5-1 trading plan and may not subsequently enter into any additional 10b5-1 trading plan involving

[3] The term "officer" for purposes of the new cooling-off period and certification requirements means any officer as defined in Rule 16a-1(f) under the Exchange Act.

purchases or sales of the issuer's securities on the open market. This restriction is subject to the following exceptions:

- a series of separate contracts with different broker-dealers or other agents to execute trades may be considered part of a single "plan," provided that the individual constituent contracts, when taken as a whole, meet all of the applicable conditions of Rule 10b5-1;

- a person may have one later-commencing 10b5-1 trading plan for purchases or sales of any securities of the issuer on the open market under which trading is not authorized to begin until after all trades under the earlier-commencing 10b5-1 trading plan are completed or expired without execution; and

- a 10b5-1 trading plan that authorizes an agent to sell only securities as necessary to satisfy tax withholding obligations arising exclusively from the vesting of a compensatory award, and where the insider does not otherwise exercise control over the timing of sales, will not be considered an additional 10b5-1 trading plan.

Limitation on Use of Single-Trade 10b5-1 Trading Plans. A person (other than an issuer) may not have more than one single-trade 10b5-1 trading plan in any 12-month period. These are plans designed to effect the open-market purchase or sale of the total amount of securities as a single transaction.

Amended Good Faith Requirement

The rule amendments modify the existing good faith condition to add the condition that any person entering into a 10b5-1 trading plan "has acted in good faith with respect to" the plan. According to the SEC, this is intended to address longstanding concerns that insiders could potentially engage in impermissible trading or improperly influence the timing of corporate disclosures to benefit trades under a previously adopted trading plan.

Modifications to 10b5-1 Trading Plans

The amendments to Rule 10b5-1 provide that any modification or change to the amount, price, or timing of the purchase or sale of the securities underlying a 10b5-1 trading plan constitutes the termination of the plan and the adoption of a new trading plan. This includes a trading plan modification in connection with the substitution or removal of a broker that is executing trades, if the action changes the price or date on which purchases or sales are to be executed. As a result, any amendment or modification that affects the amount, price or timing of purchase or sale of securities, even one that might be considered immaterial in nature, would trigger the need for a new cooling-off period before trading can commence again. It also would constitute the termination of an existing 10b5-1 trading plan and the adoption of a new plan that would need to be disclosed under the new disclosure rules discussed below.

IV. New Disclosure Requirements for 10b5-1 Trading Plans and Insider Trading Policies

The amendments establish new disclosure requirements relating to 10b5-1 trading plans adopted by insiders and company insider trading policies.

- Under new Item 408(a) of Regulation S-K, domestic public companies must disclose, on a quarterly basis on Form 10-Q and Form 10-K (for the fourth quarter), whether, during the last fiscal quarter, any officer or director adopted or terminated any 10b5-1 trading plan or "non-Rule 10b5-1 trading arrangement."[4] This disclosure must include the material terms of the trading plan, such as (i) the names and titles of the officers and directors adopting or terminating a plan, (ii) the date of adoption or termination, (iii) the stated duration of the plan, (iv) the aggregate amount of securities to be sold or purchased under the plan and (v) whether the plan is a 10b5-1 trading plan or is a non-Rule 10b5-1 trading arrangement. Price terms do not have to be disclosed. As discussed in Section III above, any modification or change to the amount, price, or timing of the purchase or sale of the securities underlying a 10b5-1 trading plan constitutes the termination of the plan and the adoption of a new trading plan, triggering the need to disclose the termination and adoption under new Item 408(a).

- Under new Item 408(b) of Regulation S-K, all public companies must disclose annually whether the company has adopted insider trading policies and procedures relating to the purchase, sale or other disposition of the company's securities by directors, officers or employees, or by the company and, if so, a description of these policies and procedures. A company that has not adopted insider trading policies or procedures will be required to provide an explanation of why it has not done so. This disclosure will be required in Annual Reports on Form 10-K or, for foreign private issuers, Form 20-F, and in proxy and information statements (and, if included in a proxy statement filed within 120 days after a company's year-end, may be incorporated by reference in the company's Form 10-K).

- All public companies will also be required to attach as exhibits to their Annual Reports on Form 10-K or 20-F a copy of their insider trading policies and procedures.[5]

V. New Stock Option Grant Disclosures

New Item 402(x) of Regulation S-K will require both narrative and tabular disclosures regarding certain stock option granting practices. These disclosures will be required in Annual Reports on Form 10-K and proxy and information statements which, if included in a proxy statement filed within 120 days after a company's year-end, may be incorporated by reference in the company's Form 10-K.

Under this new item, a company must provide narrative disclosure discussing its policies and practices regarding the timing of awards of stock options, SARs and similar option-like

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[4] A "non-Rule 10b5-1 trading arrangement" is an arrangement that does not satisfy all of the conditions of Rule 10b5-1 but which may nevertheless not violate Rule 10b-5. It requires the covered person to not be aware of MNPI at the time they adopt a written arrangement for trading, and the trading arrangement must either (i) specify the key terms of the transaction, (ii) include a formula or algorithm, or computer program, for determining the key terms, or (iii) not permit the covered person to exercise any subsequent influence over how, when, or whether to effect trades.

5 If all of these policies and procedures are included in the company's code of ethics as required by Item 406(b) of Regulation S-K and the code of ethics is filed as an exhibit, there would be no need to separately file the insider trading policies and procedures. However, a company that merely posts its code of ethics on its website cannot rely on the posting to fulfill the new requirement to file its insider trading policies as an exhibit.

instruments in relation to the disclosure of MNPI, including how the board determines when to grant these awards. In addition, a company must disclose whether the board or compensation committee takes MNPI into account when determining the timing and terms of applicable awards, and, if so, how, and whether the company has timed the disclosure of MNPI for the purpose of affecting the value of executive compensation.[6]

New Item 402(x) also provides that if, during the last completed fiscal year, stock options, SARs or similar option-like instruments were awarded to a named executive officer ("NEO") within a period starting four business days before and ending one business day after the filing of a Form 10-K or 10-Q, or the filing or furnishing of a Current Report on Form 8-K that discloses MNPI (including earnings information),[7] the company must provide the following information concerning each such award in a tabular format:

- the name of the NEO;
- the grant date of the award;
- the number of securities underlying the award;
- the per-share exercise price;
- the grant date fair value of the award computed using the same methodology as used for the registrant's financial statements under generally accepted accounting principles; and
- the percentage change in the market price of the underlying securities between the closing market price of the security one trading day prior to and the trading day beginning immediately following the disclosure of MNPI.

New Item 16J in Form 20-F will require foreign private issuers to provide analogous disclosure in their annual reports on that form. As discussed in the adopting release, the new requirement is designed so that this new tabular disclosure requirement will lead to more visibility around company practices of "spring-loading" or "bullet-dodging" award grants made by the issuer to the NEOs that might be strategically timed to the release of MNPI.[8]

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[6] This new disclosure requirement expands upon existing Item 402(b)(iv) of Regulation S-K, which contemplates discussion, within the Compensation Discussion & Analysis section of the proxy statement, of how a determination is made regarding the timing of awards of equity-based instruments, including stock options.

[7] This does not include a Current Report on Form 8-K disclosing a material new option award grant under Item 5.02(e), which covers the adoption or modification of material compensatory plans.

[8] Spring-loaded awards are where a company grants an option award shortly before it discloses favorable MNPI. Spring-loaded awards can cause a call option to be in-the-money when it would have otherwise be at-the-money. Bullet-dodging awards are where a company grants an option award shortly before it discloses unfavorable MNPI. Bullet-dodging grants can cause a call option to be at-the-money when it would otherwise be out-of-the-money.

VI. Amendments to Forms 4 and 5

Rule 16a-3 and Forms 4 and 5 have been amended to require that filers of Forms 4 and 5 identify whether a reported purchase or sale was made under a 10b5-1 trading plan by checking a new Rule 10b5-1(c) box on the applicable form.

In addition, Section 16 insiders will now be required to report bona fide gifts of equity securities on Form 4 by the end of the second business day following the gift date, rather than, as previously, on Form 5 within 45 days of the end of an issuer's fiscal year.

VII. Takeaways

After the amendments to Rule 10b5-1 become effective, insiders at public companies who wish to adopt new, or amend current, 10b5-1 trading plans should review the new rules to ensure compliance, in particular with regard to the new certification requirements and mandatory cooling-off periods. We expect that brokers and other financial intermediaries which facilitate 10b5-1 trading plans will modify their forms for such plans accordingly. All public companies, including those where insiders are not expected to adopt new 10b5-1 trading plans, should be attentive to the following consequences of the SEC's rulemaking.

- 10b5-1 trading plans entered into before the effective date of the new rules will not need to be revised, but if an amendment after the effective date modifies the amount, price, or timing of the purchase or sale of the securities under the plan, the amendment would be regarded as a termination of the existing plan and the adoption of a new trading plan that would require compliance with the new rules in order to satisfy Rule 10b5-1.

- Beginning as early as the periodic report for the period ending June 30, 2023, public companies will need to comply with new disclosure requirements with respect to 10b5-1 trading plans adopted or terminated by their insiders during the most recent quarter.

- Public companies should review their insider trading policies and procedures for possible changes to address the new requirements for 10b5-1 trading plans and the new disclosure requirements applicable to these policies and procedures.

- Public companies that make use of stock options will need to take into account the new disclosure obligations aimed at curbing spring-loaded or bullet-dodging grants when timing grants of option, SARs and similar awards and the release of MNPI. This may entail revising board or compensation committee calendars in order to change the timing of expected compensation actions in order to avoid these disclosure requirements.

- Public companies and their officers and directors will need to modify internal compliance processes to ensure that all Section 16 reporting persons comply with the updated reporting requirements for Forms 4 and 5.

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Appendix: Compliance Dates

New Rule 10b5-1 Conditions		
Trading plan entered into before February 27, 2023	**New trading plan entered into after February 27, 2023**	**Modification of trading plan after February 27, 2023**
New rules do not apply, unless the plan is modified after February 27, 2023	New rules apply	New rules apply

Disclosure Rules for Directors and Section 16 Officers		
Requirement	**Compliance Date**	**First Affected Filing**
Amendments to Forms 4 and 5	On or after February 27, 2023	First Form 4 or 5 filed on or after February 27, 2023

Disclosure Rules for Issuers		
Requirement	**Compliance Date***	**First Affected Filing for Calendar Fiscal Year Issuers**
Item 408(a) of Regulation S-K (quarterly disclosure regarding the adoption or termination of officer and director trading plans)	First filing covering a full fiscal period on or after April 1, 2023	Form 10-Q for second quarter 2023
	SRCs: First filing covering a full fiscal period on or after October 1, 2023	*SRCs:* Form 10-K for 2023 fiscal year
Item 408(b) of Regulation S-K and Item 16J of Form 20-F (annual disclosure of insider trading policies and procedures)	First filing covering a full fiscal period on or after April 1, 2023	Form 10-K for the 2024 fiscal year filed in 2025 or proxy statement for 2025 annual meeting**
	SRCs: First filing covering a full fiscal period on or after October 1, 2023	*SRCs*: Form 10-K for 2024 fiscal year filed in 2025 or proxy statement for 2025 annual meeting**
	FPIs: First filing covering a full fiscal period on or after April 1, 2023	*FPIs*: Form 20-F for 2024 fiscal year filed in 2025
Filing insider trading policies as exhibits to annual report	First filing covering a full fiscal period on or after April 1, 2023	Form 10-K for the 2024 fiscal year filed in 2025
	SRCs: First filing covering a full fiscal period on or after October 1, 2023	*SRCs*: Form 10-K for 2024 fiscal year filed in 2025
	FPIs: First filing covering a full fiscal period on or after April 1, 2023	*FPIs*: Form 20-F for 2024 fiscal year filed in 2025
Item 402(x) of Regulation S-K (annual stock option grant disclosures)	First filing covering a full fiscal period on or after April 1, 2023	Form 10-K for the 2024 fiscal year filed in 2025 or proxy statement for 2025 annual meeting**
	SRCs: First filing covering a full fiscal period on or after October 1, 2023	*SRCs*: Form 10-K for 2024 fiscal year filed in 2025 or proxy statement for 2025 annual meeting**

* The new disclosure rules are applicable to all issuers except as noted for smaller reporting companies (SRCs) and foreign private issuers (FPIs).

**The disclosure requirements relate to Form 10-K but may be incorporated by reference from a proxy or information statement involving the election of directors, if filed within 120 days of the end of the fiscal year covered by the Form 10-K.