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Securities Alert

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SEC adopts new requirements for Rule 10b5-1 insider trading plans and related disclosures

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The amended rules substantially alter the regulatory landscape and add new disclosure requirements relating to Rule 10b5-1 plans and insider trading arrangements.

What's the Impact?

- The amendments to Rule 10b5-1 impose mandatory cooling-off periods and other new substantive conditions on the availability of the Rule 10b5-1(c)(1) affirmative defense from liability for insider trading
- Issuers will need to update their existing insider trading policies and procedures, and must comply with new disclosure requirements relating to the material terms of insider trading plans and arrangements established by their directors and executive officers and stock option (and similar) grants to named executive officers
- Forms 4 and 5 will require identification of transactions under a Rule 10b5-1 plan and the reporting deadline for bona fide gifts is accelerated
- The amendments will become effective 60 days after publication in the *Federal Register*

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On December 14, 2022, the Securities and Exchange Commission (SEC) adopted amendments to the SEC's rules and forms relating to insider trading under Rule 10b5-1(c)(1) plan arrangements. As adopted, the final rules largely reflect the proposals offered by the SEC for comment in December 2021, which were summarized in our prior alert, but with several important changes.

The amendments will be effective sixty (60) days after publication in the *Federal Register*. Companies must begin to comply with the expanded quarterly and annual disclosure and tagging requirements in the first filing of a periodic report or proxy or information statement that covers the first full fiscal period that begins on or after April 1, 2023. For smaller reporting companies, the expanded quarterly and annual disclosure and tagging requirements will be effective for full fiscal periods beginning on or after October 1, 2023. The amendments do not affect trading plans entered into before the revised rule's effective date, except to the extent that certain changes or modifications are made after the effective date of the final rules.

This alert summarizes key provisions of the amendments as adopted.

Background

Section 10(b) of the Securities Exchange Act of 1934, as amended (Exchange Act), and Rule 10b-5 thereunder prohibit purchases or sales of company securities on the basis of (i.e., when aware of) material nonpublic information in breach of a duty owed to the company, its shareholders, or any person who is the source of the material nonpublic information. Rule 10b5-1(c)(1) provides an affirmative defense to liability for insider trading where certain conditions set forth in that rule are satisfied. Conducting transactions pursuant to a written trading plan entered into in compliance with the conditions specified in Rule 10b5-1(c)(1) significantly reduces the risk of insider trading liability, making Rule 10b5-1 plans a popular and widely used arrangement for trading company securities by directors, officers, and other company insiders who may regularly have access to material nonpublic information, in addition to companies themselves.

The amendments to Rule 10b5-1 and the newly adopted disclosure requirements are intended to increase transparency and address potentially abusive practices that raise concerns that company insiders may be trading opportunistically under Rule 10b5-1 in ways that harm investors and undermine the integrity of the securities markets. Potentially abusive practices cited by the SEC include: using multiple overlapping plans to selectively cancel individual trades on the basis of material nonpublic information; adopting a plan close in time before the release of quarterly financial results or other material nonpublic information; commencing trades soon after the adoption of a new plan or modification of an existing plan; terminating trading arrangements shortly after adoption; conducting company share repurchases to raise the price of the company's stock before sales by corporate insiders; granting spring-loaded options and similar equity awards to directors and officers before the release of material nonpublic information; and insiders making gifts while aware of material nonpublic information.

As adopted, the amendments codify certain "best practices" that have evolved in the 20-plus years since Rule 10b5-1 was adopted, but also impose new disclosure requirements and

substantive restrictions for companies, directors, officers, and other insiders conducting transactions under Rule 10b5-1(c)(1) plans and other trading arrangements.

Rule 10b5-1(c)(1)'s conditions for use of a Rule 10b5-1(c)(1) plan that affords the benefits of the affirmative defense currently include:

- A binding contract, instruction, or written plan for trading securities, entered into at a time the person is not aware of the material nonpublic information, that:
  - Specifies the amount of securities to be purchased or sold, the price, and the date;
  - Provides a written formula, algorithm, or computer program for determining the amount of securities to be purchased or sold, the price, and the date; or
  - 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 exercises such influence is not aware of the material nonpublic information when doing so; and
- The purchase or sale that occurred was pursuant to the contract, instruction, or plan; and
- The contract, instruction, or plan was entered into in good faith and not as part of a plan or scheme to evade the prohibitions of Exchange Act Section 10(b) and Rule10b-5.

In addition, Rule 10b5-1(c)(2) provides that a company seeking to claim the affirmative defense may demonstrate that a purchase or sale of securities is not made on the basis of material nonpublic information by showing that (a) the individual making the investment decision on behalf of the company was not aware of the material nonpublic information and (b) the company had implemented reasonable policies and procedures to prevent trading on the basis of material nonpublic information.

Amendments to Rule 10b5-1

The amendments to Rule 10b5-1 add the following conditions and restrictions for plans and other trading arrangements intended to qualify for the Rule 10b5-1(c)(1) affirmative defense.

Minimum cooling-off periods

- **For company directors or Section 16 officers** (i.e., the president, principal financial officer, principal accounting officer, any vice-president in charge of a principal business unit, division or function, any other officer who performs a policy-making function, or any other person who performs similar policy-making functions), a minimum waiting period before any trading can commence of the later of:
  - 90 days after the adoption of the Rule 10b5-1 plan or other trading arrangement; or
  - two (2) business days following disclosure of the issuer's financial results in a Form 10-Q or Form 10-K for the fiscal quarter in which the plan or other trading arrangement was adopted or, for foreign private issuers, in a Form 20-F or Form 6-K that discloses such financial results,

  in either case, subject to a maximum of 120 days after adoption of the plan or other trading arrangement.
- **For persons other than directors, Section 16 officers or the issuer** (such as, for example,

non-officer employees), a 30-day minimum waiting period after adoption of the plan or other trading arrangement before any trading can commence.

- The amendments to Rule 10b5-1 (c)(1) also codify and clarify existing SEC guidance regarding the effect of plan modifications. As amended, Rule 10b5-1(c)(1) provides that a modification or change to the amount, price, or timing of the purchase or sale of securities covered by the plan or other trading arrangement (or a modification or change to a written formula or algorithm, or computer program that affects the amount, price, or timing of the purchase or sale of such securities) constitutes a termination of the plan or other trading arrangement and the adoption of a new plan or arrangement, triggering the start of a new cooling-off period. However, other modifications (for example, an adjustment for stock splits or a change in account information) will not trigger commencement of a new cooling-off period.
- The SEC declined to adopt a minimum waiting period for issuers at this time (a 30-day cooling off period was proposed), noting that further consideration of this issue is warranted. We note in that regard that December 2021 proposed rule changes to expand issuer reporting requirements relating to share repurchase activities also remain subject to SEC consideration and final rulemaking, with a reopened comment period scheduled to end January 11, 2023.

Certification requirement

- A director or Section 16 officer adopting a new 10b5-1(c)(1) plan or other trading arrangement (or entering into a modification thereof) will be required to include in the plan document a representation certifying that at the time of the adoption (or modification):
  - They are not aware of material nonpublic information about the issuer or its securities; and
  - 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 Rule 10b-5.

Many standard form Rule 10b5-1(c)(1) plan documents currently include a similar representation. As adopted, the amendments do not impose a minimum retention period (as was proposed) or SEC filing requirement for the certifications.

Restrictions on multiple overlapping Rule 10b5-1 trading arrangements and single-trade arrangements

- As amended, the conditions to Rule 10b5-1(c)(1) provide that the affirmative defense will not be available to any person — other than the issuer — for multiple overlapping plans or other trading arrangements for open market purchases or sales of any class of securities of that issuer at any given time, subject to the following exceptions:
  - A person may enter into a series of separate contracts with different brokers or other agents to execute trades pursuant to a single Rule 10b5-1 plan that covers securities held in different accounts. The contracts may be treated as a single plan, so long as the separate contracts, when taken together as a whole, satisfy all the applicable conditions of, and remain collectively subject to, the provisions of Rule 10b5-1(c)(1). A modification of any such contract will be a deemed a modification of each other contract or instruction and such single plan.

- Two separate Rule 10b5-1 plans may be maintained at the same time if trading under the later-commencing plan is not authorized to begin until after all trades under the earlier-commencing plan are completed or expire without execution. Both plans will be required to meet all other conditions of the affirmative defense, however, including all applicable cooling-off periods.
- A plan or plans established solely to authorize an agent to execute sell-to-cover transactions to satisfy an insider's tax withholding obligations arising from the vesting of equity awards generally will not cause an insider to lose the affirmative defense for transactions made pursuant to a separate, otherwise eligible Rule 10b5-1 (c)(1) plan. For plans to qualify for this exception and also be eligible for the benefit of the affirmative defense, (a) the additional plans may authorize an agent to sell only such securities as are necessary to satisfy the insider's tax withholding obligations incident to the vesting of a compensatory equity award and (b) the insider may not otherwise exercise control over the timing of such sales.

/ The affirmative defense will be available for only one single-trade plan during any 12-month period, except in the case of qualified plans authorizing sell-to-cover transactions as discussed above. A single-trade plan is a plan that is designed to effect the open-market purchase or sale of the total amount of securities covered by the plan in a single transaction. The adopting release notes that a plan that leaves the broker or other agent discretion over whether to execute the plan as a single transaction is not considered a single-trade plan, nor is a non-discretionary plan where it is reasonably foreseeable at the time the plan is entered into that the plan might result in multiple transactions.

/ As with the cooling-off period requirements, the SEC declined to adopt proposed limitations on multiple plans and single-trade plans for issuers at this time, noting that further consideration is warranted.

Expanded good faith requirement

/ In addition to the existing requirement that a plan must be entered into in good faith and not as part of a plan or scheme to evade the prohibitions of Rule 10b-5, the amendments to Rule 10b5-1(c) (1) expand the good faith requirement to span the duration of the plan. As amended, Rule 10b5-1(c) (1) requires the person to have acted in good faith with respect to the plan. This additional condition is intended to help ensure that traders do not engage in opportunistic trading under Rule 10b5-1 plans and to deter corporate insiders from improperly influencing the timing of corporate disclosures to benefit their trades under a plan.

Effect on existing Rule 10b5-1 Plans

/ The amendments to Rule 10b5-1(c)(1) will not affect the affirmative defense available under an existing Rule 10b5-1(c)(1) plan that was entered into before the effective date of the amendments to Rule 10b5-1(c), except to the extent any of that grandfathered plan's key terms are modified or changed after the effective date of the amendments. If so modified, the grandfathered plan would be deemed to be terminated and the modified plan would be

deemed a new plan. As a result, the modified plan would have to comply with Rule 10b5-1(c)(1) as amended to receive the benefit of the affirmative defense.

New disclosure requirements

The final rule amendments substantially expand required disclosures relating to Rule 10b5-1 trading arrangements, director and officer option grants, and company insider trading policies and procedures. These expanded disclosure requirements are intended to provide greater transparency to investors and the SEC and reduce potential abuse by insiders, and include the following elements.

Quarterly reporting of trading plans and other trading arrangements

- New Item 408(a) of Regulation S-K will require companies to disclose the adoption, modification, and termination of any Rule 10b5-1 trading plan or arrangement, as well as any non-Rule 10b5-1 trading arrangements covering transactions in the company's securities, by the company's directors or Section 16 officers (but not by the issuer or insiders other than directors and officers) and the material terms of each arrangement (other than pricing terms), such as the name and title of the director or officer, date of adoption or termination of the trading arrangement, duration of the trading arrangement, and aggregate number of securities to be purchased or sold. The disclosure will also be required to identify whether the arrangement is a Rule 10b5-1 trading arrangement (meaning any contract, instruction, or written plan for the purchase or sale of securities of the SEC reporting company that is intended to satisfy the affirmative defense conditions of Rule 10b5-1(c)(1)) or a non-Rule 10b5-1 trading arrangement. Under Item 408(c), a "non-Rule 10b5-1 trading arrangement" of a company director or Section 16 officer is defined to mean a written arrangement for trading company securities, where the trading arrangement: 1) specifies the amount of securities to be purchased or sold, the price and the date for the transactions; 2) includes a written formula or algorithm, or computer program, for determining the amount of securities to be purchased or sold and the price for the transactions; or 3) does not allow the individual to exercise any subsequent influence over the trades, provided also that any other person exercising such influence pursuant to the trading arrangement must not be aware of material nonpublic information when doing so.
- These disclosures (tagged using inline XBRL) will be required in the company's Form 10-Q and Form 10-K covering the reporting period in which the relevant plan is entered into, modified, or terminated. Foreign private issuers will not be subject to the Item 408(a) disclosure requirements.

Disclosure of insider trading policies and procedures

- New Item 408(b) of Regulation S-K (and Item 16J in Form 20-F for foreign private issuers) will require a reporting company to disclose whether the company has adopted insider trading policies and procedures, and, if adopted, to file copies of such policies and procedures as an

exhibit to the company's Form 10-K or Form 20-F, as applicable.

- If a company has not adopted insider trading policies and procedures, it must provide an explanation of why it has not done so.
- These disclosures (tagged using inline XBRL) will be required in the company's annual reports on Form 10-K or Form 20-F, as applicable, and proxy and information statements on Schedule 14A and 14C. As with other disclosures included in Form 10-K and Form 20-F, the disclosures provided relating to the company's insider trading policies and procedures (or lack thereof) will be subject to the CEO and CFO certifications required by Section 302 of the Sarbanes-Oxley Act of 2002.

Annual disclosures regarding the timing of certain grants of options and similar equity instruments

- New Item 402(x) of Regulation S-K will require narrative disclosure describing the company's option grant policies and practices regarding the timing of option grants in relation to the release of material nonpublic information, including how the board determines when to grant options and whether, and if so, how, the board or compensation committee takes material nonpublic information into account when determining the timing and terms of an option award. Companies must also address whether the company timed the disclosure of material nonpublic information for the purpose of affecting the value of executive compensation. The adopting release notes that the new narrative disclosure and table (described below) apply to stock options, SARs, and "similar option-like instruments."
- In addition, Item 402(x) will require tabular disclosure regarding each option award (and similar option-like equity awards) granted to a named executive officer within the period beginning four (4) business days before the filing of a periodic report on Form 10-Q or Form 10-K, or the filing or furnishing of a current report on Form 8-K that discloses material nonpublic information (other than a Form 8-K filed to report only a new option grant under Item 5.02(e)) and ending one (1) business day after the filing or furnishing of that report. Information to be included in the table includes, for each award, the name of the award recipient, grant date, number of securities underlying the award, exercise price of the award, grant date fair value, and percentage change in the market price of the underlying securities between the closing market price one trading day before and one trading day after the disclosure of such material nonpublic information.
- These disclosures, which the SEC indicates are intended to provide shareholders with a full and complete picture of "spring-loaded" or "bullet-dodging" option grants during the most recently completed fiscal year, will be required in the company's annual reports on Form 10-K and proxy and information statements related to the election of directors, shareholder approval of new compensation plans, and solicitations of advisory say-on-pay votes. Smaller reporting companies and emerging growth companies will be subject to the Item 402(x) reporting requirements, with scaled disclosure requirements.

Identification of trading plan transactions on Forms 4 and 5

- Section 16 officers and directors will be required to indicate in Form 4 and Form 5 filings whether a reported transaction was made pursuant to a plan intended to satisfy the affirmative defense conditions of Rule 10b5-1(c) (1) and to provide the date of adoption of the arrangement.

Accelerated mandatory Form 4 reporting of gifts

- Bona fide gift transfers by Section 16 reporting persons, including Section 16 officers, directors, and 10%+ shareholders, will be required to be reported within two business days of the transfer on Form 4. Delayed reporting on Form 5 will no longer be permitted.

Key action items

Companies will want to begin now to prepare for the required disclosures and provide necessary training for directors, officers, and other insiders on the new trading plan conditions and related reporting requirements. More specifically, companies may want to begin now to:

- Review the company's existing insider trading policies and procedures (including, in view of the discussion in the adopting release, the duration of blackout periods and treatment of proposed gifts of stock by insiders) and any model trading plan documents to identify revisions that may be needed to address the new requirements.
- If the company does not currently have written insider trading policies and procedures, consider adopting policies structured to meet the requirements of amended Rule 10b5-1.
- Review the company's existing option award policies and practices to identify any timing issues in relation to the release of material nonpublic information and consider whether any changes are necessary or desirable in light of the expanded disclosure requirements.
- For venture capital funds and other institutional investors with a representative on the issuer's board, in view of the discussion in the adopting release, consider whether future resale transactions can be structured to avoid relying on the Rule 10b5-1(c)(1) affirmative defense, or the implications of continuing to do so.
- Prepare necessary updates to internal education and information materials provided to directors, officers, and other insiders to incorporate new and revised requirements to Rule 10b5-1 plan conditions and Section 16 reporting obligations.
- Evaluate whether and what changes to disclosure controls and internal processes may be needed to address the requirements of the new rules.

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