Client Alert

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SEC Amendments Regarding Rule 10b5-1 Insider Trading Plans and Related Disclosures

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On December 14, 2022, the Securities and Exchange Commission (SEC) adopted amendments regarding Rule 10b5-1 insider trading plans and related disclosures. The amendments aim to strengthen investor protections concerning insider trading and to help shareholders understand when and how insiders are trading in securities for which they may at times have material nonpublic information (MNPI). In light of these amendments, issuers should review and revise, if needed, their insider trading policies and equity grant policies.

In 2000, the SEC adopted Rule 10b5-1 to provide more clarity on what was prohibited with respect to trading on the basis of MNPI and to provide insiders, who typically hold MNPI, an affirmative defense when trading public company securities. Rule 10b5-1(c) established an affirmative defense whereby insiders can set up future trades pursuant to a binding contract or plan adopted in good faith while the insider does not have MNPI, and the plan can be carried out even if the insider later acquires MNPI. This affirmative defense shifts the insider trading analysis (i.e., whether the insider has MNPI) from the time the securities are purchased or sold to the time when the Rule 10b5-1 plan is put into place. However, the rule has been criticized by some for leaving gaps that can be manipulated.

The amendments to Rule 10b5-1 add new conditions to the Rule 10b5-1 affirmative defense to address what the SEC and others perceive as gaps. Under the amendments, the following additional conditions have to be met in order to claim the affirmative defense:

- Mandatory cooling-off periods following newly adopted or modified Rule 10b5-1 plans.
- Representations in the newly adopted or modified Rule 10b5-1 plan from directors and officers certifying that they are not aware of MNPI when adopting a new or modified Rule 10b5-1 plan and that they are adopting the plan in good faith and not as part of a plan or scheme to evade the prohibitions of Rule 10b-5.
- No overlapping Rule 10b5-1 plans for anyone other than issuers (other than in limited circumstances).
- Only one single-trade plan in a 12-month period for anyone other than issuers.

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- Good faith actions with respect to the Rule 10b5-1 plan by all persons entering into that plan.

A cooling-off period is a specified time period during which insiders cannot trade under a Rule 10b5-1 plan after it is adopted or modified in a manner that changes the sales or purchase prices or price ranges, the amount of securities to be sold or purchased or the timing of transactions. Under the amendments, Rule 10b5-1 plans of directors and Section 16 officers require a cooling-off period of the later of (1) 90 days following plan adoption or modification and (2) two business days following the disclosure in periodic reports on Forms 10-Q, 10-K, 20-F or 6-K (as applicable) of the issuer's financial results for the fiscal quarter in which the plan was adopted or modified (but not to exceed 120 days following plan adoption or modification). Under the amendments, Rule 10b5-1 plans of persons other than issuers or directors and Section 16 officers require a 30-day cooling-off period. The cooling-off periods are intended to ensure that even if an insider holds information not known to investors at the time of a plan adoption or modification, that information will be stale by the time trades are made under the plan.

The amendments also prohibit overlapping Rule 10b5-1 plans and more than one single-trade plan during a 12-month period for anyone other than issuers. In its adopting release, the SEC notes that concerns have been raised that corporate insiders use multiple overlapping plans to selectively cancel individual trades on the basis of MNPI, commence trades shortly after the adoption of a new plan or otherwise unfairly exploit informational asymmetries. This amendment is intended to prevent such practices.

Finally, under the amendments, insiders who enter into a Rule 10b5-1 contract, instruction or plan must act in good faith with respect to the contract, instruction or plan. Directors and Section 16 officers are required to make representations in the new or modified Rule 10b5-1 plan certifying that they are not currently aware of MNPI and that they are adopting the plan in good faith and not as part of a plan or scheme to evade the prohibitions of Rule 10b-5.

With respect to existing Rule 10b5-1 plans, the SEC specifically clarified that amendments to Rule 10b5-1(c)(1) would not affect the affirmative defense available under an existing plan that was entered into prior to the revised rule's effective date, except to the extent that such a plan is modified or changed in the manner described in Rule 10b5-1(c)(iv) after the effective date of the final rules. In that case, the modification or change would be equivalent to adopting a new trading arrangement, and, thus, amended Rule 10b5-1(c)(1) would be the applicable regulatory affirmative defense that would be available for that modified arrangement.

In addition to the additional Rule 10b5-1 conditions, the amendments also contemplate additional disclosure including:

- Additional disclosure on Forms 4 or 5.
- Quarterly disclosure of Rule 10b5-1 plans.
- Insider trading policy disclosure on an annual basis.
- Stock options and similar awards disclosure.

- Inline XBRL tagging of the required insider trading policy and stock option disclosure.
- Disclosure of securities as gifts on Form 4.

Under the amendments, Section 16 reporting persons are required to indicate on Form 4 or 5 whether the disclosed transactions are intended to satisfy the affirmative defense conditions of Rule 10b5-1(c). Issuers are also required to disclose in their periodic reports on a quarterly basis whether any director or Section 16 officer has adopted or terminated a Rule 10b5-1 or other trading plans, and to provide the material terms of the plan (other than pricing terms) such as the date of adoption or termination, name and title of any director or officer involved, duration of the plan and aggregate amount of securities subject to the plan. Additionally, issuers are required to disclose annually if they have adopted an insider trading policy and, if so, to file the insider trading policy as an exhibit to the issuer's annual report. If issuers have not adopted an insider trading policy, they will be required to disclose why not.

Additionally, the amendments require companies to disclose a table of stock options, stock appreciation rights or similar option-like instruments granted within four business days before and one business day after the filing of a periodic report or the release of MNPI on Form 8-K. This amendment is intended to address the practice of granting stock options and other similar awards with option-like features to insiders in coordination with the release of MNPI, which the SEC perceives as a potential misuse of MNPI.

The amendments require companies to tag in Inline XBRL the newly required information on insider trading policies and awards of stock options and similar awards.

Finally, the amendments require Section 16 reporting persons to report bona fide gifts of securities on Form 4 before the end of the second business day following the date of the execution of the transaction instead of on a Form 5 that is due within 45 days after the end of the issuer's fiscal year. This new mandatory Form 4 disclosure requirement is intended to address the concern of insiders gifting securities while they hold MNPI or backdating a stock gift in order to maximize a donor's tax benefit. In its adopting release, the SEC notes that the majority of insiders already report gift transactions on Form 4.

The amendments will become effective 60 days following publication of the adopting release in the Federal Register. Section 16 reporting persons will be required to comply with the amendments to Forms 4 and 5 for beneficial ownership reports filed on or after April 1, 2023. Issuers that are not smaller reporting companies will be required to comply with the new disclosure and tagging requirements in Exchange Act periodic reports on Forms 10-Q, 10-K and 20-F and in any proxy or information statements in the first filing that covers the first full fiscal period that begins on or after April 1, 2023. Issuers that are smaller reporting companies will be required to comply with the new disclosure and tagging requirements in Exchange Act periodic reports on Forms 10-Q, 10-K and 20-F and in any proxy or information statements in the first filing that covers the first full fiscal period that begins on or after October 1, 2023.

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