SULLIVAN & CROMWELL LLP

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SEC Proposes New Requirements for Insider Trading Plans and Issuer Share Repurchases

SEC Proposals Would Raise the Procedural, Substantive and Disclosure Requirements for Rule 10b5-1 Trading Plans and Establish New Disclosure Requirements for Share Repurchases, Including a New Form SR

SUMMARY

On December 15, 2021, the Securities and Exchange Commission unanimously proposed amendments that would (1) implement mandatory cooling-off periods for Rule 10b5-1 trading plans, (2) enhance the affirmative defense requirements under Rule 10b5-1 (including by adding a written certification requirement and providing that the affirmative defense would not be available for overlapping plans or to more than one single-trade Rule 10b5-1 trading plan during any consecutive 12-month period) and (3) impose new disclosure requirements regarding insider trading plans. These amendments also would impose new disclosure requirements for grants of equity compensation awards made close in time to disclosure of material non-public information and require reporting gifts of securities by insiders on Form 4.

On the same day, the SEC, by a 3-to-2 vote, also proposed amendments to enhance the disclosure requirements around issuer share repurchases by (1) requiring issuers to furnish a new Form SR by the end of the first business day following execution of a share repurchase order and (2) amending Item 703 of Regulation S-K to require additional detail regarding share repurchases, including disclosure of the process and criteria used for determining how much to repurchase and whether any repurchases were made pursuant to a Rule 10b5-1 trading plan or in reliance on the Rule 10b-18 non-exclusive safe harbor.

Many of the proposed changes build upon SEC Chair Gary Gensler's June 2021 remarks (discussed here) and the SEC's Investor Advisory Committee's September 2021 recommendation (discussed here). The public comment period will be open for 45 days after publication of each proposed amendment in the Federal Register.

PROPOSED AMENDMENTS ON INSIDER TRADING PLANS

The SEC's proposals relating to Rule 10b5-1 under the Securities Exchange Act of 1934 (the "Exchange Act") and insider trading plans include:

- *Cooling-Off Period for Director and Officer Purchases*. The SEC proposes requiring a mandatory cooling-off period of at least 120 days for directors and officers between adoption or modification of a Rule 10b5-1 trading plan and the first trade under the newly adopted or modified plan. The proposed amendments would clarify that ***any*** modification to a Rule 10b5-1 trading plan is deemed to be a termination of the plan, thereby triggering the applicable cooling-off period before any new trades can be made under the plan. The proposed amendments do not limit modifications to those that are material to the trading plan. The proposed 120-day cooling-off period would be longer than periods generally recommended by practitioners, which typically are in the range of one or two months.
- *Cooling-Off Period for Issuer Repurchases*. The SEC proposes requiring a mandatory cooling-off period of at least 30 days for issuer repurchases. A cooling-off period for issuers previously has not been a prominent part of the dialogue around cooling-off periods for Rule 10b5-1 trading plans. In fact, when the SEC's Investor Advisory Committee issued its recommendations regarding Rule 10b5-1 trading plans in September 2021, the Committee included a note stating that the Committee "did not consider issuer share buybacks in its deliberations on this recommendation and believes that any changes to the regulation of these programs should be addressed separately."[1] The proposed 30-day cooling-off period for issuers would be much longer than that currently recommended by practitioners, which is typically no cooling-off period.
- *Certification Requirement*. The proposed rules would require a written certification as a condition to the availability of the affirmative defense under Rule 10b5-1. Under the proposed rule, a director or officer (as defined in Section 16 of the Exchange Act) would be required to promptly furnish to the issuer a written certification at the time of adoption of a Rule 10b5-1 trading plan stating that, at the time of the adoption of the trading plan, (1) they were not aware of material nonpublic information ("MNPI") and (2) they adopted the plan in good faith and not as part of a scheme to evade Section 10(b) of the Exchange Act or Rule 10b-5 thereunder. The proposed amendments provide that ***any*** modification or amendment to an existing plan is treated as a new plan, thus requiring a new certification. Once again, neither modification nor amendment is qualified by materiality. A certification would not be required if a director or officer terminates an existing Rule 10b5-1 trading plan without adopting a new or modified Rule 10b5-1 trading plan.
- *Limitations on the Number of Plans That May Be Adopted*. Chair Gensler's remarks in June 2021 noted that there currently are no limits on the number of plans that insiders may adopt, and that with the ability to enter into multiple trading plans and to cancel such plans at any time, "insiders might mistakenly think they have a 'free option' to pick amongst favorable plans as they please." The proposed rule provides that the affirmative defense under Rule 10b5-1 would not be available for overlapping plans for open market purchases or sales of the same class of securities or to more than one single-trade Rule 10b5-1 trading plan during any consecutive 12-month period.
- *Expansion of Good Faith Requirement*. The SEC proposes amending Rule 10b5-1 to expand the current good faith requirement by adding the condition that a contract, instruction or plan be "operated" in good faith in addition to having been "entered into" in good faith. The proposed

amendment is intended to clarify that an insider that cancels or modifies a Rule 10b5-1 trading plan in an effort to evade the prohibitions of the Rule 10b5 or uses their influence to make a trade more profitable or avoid or reduce a loss by manipulating the timing of corporate disclosures would not be able to rely on the affirmative defense under Rule 10b5-1.

- *Public Disclosure of Trading Plans*. The SEC proposes the following enhanced public reporting and disclosure requirements in connection with insider trading plans:
  - *Item 408 of Regulation S-K*. Adding a new Item 408 to Regulation S-K that would require quarterly disclosure on Form 10-Q and Form 10-K about the adoption, termination and terms (including the date of adoption or termination, duration and aggregate amount of securities to be sold or purchased) of a Rule 10b5-1 trading plan or other preplanned trading arrangement (including plans not intended to comply with the affirmative defense requirements of Rule 10b5-1) by the issuer or its Section 16 insiders. The proposing release does not provide any guidance as to what constitutes a preplanned trading arrangement that does not comply with Rule 10b5-1. For example, it is unclear if this would encompass a series of limit orders to purchase or sell securities.

    Proposed Item 408 would also require disclosure in annual reports on Form 10-K and proxy statements regarding insider trading policies applicable to directors, officers, and employees and the issuer itself. Further, the proposed disclosures would require the information to be tagged using inline XBRL. In the proposal, the SEC acknowledges that insider trading policies can vary significantly among companies and, as a result, the proposed amendments do not specify all details that an issuer should address in its insider trading policies or prescribe specific language that such policies must include. An issuer would be permitted to cross-reference to sections of its code of ethics that constitute insider trading policies. The proposed disclosures would be subject to the certifications by the issuer's principal executive officer and principal financial officer that are required by Section 302 of the Sarbanes-Oxley Act of 2002.
  - *Forms 4 and 5*. Amending Forms 4 and 5 to include (1) a new, mandatory checkbox that would indicate whether a trade was made pursuant to a Rule 10b5-1 trading plan and, if so, require disclosure of the date of adoption of the Rule 10b5-1 trading plan, and (2) a second, optional checkbox that would allow a filer to indicate whether a reported transaction was made pursuant to a pre-planned trading arrangement that is not intended to satisfy the conditions of Rule 10b5-1.

The SEC's proposals relating to Rule 10b5-1 under the Exchange Act and insider trading plans do not impact the purchase or sale of shares outside of the Rule 10b5-1 safe harbor, including purchases by persons who are not aware of MNPI conducted in accordance with the non-exclusive safe harbor in Rule 10b-18 under the Exchange Act.

In the same set of proposals, the SEC also is proposing new disclosure requirements in connection with equity grants and insider transactions:

- *Item 402 of Regulation S-K*. Amending Item 402 of Regulation S-K to add a new clause requiring (1) narrative disclosure of an issuer's policies and practices regarding grants of stock options, stock appreciation rights or similar instruments[2] and (2) tabular disclosure of each such award granted to a named executive officer within 14 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 MNPI and the market price of the relevant securities on the trading days before and after disclosure of the MNPI. The proposed amendments to Item 402 disclosure requirements would apply to annual reports on Form 10-K and proxy statements and would require that the information provided be tagged using in-line XBRL. Smaller reporting companies and emerging growth companies would not be exempt from the proposed

disclosures, although they would be permitted to limit their disclosures, consistent with the general scaled approach to their executive compensation disclosure.

- *Reporting Gifts of Securities*. Modifying Form 4 to require the reporting of bona fide gifts of equity securities. Under the proposal, a Section 16 insider making a gift of equity securities would be required to report the gift on Form 4 before the end of the second business day following the date of execution of the transaction rather than on Form 5 within 45 days after the end of the issuer's fiscal year. In connection with proposing this change, SEC Chair Gensler noted in an accompanying statement that "charitable gifts of securities are subject to insider trading laws." A footnote to the proposing release states that "[f]or example, a donor of securities violates Exchange Act Section 10(b) if the donor gifts a security of an issuer in fraudulent breach of a duty of trust and confidence when the donor was aware of material nonpublic information about the security or issuer, and knew or was reckless in not knowing that the donee would sell the securities prior to the disclosure of such information."

PROPOSED AMENDMENTS ON ISSUER SHARE REPURCHASES

In a separate set of proposals, the SEC also proposes the following enhanced public reporting and disclosure requirements in connection with issuer share repurchases:

- *Form SR*. Requiring issuers to furnish a new Form SR within one business day after execution of an issuer's share repurchase order. In recognition of the short filing time-frame, the SEC notes that the Form SR is furnished and not filed with the SEC and, therefore, late filings would not affect an issuer's ability to use Form S-3. Under the proposed rule, Form SR would require the following disclosure in tabular format, by date:
  - the total number of shares purchased (whether or not pursuant to a publicly announced share repurchase plan or program);
  - the average price paid for share; and
  - the total number of shares purchased (i) on the open market (but not in tender offers or pursuant to the exercise of put options or other transactions), (ii) in reliance on the safe harbor in Rule 10b-18 and (iii) pursuant to a Rule 10b5-1 trading plan.
- *Item 703 of Regulation S-K*. Amending Item 703 of Regulation S-K to require additional details regarding the structure of an issuer's repurchase program and its share repurchases, including (1) the objective or rationale for share repurchases and the process or criteria for determining the amount of repurchases, (2) policies or procedures relating to purchases of the issuer's securities by its officers and directors during a repurchase program, (3) whether repurchases were made pursuant to a Rule 10b5-1 trading plan and, if so, the date that that plan was adopted or terminated, (4) whether repurchases were made in reliance on the Rule 10b-18 non-exclusive safe harbor and (5) purchases or sales of securities by Section 16 insiders within 10 business days before or after the announcement of a repurchase plan.[3]

FOREIGN PRIVATE ISSUERS

Notably, foreign private issuers would also be subject to annual disclosure of insider trading policies and procedures under new Item 16J of Form 20-F, similar to the proposed new Item 408 described above, and such disclosures would be subject to the officer certifications required by Section 302 of the Sarbanes-Oxley Act of 2002. The proposed rules on reporting and disclosure for share repurchases would also extend to foreign private issuers, who would be required to furnish the new Form SR and subject to

enhanced annual disclosure requirements for share repurchases under amended Item 16E of Form 20-F, similar to the proposed amended Item 703 described above. The SEC has asked for comment on whether foreign private issuers should be exempted from any of these requirements.

KEY TAKEAWAYS

The proposed amendments would represent a substantial expansion of the disclosure requirements relating to insider trading plans and share repurchases, as well as the requirements for the affirmative defense under Rule 10b5-1. If adopted as proposed, the amendments will substantially limit the usefulness of Rule 10b5-1 trading plans for purchases and sales of shares and create uncertainty as to the availability of the affirmative defense (especially with the condition that the plan be "operated" in good faith). As a result, we would expect use of Rule 10b5-1 trading plans to decline significantly.

The prohibition against multiple plans, and the limitation of one single sales plan per year, raise issues with respect to employee benefit plan transactions and other automatic purchase plans that typically rely on Rule 10b5-1. These include share withholding upon the vesting or delivery of equity compensation awards, purchases under employee stock purchase plans and the reinvestment of dividends pursuant to dividend reinvestment plans.

The additional procedural, substantive and disclosure requirements for directors and officers had been expected and implement recommendations that have been made by the SEC's Investor Advisory Committee. In contrast, as noted by two of the Commissioners, the proposed rules impose additional requirements on issuers that have not been supported by any analysis of issuer share repurchases. Commissioner Roisman questioned the need for a 30-day cooling-off period for issuers. Specifically, Commissioner Roisman stated that he would prefer to "exclude issuers from the mandatory cooling-off period altogether" as "[c]ompanies typically only have specific windows in which they engage in open-market transactions in order to ensure that they are not trading while in possession of material non-public information." Commissioner Peirce also expressed concerns with respect to the proposed amendments to disclose issuer share repurchases, stating "[t]oday's proposal unpersuasively attempts to justify itself by pointing to information asymmetries that may exist between issuers and affiliated purchasers, on the one hand, and investors, on the other . . . Why not address such a concern through a more tailored requirement to disclose buyback announcements and terminations?" In fact, the beneficiaries of the additional trading information required by proposed Form SR are likely to be opportunistic institutional traders who will try to predict corporate events based on the timing of issuer share repurchases, including issuers ceasing to make repurchases under announced share repurchase plans.

Given that the 45-day period for comments is shorter than the standard comment period, we expect that industry groups will request an extension to meaningfully comment on the proposals.

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ENDNOTES

1 *See* Recommendation of the Investor Advisory Committee regarding Rule 10b5-1 Plans, approved by the Advisory Committee at the September 9, 2021 Meeting, *available at* https://www.sec.gov/spotlight/investor-advisory-committee-2012/20210916-10b5-1-recommendation.pdf.

2 The reference to "similar instruments" does not appear to cover restricted stock or restricted stock units, but this point is not expressly addressed in the proposing release.

3 While Item 5 is discussed in the proposing release, it appears to have been inadvertently omitted from the proposed rule.

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