December 16, 2022

# SEC Adopts New Requirements for Rule 10b5-1 Trading Plans

## New Rules Impose Procedural, Substantive and Disclosure Requirements for Rule 10b5-1 Trading Plans

### SUMMARY

On December 14, 2022, the Securities and Exchange Commission unanimously adopted rules and amendments that:

- Implement mandatory cooling-off periods for Rule 10b5-1 trading plans for directors, officers and other persons (other than the issuer);
- Enhance the affirmative defense requirements under Rule 10b5-1 (including by adding a written certification requirement and providing that, for non-issuers, the affirmative defense will not be available for overlapping plans or to more than one single-trade plan during any consecutive 12-month period); and
- Add required disclosure regarding insider trading plans, policies and procedures.

In a significant change from the proposed rules, the final rules do not require a cooling-off period for issuers or prohibit issuers from entering into overlapping plans or multiple single-trade plans. On the other hand, the rules require a cooling-off period for all persons other than the issuer, whereas the proposed rules had limited the cooling-off period to issuers, directors and officers.

The amendments also add new disclosure requirements for grants of options, stock appreciation rights and other similar instruments made close in time to disclosure of material non-public information, or MNPI, and require reporting gifts of securities by insiders on Form 4, rather than on Form 5.

### PROPOSED RULES AND AMENDMENTS

On December 15, 2021, the SEC issued proposed rules and amendments (which were re-released, with minor technical amendments, on January 13, 2022) to various rules and forms that relate to Rule 10b5-1

trading plans. Our Memorandum to Clients, dated December 17, 2021, discusses the proposed rules and amendments. During the comment period, which ended on April 1, 2022, the SEC received more than 160 comment letters that addressed, among other things, the length of the proposed cooling-off period for insiders, the applicability of the proposed cooling-off period to issuers and the proposed restrictions on overlapping and single-trade plans.

## FINAL RULES AND AMENDMENTS

The SEC's final rules and amendments relating to Rule 10b5-1 and insider trading plans in many respects track the proposed rules and amendments but include some significant changes, in particular with respect to mandatory cooling-off periods and the limitations on overlapping and single-trade plans as they apply to issuers. The final rules provide:

- ***Cooling-Off Period for Directors and Officers***. The final rules require directors and officers[1] who rely on the Rule 10b5-1(c)(1) affirmative defense to wait to initiate any trades under a Rule 10b5-1 plan until the later of:
  - 90 days after adopting the plan; and
  - the earlier of (1) two business days after the release of financial results on Form 10-Q or Form 10-K for the fiscal quarter in which the plan was adopted or (2) 120 days after adopting the plan.

  Although the final 90-day minimum cooling-off period is shorter than the SEC's initial 120-day proposal, it is still longer than the periods generally recommended by practitioners, which were typically in the range of one or two months.
- ***Cooling-Off Period for Persons Other than Directors, Officers or the Issuer***. The final rules allow a shorter cooling-off period of 30 days for other persons, such as employees, who may also seek to benefit from the Rule 10b5-1(c)(1) affirmative defense. This cooling-off period had not been part of the proposed rules and will significantly affect employee benefit plans. For example, the SEC notes that the Rule 10b5-1(c)(1) affirmative defense is available for purchasers of securities pursuant to employee stock purchase plans and that, in order to comply with the revised Rule 10b5-1 cooling-off period, the purchase plans will need to defer purchases for all participants at least one month (or, typically, two bi-weekly pay periods) and for officers at least three months.
- ***Cooling-Off Period for Issuer Repurchases***. The final rules do not require a cooling-off period for issuers, although the SEC notes in the Adopting Release that they "are continuing to consider whether regulatory action is needed to mitigate any risk of investor harm from the misuse of Rule 10b5-1 plans by the issuer, such as in the share repurchase context."
- ***Changes to Existing Plans That Trigger a New Cooling-Off Period***. The SEC's proposed rule would have deemed ***any*** modification of a trading plan (without regard to materiality) as a termination of the existing plan and adoption of a new plan and therefore trigger a new cooling-off period. In response to comments, the final rules only apply this treatment to changes to the amount, price or timing of the purchase or sale of the securities under a trading plan (or, for plans governed by an algorithm, computer program or formula, changes that impact amount, price or timing).
- ***Certification Requirement***. The final rules require a written certification as a condition to the availability of the affirmative defense under Rule 10b5-1(c)(1) for directors and officers.[2] Consistent with the proposed rules, a director or officer will be required to certify at the time of adoption of a Rule 10b5-1 plan that, at the time the plan was adopted:
  - they were not aware of MNPI; and

- they adopted the plan in good faith and not as part of a plan or scheme to evade Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act") or Rule 10b-5.

The final rules require this certification to be included as a representation in the trading plan itself, which in our experience is standard practice, whereas the proposed rule would have required directors and officers to furnish this certification to the issuer as a separate document. The SEC did not adopt its proposed rule that directors and officers be required to retain copies of the certifications for a period of 10 years.

- ***Limitations on the Number of Plans That May Be Adopted***. The final rules provide that the affirmative defense under Rule 10b5-1(c)(1) is generally not available (1) for overlapping plans for open market purchases or sales of ***any*** class of securities of the issuer (rather than just the class transacted in, as provided in the proposed rule) or (2) to more than one single-trade Rule 10b5-1 trading plan during any consecutive 12-month period. In each case, the limitations are not applicable to issuers, with the SEC noting in the Adopting Release that further consideration as to their application to issuers is warranted. Other key modifications or clarifications to the proposed rules include:
  - In the Adopting Release, the SEC indicates that the multiple plan restriction will not apply to purchases or sales conducted pursuant to employee stock ownership plans or dividend reinvestment plans, since these transactions are conducted directly with the issuer.
  - The final rules permit multiple overlapping plans in certain circumstances to satisfy tax obligations related to equity compensation, such as "sell-to-cover" transactions in which a plan authorizes an agent to sell securities as needed to satisfy tax withholding obligations. However, this exception applies only to tax withholding and does not encompass the payment of the exercise price of an option, warrant or other right. This exception will be, therefore, of little utility to the exercise of options, warrants or other rights where it is contemplated that the exercise price will be paid through broker sales of securities into the open market. It will, however, be useful in the case of tax withholding upon the vesting of restricted stock or restricted stock units.
  - The SEC also clarifies in the Adopting Release that a series of distinct contracts with, for example, different financial institutions or brokers may be treated as a single plan if, taken together, the contracts satisfy Rule 10b5-1(c)(1) and are treated as a single plan, including that a modification of one contract acts as a modification of the entire series of contracts.
  - The final rules permit insiders to maintain two separate Rule 10b5-1 plans at the same time as long as trades under the later-commencing plan are only authorized to begin after all trades under the earlier-commencing plan have been completed or expired. However, this exception will not be available if the first trade under the later-commencing plan occurs during the cooling-off period that would have been applicable to the later-commencing plan if the date of adoption of that plan were to be deemed to be the date of termination of the earlier plan. As a result, this exception will permit an insider to maintain Rule 10b5-1 plans that are continuously in effect so long as the second plan is entered into a sufficient period of time before the expiration of the first plan to comply with the applicable cooling-off period.
  - While noting that our comment letter requested exemptions from the limitations on single-trade plans for "derivative transactions, gifts, estate planning transactions and employee benefit transactions," the SEC did not expressly address those categories of transactions. However, the SEC does indicate in the Adopting Release that a single-trade plan will not arise where:
    - An agent has discretion over whether to execute the plan as a single transaction; or
    - The plan procedures for execution of the transactions depend on "events or data not known at the time the plan is entered into," and "it is reasonably foreseeable at the time the plan is entered into that the plan ***might*** result in multiple transactions" (emphasis added). However, the SEC declined to provide any further guidance on the scope of single-trade plans.

- ***Expansion of Good Faith Requirement***. The final rules expand the current good faith requirement by adding the condition that the person subject to the plan "has acted in good faith with respect" to the plan, in addition to the existing requirement that plans be "entered into" in good faith. The amendment is intended to clarify that a person (including the issuer) that cancels or modifies a Rule 10b5-1 trading plan in an effort to evade the prohibitions of Rule 10b-5 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(c)(1).
- ***No MNPI When Entering Into Plan***. The Adopting Release contains an extensive discussion of whether a person can enter a Rule 10b5-1 trading plan while aware of MNPI so long as the MNPI is stale or disclosed by the time transactions are executed under the plan. The SEC, consistent with the historical position of its Staff,[3] indicates that the Rule 10b5-1(c)(1) affirmative defense will not be available in that case, but other defenses to Rule 10b-5 liability may be available to the person executing the plan.
- ***Public Disclosure of Trading Plans***. The SEC adopted public reporting and disclosure requirements in connection with insider trading plans:
  - ***Item 408 of Regulation S-K***. New Item 408 to Regulation S-K requires quarterly disclosure on Form 10-Q and Form 10-K about the adoption, termination and material 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 any plan not intended to comply with the affirmative defense requirements of Rule 10b5-1(c)(1), referred to as a "non-Rule 10b5-1 trading arrangement") by an issuer's directors or officers (but not by the issuer). Under the final rules:
    - The material terms of a plan do not include the price at which the individual executing the plan is authorized to trade.
    - The disclosure must indicate whether any trading arrangement is a Rule 10b5-1 trading arrangement or a non-Rule 10b5-1 trading arrangement.
    - A trading arrangement is a "non-Rule 10b5-1 trading arrangement" if the director or officer asserts that, at a time when they were not aware of MNPI:
      - they adopted a written arrangement for trading securities; and
      - the arrangement specified the date, amount and price of securities to be purchased or sold; the arrangement included a written formula, algorithm or computer program for determining the date, amount and price of securities to be purchased or sold; or the arrangement did not permit the covered person to exercise any subsequent influence over how, when, or whether to effect purchases or sales; and the purchases or sales were effected by an agent not aware of MNPI.
  - Any modification or change to a Rule 10b5-1 plan or non-Rule 10b5-1 trading arrangement that constitutes the termination of an existing plan is also required to be disclosed.
  - Item 408 also requires disclosure in Annual Reports on Form 10-K and proxy statements as to whether the issuer has adopted insider trading policies applicable to directors, officers, and employees and the issuer itself. The information must be tagged using inline XBRL. Despite commentators urging the SEC to exclude foreign private issuers from the new disclosure requirement on the basis that foreign private issuers are subject to home-country requirements, the final rule requires foreign private issuers to include the required disclosure in their Forms 20-F. In a change from the proposed rules, the final rules do not require disclosure of the registrant's policies and procedures within the body of the annual report or proxy/information statement; instead, the SEC is adopting amendments to Item 601 of Regulation S-K to require issuers to file a copy of their insider trading policies and procedures as an exhibit to Forms 10-K and 20-F. Alternatively, if an issuer's insider trading policies are

included in the issuer's code of ethics, and the code of ethics is included as an exhibit to the Form 10-K or Form 20-F, that filing would satisfy the new requirement.

- ***Forms 4 and 5***. Forms 4 and 5 will be amended to include a new, mandatory checkbox that will indicate whether a trade was made pursuant to a plan that is "intended to satisfy the affirmative defense conditions" of Rule 10b5-1(c).

The SEC also adopted new disclosure requirements in connection with option grants to named executive officers and gifts:

- ***Item 402 of Regulation S-K***. Item 402 of Regulation S-K now requires (using inline XBRL): (1) disclosure of an issuer's policies and practices regarding grants of stock options, stock appreciation rights or similar instruments and (2) tabular disclosure of each such award granted to a named executive officer within the four business days before and one business day after the filing of a periodic report or the filing or furnishing of a Current Report on Form 8-K that contains MNPI and the percentage change in the market value of the securities underlying the award between those dates. These new disclosures do not apply to restricted stock or restricted stock units. Smaller reporting companies and emerging growth companies are not exempt from the disclosures, although they are permitted to limit their disclosures, consistent with the general scaled approach to their executive compensation disclosure. Given these disclosure requirements, we would expect issuers to generally plan their awards of options, stock appreciation rights and similar instruments so that they are not made during these periods.
- ***Reporting Gifts of Securities***. Form 4 will be modified to require the reporting of bona fide gifts of equity securities. A Section 16 insider making a gift of equity securities will 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 responding to commentators who suggested that bona fide gifts were not subject to Rule 10b-5 liability, the SEC indicated its view "that the affirmative defense of Rule 10b5-1(c)(1) is available for any bona fide gift of securities, including a gift that might otherwise cause the donor to be subject to liability under Section 10(b), because when making the gift the donor was aware of MNPI 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."

## EFFECTIVENESS

The final rules 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 beginning April 1, 2023, and issuers will be required to comply with new periodic and proxy reporting requirements beginning with filings that cover full fiscal periods beginning on or after April 1, 2023, although smaller reporting companies will have an additional six months to comply.

Rule 10b5-1 plans in effect on the effective date of the new rules will be entitled to the benefit of grandfathering and, accordingly, will not need to be amended to comply with the new rules. However, if a grandfathered plan is modified or amended in a manner that changes the amount, price or timing of transactions under the plan, under the rule amendments, the plan will be deemed to be terminated and, at that time, will need to comply with the new rules. The SEC did not adopt a transition period for existing Rule 10b5-1 plans that are amended after the effective date of the new rules in a manner permitted by the terms of the plan as in effect prior to the effective date, as suggested by some commentators.

## KEY TAKEAWAYS

The final rules represent a significant expansion of the requirements for the affirmative defense under Rule 10b5-1(c)(1), particularly for insiders, and of the disclosure requirements relating to insider trading plans, policies and procedures. Listed below are certain suggestions for issuers and others in light of the new rules.

### Issuers

- Review employee benefit plans for compliance with the applicable cooling-off periods, certification requirements and limitations on single-trade plans and overlapping plans.
- Adopt disclosure controls and procedures for Item 408 and Item 402 reporting and reporting of gifts on Form 4.
- Consider the impacts of public disclosure of trading plans by insiders.
- Review insider trading policies in light of the new requirement to file the policies and the SEC's position on gifts.
- Consider imposing cooling-off periods on new plans for insiders entered into prior to the effective date of the rules.
- Adopt procedures to monitor the timing of grants versus filing of periodic and current reports.

### Issuers and Others

- Revise forms of Rule 10b5-1 trading plans to add new cooling-off periods and certification requirements.
- Review all existing plans to determine how they will be categorized under the final rule.

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## ENDNOTES

[1] Under the final rule, the cooling-off period applies to officers subject to the filing requirements of Section 16 of the Exchange Act, which are defined to include an issuer's president, principal financial officer, principal accounting officer (or, if there is no such accounting officer, the controller), any vice-president of the issuer in charge of a principal business unit, division or function (such as sales, administration or finance), any other officer who performs a policy-making function or any other person who performs similar policy-making functions for the issuer.

[2] Like the cooling-off period, the certification requirement applies to officers subject to the reporting requirements of Section 16. *See* Note 1 above.

[3] *See* SEC, Compliance & Disclosure Interpretation 120.20, *available at* https://www.sec.gov/divisions/corpfin/guidance/exchangeactrules-interps.

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