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SEC Proposes Amendments Regarding 10b5-1 Trading Plans and Disclosures for Executive Officer Equity Grants and Gifts

On December 15, 2021, the SEC proposed amendments (available here) to Rule 10b5-1, which provides an affirmative defense to insider trading liability under Rule 10b-5. To be eligible for the defense, the trading person must show that a trade is made pursuant to a contract, instruction or plan (a "10b5-1 plan") which was entered into at a time that the person was not in possession of material non-public information, and that specifies the amount of securities to be sold and the pricing and timing parameters of such sales, and over which the person does not exercise any subsequent influence. These proposed amendments address areas where the SEC sees the potential for abusive practices by imposing mandatory cooling-off periods, eliminating the use of multiple or overlapping 10b5-1 plans, and requiring significantly more disclosures regarding trading by issuers and insiders (under 10b5-1 plans and otherwise). The amendments as proposed do not identify any transition measures or periods; if they are adopted as proposed without any transition provisions, companies and plan participants will want to consider the eligibility of existing 10b5-1 plans for the affirmative defense under Rule 10b5-1(c). The SEC's comment period on the proposal will close 45 days after it is published in the *Federal Register.*

Under the proposed amendments:

- 10b5-1 plans by "Section 16" directors and officers[1] would be required to include a mandatory 120-day cooling-off period between the adoption of a plan and the first trade thereunder, and after any modifications to an existing plan;
- 10b5-1 plans by issuers would require a mandatory 30-day cooling-off period between the adoption of a plan and the first trade thereunder, and after any modifications to an existing plan;
- the Rule 10b5-1 affirmative defense would not be available for multiple or overlapping trading plans, and its availability for single-trade plans would be limited to just one single-trade plan in any 12-month period;
- when adopting a 10b5-1 plan, officers and directors would be required to certify to the issuer that they are not aware of any material non-public information, and they are adopting the plan in good faith and not as part of a scheme to evade the insider trading laws;

[1] These are directors and executive officers required to make filings on Forms 3, 4 and 5 under Section 16 of the Exchange Act of 1934, as amended.

- issuers would be required to disclose, on a quarterly basis, information regarding the adoption and termination of 10b5-1 trading plans and other trading plans, by the issuer and its officers and directors;
- issuers would be required to disclose whether they have adopted an insider trading policy and to describe such policy;
- issuers would be required to provide new annual quantitative disclosures regarding equity award grants made within 14 days before or after the issuer's disclosure of material non-public information (including earnings releases); and
- gifts by insiders would need to be disclosed within two business days on Form 4 (instead of on a Form 5 due 45 days after the company's year-end).

Cooling-Off Periods

Currently, trading under 10b5-1 plans may commence on the same day the plan is executed, although many plans do include a cooling-off period. To reduce the risk that insiders may benefit from material non-public information at the time they adopt a 10b5-1 plan, the proposed amendments would require 10b5-1 plans to include cooling-off periods between the entry into the plan and the first trade thereunder of 120 days for directors and officers, and 30 days for issuers. The 120-day cooling-off period in particular would mean that trading under a 10b5-1 plan generally would not commence until the results for the quarter in which the plan was adopted were announced.

These cooling-off periods would also apply to trades occurring after any modification of the plan. The cancellation of a trade would be deemed to be the termination of the plan and adoption of a new one, and require the observance of the cooling-off period before any new trades could occur under a subsequent plan.

Limitations on the use of multiple or overlapping plans and single-trade plans

To reduce the potential abuse of multiple and overlapping 10b5-1 plans and the potential to circumvent the proposed cooling-off periods, the proposed amendments limit sellers to just one 10b5-1 plan at a time. If, at the time the plan is entered into, a seller has other outstanding plans, or subsequently enters into additional plans, then the plans will not be eligible for the Rule 10b5-1(c) affirmative defense. In addition, the proposed amendments would limit sellers to just one "single trade" 10b5-1 plan (where all the shares covered by the plan are sold in one transaction) in any 12-month period.

Certifications

Under the proposed rules, at the time that they enter into a 10b5-1 plan, directors and officers would have to furnish certifications to the issuer that:

- 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 Exchange Act Section 10(b) and Exchange Act Rule 10b-5.

These certifications would not be filed with the SEC. Rather, directors and officers would need to retain them for a period of 10 years. The SEC noted that the goal of the certification is to ensure that the director/officer is aware of their legal obligations, and that the certifications would not be an independent basis of liability under Exchange Act Section 10(b) and Rule 10b-5.

Disclosures

The amendments would require a number of additional disclosures by issuers and insiders.

10b5-1 Plans
Proposed new Item 408(a) of Regulation S-K would require issuers to disclose, on a quarterly basis in their Form 10-Q or Form 10-K:

- whether the issuer or any directors or officers have adopted or terminated any 10b5-1 plan or other contract, instruction or written plan to purchase or sell the issuer's securities; and
- with respect to any such plan, a description of the material terms thereof, including:
  - the name and title of the director or officer, if applicable;
  - the date of adoption or termination;
  - the duration; and
  - the aggregate amount of securities to be sold or purchased.

Trading Policies
Proposed Item 408(b) of Regulation S-K would require issuers to disclose annually in their Form 10-K and proxy statement:

- whether they have adopted insider trading policies regarding trading by directors, officers and employees;
- if they have not done so, to explain why not; and
- if they have done so, to disclose those policies and procedures.

Timing of Equity Award Grants
The SEC has in the past expressed concern regarding the timing of grants of stock options, which have an exercise price based on the fair market value of the underlying stock at the time of grant, in proximity to the release of material non-public information. The SEC has also proposed new Item 402(x) of Regulation S-K, that would require in the annual meeting proxy and/or Form 10-K general disclosure regarding the issuer's policies and practices on the timing of certain equity grants (stock options, SARs or similar instruments) in relation to the disclosure of material non-public information. In addition, there would be specific disclosures regarding any such equity award granted to named executive officers (that is, the individuals for whom executive compensation disclosure is required in the annual proxy statement) within 14 calendar days before or after the filing of a periodic report on Form 10-Q or Form 10-K, an issuer share repurchase or the filing or furnishing of a current report on Form 8-K that contains material non-public information. Issuers would be required to present, in tabular format, the following information on a grant-by-grant basis:

- the name of the executive officer;
- the grant date;
- the number of securities underlying options;
- the per-share exercise or strike price of the option award;
- the grant date fair value of each equity award;

- the market value of the securities underlying the award on the trading day before the disclosure of the material non-public information; and

- the market value of the securities underlying the award on the trading day after the disclosure of the material non-public information.

Identifying 10b5-1 Plan Sales on Form 4

In order to help investors and the public "better discern whether Rule 10b5-1 trading arrangements are being used to engage in opportunistic trading on the basis of inside information" the SEC has proposed requiring additional disclosures on Forms 4 and 5. Many Section 16 filers currently voluntarily report in Form 4 footnotes whether transactions are pursuant to 10b5-1 plans. Under the proposed amendments, they would be required to indicate, by ticking a box on the Form 4 or 5, whether the reported transaction is being made pursuant to a 10b5-1 plan and the date of adoption or modification of the plan, and would have the opportunity to provide additional relevant disclosures about the transaction.

Gifts by Insiders

Historically, Section 16 insiders have been permitted to report gifts of securities on a delayed basis on a Form 5 due within 45 days following the issuer's year end. Motivated by concerns that the delays in reporting gifts under Section 16 create the potential for abuse regarding the timing and valuation of such gifts, the SEC has proposed that any gift by a Section 16 insider must be reported on Form 4 within two business days of the gift.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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