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SEC PROPOSES BIG CHANGES TO RULE 10B5-1 PLAN REQUIREMENTS; ISSUES WARNING ABOUT "INSIDER GIFTING"

Dec 16, 2021

On December 15, 2021, the SEC proposed significant changes to the requirements for Rule 10b5-1 trading plans.

The SEC attributed the proposals to concerns expressed by courts, commentators and members of Congress that the rule has allowed insiders to take advantage of loopholes, citing studies that purport to show trading by insiders using plans have outperformed trading by insiders not using such plans. Areas of criticism include insiders' use of multiple overlapping plans, selectively cancelling trades, and commencing trades quickly after adoption or modification of plans, as well as issuers' alleged useof Rule 10b5-1 trading plans to conduct share repurchases to increase stock prices before sales by insiders. The proposals also address SEC concerns relating to insider trading policies, option grant practices and opportunistically timed gifts of shares by insiders.

Although proposed unanimously by the Commissioners, Commissioners Peirce and Roisman expressed concerns about certain aspects of the proposal and encouraged commentators to weigh in, including concerns regarding a proposed certification requirement, a new requirement for plans to be "operated" (in addition to being entered into) in good faith, several new disclosure obligations, and a new 30-day cooling-off period for issuers.

Proposed changes to 10b5-1 requirements

The proposed amendments would add new conditions to the availability of the Rule 10b5-1(c)(1) affirmative defense to insider trading liability, including:

- ***Cooling-off period for insiders.*** 10b5-1 trading arrangements entered into by Section 16 officers or directors would need to include a 120-day cooling-off period before the first trade, including after any modification of a plan.
- ***Cooling-off period for issuers.*** 10b5-1 trading arrangements entered into by issuers would need to include a 30-day cooling-off period before the first trade, including after any modification of a plan.

- ***Certification of non-awareness.*** When adopting a new or modified plan, Section 16 officers and directors would need to certify that (1) they are not aware of material nonpublic information about the issuer or the security and (2) they are adopting the plan in good faith and not as part of a scheme to evade antifraud rules.
  - The certification is intended to reinforce awareness of legal requirements and would not need to be filed with the SEC and, according to the SEC, would not provide an independent basis of liability.

- ***Overlapping plans ineligible.*** The Rule 10b5-1 defense would not apply to multiple overlapping Rule 10b5-1 plans for open market trades in the same class of securities.
  - The SEC believes this condition is consistent with the existing prohibition on entering into or altering a "corresponding or hedging transaction or position" with respect to a planned transaction. According to the SEC, this requirement was designed to prevent schemes to exploit inside information by setting up pre-existing hedged trading programs, and then canceling execution of the unfavorable side of the hedge, while permitting execution of the favorable transaction.
  - The SEC noted that, currently, a person could adopt multiple overlapping plans and exploit inside information by setting up trades timed to occur around dates on which he or she expects the issuer will likely release material non-public information. Similarly, a person could circumvent the proposed cooling-off period by setting up multiple overlapping plans, and deciding later which trades to execute and which to cancel after the person becomes aware of material non-public information but before it is publicly released.
  - The restriction would not apply to transactions with the issuer, such as insider acquisitions of shares through participation in employee stock ownership plans or dividend reinvestment plans.

- ***Only one single transaction Rule 10b5-1 plan every 12 months.*** 10b5-1 trading arrangements to execute a single trade would be limited to one plan per 12-month period.
  - The SEC cited recent research indicating that "single-trade plans are consistently loss avoiding and often precede stock price declines."
  - The proposed limitation is intended to balance legitimate one-time liquidity needs against potential for abuse.

- ***Good faith requirement extended.*** 10b5-1 trading arrangements would not only need to be entered into in good faith, but would also need to be "operated" in good faith throughout the duration of the trading plan.

Increased Disclosure Requirements

The proposed rules would require increased issuer disclosure regarding Rule 10b5-1 trading arrangements as well as option or option-like equity grants, and issuer insider trading policies and procedures, including:

- ***Annual disclosure of insider trading policies.*** A requirement for an issuer to disclose – using Inline XBRL – in its annual reports on Form 10-K or 20-F and proxy and information statements (1) whether or not (and if not, why not) the issuer has adopted insider trading policies and procedures and (2) if adopted, such trading policies and procedures.
  - The SEC noted that the disclosure could address not only purchases and sales, but other dispositions such as gifts where material non-public information "could be misused."
  - Issuing a cautionary note about the timing of gifts of securities, the SEC stated that the Exchange Act does not require that a "sale" of securities be for value, declaring that:
    - "[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. The affirmative defense under Rule 10b5-1(c)(1) is available for planned securities gifts."
    - As many, if not most, charities immediately liquidate shares received as gifts, companies may want to consider revisiting their policies regarding the timing of stock gifts by insiders in light of the SEC's cautionary note as well as recent publicity, such as this July 2021 Wall Street Journal article headlined "Improper 'Insider Charitable Giving' Is Widespread, Study Says," and academic commentary, such as this August 2020 UCLA law professor blog post and this 2016 U Penn Bus law review article. Additionally, as noted below, stock gifts would have increased visibility under proposed Form 4 two-business day reporting requirements for gifts.

- ***Quarterly disclosure of 10b5-1 and other trading plans.*** A requirement for an issuer to disclose quarterly in its periodic reports – using Inline XBRL – the adoption and termination of Rule 10b5-1 trading arrangements and other pre-planned trading arrangements (whether or not

compliant with Rule 10b5-1) by directors, officers and issuers, and the material terms of such trading arrangements.

- ***New 10b5-1 checkbox requirement for Forms 4 and 5.*** A requirement that Section 16 officers and directors disclose by checking a box on Forms 4 and 5 whether a reported transaction was made pursuant to a 10b5-1(c) trading arrangement.
  - Filers would be required to provide the date of adoption of the trading plan, and would have the option to provide additional relevant information about the transaction.
  - A second, optional checkbox would be available for filers to indicate whether a transaction was made pursuant to a pre-planned arrangement that is not intended to comply with Rule 10b5-1.

- ***Annual disclosure of option grant policies.*** A requirement for an issuer to disclose in its annual reports on Form 10-K and proxy and information statements, using Inline XBRL, its grant policies and practices for options, SARs and similar instruments, and to provide tabular disclosure showing grants made within 14 days before or after the release of material nonpublic information – e.g., 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 material nonpublic information – and the market price of the underlying securities on the trading day before and after the release of such information.
  - The SEC acknowledged that its existing guidance calls for disclosure of the timing of grants in relation to the release of material non-public information – including spring-loading or bullet-dodging – but is concerned that existing requirements do not result in adequate information about timing of grants.
  - The new rules would require narrative disclosure about an issuer's grant policies and practices for options and option-like instruments (such as SARs and similar instruments) regarding the timing of grants and 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 award. For companies that are subject to CD&A, the proposed narrative disclosure could be included in CD&A.

- ***Faster reporting of gifts.*** The proposed amendments would require corporate insiders subject to the reporting requirements of Exchange Act Section 16 to disclose bona fide gifts of securities on Form 4 within two business days.

For further information on this topic, please contact Randy Wang or any other BCLP Securities and Corporate Governance lawyer. Additional resources are available on our website for the BCLP Securities and Corporate Governance Practice. Bryan Cave Leighton Paisner LLP makes available the information and materials in its website for informational purposes only. The information is general in nature and does not constitute legal advice. Further, the use of this site, and the sending or receipt of any information, does not create any attorney-client relationship between us. Therefore, your communication with us through this website will not be considered as privileged or confidential.

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