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HOW NARROW WILL THE 10B5-1 SAFE HARBOR BECOME? BUSINESS COMMUNITY CALLS FOR MAJOR CHANGES TO SEC'S PROPOSALS

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The comment period for the SEC's proposed amendments to Rule 10b5-1 expired on April 1, 2022. A review of some representative submissions generally showed strong support from institutional and retail investors. By contrast, the business community – including trade groups, public companies and law firms – generally opposed key elements as presented and proposed specific changes.

As discussed in our December 16 client alert, the proposed amendments would include:

- Cooling-off periods for insiders (120 days) and companies (30 days) following Rule 10b5-1 plan adoption and modification
- Prohibition on overlapping plans
- Only one single trade (bullet) plan every 12 months
- Certifications by insiders that they are not aware of material nonpublic information (MNPI)
- Good faith requirement for the operation of trading plans
- Increased issuer disclosure requirements for trading plans and transactions, equity grant policies and transactions, and insider trading policies

Support from investor community

Predictably, institutional and retail investors and investor groups, such as Council of Institutional Investors, NYC Office of Comptroller and Colorado PERA, as well as groups such as NASAA, AFL-CIO and Public Citizen, applauded the proposals and generally refrained from suggesting any changes, other than a few recommendations for disclosure of adoption or termination of plans on Form 8-K instead of Form 10-Q. Suggestions included the following:

- NASAA recommended extending the 120-day cooling off period to all trading arrangements (not just insiders' trading arrangements), including those of rank and file employees and issuers

- NASAA also recommended extending the prohibition on overlapping plans to arrangements for all of the issuer's equity securities and derivatives, including warrants and options; and eliminating bullet plans from the safe harbor altogether

- Charles Morris – Greenhouse Funds proposed that the SEC consider a different form of Section 16 filing (e.g., a Form 4A or 4X) for non-10b5-1 trades so that they can be more readily identified, believing that those "opportunistic" trades (as compare to plan trades) provide more useful information for other investors for signaling purposes.

Changes proposed by corporate advisors and groups

The business community raised a number of specific and detailed objections to key aspects of the proposal, noting that the creation of the burdensome requirements to rely on the Rule 10b5-1(c) safe harbor may reduce the usefulness of the safe harbor. Commenters included the ABA Securities Regulation Committee, SIFMA, Society for Corporate Governance, US Chamber of Commerce, NYSE and 383 Listed Companies and National Association of Manufacturers (NAM), and a number of law firms, public companies and other organizations. Several comments noted that the concerns cited in the proposed release could be addressed by enforcement actions under existing law without reducing the usefulness of the safe harbor generally. While commenters' views varied, the recommendations included:

- Reduce the proposed 120-day cooling off period, with alternatives ranging from 30-45 days, or the shorter of 45 or 60 days and one or two business days after the next earnings release, or no cooling off period at all (one commenter proposed no cooling off period when plans are entered into within five days after an earnings release)
  - A number proposed exclusions for employee benefit plan and certain other types of transactions that do not present potential for abuse
  - A number urged that only material modifications should trigger a new cooling off period
  - Some suggested excluding suspensions imposed by the issuer

- Eliminate any cooling off period for *issuers*, noting the absence of any supporting evidence of abuse and concern that the requirement would interfere with legitimate repurchase activity
  - Alternatively, reduce the cooling off period – e.g., to ten days or two weeks

- If an issuer cooling off period were adopted, some commentators proposed excluding accelerated share repurchase (ASR) programs and other privately negotiated transactions, as well as immaterial plan amendments or modifications

- Do not extend any cooling off period to employees who are not officers and directors as they may have more limited financial resources and are less likely to have access to MNPI
- Clarify and/or narrow the proposed restriction on overlapping plans
  - Not clear any prohibition is really needed, since overlapping plans that result in impermissible hedges are already prohibited, and it is unclear how overlapping plans can be used to circumvent cooling-off periods – particularly in the case of issuer plans
  - Alternatively, the SEC could limit the prohibition against overlapping plans to those that contemplate trades that would offset, in whole or in part, trades under another Rule 10b5-1 plan
  - Clarify that the prohibition would not apply to the adoption of a new plan while an existing plan is in effect so long as no trades may commence under the new plan until the existing plan has expired
  - Clarify that the prohibition would only apply to the extent the plans contemplate potential trading activity on the same day
  - If adopted, exclude legitimate arrangements that do not create potential for abuse, such as sell-to-cover and net share withholding arrangements; separate pools of shares managed by different brokers; gifts, estate planning transactions and derivatives; and certain employee benefit transactions, such as ESPPs
  - Permit issuers to conduct concurrent 10b5-1 or 10b-18 repurchases at the same time as an ASR
- Clarify or eliminate the proposed 12-month prohibition on single trade arrangements
  - Not clear any prohibition is really needed with a properly defined prohibition on multiple overlapping plans
  - If adopted, should exclude issuers and only apply to directors and executive officers
  - Should exclude employee benefit arrangements such as sell-to-cover and tax withholding
  - Soften to permit one trade per quarter or two trades per year

- Eliminate certification and related record-keeping requirement as unnecessary and burdensome, thereby discouraging the use of 10b5-1 plans
  - The proposal duplicates existing legal requirements (i.e., plan cannot be adopted when in possession of MNPI) and imposes an administrative burden without a corresponding legal benefit
  - Execution brokers typically already require equivalent representations
  - If adopted, the representations could instead be included as part of Form 4 filing; or required as part of any written trading plan relying on the safe harbor
  - Should explicitly provide that the certification does not establish an independent basis of liability

- Eliminate the proposed new requirement that the plan be "operated in good faith"
  - Too vague and ambiguous; creates uncertainty as to the conduct intended to be proscribed
  - Cooling off period would already address any concerns with terminating or amending plans; it is unlikely that a corporate disclosure decision would be viewed as having resulted from the failure by an insider to act in good faith

- The quarterly disclosure requirement should be eliminated or clarified
  - The proposal is duplicative of Form 4 filings
  - If adopted, issuers should be permitted to exclude dates, pricing, share amounts or other economic terms in order to prevent front-running or other market manipulation

- The requirement for annual disclosure of insider trading policies should be eliminated or simplified
  - Would not provide useful information for investors
  - If adopted, should permit issuers to simply reference their corporate website or attach as exhibit to filing, similar to code of ethics
  - Alternatively, should require disclosure by an issuer only if it *does not have* an insider trading policy

- The requirement to disclose the timing of option grants and similar equity instruments should be eliminated

- Substantially duplicative of other disclosure requirements
- Following adoption of SAB 120, spring-loading or bullet-dodging is not problematic; rulemaking unnecessary and unduly burdensome, with potential improper implication of abusive grant activity
- If adopted, should narrow length of coverage window

Push-back on SEC position on gifts of securities

As noted in our December 16 client alert, the SEC included in its proposals a cautionary warning about the timing of gifts of securities. Some commenters strongly objected to the SEC's warning, noting the absence of any judicial or SEC precedent for its position, and its failure to explain the circumstances where a charitable gift would involve a fraudulent breach of trust and confidence. Instead, a donor should be able to avoid insider trading liability by obtaining the charitable donee's commitment not to dispose of the securities until any MNPI known by the donor at the time of the donation has become public or stale."

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