Katten

CAPITAL MARKETS ADVISORY

SEC Adopts Amendments to Rule 10b5-1 Plan Requirements and Increases Disclosure Requirements Regarding Insider Trading Policies

December 27, 2022

On December 14, the Securities and Exchange Commission (SEC) unanimously adopted amendments to Rule 10b5-1 and related regulations governing "10b5-1 Plans." 10b5-1 Plans enable (1) public company insiders to sell their company's stock or (2) issuers to repurchase their shares, each at times when they otherwise might be prevented from doing so because they possess material non-public information (MNPI).

The adopted amendments:

- Add new conditions to the availability of the Rule 10b5-1(c)(1) affirmative defense from insider trading liability, such as mandatory cooling-off periods, new restrictions on the use of 10b5-1 Plans and required representations by those using 10b5-1 Plans.
- Impose new disclosure requirements regarding officer and director trading plans, insider trading policies and timing of certain stock awards; and
- Amend Forms 4 and 5 to require identification of Rule 10b5-1 transactions and earlier reporting of stock gifts.

Rule 10b5-1 plans that are 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 existing plan will effectively be deemed to be terminated and replaced with a new plan, with further trading under the plan having to comply with the new rules.

The final rules will be 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 for beneficial ownership reports filed on or after April 1, 2023. Issuers will be required to comply with the new disclosure requirements in Exchange Act periodic reports on Forms 10-Q, 10-K and 20-F and in any proxy or information statements commencing with the first filing that covers a full fiscal period that begins on or after April 1, 2023. The final amendments defer by six months the date of compliance with the additional disclosure requirements for smaller reporting companies. The full text of the adopting release may be found here.

The History

In the SEC's open meeting on December 14, SEC Chair Gary Gensler noted that many market participants have weighed in with proposals to update regulations regarding insider trading over the last two decades, including notably:

- On September 14, 2020, former SEC Chair Jay Clayton recommended mandatory cooling-off periods after the adoption, amendment or termination of a 10b5-1 Plan in his letter to a former Chair of the House Financial Service Committee;[1]
- SEC Chair Gary Gensler on June 24, 2021, stated in a speech that Rule 10b5-1 Plans "have led to real cracks in our insider trading regime" and directed SEC staff to consider and recommend restrictions on the use of such plans;
- On June 24, 2021, bipartisan legislation was re-introduced in the US Senate directing the SEC to study whether Rule 10b5-1 should be amended;[2]
- On August 26, 2021, the Investor as Owner Subcommittee of the SEC's Investor Advisory Committee (IAC) released draft recommendations regarding amendments to rules governing 10b5-1 Plans, which the IAC formally approved at its meeting held on September 9, 2021;
- On January 13, 2021, the SEC proposed amendments to the rules governing 10b5-1 Plans (the Proposed Rule) that were mostly in line with the IAC's recommendations (as discussed in a prior edition of *Capital Markets Compass*); and
- On December 14, 2022, the SEC adopted its final rule on Insider Trading Arrangements and Related Disclosures (the Final Rule).

Key Differences Between the Proposed Rule and the Final Rule

In the Final Rule's adopting release, the SEC noted that since issuing the Proposed Rule, they had received and considered over 160 comment letters on the Proposed Rule leading to notable modifications from the Proposed Rule. The changes include:

- A shorter cooling-off period for directors and officers. The cooling-off period in the Final Rule is shorter in comparison to the 120-day cooling-off period in the Proposed Rule.
- Carve outs for issuers. In the Final Rule, only insiders are restricted from using multiple overlapping 10b5-1 Plans, whereas the Proposed Rule considered imposing this restriction on issuers as well.
- Broader definition of multiple overlapping 10b5-1 Plans. In the Final Rule, the reference to the "same class of securities" in the Proposed Rule has been removed from the description of what qualify as multiple overlapping 10b5-1 Plans. As a result, the prohibition on multiple overlapping 10b5-1 Plans will also apply if the two plans relate to different classes of an issuer's securities.
- More tailored disclosure requirements around options award grants. Both the Proposed Rule and the Final Rule require tabular disclosures of information on awards of options, stock appreciation rights (SARs), and/or similar option-like instruments granted to corporate insiders during specified windows before and immediately after the release of MNPI. However, in the Final Rule these windows are shorter, potentially resulting in fewer required disclosures.

[1] Letter from Jay Clayton, former Chair of the SEC, to Representative Brad Sherman, former Chairman of the House Financial Services Committee (Sept. 14, 2020); *See also* SEC Chairman Urges Corporate Insiders to Avoid Quick Stock Sales, Paul Kiernan, WSJ (Nov. 17, 2020).

[2] Promoting Transparent Standards for Corporate Insiders Act; Cong. 117th 1st Session.

Final Rules and Amendments

Rule 10b5-1 was adopted to provide more clarity regarding the meaning of "manipulative or deceptive device[s] or contrivance[s]" prohibited by Section 10(b) and Rule 10b-5 with respect to trading on the basis of MNPI. In that Rule, the SEC provided that a trade is made on the basis of MNPI if the person making the purchase or sale was "aware" of the MNPI when the trade was made (i.e., the person does not necessarily need to "use" the MNPI in making the trading decision). However, subsection (c)(1) of Rule 10b5-1 established an affirmative defense to insider trading liability, which the Commission intended "to cover situations in which a person can demonstrate that the MNPI did not factor into the trading decision," with 10b5-1 Plans adopted under that subsection providing appropriate flexibility for those who would like to plan a trade in advance.

Since the SEC's establishment of that affirmative defense, market participants and regulators have raised concerns that traders have inappropriately attempted to benefit from the liability protection of 10b5-1 Plans. In the Final Rule, the SEC cited academic studies which found that trades made under Rule 10b5-1 Plans that were executed in close proximity to upcoming earnings announcements have been abnormally profitable.[3] The Final Rule also mentions studies that found that trades made by corporate insiders under a 10b5-1 Plan are frequently more profitable than trades made by corporate insiders outside of a 10b5-1 Plan.[4] Further reference was made to certain analyses of the use of multiple overlapping 10b5-1 Plans in combination with canceling trades and adopting new plans that found that insiders may in some cases be using such tactics to "game the system."[5]

The newly adopted amendments are designed to address these concerns and prevent corporate insiders from the perceived opportunist trading on the basis of MNPI through the use of 10b5-1 Plans.

1. New Cooling-off Periods

Previously under Rule 10b5-1(c)(1), a corporate insider was not required to wait between adopting a new 10b5-1 Plan and making the first trade under such 10b5-1 Plan (although such waiting periods have frequently been included in Rule 10b5-1 Plans, often as required by issuer adopted insider trading plans, as a best practice). In the Final Rule, the SEC has now mandated the imposition of a waiting (or "cooling-off") period between the adoption of a 10b5-1 Plan and when trades may begin.

The Final Rule imposes varying cooling-off periods for specific corporate actors:

- Directors and officers. Trading under 10b5-1 Plans adopted by directors and officers may commence only upon the later of: (1) 90 days following plan's adoption or modification; or (2) two business days following the disclosure in a periodic report of the issuer's financial results for the fiscal quarter in which the plan was adopted or modified (but not to exceed 120 days following plan adoption or modification).
- Persons other than issuers, directors or officers. Before any persons (other than issuers or directors and officers) can commence trading under a 10b5-1 Plan, they must wait 30 days following adoption or modification of that 10b5-1 Plan.
- Issuers. No cooling-off period is required with respect to issuers that adopt 10b5-1 Plans. As noted in the Final Rule, the SEC believes that further consideration on this topic is warranted and the SEC will continue to consider whether regulatory action is needed.

[3] David Larcker et al., Gaming the System: Three "Red Flags" of Potential 10b5-1 Abuse, STAN. CLOSER LOOK SERIES (Jan. 2021).

[4] Alan D. Jagolinzer, SEC Rule 10b5-1 and Insiders' Strategic Trade, 55 MGMT. SCI. 224 (2009); M. Todd Henderson et al., Offensive Disclosure: How Voluntary Disclosure Can Increase Returns from Insider Trading, 103 GEO. L.J. 1275 (2015); Taylan Mavruk & H. Nejat Seyhun, Do SEC's 10b5-1 Safe Harbor Rules Need to Be Rewritten?, 2016 COLUM. BUS. L. REV. 133 (2016); Artur Hugon & Yen-Jung Lee, SEC Rule 10b51 Plans and Strategic Trade Around Earnings Announcements, (2016).

[5] John P. Anderson, Anticipating a Sea Change for Insider Trading Law: From Trading Plan Crisis to Rational Reform, 2015 UTAH L. REV. 339 (2015).

- Certain modifications trigger additional cooling-off periods. Note that, if an existing 10b5-1 Plan is modified in a manner that changes the amount, price, or directed timing of the purchase or sale of the securities, then an additional cooling-off period is required. The number of days for the cooling-off period in the event of such a modification would be that period appropriate for the director, officer or other corporate insider as discussed above. Further, certain changes related to the broker-dealer or agent administering a 10b5-1 Plan (i.e., canceling the agent's contract) may also fall under the definition of such a modification that require an additional cooling off period. The Final Rule is also consistent with the SEC's prior guidance on the effect of plan modifications, in that a modification that does not change the sales or purchase prices or price ranges, the amount of securities to be sold or purchased, or the timing of transactions under a Rule 10b5-1 Plan (such as an adjustment for stock splits or a change in account information) will not trigger a new cooling-off period.[6]

2. Limitations on Overlapping Plans and "One-And-Done" Plans

In the adopting release for the Final Rule, the SEC discussed its concern that a person previously could adopt multiple plans and set up trades timed to occur around dates on which they expect the issuer to release MNPI (such as earnings releases) and selectively cancel or terminate plans on the basis of MNPI.[7] The SEC also noted recent research indicating that 10b5-1 Plans that are designed to only cover a single trade often have the effect of loss avoidance and are often adopted before stock price declines.[8]

Accordingly, the Final Rule provides that the affirmative defense under Rule 10b5-1(c)(1) will not be available for any trades by persons, other than the issuer, that has established multiple overlapping trading arrangements. This condition precludes separate, overlapping arrangements even where each relates to a different class of securities of the same issuer. However, plans with separate brokers will be deemed to constitute a single plan where, taken together, the plans otherwise satisfy the conditions of Rule 10b5-1(c)(1). Further, this condition would not restrict a person from maintaining separate trading arrangements at the same time, so long as trades under the later-commencing plan do not commence until the completion or expiration of the earlier plan (plus any effective cooling-off period, to the extent the earlier plan was terminated). An overlapping plan that provides for only "sell-to-cover" transactions to satisfy tax withholding obligations in respect of vesting of equity awards also generally will not violate this condition.

In addition, other than for the issuer, the affirmative defense under Rule 10b5-1(c)(1) will only be available for one plan designed to effect a single trade (sometimes referred to as a "one-and-done" plan) in any 12-month period.

3. New Representations Required by Plan Participants

The Final Rule also requires:

- Directors and officers to certify at the time of the adoption of a new or modified 10b5-1 Plan, that: (1) they are not aware of MNPI about the issuer or its securities; and (2) they are adopting the 10b5-1 Plan in good faith and not as part of a plan or scheme to evade the prohibitions of Rule 10b-5.
- All persons entering into a 10b5-1 Plan to also certify they are acting in good faith when entering into such 10b5-1 Plan (in addition to the current requirement that a Rule 10b5-1 trading arrangement actually be entered into in good faith). According to the adopting release, the new requirements serve to clarify that the affirmative defense will not be available to a trader that cancels or modifies a plan in an effort to benefit their trading results, such as by using their influence to affect the timing of the announcement of MNPI, or otherwise attempting to evade the prohibitions of the rule.

---

[6] *Selective Disclosure and Insider Trading*, Release No. 33-7881 (Aug. 15, 2000) [65 FR 51716 (Aug. 24, 2000)]. The initial Rule 10b5-1 adopting release in August 24, 2000, qualified the third affirmative defense to insider trading liability with footnote 111, "[A] person acting in good faith may modify a prior contract, instruction, or plan before becoming aware of material nonpublic information. In that case, a purchase or sale that complies with the modified contract, instruction, or plan will be considered pursuant to a new contract, instruction, or plan."

[7] *See*, *supra* note 3 and 5.

[8] *See*, *supra* note 3.

4. Enhanced Disclosure of Rule 10b5-1 Plans and Insider Trading Policies

The newly adopted amendments seek to provide greater transparency regarding the use of 10b5-1 Plans by requiring additional disclosures around trading arrangements, which must be tagged in Inline XBRL.

- Disclosure of trading arrangements. The Final Rule requires an issuer to disclose in a Form 10-Q or Form 10-K, as applicable, whether, any director or officer has adopted, modified or terminated any 10b5-1 Plan during the registrant's last fiscal quarter, as set forth in new Item 408(a) of Regulation S-K. The disclosure must include a description of the material terms of any such 10b5-1 Plan, but the issuer does not need to include information relating to the particular trading prices at which the 10b5-1 Plan has authorized buying or selling.
- Disclosure of insider trading policies and procedures. The Final Rule requires annual disclosure of a registrant's insider trading policies and procedures, including disclosure regarding whether registrants have adopted such policies and procedures, and if the registrant has not adopted such insider trading policies and procedures, it must explain why that is the case, as set forth in new Item 408(b) of Regulation S-K. These disclosures will be in annual reports on Forms 10-K and 20-F and also in proxy and information statements on Schedules 14A and 14C. However, as is the case with certain other information required to be included in both annual reports and proxy statements, an issuer will be permitted to incorporate by reference the information required by Item 408(b) from a definitive proxy or information statement involving the election of directors, so long as the proxy or information statement is subsequently filed within 120 days of the end of the issuer's fiscal year. An issuer will also be required to file a copy of its insider trading policies and procedures as an exhibit to its annual report on Form 10-K or 20-F, as applicable.
- Option awards. The Final Rule requires an issuer to provide a discussion of its policies and practices regarding the timing of the awards of stock options, SARs and similar instruments in relation to the potential possession of MNPI by recipients, including how the board determines when to grant such awards and if the potential possession of MNPI by the recipient has been considered. Issuers must report information regarding options granted in the period beginning four business days before a triggering event and ending one business day after a triggering event. The triggering events include the filing of a periodic report (e.g., Form 10-Q or Form 10-K) or the filing or furnishing of a current report on Form 8-K that contains MNPI (except for an Item 5.02(e) Form 8-K that only discloses a material new option award grant).
- Amendments to Form 4 and 5. Form 4 and 5 filers must indicate via a new checkbox if a reported transaction was intended to satisfy the affirmative defense conditions of Rule 10b5-1(c).

Note that certain of the new 10b5-1 related disclosures included in Form 10-K or Form 20-F will now also be subject to the certifications required by Section 302 of the Sarbanes-Oxley Act of 2002, which require CEOs and CFOs to certify, among other things, that based on their knowledge, the form they have signed does not contain untrue statements of material facts or omit to state material facts necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the periods covered by the reports. As a result these executives may have additional liability under Rule 13a-14, which provides the SEC with a cause of action against CEOs and CFOs that make false certifications.

5. Reporting of 10b5-1 Plan Transactions and Gifts Pursuant to Section 16

Consistent with the additional disclosure requirements for issuers as discussed above, Form 4 and 5 filers (as required by Section 16(a) of the Securities Exchange Act of 1934) will be required to indicate via a new checkbox if a reported transaction was intended to satisfy the affirmative defense conditions of Rule 10b5-1(c).

Additionally, in its proposing release the SEC noted that the delayed reporting of gifts on Form 5 may allow Section 16 reporting persons to engage in what it perceives as problematic practices involving gifts of equity securities, such as making stock gifts while in possession of MNPI or backdating stock gifts in order to maximize

the tax benefits associated with such gifts. The SEC sought to address these practices by requiring that all "bona fide" gifts of stock by Section 16 directors and officers be reported on Form 4 by the end of the second business day following the date of any such gift.

Next Steps for Public Companies and Best Practices

While many companies already impose certain restrictions with respect to use of 10b5-1 Plans, the final rules significantly expand requirements for such plans, in addition to imposing the new disclosure obligations.

In light of these amendments, public companies may want to consider taking the following actions:

- Review and amend existing trading policies, including pre-clearance requirements, to the extent necessary to ensure (1) the policies impose the appropriate requirements on 10b5-1 Plans permitted thereunder, such as the required cooling-off periods, limitations on overlapping plans and restrictions on the number of single-trade plans, and (2) the appropriate individuals responsible for insider trading policy compliance (compliance teams) receive all of the information regarding insiders' 10b5-Plans necessary for the companies to satisfy their own disclosure obligations and assist insiders with Section 16 filings, all taking into account the new filing requirement for such polices;
- Educate directors, officers and corporate insiders on the changes to the trading policies and the applicable standards of compliance;
- Ensure that their compliance teams are able to readily access information as to how 10b5-1 Plans are being used by insiders, including as to orders for trading modifications and cancelations;
- Adopt disclosure controls relating to the reporting of gifts on Form 4; and
- Update the board on additional disclosure requirements with respect to granting of stock options and other similar compensation, and adopt (or modify existing) equity award policies and procedures to address the timing of grants in relation to SEC filings and other events.

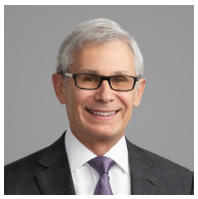
More generally, companies should assess the likely impacts of the changes on their insider trading policies on their directors and officers, and work to find solutions that comply with the new rules while still allowing corporate insiders to achieve liquidity goals.

CONTACTS

If you have questions about this client advisory or would like support in assessing or building your company's compliance program in light of the new regulations, contact any of the following attorneys or your regular contact in Katten's Capital Markets practice.

Lawrence Levin
+1.312.902.5654
lawrence.levin@katten.com

Mark Wood
+1.312.902.5493
mark.wood@katten.com



Matthew S. Brown
+1.312.902.5207
matthew.brown@katten.com

Vlad M. Bulkin
+1.202.625.3838
vlad.bulkin@katten.com

Farzad F. Damania
+1.212.940.3838
farzad.damania@katten.com

Chris Harrison
+44 (0) 20 7776 7623
christopher.harrison@katten.co.uk

Timothy Kirby
+1.212.940.6494
tim.kirby@katten.com

Jeffrey R. Patt
+1.312.902.5604
jeffrey.patt@katten.com

Alyse A. Sagalchik
+1.312.902.5426
alyse.sagalchik@katten.com

Jonathan D. Weiner
+1.212.940.6349
jonathan.weiner@katten.com

Jennifer Howard
+1.202.625.3696
jennifer.howard@katten.com

Michelle Mount
+1.212.940.6456
michelle.mount@katten.com

Katten

katten.com

CENTURY CITY | CHARLOTTE | CHICAGO | DALLAS | LONDON | LOS ANGELES | NEW YORK | ORANGE COUNTY | SHANGHAI | WASHINGTON, DC

12/23/22