Getting Ready for Amended Rule 10b5-1 and Other New SEC Requirements Relating to Insider Trading

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In December 2022, the Securities and Exchange Commission (SEC) adopted amendments to Exchange Act Rule 10b5-1, the rule that provides an affirmative defense to claims of insider trading for persons acquiring or disposing of company stock pursuant to an appropriately adopted trading plan. The amendments impose significant new restrictions on the adoption and use of Rule 10b5-1 trading plans. In addition, the new rules include several new disclosure and reporting requirements that seek to address SEC concerns regarding insider trading.

Below we provide an overview of Rule 10b5-1 and the recent amendments and identify practical considerations for issuers and company insiders.

Background

The SEC adopted Rule 10b5-1 in 2000 to define when a purchase or sale constitutes trading "on the basis of" material non-public information (MNPI) in insider trading cases brought under Section 10(b) and Rule 10b-5 of the Exchange Act.[1] Rule 10b5-1 broadly provides that a person trades "on the basis of" MNPI when the person "was aware of" MNPI at the time of the trade.[2] However, the rule also provides an affirmative defense to insider trading where a trade is made pursuant to a written contract, instruction or plan (hereinafter plan) to purchase or sell the securities that was entered into when the trader was not aware of MNPI.[3] The plan must either (i) specify the price, amount and date of the trade, (ii) include a written formula or algorithm for determining the price,

[1] Selective Disclosure and Insider Trading, 17 C.F.R. Parts 240, 243 and 249 (Aug. 15, 2000), https://www.sec.gov/rules/final/33-7881.htm.
[2] 17 C.F.R. § 240.10b5-1(b) (2000).
[3] *Id.* at (c).

amount and date of the trade, or (iii) not allow the adopter of the plan to exercise any subsequent influence over how, when or whether a trade occurs.[4]

In recent years, the SEC has voiced increasing alarm that insiders may be abusing Rule 10b5-1 plans based on concerns by the SEC about, among other things, the lack of requirements for a "cooling off" period after adoption, insiders' ability to establish multiple plans, and the fact that plans can be canceled at any time, including when an insider is in possession of MNPI. In June 2021, SEC Chairman Gary Gensler reported that he had asked the SEC staff to review the rule and consider potential reforms,[5] and in December 2021, the SEC initially proposed rule amendments "intended to reduce . . . potentially abusive practices associated with Rule 10b5-1(c)(1) trading arrangements."[6]

Nearly one year after proposing the initial amendments, the final rule was adopted by the SEC in a surprising unanimous 5-0 vote. In the adopting release, the SEC described the amendments as "designed to address concerns about abuse of the rule to trade securities opportunistically on the basis of material nonpublic information in ways that harm investors and undermine the integrity of the securities markets."[7] During an open meeting at which the final rule was adopted, the SEC chair and all four other commissioners commented on the importance of taking action to curb potential abuses of Rule 10b5-1.

Amendments to Rule 10b5-1

The amendments impose new requirements for insiders to avail themselves of the affirmative defense to insider trading provided by Rule 10b5-1(c). The requirements of Rule 10b5-1(c), as amended, are summarized in the table below, followed by discussion of the amended provisions (which are highlighted in the table).

[4] *Id.*
[5] Chairman Gary Gensler, U.S. Sec. Exch. Comm'n, Prepared Remarks: CFO Network Summit (June 7, 2021), https://www.sec.gov/news/speech/gensler-cfo-network-2021-06-07.
[6] Rule 10b5-1 and Insider Trading, Release No. 33-11013 (Dec. 15, 2021), www.sec.gov/rules/proposed/2022/33-11013.pdf.
[7] Insider Trading Arrangements and Related Disclosures, Release No. 33-11138 (Dec. 14, 2022), https://www.sec.gov/rules/final/2022/33-11138.pdf [hereinafter Adopting Release].

Conditions of 10b5-1 Affirmative Defense	Condition Is Applicable to:		
	Directors and Officers	Other Persons (Other Than the Issuer)	Issuers
Person who enters plan must be unaware of MNPI when adopting the plan	Applies	Applies	Applies
The plan must specify the price, amount and date of the trade or how the price, amount and date will be determined (e.g., formula, algorithm, or without subsequent influence by the adopter of the plan)	Applies	Applies	Applies
Transactions occur pursuant to the plan	Applies	Applies	Applies
Person must have entered the plan in good faith	Applies	Applies	Applies
Person who entered into plan must have acted in good faith throughout the life of the plan*	Applies	Applies	Applies
Cooling-off period before transactions commence under the plan (or a modification of the plan)*	Applies (90-120 days)	Applies (30 days)	N/A
Person must certify when entering the plan that they are not aware of MNPI and are acting in good faith*	Applies	N/A	N/A
Limitation on multiple overlapping plans*	Applies	Applies	N/A
Limitation on single-trade plans*	Applies	Applies	N/A
* *New condition under the amended rule.*			

Cooling-Off Periods for Insiders. Rule 10b5-1 plans put in place by directors and "officers" (as defined in Rule 16a-1(f)) of an issuer must include a cooling-off period for both plan adoptions and modifications. The cooling-off period applicable to directors and officers prevents trades from occurring under a plan until the *later of*:

(i) 90 days following plan adoption or modification or

(ii) two business days following the disclosure in Forms 10-K or 10-Q of the issuer's financial results for the fiscal quarter in which the plan was adopted or modified,

but in no case is the cooling-off period required to exceed 120 days following plan adoption or modification.

In the adopting release, the SEC expressed the view that because earnings results often are announced prior to the periodic report filing, the cooling-off period outlined in (ii) above is expected to prevent officers and directors from profiting on MNPI contained in a periodic report but not reflected in an earlier-released current report or press release.[8] The amended rule, therefore, does

[8] *Id.* at 142 n. 419.

not include an exception or shorter cooling-off period in instances where a company discloses its quarterly financial results before filing the corresponding Form 10-Q or 10-K.

Persons (other than the issuer) that are not directors and officers are required to observe a shorter 30-day cooling-off period for both plan adoptions and modifications. There is no financial hardship exception from the cooling-off periods.

Changes that do not modify 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 will not trigger a new cooling-off period. For example, changes in account information, substitution of the executing broker-dealer or agent, or adjustments for stock splits are not considered modifications of the plan.

In a departure from the proposed rule, issuers *are not* subject to cooling-off periods; however, the SEC has indicated that further consideration of this and other matters regarding issuer use of Rule 10b5-1 is warranted and stated in the adopting release that it is "continuing to consider whether regulatory action is needed to mitigate any risk of investor harm from the misuse of Rule 10b5-1 plans" by issuers.[9]

Director and Officer Certifications. Directors and officers must personally certify pursuant to a representation in a Rule 10b5-1 plan that (i) they are "not aware of any material nonpublic information about the security or issuer" and (ii) they are "adopting the plan in good faith and not as part of a plan or scheme to evade the prohibitions of this section." This certification is intended, in part, to reinforce directors' and officers' cognizance of their obligation not to trade or enter into a trading plan while aware of MNPI. The amended rule does not require these personal certifications where a director or officer terminates an existing Rule 10b5-1 plan and does not adopt a new or modified trading arrangement for which the affirmative defense is sought.

Limitations on the Number of Trading Plans and on Single-Trade Plans. Other than with respect to issuer Rule 10b5-1 plans, the affirmative defense under amended Rule 10b5-1 generally will no longer be available to a person that has multiple overlapping plans. Plans are considered to be overlapping if they cover the same time period. Further, the affirmative defense will only be available for one single-trade plan during any consecutive 12-month period. A plan that is "designed to effect" the purchase or sale of securities as a single transaction and which has the practical effect of requiring such a result (i.e., without leaving discretion to the agent) will be treated as a single-trade plan; plans that might result in multiple transactions, or which allow for the agent's future acts to depend on events or data not known at the time the plan is entered into, generally will not be deemed single-trade plans.

Despite the general prohibitions on multiple overlapping plans and single-trade plans, the final amendments allow the following specific accommodations without jeopardizing the availability of the affirmative defense:

[9] *Id.* at 37.

- The use of more than one broker-dealer or other agent to execute trades as part of a single "plan," provided the contracts with each broker-dealer or other agent, when taken together, meet all of the applicable conditions and remain subject to the provisions of Rule 10b5-1(c)(1).
- Maintaining two, separate Rule 10b5-1 plans, so long as trading under the later plan is not authorized to begin until after all trades under the earlier plan are completed or expire without execution, and provided that the later plan observes an "effective cooling-off period" (i.e., the applicable cooling-off period that would apply if the later plan were deemed to be put in place the day the earlier plan was terminated and the applicable cooling-off period were then observed).
- Maintaining multiple Rule 10b5-1 plans if the insider has in place another Rule 10b5-1 plan or plans that only authorize the sale of securities as necessary to satisfy tax withholding obligations incident to the vesting of a compensatory award, such as restricted stock or stock appreciation rights, and the insider does not otherwise exercise control over the timing of such sales (i.e., qualified "sell-to-cover" transactions). This accommodation does *not* extend to sales incident to the exercise of options, which involve discretionary action on the part of the insider.

Extension of Good Faith Requirement. Unlike the other amendments, the amendments in this regard apply equally to issuers and their insiders. The amendments clarify that the person entering into the plan must not only act in good faith upon entering the plan but must also act with good faith throughout the duration of the plan. By way of example, the affirmative defense would not be available for a trader who improperly influences the timing of a corporate disclosure to benefit a trade scheduled to occur under an operative Rule 10b5-1 plan. While, as noted above, the SEC has voiced concerns about an insider's ability to cancel a plan at any time, the adopting release leaves open the question whether a Rule 10b5-1 plan cancellation could be construed as acting in bad faith with respect to the plan.[10] The obligation to act in good faith is generally limited to activities within the control of the insider. As such, actions outside of the insider's control or influence, such as cancellations directed by the issuer that are outside the control or influence of the insider, may not, by themselves, implicate the good faith condition.

New Disclosure Requirements

Historically, there have been no meaningful required disclosures concerning the use of Rule 10b5-1 plans by issuers or insiders. The rule amendments add new Item 408 to Regulation S-K, amend Item 402 of Regulation S-K, and make conforming amendments to Forms 10-Q and 10-K (and Form 20-F, which is not discussed herein), to provide for new disclosure requirements concerning Rule 10b5-1 plans and issuer policies and practices relating to insider trading.

[10] *See id.* at 17 (text accompanying n. 40) and 42 n. 137.

Quarterly and Annual Disclosures. Pursuant to new Item 408, quarterly disclosure in Forms 10-K and 10-Q will be required if, during the last completed quarter, any director or officer of the issuer adopted or terminated a "Rule 10b5-1 trading arrangement" or "non-Rule 10b5-1 trading arrangement."[11] A description of the material terms of such arrangement is required, which includes the name and title of the director or officer, date of adoption or termination, duration, and aggregate number of securities to be sold or purchased. Terms with respect to price are *not* required.

Annually, issuers will be required to disclose in their Forms 10-K and proxy statements whether they have adopted insider trading policies and procedures, and if not, to explain why not. A copy of any such policies and procedures must be filed as an exhibit to Form 10-K. As a result, and contrary to general practice historically, issuer insider trading policies will now become public documents.

Compensation Disclosures. Pursuant to new Item 402(x), issuers will be required to disclose in their proxy statements their policies and practices on the timing of awards of stock options, SARs and/or similar option-like instruments in relation to the disclosure of MNPI, along with a discussion of how the board determines when to grant such awards. Issuers are also required to disclose whether and how the board or compensation committee considers MNPI when determining the timing and terms of an award and whether the issuer has timed the disclosure of MNPI to affect the value of executive compensation. For issuers that are required to provide Compensation Discussion and Analysis (CD&A) disclosure, this narrative disclosure could be included in the CD&A, which may already discuss these topics.

New disclosures, in the tabular format below, are also required regarding awards made to named executive officers during the last completed fiscal year at any time during any period beginning four business days before the filing of a periodic report (i.e., Form 10-K or Form 10-Q) or the filing or furnishing of a current report on Form 8-K that discloses MNPI (including earnings information, but excluding Forms 8-K filed under Item 5.02(e) solely to report the granting of options) and ending one business day after the filing or furnishing of such report.

[11] For purposes of Item 408, a director or officer (each, a "covered person") has entered into a "non-Rule 10b5-1 trading arrangement" if the arrangement accords with the requirements of the Rule 10b5-1 affirmative defense that the SEC adopted in 2000: (1) the covered person asserts that at a time when they were not aware of material nonpublic information about the security or the issuer of the security they had adopted a written arrangement for trading the securities; and (2) (i) specified the amount of securities to be purchased or sold and the price at which and the date on which the securities were to be purchased or sold; (ii) included a written formula or algorithm, or computer program, for determining the amount of securities to be purchased or sold and the price at which and the date on which the securities were to be purchased or sold; or (iii) did not permit the covered person to exercise any subsequent influence over how, when, or whether to effect purchases or sales; provided, in addition, that any other person who, pursuant to the trading arrangement, did exercise such influence must not have been aware of material nonpublic information when doing so.

Name	Grant date	Number of securities underlying the award	Exercise price of the award ($/Sh)	Grant date fair value of the award	Percentage change in the closing market price of the securities underlying the award between the trading day ending immediately prior to the disclosure of material nonpublic information and the trading day beginning immediately following the disclosure of material nonpublic information
(a)	(b)	(c)	(d)	(e)	(f)

Among other information about the awards, the tabular disclosure will include the percentage change in the market price of the underlying securities between the closing market price of the security one trading day prior to and one trading day following the disclosure of MNPI.

Tagging. Consistent with other recent SEC rule amendments, the new disclosures described above must also be tagged using inline XBRL.

Section 16 Reporting Changes

Section 16 Forms. Forms 4 and 5 filers will now need to indicate by checkbox on those forms whether a reported transaction was intended to satisfy the affirmative defense conditions of Rule 10b5-1(c).

Accelerated Reporting of Gifts. The amendments also amend Rule 16a-3 to require that dispositions via bona fide gifts of equity securities be reported on Form 4 within two business days of the gift, rather than on a delayed basis on Form 5 (due 45 days after the company's fiscal year-end) as had previously been permitted. Acquisitions by gift are still eligible for deferred reporting on Form 5.

SEC Interpretations Regarding Treatment of Gifts for Insider Trading Purposes

The adopting release articulates the SEC's position that the terms "trade" and "sale" in Rule 10b5-1(c)(1) include bona fide gifts of securities and that the Rule 10b5-1(c) affirmative defense is available to such gifts, a position that the SEC began to lay out when the Rule 10b5-1 amendments were proposed. In this regard, the adopting release quotes footnote 55 to the proposing release, in which the SEC stated that "a donor of securities violates 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."[12] The

[12] Adopting Release at 110.

SEC also stated in the adopting release that it agreed with academic authors cited in the proposing release "who observe that a gift followed closely by a sale, under conditions where the value at the time of donation and sale affects the tax or other benefits obtained by the donor, may raise the same policy concerns as more common forms of insider trading."[13] The SEC rejected the suggestion in comments made to the rule proposal that the SEC "narrow the scope of the gift limitations, such as by applying it only to gifts made to charities affiliated with the Section 16 reporting person or exempting donors who obtain a commitment from the charitable donee not to sell the donated stock until after any material nonpublic information known by the donor at the time of the donation has become public or stale."[14] In rejecting the proposal to exempt donors that obtain such a commitment, the SEC explained, "We doubt any such approach would be effective in maintaining investor confidence because it may be difficult or impossible to verify whether the donor had obtained a binding commitment to refrain from such a sale."[15]

This position may require issuers to revisit their insider trading policies and treatment of gifts. For instance, more issuers may begin to treat bona fide gifts of securities the same as market sales of securities under their insider trading policies. This could present complications for insiders who have traditionally made gifts around year end, particularly if issuers subject such gifts to company blackout periods, which often are in effect in the days and weeks leading up to year end. The SEC acknowledged this point and noted that the Rule 10b5-1(c) affirmative defense is available for bona fide gifts 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 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."[16]

Timing and Treatment of Legacy Rule 10b5-1 Plans

The above changes become effective February 27, 2023, with the Section 16 changes first effective for Forms 4 and 5 filed on or after April 1, 2023. The new disclosures in Form 10-K, Form 10-Q, and proxy or information statements will be first required in the filing that covers the first full fiscal period beginning on or after April 1, 2023. A further six-month delay applies for smaller reporting companies to comply with these new disclosure requirements.

The amendments to Rule 10b5-1(c)(1) will not affect the affirmative defense available under an existing Rule 10b5-1 plan that was entered into prior to the effective date of the amendments to the rule, except to the extent that such a plan is modified after the effective date. For insiders considering entering into a new Rule 10b5-1 trading arrangement, it may be prudent to do so ahead of the effective date of the rule before compliance with additional amendments to the rule take effect.

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[13] *Id.* at 112.
[14] *Id.* at 114.
[15] *Id.*
[16] *Id.* at 112-113.

Select Departures from the Proposing Release

The adopting release retreated from a few of the amendments initially proposed. Notably, the adopting release:

- Does not subject issuers to a cooling-off period.
- Does not require directors or officers to make a *separate* certification (outside the plan documents) that they entered a Rule 10b5-1 plan in good faith or to retain such a certification for ten years.
- Provides some exceptions for multiple overlapping plans, as described above.
- Does not require quarterly disclosure of the issuer's entry into trading plans.
- Does not require disclosure of the pricing terms in plans entered into by directors and officers.
- Does not require disclosure of the issuer's insider trading policies and procedures within the body of the annual report or proxy/information statement, but instead requires an exhibit filing.
- Narrowed the tabular disclosure requirements in the final amendments to Item 402(x) of Regulation S-K, including to eliminate the share repurchase disclosure trigger.

Practical Considerations

Companies should consider the following actions in light of the Rule 10b5-1 amendments and newly adopted disclosure requirements. Similarly, company insiders will want to take note of these developments and the resulting amendments to the company policies to which they are subject, which might prompt changes to insiders' securities trading practices.

Policy Changes

Companies should review and update insider trading and Rule 10b5-1 policies as necessary to reflect the new conditions and otherwise comply with the latest amendments. Particular areas of focus should include requirements for the adoption, use and modification of Rule 10b5-1 plans, including with respect to the use of single-trade plans or multiple plans and the inclusion of cooling-off periods. Companies should also review any sell-to-cover arrangements to confirm that those arrangements satisfy the SEC's definition of a qualified sell-to-cover arrangement.

Companies that currently require that all trades be made under Rule 10b5-1 plans should consider whether the new conditions added to Rule 10b5-1(c) warrant any modifications of that policy.

The treatment of gifts under insider trading policies should be reviewed in light of the commentary in the adopting release discussed above. Companies may need to tighten policies around bona fide gifts during company blackout periods and other times when MNPI may be present (similar to how other trades are treated). Insiders considering gifting arrangements pursuant to Rule 10b5-1 plans will need to be mindful about timing requirements and the relationship to other plans given the

prohibition on multiple overlapping plans. These changes are likely to represent departures from past practices for companies and insiders and will need to be taken into account in making plans for year-end gifts of company securities. For example, company insiders who make trades pursuant to Rule 10b5-1 plans and plan to make year-end gifts should consider making gifts during the last open window before the end of the year outside of a Rule 10b5-1 plan, so that there would not be overlapping plan problems.

In light of the new disclosure requirements of Item 408 of Regulation S-K and the corresponding amendments to Forms 10-K and 10-Q, companies should also consider their current procedures regarding insider trading and whether any updates are merited. This applies to any written or unwritten procedures that supplement the company's written insider trading policy. Preclearance procedures should be a key area of focus. Companies that do not have any procedures in place should consider whether to require that insiders preclear any proposed Rule 10b5-1 plans with the company before entering into such plans, while companies that already have such preclearance procedures in place should evaluate the need for any changes to their procedures' administration or scope. In addition, companies should review any supplemental policies, information or instructions related to the company's insider trading policy, such as how to access the policy and attend relevant trainings, how the company makes and apprises insiders of decisions regarding black-out periods, and other relevant guidance that may not be contained within the insider trading policy itself. Companies are reminded that the new exhibit filing requirement in Item 601 of Regulation S-K will require the filing of all insider trading policies *as well as any* procedures that have been adopted by the company, meaning this exhibit may include more than the formal insider trading policy.

Companies should also consider whether enhanced disclosure controls and procedures are needed to ensure compliance with the new disclosure requirements concerning Rule 10b5-1 plans and related company policies and practices. In particular, new quarterly controls should be put in place to identify when directors and officers have adopted or terminated a "Rule 10b5-1 trading arrangement" or "non-Rule 10b5-1 trading arrangement."

Finally, the Rule 10b5-1 amendments largely exempted issuers from many of the new requirements, while leaving open the possibility that new changes could be forthcoming. That said, companies should assess their current repurchase plans for compliance with the requirement that company repurchases pursuant to a Rule 10b5-1 plan must comply with the new good faith requirement discussed above, namely that the person who entered into the contract, instruction, or plan has acted in good faith with respect to the contract, instruction or plan.

Section 16

Companies should apprise company insiders, and their brokers, as applicable, of the changes to Section 16, including the requirements to (i) indicate by checkbox whether a reported transaction was intended to satisfy the affirmative defense conditions of Rule 10b5-1(c) and (ii) report dispositions by bona fide gift on Form 4 within two business days of the transaction. In addition,

companies should be sure to update their Form 4 and 5 templates to reflect the new checkbox requirement.

Option Granting Practices

Companies should review and discuss the amendments to Item 402(x) and the related disclosure requirements with their compensation committees. Companies and their compensation committees will need to consider these upcoming disclosure requirements, particularly if changes in practice are desirable to implement in 2023 for reporting in the company's 2024 proxy statement.

Additionally, companies should conduct a review of their equity grant policies, including any practices regarding the timing of grants, and assess whether changes are needed with respect to the timing of board or compensation committee discussions regarding equity compensation matters or the timing of the issuance of awards.

Education and Coordination

The amendments to Rule 10b5-1 impose significant changes to the operation of the rule and the requirements, particularly for directors and officers. Brokers will no doubt be cognizant of the rule change, but companies will need to educate insiders about the rule change and the concordant effect on the company's policies and procedures. Communications with insiders and brokers should take place prior to the effective date of the new rules to ensure no early foot faults.

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