SEC Adopts Amendments to Rule 10b5-1 and Related Disclosure Requirements

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On December 14, 2022, the SEC adopted[1] amendments to Rule 10b5-1 as well as related new disclosure requirements for companies. In addition, Forms 4 and 5 are amended to require the identification of transactions made pursuant to Rule 10b5-1, and dispositions by bona fide gift are now required to be reported on Form 4 within two business days.

Notably, the new requirements for 10b5-1 plans for the most part do not apply to issuer 10b5-1 plans, nor do the new Form 10-K/Form 10-Q disclosure requirements for trading plans adopted or terminated apply to issuer plans. The SEC is considering whether to adopt new rules that apply to issuer repurchases.[2]

What changes did the SEC adopt?

- New conditions to satisfying the requirements for the affirmative defense under Rule 10b5-1, including new cooling-off periods, a certification requirement, modifications to the good faith requirement, and restrictions on multiple and single trade plans (subject to certain exceptions). Rule 10b5-1 plans entered into prior to the effective date of February 27, 2023 continue to be governed by Rule 10b5-1 as in effect prior to the effective date, unless modified (in the manner described in amended Rule 10b5-1(c)(iv)).
- New quarterly disclosure requirements for companies regarding the adoption, modification, and termination of 10b5-1 and non-10b5-1 trading plans, new annual disclosures regarding insider trading policies (including a requirement to file policies as exhibits), and new disclosures regarding options granted close in time to material disclosures by a company.
- Forms 4 and 5 are amended to require the identification of transactions made pursuant to Rule 10b5-1, and dispositions by bona fide gift must now be reported on Form 4 within two business days.

What are the new requirements for 10b5-1 plans for Section 16 officers[3] and directors?

- A new cooling-off period after plan adoption before trades may be executed.
- A new certification requirement.
- Restrictions on using multiple plans.
- A limitation on the ability to use the affirmative defense for more than one single-trade plan during any consecutive 12-month period.
- A new condition that the person relying on the affirmative defense must act in good faith in connection with the operation of the plan.

These new requirements are explained in more detail below and are also applicable to insiders of smaller reporting companies, emerging growth companies, and foreign private issuers.

What are the new quarterly and annual disclosure requirements for issuers?

- Quarterly disclosures regarding the adoption or termination of 10b5-1 plans and non-10b5-1 trading plans by Section 16 officers and directors.
- Annual disclosures regarding whether a company has adopted insider trading policies and procedures (and filing such policies and procedures as an exhibit to the Form 10-K).

These new requirements are explained in more detail below and are also applicable to smaller reporting companies and emerging growth companies. Foreign private issuers are not subject to the quarterly disclosures, but their annual reports on Form 20-F must include disclosures about the companies' insider trading policies and procedures, and such policies and procedures are required to be filed as an exhibit to the Form 20-F.

What is the new checkbox on Forms 4 and 5; how are gifts reported?

- There is a new Rule 10b5-1(c) checkbox on these forms, which is required to be checked if a transaction under a 10b5-1 plan is reported. In addition, the date of adoption of the plan needs to be disclosed in the "Explanation of Responses" section of the form.
- Dispositions of equity securities by bona fide gift now must be reported on Form 4 within two business days, rather than optionally deferred to a year-end Form 5.[4] Acquisitions by gift may continue to be reported on Form 5.

What are the new disclosures for options and similar instruments?

- Tabular and narrative disclosures regarding awards of options, stock appreciation rights, and other option-like instruments granted to insiders shortly before or after the release of material nonpublic information.

These new requirements are explained in more detail below and are also applicable to smaller reporting companies and emerging growth companies.

What is the new required cooling-off period for Section 16 officers and directors?[5]

- The cooling-off period is a waiting period between the date that a trading plan is adopted and the date of the first transaction to be executed under the plan.
- The cooling-off period also applies to certain plan modifications (discussed below).
- The new cooling-off period expires after the later of (i) 90 days after the adoption of the plan and (ii) two business days following[6] the disclosure of the issuer's financial results in a Form 10-Q or Form 10-K for the fiscal quarter in which the plan was adopted, but not more than 120 days after plan adoption. For foreign private issuers, the two business-day period runs from disclosure in a Form 20-F or Form 6-K.
- The 10b5-1 plan must include the required cooling-off period.

What kinds of modifications would trigger a new cooling-off period?

- Any modification or change to the amount, price, or timing of the purchase or sale of the securities (or a modification or change to a written formula or algorithm, or computer program that affects the amount, price, or timing of the purchase or sale of the securities) is treated as a termination of a 10b5-1 plan, and the adoption of a new 10b5-1 plan.
- A change in brokers that doesn't involve a change in the amount, price, or timing would not be treated as a termination and adoption.

What is the new certification requirement for plans of Section 16 officers and directors?

- 10b5-1 plans for Section 16 officers and directors must include a certification that (i) the officer or director is not aware of material nonpublic information and (ii) the officer or director is adopting the plan in good faith and not as part of a plan or scheme to evade the prohibitions of Rule 10b-5.
- In the adopting release, the SEC states that it expects that such representations in the plan also will be made to the issuer, and that issuers may wish to include disclosure of such representations in the new disclosures required in Forms 10-K and 10-Q under Item 408(a) of Regulation S-K (discussed below).

Do the amendments to Rule 10b5-1 affect awards under equity incentive plans?

- Yes. Restricted stock units, restricted stock awards, and similar instruments that provide for sell-to-cover and which are intended to comply with Rule 10b5-1 will need to comply with the requirements of the amended rule, except as discussed below with respect to multiple and single trade plans.

What are the new restrictions on multiple plans and single trade plans?

- Section 16 officers, directors, and other persons (other than the issuer) may not enter into or have outstanding another 10b5-1 plan that would cover purchases or sales of any class of securities in the open market.
  - For these purposes, concurrent plans with different brokers would be deemed to constitute a single plan if the plans could be combined into a single plan that would satisfy the requirements of Rule 10b5-1. In such cases, the collective agreements must be treated as a single plan, and, as a result, a modification of one plan would be treated as a modification of each of the constituent plans.
  - The person may have one later-commencing plan under which trading under the later plan may not commence until after all trades are completed under the prior plan or the prior plan expires; in addition, if the prior plan is voluntarily terminated, the first trade under the later plan may not commence until after the applicable cooling-off period running from the date of termination of the prior plan.
  - Sell-to-cover trading plans are not subject to this restriction. However, in order to be eligible for this exception, the sell-to-cover plan may only provide for the sale of such number of securities necessary to satisfy tax withholding obligations arising from the vesting of a compensatory award (other than upon the exercise of options). Subject to further clarification from the SEC Staff, the availability of this exception may be limited, given the complexities of determining the withholding obligations.
  - Transactions not involving open market transactions under employee stock ownership plans (ESOPs) and dividend reinvestment plans (DRIPs) are not subject to this restriction.
- Section 16 officers, directors, and other persons (other than the issuer) also may not enter into a plan designed to effect the open-market purchase or sale of the total number of securities covered by the plan in a single transaction if such person has entered into a similar plan within the prior 12-month period.
  - Eligible sell-to-cover trading plans (as described above) are not subject to this restriction.
  - In the adopting release, the SEC states that a plan is "designed to effect" the purchase or sale as a single transaction when the plan has the practical effect of requiring such a result.

What changes were made to the good faith requirement in Rule 10b5-1?

- Since its adoption in 1980, one of the conditions to the affirmative defense is that the insider enter into the 10b5-1 plan in good faith and not as part of a plan or scheme to evade the prohibitions of Rule 10b-5. The amendments add the requirement that the insider has acted in good faith with respect to the 10b5-1 plan. This was designed to address, for example, plan modifications or terminations by the insider, or actions by the insider to influence the timing of the release of material information by the issuer.
- The amended good faith requirement applies to all corporate insiders, including issuers.

What are the new disclosure requirements for issuers with regard to 10b5-1 and non-10b5-1 trading plans?

- New Item 408(a) of Regulation S-K requires disclosure in Forms 10-Q and 10-K of the adoption or termination of any 10b5-1 or "non-10b5-1" trading plan by any director or Section 16 officer during the last fiscal quarter.
- This disclosure requirement is applicable to sell-to-cover plans that are 10b5-1 or non-10b5-1 plans.
- Required disclosures include whether the trading plan is intended to satisfy the affirmative defense of Rule 10b5-1(c) and the material terms of the plan (other than price), such as:
  - Name and title of the director or Section 16 officer;
  - The adoption or termination date of the plan (as discussed above, certain modifications are deemed to be a termination and adoption of a new plan);
  - The duration of the plan; and
  - The aggregate number of shares to be purchased or sold pursuant to the plan.

- For purposes of these disclosures, a “non-10b5-1 trading plan”[7] is a contract, instruction, or plan for the purchase or sale of securities not intended to satisfy the conditions of Rule 10b5-1, where:
  - The Section 16 officer or director asserts at the time of adoption that she or he was not aware of material nonpublic information; and
  - The plan specified the amount, date, and pricing (or methodology or didn’t permit any influence by the covered person) for the purchase or sale in the manner required for a 10b5-1 trading plan.
  - Non-10b5-1 trading plans would, for example, cover plans that didn’t satisfy the cooling-off period requirement.
  - Subject to SEC Staff interpretive guidance, non-10b5-1 trading plans also could cover any open-market limit order.

What are the new disclosure requirements for issuers with regard to insider trading policies?

- New Item 408(b) of Regulation S-K requires that companies disclose whether they have adopted insider trading policies and procedures governing the purchase, sale, or other disposition of the company’s securities by directors, officers, employees, or the company. Companies that have not adopted such insider trading policies and procedures must disclose why they have not done so.
  - Given the disclosures required by Item 408(b), companies should consider formalizing the applicability of their insider trading policies to company repurchases and offerings.
  - In the adopting release, the SEC noted that a company’s code of ethics may contain specific policies and restrictions that address insider trading. If all of the company’s insider trading policies and procedures are included in a company’s code of ethics, then a company may file its code of ethics to satisfy the exhibit requirement discussed below.
- In the adopting release, the SEC commented that gifts are deemed to be dispositions subject to the insider trading laws. Accordingly, insider trading policies should address gifts based on the SEC’s position, which differs from how many issuers have addressed gifts in their insider trading policies.
- Item 408(b) disclosures will be required in both the proxy statement and Form 10-K (which may incorporate by reference to the proxy disclosures), or in Form 20-F for foreign private issuers.
  - The company’s insider trading policies and procedures must be filed as an exhibit.[8]
  - Descriptions of the policies and procedures in the body of the report or proxy statement are not required (though practice may evolve).
- The disclosures required by Items 408(a) and (b) are covered by the CEO’s and CFO’s certifications required by Section 302 of the Sarbanes-Oxley Act of 2002. Accordingly, it will be appropriate for the company’s principal legal or compliance officer to provide a sub-certification upon which the CEO and CFO may rely in giving their certifications.
- Note that new Items 408(a) and (b) are also applicable to smaller reporting companies and emerging growth companies, and Item 408(b) is applicable to foreign private issuers.

What new narrative disclosures are required with respect to options and similar instruments?

- New Item 402(x) requires disclosure of companies’ policies and practices on the timing of awards of options and option-like instruments[9] in relation to the disclosure by a company of material nonpublic information, including:
  - How the board determines when to grant such awards (for example, on a predetermined basis);
  - Whether the board or compensation committee takes material nonpublic information into account when determining the timing and terms of awards and, if so, how; and
  - Whether the company has timed the disclosure of material nonpublic information for the purpose of affecting the value of executive compensation.

- Notably, the final sub-bullet above could apply to equity instruments other than options and option-like instruments.
- Although Item 402(x) does not require that companies adopt policies or modify their policies, companies should revisit their equity grant policies and determine whether revisions are appropriate.
- Note that the new disclosure requirements also apply to smaller reporting companies and emerging growth companies, although the covered named executive officers are determined in accordance with applicable scaled disclosure requirements.

What new tabular disclosures are required with respect to options and similar instruments?

- New tabular disclosures are required if, during the last fiscal year, the company awarded options or option-like instruments to a named executive officer in the period beginning four business days before the filing (or furnishing) of a Form 10-K, a Form 10-Q, or a Form 8-K that discloses material nonpublic information and ending one business day after the filing or furnishing of such report. Information concerning each such award should include:
    - The name of the named executive officer who received the grant;
    - The grant date;
    - The number of shares underlying the award;
    - The per-share exercise price of the award;
    - The grant date fair value of the award; and
    - The percentage change in the market price of the underlying shares between the closing market price one trading day prior to and the trading day beginning immediately following the disclosure of the material nonpublic information.
- Note that the new disclosure requirements also apply to smaller reporting companies and emerging growth companies, although the covered named executive officers are determined in accordance with applicable scaled disclosure requirements.

What are the new iXBRL requirements?

- The new disclosures required under Items 408(a) and 408(b) of Regulation S-K are required to be provided in an interactive data file.
- The new disclosures required under Items 402(x) of Regulation S-K are required to be provided in an interactive data file.

When are the new rules effective?

- The amendments to Rule 10b5-1 are effective February 27, 2023. Plans effective prior to February 27, 2023 are not subject to the amended rules unless there is a plan modification.
- The amendments to the Section 16 rules requiring that dispositions pursuant to bona fide gift must be reported on Form 4 are effective February 27, 2023. The amendments to Forms 4 and 5 (requiring identification of transactions pursuant to 10b5-1 plans) are effective beginning April 1, 2023.
- The new disclosures under Items 402(x) and 408 of Regulation S-K are effective for the first filing that covers the first full fiscal period beginning on or after April 1, 2023 (October 1, 2023 in the case of smaller reporting companies). This means that for a calendar fiscal year company that is not a smaller reporting company, its Form 10-Q for its fiscal quarter ending June 30, 2023 will need to include disclosures about trading plans adopted during that fiscal quarter. Disclosures required by Item 402(x) (regarding option grant policies and tabular disclosures) and Item 408(b) (regarding the company's insider trading policy and the requirement to file its insider trading policy as an exhibit) will be required in such a company's 2024 Form 10-K (filed in 2025).
- Inline XBRL tagging requirements for Item 402(x) and Item 408 disclosures are required beginning with the first filing that covers the first full fiscal period beginning on or after April 1, 2023 (October 1, 2023 in the case of smaller reporting companies).

What should companies do now?

- Companies should begin reviewing their insider trading policies and Rule 10b5-1 trading plan procedures and consider what changes should be made to align with the amended rules and the SEC's position on the treatment of dispositions by gift. Many companies' insider trading policies currently do not restrict dispositions by bona fide gift. Dispositions by gift should be made subject to the same restrictions as any sale transaction.
- Companies should have procedures in place to ensure that gifts by Section 16 persons are reported currently on Form 4. This is effective February 27, 2023.
- Companies should have procedures in place to ensure that Forms 4 and 5 filed beginning April 1, 2023 use the amended forms. Transactions pursuant to Rule 10b5-1 plans (that are intended to comply with the amended rule) should be identified by checking the box and including the required disclosures in the "Explanation of Responses" section of the form.
- Companies should have procedures in place to ensure that new 10b5-1 plans (as well as modifications of existing 10b5-1 plans) comply with the applicable cooling-off period, restrictions on multiple and single trade plans, and certification requirements.
- Companies should review, as appropriate, brokerage firm forms of 10b5-1 plans to confirm compliance with the amended rules (for plans effective on or after February 27, 2023) and consider requiring that the forms provide that the specified 10b5-1 representations are made for the benefit of the company.
- Companies should advise their Section 16 persons (and other insiders) of the new cooling-off periods and restrictions on multiple and single trade plans and discuss with Section 16 persons the need to implement Rule 10b5-1 trading plans further in advance of trades. Companies and insiders should consider, as alternatives to Rule 10b5-1 trading plans, using non-Rule 10b5-1 trading plans, or insiders executing transactions outside of Rule 10b5-1 or non-10b5-1 trading plans (for example, during quarterly trading windows, assuming a special trading blackout is not in effect). For companies that require their insiders to use Rule 10b5-1 plans as the exclusive manner in which to trade in company securities, such companies should reconsider this policy, given the more restrictive requirements for Rule 10b5-1 trading plans.
- Companies should consider the requirements for qualifying sell-to-cover plans and whether Section 16 persons' and other insiders' sell-to-cover Rule 10b5-1 trading plans can be structured to satisfy the exceptions to the restrictions on multiple and single trade plans.
- Companies should consider formalizing their policies concerning company repurchases and offerings that are designed to promote compliance with insider trading laws.
- Companies should consider whether any changes should be made to their equity grant policies and consider the timing of option grants in relation to their earnings releases and Forms 10-Q and 10-K filings.
- Companies should have procedures in place to ensure compliance with the new iXBRL tagging requirements.

References

[1] See Insider Trading and Arrangements and Related Disclosures, Release No. 34-96492 (December 14, 2022).

[2] In the adopting release, the SEC states that a corporation is considered an insider with regard to its duty to either disclose or abstain from trading when purchasing its own shares on the basis of material nonpublic information. The SEC further comments that the misuse of material nonpublic information by issuers when trading in their own securities can result in significant harm to investors.

[3] Rule 16a-1(f) defines an officer as "an issuer's president, principal financial officer, principal accounting officer (or, if there is no such accounting officer, the controller), any vice-president of the issuer in charge of a principal business unit, division or function (such as sales, administration or finance), any other officer who performs a policy-making function, or any other person who performs similar policy-making functions for the issuer. Officers of the issuer's parent(s) or subsidiaries shall be deemed officers of the issuer if they perform such policy-making functions for the issuer. In addition, when the issuer is a limited partnership, officers or employees of the general partner(s) who perform policy-making functions for the limited partnership are deemed officers of the limited partnership. When the issuer is a trust, officers or employees of the trustee(s) who perform policy-making functions for the trust are deemed officers of the trust."

[4] Many insiders already voluntarily report gifts on Form 4.

[5] The cooling-off period for persons other than Section 16 officers and directors (other than the issuer) is 30 days.

[6] For example, assuming a filing after 4:00 pm EDT on a Monday, the 2-day period would end after 4:00 pm EDT on the following Wednesday, and trading could commence on Thursday. Subject to SEC Staff interpretive guidance, the cooling-off period could be interpreted such that trading could commence on the second business day following the date of filing.

[7] In the adopting release, the SEC observed that insiders may use non-Rule 10b5-1 trading plans to provide defenses to liability under Section 10(b). The SEC further observed that absent the disclosure requirement for non-Rule 10b5-1 trading plans, insiders might be more likely to use non-Rule 10b5-1 trading plans and rely on alternative defenses to liability under Section 10(b) in order to avoid the disclosure requirements for Rule 10b5-1 plans.

[8] We expect that companies will revisit and enhance their insider trading policies. In the adopting release, the SEC noted that such policies and procedures may include the issuer's process for analyzing whether directors, officers, employees, or the issuer itself, when conducting an open-market share repurchase, have material nonpublic information; the issuer's process for documenting such analyses and approving requests to purchase or sell its securities, whether through Rule 10b5-1 plans or otherwise; and/or how the issuer enforces compliance with any such policies and procedures it may have.

[9] Although Item 402(x) requires disclosures only with respect to options, the adopting release references disclosures with respect to options, SARs, and option-like instruments.

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