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SEC proposes rule amendments related to Rule 10b5-1 trading plans

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On December 15, 2021, the SEC proposed amendments that add new conditions to the availability of the affirmative defense under Rule 10b5-1 to insider trading liability and new disclosure requirements under Rule 10b5-1 for trading plans

Since 2000, Rule 10b5-1 has provided company insiders with a helpful tool to be able to liquidate some of their holdings in a company's stock to diversify their wealth without fear of committing insider trading. The rule provides corporate officers and directors with an affirmative defense when the insiders adopted trading plans in good faith and while not in possession of material nonpublic information ("MNPI") and the trades are made pursuant to a written plan. Many corporate insiders have used Rule 10b5-1 to diversify their holdings in their companies' securities especially because an increasing amount of executive compensation is paid in the form of company securities. However, according to the SEC, some courts, commentators, and members of Congress are concerned that Rule 10b5-1 has been abused by some to allow insiders to take advantage of the liability protections provided by the rule to opportunistically trade securities on the basis of MNPI. Currently, issuers are not required to disclose the use of Rule 10b5-1 trading arrangements by issuers or insiders, although many insiders and issuers do so voluntarily. To address perceived issues and provide increased transparency, the SEC now has proposed rule amendments to address apparent loopholes in the rule that allow corporate insiders to unfairly exploit informational asymmetries and to minimize the danger that insiders engage in improper trading practices under Rule 10b5-1.

The proposed rule amendments would:

- Impose a 120-day cooling-off period and prohibit overlapping plans. The affirmative defense of Rule 10b5-1(c) would require a 120-day cooling-off period for insiders before trading could commence after the adoption of a plan. Overlapping trading plans would be prohibited, and single-trade plans would be limited to one per 12-month period. Issuer 10b5-1 trading plans would require a 30-day cooling-off period between adopting and the start of trading. Modification of a trading plan would be considered the adoption of a new plan, triggering a new 120-day or 30-day cooling-off period as applicable.
- Require director and officer certifications. At the time of adopting or modifying a Rule 10b5-1 trading arrangement directors and officers would be required to provide to the issuer a written certification that states: (1) they were not aware of MNPI regarding the issuer or its securities, and (2) they are adopting the plan in good faith. Issuers would be required to retain this certification for 10 years.

Note: Two Commissioners, while supporting the proposed rule, primarily related to the cooling-off period, raised concerns about some of the additional disclosure and other requirements of the proposal and invited further public comments on parts of it. For example, Commissioner Hester Peirce questioned the benefit of the certification condition, especially because the no MNPI and good faith conditions are already part of the Rule 10b5-1(c) affirmative defense.

- Mandate new company disclosures regarding companies' insider trading policies and Rule 10b5-1 plans. Companies would be required to disclose: (a) their insider trading policies and procedures in their 10-Ks and proxy statements (and if companies have not adopted such policies and procedures explain why they have not done so); and (b) the adoption and termination (including modification) of Rule 10b5-1 plans by directors, officers, and issuers in their 10-Qs, including the duration and aggregate number of securities subject to the plan and a description of any modification. Companies would also be required to disclose other trading arrangements that are not designed to satisfy Rule 10b5-1.
- Add a new disclosure about the timing of certain equity awards. The one amendment would require proxy statement disclosure regarding option grants to named executive officers and directors and the release of MNPI. A new table would require companies to provide proxy statement disclosure about the timing of option grants for named executive officers and directors and the release of MNPI. A new paragraph (x) would be added to Item 402 of Regulation S-K that would require tabular disclosure of each option award (including the number of securities underlying the award, the date of grant, the grant date fair value, and the option's exercise price) granted within 14 calendar days before or after 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 MNPI; the market price of the underlying securities the trading day before disclosure of the MNPI; and the market price of the underlying securities the trading day after disclosure of the MNPI.
- Add a new checkbox to Section 16 reports on Form 4 and Form 5 on whether the reported transactions were made pursuant to a Rule 10b5-1 trading arrangement. (It is already common for insiders using a Rule 10b5-1 plan to make this disclosure voluntarily.)
- Make gifts reportable on Form 4 (not Form 5 – which is due 45 days after the end of the year), which would require reporting two business days after the date of the gift.

The comment period on these proposals will expire 45 days after publication of the proposals in the *Federal Register*, which is expected shortly. The proposing release is available here.