TheCorporateCounsel.net

"Rule 10b5-1 & Buybacks: Practical Impacts of SEC's Proposals"

Wednesday, January 12, 2022

Course Materials

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2:00 - 3:00 pm Eastern [archive and transcript to follow]

The SEC has proposed significant changes to the rules governing insider trading plans and corporate repurchases. As the SEC reviews comments and considers finalizing these rules, what steps should companies be taking? This webcast will highlight significant aspects of the proposals and discuss what companies and their advisors can do to prepare for changing compliance requirements. Join:

- **Brian Breheny**, Partner, Skadden, Arps, Slate, Meagher & Flom LLP
- **Ning Chiu**, Partner, Davis Polk & Wardwell LLP
- **Meredith Cross**, Partner, WilmerHale LLP
- **Keir Gumbs**, Chief Legal Officer, Broadridge Financial Solutions
- **David Lynn**, Partner, Morrison & Foerster LLP and Senior Editor, TheCorporateCounsel.net

Topics of the webcast include:

- Overview of Proposed Changes
- Required Policy & Process Changes if Proposals Are Adopted
- Required Disclosure Changes if Proposals Are Adopted
- What Companies Should Do Now
- Is it Worthwhile to Comment?
- Rulemaking Process: Expectations & Next Steps

“Rule 10b5-1 & Buybacks: Practical Impacts of SEC's Proposals”

Course Outline / Notes

1. Overview of Proposed Changes

2. Required Policy & Process Changes if Proposals Are Adopted

3. Required Policy & Process Changes if Proposals Are Adopted

4. What Companies Should Do Now

5. Is it Worthwhile to Comment?

6. Rulemaking Process: Expectations & Next Steps

“Rule 10b5-1 & Buybacks: Practical Impacts of SEC's Proposals”

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December 16, 2021

Rule 10b5-1: SEC Proposes Amendments to Conditions & Disclosure Requirements

Yesterday, the SEC issued proposed amendments to Rule 10b5-1 and related rules imposing new conditions & disclosure requirements for 10b5-1 plans and securities transactions by companies and insiders. Here's a copy of the163-page proposing release & the two-page fact sheet on the proposed rules. The SEC's press release also provides a good summary of the proposal:

> The proposed amendments to Rule 10b5-1 would update the requirements for the affirmative defense, including imposing a cooling off period before trading could commence under a plan, prohibiting overlapping trading plans, and limiting single-trade plans to one trading plan per twelve month period. In addition, the proposed rules would require directors and officers to furnish written certifications that they are not aware of any material nonpublic information when they enter into the plans and expand the existing good faith requirement for trading under Rule 10b5-1 plans.
>
> The amendments also would elicit more comprehensive disclosure about issuers' policies and procedures related to insider trading and their practices around the timing of options grants and the release of material nonpublic information. A new table would report any options granted within 14 days of the release of material nonpublic information and the market price of the underlying securities the trading day before and the trading day after the disclosure of the material non-public information. Insiders that report on Forms 4 or 5 would have to indicate via a new checkbox whether the reported transactions were made pursuant to a Rule 10b5-1(c) or other trading plan. Finally, gifts of securities that were previously permitted to be reported on Form 5 would be required to be reported on Form 4.

For the most part, the proposed changes to Rule 10b5-1 track the recommendations made by the SEC's Investor Advisory Committee, but the proposal does not include Form 8-K & proxy disclosure requirements relating to corporate & insider 10b5-1 plans that the IAC advocated. The portions of the proposed rules addressing disclosure of the timing of option grants follow up on the Staff's recent guidance on accounting for "spring loaded" awards. Finally, in what's become a very unusual event in recent years, the commissioners unanimously voted to approve the issuance of the rule proposal.

– **John Jenkins**

Posted by John Jenkins
Permalink: https://www.thecorporatecounsel.net/blog/2021/12/rule-10b5-1-sec-proposes-amendments-to-conditions-disclosure-requirements.html

Davis Polk

You'd better watch out! New rules for company and insider stock transactions are coming to town

December 20, 2021 | Client Update | 17-minute read

The SEC's proposals include cooling-off periods for Rule 10b5-1 trading plans, public disclosure around Rule 10b5-1 trading plans, significant new disclosures for option grants and stock gifts, and daily reporting of stock buybacks.

On December 15, the Securities and Exchange Commission proposed new rules focused on stock and option transactions involving companies and their directors and officers, or "insiders." The proposals address concerns that have received on-and-off political, media and academic notice over the years but generated remarkably little SEC enforcement attention, suggestive of problems that are perhaps more apparent than real. Indeed the proposals seem tinged with the conviction that stock transactions by companies and insiders are inherently suspect. While some aspects of the proposals are already common practice, others may prove problematic or give the plaintiffs' bar new arrows in its quiver.

That said, as we discussed in a September 3, 2021 client update, action on these topics has been expected for several months and the SEC is likely to move quickly to finalize rules modeled on last week's proposals after an unusually short public comment period that will expire in mid-February 2022.

When approved, the requirements will apply to a variety of everyday practices, and so public companies should soon take steps to ensure their policies and procedures facilitate compliance. The proposals include:

- Amendments to Rule 10b5-1, the SEC rule many companies and insiders rely upon when buying and selling stock,
- Amendments to the rules governing disclosure of stock option grants,
- Amendments to Forms 4 and 5, which insiders use to report stock trades and gifts, and
- New reporting requirements for company buybacks, whether or not conducted according to a Rule 10b5-1 trading plan or the commonly used Rule 10b-18 safe harbor.

Proposed changes impacting Rule 10b5-1 trading plans

Rule 10b5-1, unveiled more than two decades ago, offers a defense to the charge of illegal insider trading for securities transactions executed according to a plan entered into when the trader does not have material nonpublic information, or "MNPI," about the company. Because they frequently hold MNPI, directors, officers and other company insiders often use Rule 10b5-1 trading plans to sell and buy stock, and companies themselves often use the plans when conducting stock buybacks. Properly used, Rule 10b5-1 trading plans help companies and insiders avoid running afoul of insider trading laws when engaging in everyday stock transactions. Nevertheless, over the years academic studies and investigative journalists have suggested that some insiders may use Rule 10b5-1 trading plans for the opposite purpose: to facilitate illegal insider trading. Although the SEC's enforcement program has never uncovered a wide pattern of such abuse, the SEC is proposing six major reforms to make sure it doesn't happen.

— **Mandatory cooling-off periods**. Though not required by the current rule, many companies require a cooling-off period between execution of a Rule 10b5-1 trading plan and the first trade under the plan, and we have long recommended a cooling-off period for insider plans in order help the insider demonstrate that they were not motivated to make trades by nonpublic information known at the time of plan adoption. The SEC's proposal would require a 120-day cooling off period for insider plans and a 30-day cooling-off period for company buyback plans, in each case triggered by plan adoption, modification or amendment (whether or not ministerial in nature, and likely including a temporary suspension or a change of broker).

- *Insider trading plans*. We understand the rationale for applying cooling-off periods to insider trading plans, though we believe that a strict 120 days is longer than necessary. Provided a plan is entered into in an "open window," it usually should be enough to wait at most until the next earnings release in order to avoid the potential or appearance of trading on the basis of undisclosed information, which depending on the company and when the plan is adopted could be well short of 120 days.
- *Company buyback plans*. What is harder to understand is the basis for a 30-day cooling-off period for company buybacks—a requirement that would in some cases be too short to matter, but in most cases would be unnecessarily long and therefore needlessly limit a company's flexibility. Many companies today have no cooling-off period for stock buybacks even though they impose them on insiders, reasoning that the company itself is well-positioned to make the call of whether or not it holds MNPI and also taking account of the differing risk profiles of company purchases and insider sales. But if a company did in

fact have MNPI—for example, knowledge that the current quarter was going to strongly exceed stock market expectations—imposing a 30-day delay on trades would not necessarily ensure that the valuable information would be in the market before the first trade.

Any mandatory cooling-off period for company buyback plans would be especially problematic for accelerated share repurchase programs, or ASRs, because it would make their implementation more challenging and the cost of buying stock through ASRs more expensive. Companies would need to use a "forward starting" mechanic, which would complicate execution and undoubtedly increase the price paid to repurchase their stock.

Particularly if the SEC moves ahead with its proposal to require daily reporting of company repurchase activity (discussed below), we think the SEC should be able to rely on the powers of sunlight to prevent companies from surreptitiously repurchasing stock when they are sitting on undisclosed good news, rather than install an arbitrary speed bump as a condition to taking advantage of the Rule 10b5-1 defense. If the SEC nevertheless adopts the cooling-off period as proposed, we believe some companies will simply choose not to avail themselves of the rule's potential protections.

— **Prohibition on overlapping plans**. Although some companies prohibit their insiders from maintaining more than one Rule 10b5-1 trading plan at once, this is not currently a condition to the rule's availability. Some commenters have speculated that insiders are thus able to run two simultaneous offsetting plans—one for stock sales, and the other for stock purchases—and simply terminate the plan that looks like it will be unprofitable based on inside information known to the trader. While there is not much evidence to suggest that this sort of nefarious activity is actually going on (and indeed Section 16 short-swing profits liability could make it perilous), the SEC intends to get rid of it, just in case.

A transaction where insiders receive stock directly from the company, such as from an employee stock ownership or dividend reinvestment plan, would not be considered a prohibited overlapping plan. However, the common use of Rule 10b5-1 trading plans for share withholding upon vesting or delivery of equity awards would apparently be covered.

A prohibition on overlapping plans would also preclude companies from executing two commonly used repurchase strategies—multi-dealer, alternating day ASRs, which companies use to further reduce the cost of buying their stock using an ASR and limit credit exposure to any one bank counterparty, and ASRs executed concurrently with an agency open-market repurchase plan. The regulatory benefit of preventing companies from using these cost and risk-minimization tools is not obvious, and we expect commenters to point this out as the

SEC deliberates over these proposals.

- **Limitation on single-trade plans**. The Rule 10b5-1 defense would be available for only one "single trade" plan during any 12-month period. In view of the proposed cooling-off periods, it's hard to see what additional protection against illegal activity this disfavoring of single-trade plans is expected to achieve.

- **Mandatory reporting of *all* trading plans and insider-trading policies**. There is currently no requirement to publicly disclose the adoption, amendment or termination of a trading plan, and practice is mixed. In addition, companies are not currently required to publicly disclose the details of their insider-trading policies, and most do not. The proposals would change both—and would apply whether or not trading plans are entered into pursuant to Rule 10b5-1 (which is usually the case, except for buyback plans only intended to satisfy Rule 10b-18).

  - *Quarterly disclosure of trading plans*. A company would be required to disclose in its periodic reports any trading plans adopted or terminated by the company or any officer or director during the previous quarter, whether or not adopted under Rule 10b5-1. The disclosure would include:

    - the name and title of the officer or director, if applicable,
    - the date of adoption or termination,
    - the duration of the plan, and
    - the aggregate amount of securities to be sold or purchased under the plan.

  - *Annual disclosure of insider-trading policies*. A company would be required to state in its annual report whether it has adopted policies and procedures for directors, officers and employees that are reasonably designed to promote compliance with insider trading laws (or explain why not). While not explicit in the proposed rule text, the proposal emphasizes that this disclosure should include "meaningful and detailed information," such as the process by which the company analyzes whether officers and directors (and the company itself) are in possession of MNPI, the process for documenting the analysis and approving requests to buy or sell securities, and how the company enforces compliance. The proposal also notes that these policies might cover dispositions other than purchases and sales, such as gifts of stock (more on which below).

    The SEC's focus on insider-trading policies as they relate to stock buybacks echoes its position in an October 2020 enforcement action, where it found a company's accounting

controls inadequate to ensure compliance with its stated policy of executing buybacks in accordance with its insider-trading policy. This suggests companies may want to examine their practices around buybacks regardless of the outcome of these proposals.

- *Trade-by-trade disclosure*. If an insider trade was made under a Rule 10b5-1 trading plan, disclosure of the plan would be required in Form 4 or Form 5, as discussed below. Many companies already require their officers and directors to provide this disclosure.

— **Certifications**. Upon adopting a Rule 10b5-1 trading plan, an officer or director would be required to certify to the company in writing that they:

- are not aware of MNPI, and
- are adopting the plan in good faith and not as part of a plan to evade the prohibition against illegal insider trading.

The certification would need to be kept by the officer or director for 10 years (creating paperwork headaches for individuals), but would not be required to be filed with the SEC.

— **"Operational" good faith requirement**. Currently Rule 10b5-1 trading plans must be *adopted* in good faith. The new rules would add a requirement that they also be *operated* in good faith. The SEC briefly explains this aspect of the proposal as needed to prevent insiders from improperly amending or cancelling plans, or improperly influencing the timing of corporate disclosures, but there are no express limitations in the text of the rule. If adopted as proposed, we predict this requirement would make Rule 10b5-1 trading plans substantially less practical to use and maintain. Today, a Rule 10b5-1 trading plan can be cancelled even when the trader is aware of MNPI, and well-advised companies and insiders sometimes take advantage of this flexibility in order to halt trading that might be perfectly legal but that might be viewed skeptically in hindsight, or that might be inconsistent with other activities that unexpectedly arise, like stock offerings by large shareholders. Determining whether any such activity runs afoul of the "operational" good faith requirement—or indeed, *even determining whether to allow a plan to run its course*—is likely to become a fraught exercise.

Proposed changes to option grant disclosure

The SEC's proposals relating to the disclosure of option grants come on the heels of its November 2021 accounting guidance on how companies should recognize and disclose the cost of equity compensation awards while in possession of MNPI, including "spring-loaded" grants. In that guidance, the SEC stated that, when estimating the fair value of a grant made while holding *favorable* MNPI, the company should consider adjustments to the exercise price and the expected volatility of the share price for Black-Scholes valuation purposes.

It's clear that spring-loading grant practices are in the SEC's crosshairs, even though this activity may not technically constitute illegal insider trading (and indeed was once praised by an SEC commissioner for offering companies a cost-effective means for remunerating employees). Thus far, the SEC has trained its fire on stock options and similar "appreciation" awards. Neither the proposal nor the recent accounting guidance addresses "full value" awards such as restricted stock units.

The proposal seeks to uncover company practices that time option grants around the release of MNPI, by requiring disclosure relating to:

- **Spring-loaded option grants**—option awards granted immediately before the release of favorable MNPI likely to result in an increase in the company's stock price, resulting in the options being in-the-money shortly following the grant date, and
- **Bullet-dodging option grants**—delaying the grant of option awards until after the release of unfavorable MNPI likely to result in a decrease in the company's stock price, thereby preventing the options from being underwater shortly following the grant date.

The proposal would require companies to provide annual proxy statement disclosure of each award of stock options, stock appreciation rights or similar awards that the company granted during the prior year to its named executive officers within 14 calendar days before or after:

- the filing of a periodic report (Form 10-K or 10-Q),
- the adoption of a stock buyback plan, or
- reporting MNPI on Form 8-K (including earnings).

The disclosure would be in tabular format and tagged in Inline XBRL (perhaps to make it easier for the SEC and plaintiffs' lawyers to spot potentially suspicious activity), and would include for each named executive officer, on an-award-by-award basis:

- the number of shares underlying the award,

- the date of grant,
- the grant date fair value of the award,
- the exercise price,
- the market price of the underlying shares on the trading day before disclosure of the MNPI (for potential spring-loaded options), and
- the market price of the underlying shares on the trading day after disclosure of the MNPI (for potential bullet-dodging options).

The proposal would also require a company to provide narrative disclosure in the Compensation Discussion and Analysis (CD&A) portion of the proxy statement about its option granting policies and practices regarding the timing of option grants and the release of MNPI, including how the board determines when to grant options and whether and how MNPI is taken into account. Although foreign private issuers would not be subject to this new disclosure requirement, smaller reporting companies and emerging growth companies are not exempt.

For the vast majority of companies whose compensation programs are administered in good faith, the disclosure ramifications of the SEC's proposals are likely to accomplish nothing more than making meetings of the compensation committee more difficult to schedule.

Proposed changes to Form 4 and 5 reporting, including gifts

The SEC's proposals to require reporting of Rule 10b5-1 trading were expected. But in a surprise, the SEC also put forth new requirements around charitable gifts of stock—or "insider gifting," as Chair Gensler referred to the practice. Around 40 minutes into the meeting announcing the proposals, the chair flatly stated that "charitable gifts of securities are subject to insider trading laws," perhaps in dialogue with a *Wall Street Journal* piece on the practice last summer.

It has long been understood that a charitable gift does not itself trigger application of the insider trading laws, since no "sale" takes place and the charity can't be defrauded, and the SEC seems to have had little interest in the practice until now. But given the chair's remarks, companies may want to think about the terms under which executives should be permitted to make stock gifts close to the end of December, a popular time for giving and for claiming tax deductions.

- **Reporting gifts on Form 4**. Section 16 insiders (officers, directors and 10% shareholders) are generally required to report changes in beneficial ownership of equity securities within

two business days of the transaction, on Form 4. However, they may wait to report certain transactions, including bona fide gifts (both acquisitions and dispositions) until 45 days after the end of the company's fiscal year, through filing a Form 5.

The proposed rules would instead require Section 16 insiders to report the donation (but not receipt) of company equity securities on Form 4 within two business days. The proposed rules would cover all recipients, including family members, trusts and other estate planning vehicles and 501(c)(3) charitable organizations. The SEC indicated that it is proposing the reporting change in order to provide investors with information to evaluate gift transactions in light of potential "problematic" practices, including gifts while the donor is in possession of MNPI, or backdating gifts in order to maximize the donor's tax benefit.

In a footnote, the SEC stated: "For example, a donor of securities violates Exchange Act 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." Because the SEC did not cite judicial precedent or other authority for this proposition, it is not entirely clear what the SEC believes would constitute a donation in fraudulent breach of a duty of trust and confidence.

Despite the change in reporting requirements, a bona fide gift would remain exempt from short-swing profit disgorgement rules under Section 16 of the Securities Exchange Act of 1934.

— **Mandatory Rule 10b5-1 trading plan disclosure**. Currently, Section 16 insiders can voluntarily disclose whether a transaction reported on Form 4 or Form 5 was made pursuant to a Rule 10b5-1 trading plan. Insiders often disclose the existence of a Rule 10b5-1 trading plan this way in order to dampen any inference that the transaction (usually a sale) reflects the insider's private views of the company's near-term prospects.

Under the SEC's proposal, all Section 16 insiders would be required to report whether a transaction reported on Form 4 or Form 5 was made pursuant to a Rule 10b5-1 trading plan. The amendments would:

- add a mandatory checkbox indicating whether the transaction was made pursuant to a Rule 10b5-1 trading plan, and if so requiring disclosure of the date of plan adoption, and
- add an optional checkbox that would allow an insider to indicate whether the transaction was made under an instruction or arrangement that is not designed to satisfy Rule 10b5-1.

Proposed new stock buyback disclosure

Under current rules, a company is required to disclose information about stock buybacks in its quarterly and annual reports, including:

- the number of shares purchased,
- the average price per share,
- the number of shares purchased as part of publicly announced plans, and
- the maximum amount that may be purchased under announced plans.

The SEC proposes to increase both the frequency and disclosure around stock buybacks.

- **New daily reporting requirement**. Companies, including foreign private issuers, would be required to report information about stock buybacks on a new "Form SR" within one business day, including:
  - the number of shares purchased,
  - the average price per share,
  - the number of shares purchased on the open market,
  - the number of shares purchased under the Rule 10b-18 safe harbor, and
  - the number of shares purchased under a Rule 10b5-1 trading plan.

  It is not clear how the proposed reporting requirement would apply to repurchases pursuant to an ASR, whether upon initial settlement of the ASR, by the bank counterparty over the term of the ASR or at final settlement of the ASR.

  In a bit of good news, Form SR would be "furnished" and not "filed," and so a failure to meet the Form SR reporting deadline would not automatically result in loss of Form S-3 eligibility or "well-known seasoned issuer" status.

- **New periodic disclosure requirements**. In addition to daily reporting on Form SR, a company would be required to disclose in Forms 10-K, 10-Q and 20-F:
  - the objective or rationale for its repurchase plans, including the process through which the company determines the amount of repurchases,

- the number of shares purchased and the nature of any transaction made outside of publicly announced plans pursuant to a Rule 10b5-1 trading plan and in reliance on the Rule 10b-18 safe harbor,
- for publicly announced plans, the date each plan was announced, the dollar amount approved, the plan expiration date, each plan that has expired and each plan the company has terminated prior to expiration, and
- any policies and procedures relating to the purchase or sale of the company's stock by its officers and directors during pendency of a company buyback program.

  Companies would be required to disclose in their periodic reports (by checking a box) if any of their Section 16 insiders traded in company stock within 10 business days before or after the announcement of a share repurchase plan or program. This disclosure is designed to flag whether insiders may have opportunistically timed purchases or sales to take advantage of the price bump that may follow public announcement of a buyback plan.

Taken as a whole, daily reporting and more detailed disclosure surrounding stock buybacks (along with the new cooling-off period) raise a number of issues—particularly if daily reporting is required even for purchases that rely on the Rule 10b-18 safe harbor designed specifically to minimize the impact buybacks can have on trading prices. For example, a company's pause of a buyback program could telegraph—correctly or not—the possible existence of MNPI and thus fuel otherwise-avoidable volatility in the stock. Daily reporting could also be valuable to professional traders who could use the information to trade against the company, to the detriment of its stockholders generally.

Given that company buybacks do not raise Williams Act corporate-control concerns where real-time reporting is needed, it seems possible that the additional information provided by daily disclosures would harm rather than help investors, and that the additional information will mostly be of interest to hedge funds and the plaintiffs' bar. The new periodic disclosures could also, of course, attract SEC enforcement attention for actual or perceived discrepancies between a company's activities and the way it describes its rationale and decision-making process.

Then again, perhaps the overriding purpose of all the new buyback rules is simply to disadvantage stock repurchases over other forms of returning value to stockholders—like dividends, which have not drawn the same degree of political opprobrium as buybacks. Buybacks have advantages over dividends—they can offset dilution inherent in equity compensation plans and offer more flexibility to companies than dividends, which are sometimes viewed as permanent features once announced. We expect commenters to make these points to the SEC.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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MORRISON FOERSTER

U.S. SEC Proposes Amendments Regarding Rule 10b5-1 Plans and Related Disclosures

16 Dec 2021

Corporate Finance | Capital Markets, Corporate Governance, Public Companies Counseling + Compliance, Finance, and REITs

Client Alert

On December 15, 2021, the U.S. Securities and Exchange Commission (the SEC) proposed amendments to the affirmative defense in Rule 10b5-1(c) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and proposed a number of changes to disclosure requirements applicable to issuers and insiders. [1] The SEC described the proposed amendments as intended to address "critical gaps in the SEC's insider trading regime and to help shareholders understand when and how insiders are trading in securities for which they may at times have material nonpublic information."

If adopted after a 45-day comment period, these proposed amendments would:

- Update the requirements for the affirmative defense, including:
  - Imposing a cooling-off period before trading could commence under a plan;
  - Prohibiting overlapping trading plans; and
  - Limiting single-trade plans to one trading plan per 12-month period.
- Require directors and officers to furnish written certifications to the issuer that they are not aware of any material nonpublic information when they enter into trading plans.
- Expand the existing good faith requirement to require that Rule 10b5-1 plans *operate* in good faith.
- Require issuers to disclose in quarterly and annual filings:
  - Their policies and procedures related to insider trading; and
  - Their practices around the timing of option grants and the release of material nonpublic information.
- Require insiders to disclose the use of Rule 10b5-1 plans in Forms 4 and 5.
- Require that *bona fide* gifts of securities, which are currently permitted to be reported by insiders on Form 5, be reported more quickly on Form 4.

Background

Adopted over 20 years ago, Rule 10b5-1 provides an affirmative defense against allegations of insider trading by companies and their insiders engaging in

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transactions in the company's stock, even while in possession of material nonpublic information at the time of trading, through plans that are set up in advance. Over the years, academic studies have suggested that insiders with Rule 10b5-1 plans may achieve better returns than those not trading pursuant to Rule 10b5-1 plans. Those studies, as well as situations where insiders appeared to conduct questionable transactions under Rule 10b5-1 plans, have created negative perceptions about the use of Rule 10b5-1 plans by issuers and insiders.

In 2007, Linda Chatman Thomsen, then the Director of the SEC's Division of Enforcement, delivered a speech highlighting concerns about the use of Rule 10b5-1 plans. [2] At the time, she said that the SEC would probe issues associated with the use of Rule 10b5-1 trading plans by insiders, and those warnings by the SEC Staff continued for a few years after that speech. Citing academic studies, Thomsen noted that executives who trade within a Rule 10b5-1 plan outperformed their peers who trade outside such a plan. In response, she noted that "[w]e and others are looking at the disclosures surrounding 10b5-1 plans. We're looking at multiple and seemingly overlapping 10b5-1 plans and at asymmetrical disclosure around plans — that is, disclosure of entry into a 10b5-1 plan, without timely disclosure of related plan modifications or terminations."

In 2013, the Council of Institutional Investors (the "CII") submitted a rulemaking petition to the SEC, expressing concerns about Rule 10b5-1 plans. [3] The CII requested that the SEC consider issuing interpretive guidance or adopting amendments to Rule 10b5-1 that would require Rule 10b5-1 plans to be adopted with the additional protocols or guidelines that the CII believed would curb the potential for abuse of Rule 10b5-1 trading plans.

Following recent legislative efforts to compel the SEC to act on Rule 10b5-1 plans, in June 2021 SEC Chair Gary Gensler said that Rule 10b5-1 plans had led to "real cracks in our insider trading regime" and announced that he had asked the SEC Staff to provide recommendations on how the SEC might "freshen up" Rule 10b5-1. Gensler indicated that the Staff would look into possible reforms to Rule 10b5-1. Gensler's comments were followed by recommendations to amend Rule 10b5-1 from the SEC's Investor Advisory Committee. [4]

In the Proposing Release, the SEC states:

> We share the concern about the prevalence of trading practices by corporate insiders and issuers that suggest the misuse of material nonpublic information. We also understand that some issuers have engaged in a practice of granting stock options and other equity awards with option-like features to executive

officers and directors in coordination with the release of material nonpublic information. In addition, there is research indicating that some corporate insiders may be opportunistically timing gifts of securities while aware of material nonpublic information relating to such securities. These practices can undermine the public's confidence and expectations of honest and fair capital markets by creating the appearance that some insiders, by virtue of their positions, do not play by the same rules as everyone else.

Proposed Amendments to Rule 10b5-1

Rule 10b5-1(c)(1) establishes an affirmative defense to Rule 10b-5 liability for a trade if the trade was made pursuant to a binding contract, an instruction to another person to execute the trade for the instructing person's account, or a written plan. A person asserting a Rule 10b5-1(c)(1) defense must satisfy several conditions:

- The person must demonstrate that, before becoming aware of material nonpublic information, they had entered into a binding contract to purchase or sell the security, provided instructions to another person to execute the trade for the instructing person's account, or adopted a written plan for trading the securities;
- The person must demonstrate that the applicable contract, instructions, or plan: (i) specified the amount of securities to be purchased or sold, price, and date; (ii) provided a written formula or algorithm, or computer program, for determining amounts, prices, and dates; or (iii) did not permit the person to exercise any subsequent influence over how, when, or whether to effect purchases or sales; provided, in addition, that any other person who exercised such influence was not aware of the material nonpublic information when doing so; and
- The person must demonstrate that the purchase or sale was pursuant to the prior contract, instruction, or plan.

Rule 10b5-1(c)(1) states that a purchase or sale is not pursuant to a contract, instruction, or plan if, among other things, the person who entered into the arrangement altered or deviated from the contract, instruction, or plan, or entered into or altered a corresponding or hedging transaction or position with respect to the securities. The rule also provides that the affirmative defense of a trading arrangement is only available if the trading arrangement was entered into "in good faith and not as part of a plan or scheme to evade the prohibitions" of the rule.

Cooling-Off Period

Currently, Rule 10b5-1(c)(1) does not impose any waiting period between the date on which the trading arrangement is adopted and the date of the first transaction to be executed under the trading arrangement, although in practice many insiders include a waiting period in their Rule 10b5-1 plans. Rule 10b5-1 plan guidelines that issuers adopt as part of their insider trading prevention programs often require waiting periods, although the term of the waiting period that is prescribed varies.

The SEC proposes to amend Rule 10b5-1(c)(1) to add as a condition to the availability of the affirmative defense:

- A minimum 120-day cooling-off period after the date of adoption of any Rule 10b5-1(c)(1) trading arrangement (including adoption of a modified trading arrangement) by a director or officer (as defined in Exchange Act Rule 16a-1(f)) before any purchases or sales under the new or modified trading arrangement; and
- A minimum 30-day cooling-off period after the date of adoption of any Rule 10b5-1(c)(1) trading arrangement by an issuer before any purchases or sales under the new or modified trading arrangement.

Under the proposed amendments, for directors and officers subject to Exchange Act Section 16 reporting, and for issuers, the Rule 10b5-1(c)(1) affirmative defense would only be available for a trading arrangement that includes a cooling-off period that delays transactions under the trading arrangement for at least 120 or 30 days (whichever is applicable) after the date of adoption of any new or modified trading arrangement. The proposed amendments also include a note clarifying that a "modification" of an existing Rule 10b5-1(c)(1) trading arrangement, including cancelling one or more trades, would be deemed equivalent to terminating the plan in its entirety, and the cooling-off period would therefore apply after a "modification" before any new trades could commence.

The SEC notes in the Proposing Release that applying a cooling-off period to directors and officers is appropriate "because such individuals are more likely than others to be aware of material nonpublic information in the general course of events, and also more likely to be involved in making or overseeing key corporate decisions that have the potential to affect the issuer's stock price, including decisions about the timing of the disclosure of such information." The SEC also indicates that it is appropriate to apply a cooling-off period to issuers because it addresses concerns that issuers may conduct stock buybacks while they are aware of material nonpublic information.

Director and Officer Certifications

The SEC proposes to amend Rule 10b5-1(c)(1)(ii) to impose a certification requirement as a condition to the affirmative defense. Under the proposed amendment, if a director or officer of the issuer of the securities adopts a Rule 10b5-1 trading arrangement, as a condition to the availability of the affirmative defense, such director or officer would be required to promptly furnish to the issuer a written certification at the time of the adoption of a new/modified trading arrangement.

The certification would require a director or officer to certify at the time of the adoption of the trading arrangement:

- That they are not aware of material nonpublic information about the issuer or its securities; and
- That they are adopting the contract, instruction, or plan in good faith and not as part of a plan or scheme to evade the prohibitions of Exchange Act Section 10(b) and Exchange Act Rule 10b-5.

In the Proposing Release, the SEC indicates that the proposed certification requirement "is intended to reinforce directors' and officers' cognizance of their obligation not to trade or adopt a trading plan while aware of material nonpublic information, that it is their responsibility to determine whether they are aware of material nonpublic information when adopting Rule 10b5-1 plans, and that the affirmative defense under Rule 10b5-1 requires them to act in good faith and not to adopt such plans as part of a plan or scheme to evade the insider trading laws."

The proposed amendment includes an instruction that a director or officer seeking to rely on the affirmative defense should retain a copy of the certification for a period of ten years. The proposed amendment would not require a director, officer, or the issuer to file the certification with the SEC. The SEC indicates that the proposed certification would not be an independent basis of liability for directors or officers under Exchange Act Section 10(b) and Rule 10b-5. Rather, the SEC indicates in the Proposing Release that "the proposed certification would underscore the certifiers' awareness of their legal obligations under the federal securities law related to the trading in the issuer's securities."

Restricting Multiple Overlapping Rule 10b5-1 Trading Arrangements and Single-Trade Arrangements

In the Proposing Release, the SEC indicates that it is "concerned that a person could circumvent the proposed cooling-off period by setting up multiple overlapping Rule 10b5-1(c)(1) trading arrangements, and deciding later which trades to execute and

which to cancel after they become aware of material nonpublic information but before it is publicly released." As a result, the SEC proposes to amend Rule 10b5-1(c)(1) to eliminate the affirmative defense for any trades by a trader who has established multiple overlapping trading arrangements for open market purchases or sales of the same class of securities. Under the proposed amendment, the affirmative defense would not be available for trades under a trading arrangement when the trader maintains another trading arrangement, or subsequently enters into an additional overlapping trading arrangement, for open market purchases or sales of the same class of securities.

The SEC indicates that the proposed amendment would not apply to transactions directly with the issuer, such as acquiring shares through participation in employee stock ownership plans or dividend reinvestment plans.

The SEC also proposes to amend Rule 10b5-1(c)(1)(ii) to limit the availability of the affirmative defense for a trading arrangement designed to cover a single trade, so that the affirmative defense would only be available for one single-trade plan during any 12-month period. Under this proposed amendment, the affirmative defense would not be available for a single-trade plan if the trader had, within a 12-month period, purchased or sold securities pursuant to another single-trade plan. The SEC cites in support of this amendment recent research which indicates that single-trade plans are consistently loss avoiding and often precede stock price declines.

Requiring That Trading Arrangements Be Operated in Good Faith

Rule 10b5-1 affirmative defense is only available if a trading arrangement was entered into in good faith and not as part of a plan or scheme to evade the prohibitions of the rule. The SEC proposes to amend Rule 10b5-1(c)(1)(ii) to add the condition that a contract, instruction, or plan be "operated" in good faith. In the Proposing Release, the SEC indicates that to further require that the trading arrangement be *operated* in good faith "would help deter fraudulent and manipulative conduct and enhance investor protection throughout the duration of the trading arrangement." The SEC also indicates that the proposed amendment is intended to make clear that "the affirmative defense would not be available to a trader that cancels or modifies their plan in an effort to evade the prohibitions of the rule or uses their influence to affect the timing of a corporate disclosure to occur before or after a planned trade under a trading arrangement to make such trade more profitable or to avoid or reduce a loss."

Additional Disclosures Regarding Rule 10b5-1 Trading Arrangements

Other than disclosure currently required by Form 144 (which requires a seller to disclose the date of adoption of a Rule 10b5-1 plan or providing an instruction in accordance with the rule), there are presently no mandatory disclosure requirements concerning the use of Rule 10b5-1 trading arrangements or other trading arrangements by issuers or insiders, although some issuers and insiders elect to provide disclosure when entering into Rule 10b5-1 plans or conducting transactions under Rule 10b5-1 plans. Further, issuers are not required to disclose information about their insider trading policies or procedures.

The SEC is proposing a new Item 408 under Regulation S-K and corresponding amendments to Forms 10-Q and 10-K to require:

- Quarterly disclosure of the use of Rule 10b5-1 and other trading arrangements by an issuer, and its directors and officers for the trading of the issuer's securities; and
- Annual disclosure of an issuer's insider trading policies and procedures.

The SEC is also proposing new Item 16J to Form 20-F to require annual disclosure of a foreign private issuer's insider trading policies and procedures. In addition, the SEC is proposing amendments to Forms 4 and 5 to require insiders to identify whether a reported transaction was executed pursuant to a Rule 10b5-1(c) trading arrangements.

As proposed, Item 408(a) of Regulation S-K would require issuers to disclose:

- Whether, during the issuer's last fiscal quarter (the issuer's fourth fiscal quarter in the case of an annual report), the issuer has adopted or terminated any contract, instruction or written plan to purchase or sell securities of the issuer, whether or not intended to satisfy the affirmative defense conditions of Rule 10b5-1(c), and provide a description of the material terms of the contract, instruction or written plan, including:
  - The date of adoption or termination;
  - The duration of the contract, instruction or written plan; and
  - The aggregate amount of securities to be sold or purchased pursuant to the contract, instruction or written plan.
- Whether, during the issuer's last fiscal quarter, any director or officer has adopted or terminated any contract, instruction or written plan for the purchase or sale of

equity securities of the issuer, whether or not intended to satisfy the affirmative defense conditions of Rule 10b5-1(c), and provide a description of the material terms of the contract, instruction or written plan, including:

- The name and title of the director or officer;
- The date on which the director or officer adopted or terminated the contract instruction or written plan;
- The duration of the contract instruction or written plan; and
- The aggregate number of securities to be sold or purchased pursuant to the contract, instruction or written plan.

Proposed Item 408(b) of Regulation S-K would require issuers to disclose whether the issuer has adopted insider trading policies and procedures governing the purchase, sale, and other dispositions of the issuer's securities by directors, officers, and employees or the issuer itself that are reasonably designed to promote compliance with insider trading laws, rules, and regulations, and any listing standards applicable to the issuer. If the issuer has not adopted such insider trading policies and procedures, the issuer must explain why it has not done so, and if the issuer has adopted insider trading policies and procedures, it must disclose such policies and procedures. These disclosures would be required in an issuer's annual reports on Form 10-K and proxy and information statements on Schedules 14A and 14C. Foreign private issuers would also be required to provide analogous disclosure in their annual reports pursuant to a new Item 16J of Form 20-F.

Structured Data Requirements

The SEC is proposing to require that issuers tag the information specified by Item 408 in Inline XBRL in accordance with Rule 405 of Regulation S-T and the EDGAR Filer Manual. The proposed requirements would include block text tagging of narrative disclosures, as well as detail tagging of quantitative amounts disclosed within the narrative disclosures. In the Proposing Release, the SEC indicates that "[r]equiring Inline XBRL tagging of the disclosures provided pursuant to Item 408 would benefit investors by making the disclosures more readily available and easily accessible to investors, market participants, and others for aggregation, comparison, filtering, and other analysis, as compared to requiring a non-machine-readable data language such as ASCII or HTML."

Identification of Rule 10b5-1(c) and non-Rule 10b5-1(c)(1) Transactions on Forms 4 and 5

In December 2020, the SEC proposed, among other things, amendments to Form 4 and Form 5 to add a checkbox to these forms that would permit filers, at their

option, to indicate whether a transaction reported on the form was made pursuant to a contract, instruction, or written trading plan for the purchase or sale of equity securities of the issuer that satisfies the conditions of Rule 10b5-1(c). [5] In the December 2020 Proposing Release, the SEC noted that many Form 4 and Form 5 filers voluntarily provide additional disclosure in these forms stating that a reported transaction satisfied the affirmative defenses conditions of Rule 10b5-1(c). The SEC indicated that the checkbox option would provide filers with a more efficient method to disclose this information.

The SEC is now proposing to add a Rule 10b5-1(c) checkbox as a mandatory disclosure requirement on Forms 4 and 5. This checkbox would require a Form 4 or Form 5 filer to indicate whether a sale or purchase reported on that form was made pursuant to a Rule 10b5-1(c) trading arrangement. Filers would also be required to provide the date of adoption of the Rule 10b5-1 trading arrangement, and would have the option to provide additional relevant information about the reported transaction.

In the Proposing Release, the SEC indicates that requiring this disclosure on Forms 4 and 5 would provide greater transparency around the use of Rule 10b5-1 plans and would be consistent with the primary purpose of Exchange Act Section 16, and would provide information that could be used by issuers to comply with their Item 408 disclosure obligations.

In addition, the SEC is proposing to add a second, optional checkbox to both Form 4 and Form 5. This optional checkbox would allow a filer to indicate whether a transaction reported on the form was made pursuant to a pre-planned contract, instruction, or written plan that is not intended to satisfy the conditions of Rule 10b5-1(c).

Disclosure Regarding the Timing of Option Grants

Based on a concern that existing disclosure requirements do not provide investors with adequate information regarding an issuer's policies and practices on stock option awards timed to precede or follow the release of material nonpublic information, the SEC proposes to add a new paragraph (x) to Item 402 of Regulation S-K that would require tabular disclosure of (i) 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 material nonpublic information; (ii) the market price of the underlying securities on the trading day before disclosure of the material nonpublic information; and (iii) the market price of the underlying securities on the trading day after disclosure of the material nonpublic information. In the Proposing Release, the SEC states that the proposed amendments "are intended to provide shareholders a full and complete picture of any spring-loaded or bullet-dodging option grants during the fiscal year." The SEC also proposes to require that issuers tag the information required by Item 402(x) in Inline XBRL in accordance with Rule 405 of Regulation S-T and the EDGAR Filer Manual.

Reporting of Gifts on Form 4

Under current requirements, Section 16 reporting persons are required to report any *bona fide* gift of equity securities registered under Exchange Act Section 12 on Form 5. Exchange Act Rule 16a-3(f) provides that every person who, at any time during an issuer's fiscal year, was subject to Section 16 of the Exchange Act must file a Form 5 within 45 days after the issuer's fiscal year end to disclose certain beneficial ownership transactions and holdings not reported previously on Forms 3, 4, or 5. The acquisition and disposition of *bona fide* gifts are eligible for delayed reporting on Form 5 pursuant to Rule 16a-3(f)(1).

In the Proposing Release, the SEC indicates that it has "become aware that the length of the filing period for Form 5 may allow insiders to engage in problematic practices involving gifts of securities, such as insiders making stock gifts while in possession of material nonpublic information, or backdating a stock gift in order to maximize a donor's tax benefit."

The SEC proposes to amend Exchange Act Rule 16a-3 to require the reporting of dispositions of *bona fide* gifts of equity securities on Form 4 before the end of the second business day following the date of execution of the transaction, which would be significantly earlier than what is required under current requirements.

Next Steps

The SEC's proposed amendments are subject to a relatively short comment period of 45 days following publication of the Proposing Release in the Federal Register. We expect that given the priority placed by the SEC on addressing these issues, the SEC will act quickly to consider commenters' suggestions and adopt final rules.

[1] Release No. 33-11013, *Rule 10b5-1 and Insider Trading* (Dec. 15, 2021), available at https://www.sec.gov/rules/proposed/2021/33-11013.pdf (the "Proposing Release").

[2] *Opening Remarks Before the 15th Annual NASPP Conference*, Linda Chatman Thomsen (Oct. 10, 2007), available at https://www.sec.gov/news/speech/2007/spch101007lct.htm.

[3] *Rulemaking petition regarding Rule 10b5-1 Trading Plans*, File No. 4-658 (Jan. 2, 2013), available at https://www.sec.gov/rules/petitions/2013/petn4-658.pdf.

[4] *Recommendations of the Investor Advisory Committee Regarding Rule 10b5-1 Plans*, SEC Investor Advisory Committee (Sept. 9, 2021), available at https://www.sec.gov/spotlight/investor-advisory-committee-2012/20210916-10b5-1-recommendation.pdf.

[5] *Rule 144 Holding Period and Form 144 Filings*, Release No. 33-10991 (Dec. 22, 2020), available at https://www.sec.gov/rules/proposed/2020/33-10911.pdf (the "December 2020 Proposing Release").

Skadden

SEC Reporting & Compliance Alert

If you have any questions regarding the matters discussed in this memorandum, please contact the attorneys listed on the last page or call your regular Skadden contact.

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SEC Announces Proposals Relating to Rule 10b5-1, Share Repurchases and Other Matters

On December 15, 2021, the U.S. Securities and Exchange Commission (SEC) proposed several amendments and new disclosure requirements intended to address what it perceives as potentially abusive practices engaged in by public companies, directors and officers relating to Rule 10b5-1 trading plans, certain equity awards and gifts of securities. The SEC also proposed new disclosure rules for company share repurchases (which are often executed pursuant to Rule 10b5-1 trading plans), citing its view of the potential for opportunistic and harmful use of repurchases by company insiders. If adopted, these rules could significantly impact many of the common practices that public companies and their insiders have come to rely on to manage equity award programs and conduct share repurchases and personal trading.

Proposed Changes to Rule 10b5-1, Related Company Disclosures and Section 16 Reporting

Amendments to Rule 10b5-1

Rule 10b5-1 under the Securities Exchange Act of 1934 (Exchange Act) provides an affirmative defense to insider trading for individuals and companies that trade stocks under plans entered into in good faith and at a time when the individual or company does not possess material nonpublic information. The amendments to Rule 10b5-1 proposed by the SEC would add new conditions to the availability of the affirmative defense to insider trading liability provided by Rule 10b5-1 trading plans, including:

- **Cooling-Off Period:** The proposed amendments would require a minimum cooling-off period between when a plan is adopted or modified and when trading commences.[1] The proposed cooling-off period is 120 days for directors and officers[2] and 30 days for companies.
- **Director and Officer Certifications:** When adopting or modifying a Rule 10b5-1 plan, directors and officers would need to provide the company with a written certification stating that they are not aware of material nonpublic information about the company or its securities and that they are adopting or modifying the plan in good faith. The

[1] The proposed rules do not specify what constitutes "a modification" to an existing Rule 10b5-1 plan; however, the proposed amendments include a note clarifying that a modification, including canceling one or more trades under an existing plan, is the equivalent of terminating the existing plan and adopting a new one, which would trigger, in turn, a new cooling-off period.

[2] "Officers" refer to those defined in Exchange Act Rule 16a-1, for purposes of these proposed rules.

certifications are not filed with the SEC, but would need to be retained for 10 years.

- **Multiple, Overlapping Plans:** Having more than one Rule 10b5-1 plan for trading in the same class of securities would be prohibited. This prohibition would not apply where a person transacts directly with the company, such as participation in employee stock ownership plans or dividend reinvestment plans, which are not executed on the open market. Notwithstanding that exception, this proposed amendment would seem to significantly reduce the existing flexibility allowing insiders to preplan cashless option exercises and sell-to-cover programs, among others, which typically rely on a Rule 10b5-1 affirmative defense and therefore could be at risk for any insider who seeks to implement another type of Rule 10b5-1 trading plan for an overlapping period. In addition, as proposed, this prohibition, along with the cooling-off periods, would limit the ability of companies to conduct continuous repurchase programs under Rule 10b5-1 plans.
- **Single-Trade Arrangements:** Single-trade plans would be limited to one in any 12-month period.
- **Expanded Good Faith Requirement:** In addition to the current requirement that the Rule 10b5-1 plan be entered into in good faith, the proposed amendments would add the condition that the plan be operated in good faith. For example, the SEC notes that canceling or modifying a plan on the basis of material nonpublic information or influencing the timing of a company disclosure to make trades under a plan more profitable could run afoul of this ongoing good faith requirement.

Company Disclosures

The proposed rules would introduce the following new disclosure requirements for companies:

- **Insider Trading Policies and Procedures:** Companies, including foreign private issuers (FPIs), would be required to disclose, on an annual basis, the company's insider trading policies and procedures. If no such policies or procedures are in place, the company would need to explain why.[3]
- **Adoption, Modification and Termination of Rule 10b5-1 Plans and Other Trading Arrangements:** Companies would be required to provide quarterly disclosure of the adoption, modification and termination of the company's Rule 10b5-1 plans and other preplanned trading arrangements, as well as those of its directors and officers.[4] Companies would need to describe the material terms of each plan, including the name and title of the director or officer, if not a company plan; the date the plan was adopted, modified or terminated; the plan's duration; and the total amount of securities to be purchased or sold under the plan. Companies would not be required to disclose pricing terms.
- **Options and Similar Equity Grants:** Companies would be required to disclose policies and practices on the timing of awards of options, stock appreciation rights (SARs) and similar instruments with option-like features in relation to the disclosure of material nonpublic information.[5] Companies would need to discuss (i) how the timing of awards is decided, (ii) how material nonpublic information is considered, if it all, when determining the timing and terms of awards and (iii) whether disclosure of such information is timed to impact the value of awards.

  Companies also would be required to annually disclose in a new table any options, SARs or similar instruments granted to named executive officers within 14 calendar days before or after the filing of a periodic report on Form 10-Q or 10-K, a company share repurchase or the filing or furnishing of a current report on Form 8-K that contains material nonpublic information (including earnings releases). The table would provide the following:

  - each option award (including the number of securities underlying the award, the date of the grant, the grant date fair value and the option's exercise price); and
  - the market price of the underlying securities on the trading day before and after disclosure of the material nonpublic information.

Section 16 Reporting

The proposed amendments would also impose the following new disclosure requirements for Section 16 filers:

- **Rule 10b5-1(c) Checkbox:** A mandatory checkbox would be added to Forms 4 and 5, where filers would have to indicate whether a reported transaction was made under a Rule 10b5-1 plan. If so, filers would also need to provide the date the plan was adopted. A second, optional checkbox would allow filers to indicate whether a reported transaction was made under a plan not intended to qualify for the Rule 10b5-1 affirmative defense.
- **Gifts:** Bona fide gifts of equity securities would no longer be reported on Form 5, but instead would have to be reported on Form 4 and filed before the end of the second business day following the date of the gift.

[3] Disclosure would be required pursuant to new Regulation S-K Item 408(b). FPIs also would be required to provide analogous disclosure in their annual reports pursuant to a new proposed Item 16J of Form 20-F.

[4] Disclosure would be required pursuant to new Regulation S-K Item 408(a). As proposed, such disclosures would not be required for FPIs.

[5] A new paragraph (x) added to Regulation S-K Item 402 would require narrative and tabular disclosure for options and similar equity grants.

Proposed Share Repurchase Disclosure Rules

Currently, companies are required to make periodic disclosures of all open market and private repurchases of equity securities by the company or an affiliated purchaser.[6] The proposal would significantly alter the current disclosure framework for companies, including FPIs and certain registered closed-end funds, requiring next-business-day disclosure of repurchases on a new Form SR and enhancing the existing disclosure requirements.

Form SR Next-Business-Day Reporting

The proposed rules would require companies to report any repurchases of equity securities made by or on behalf of the company or any affiliated purchaser on a new Form SR before the end of the first business day after the repurchase is executed. Companies would furnish, not file, the Form SR with the SEC, and would use it to disclose:

- the repurchase date;
- the class of securities purchased;
- the total number of shares purchased, including all company repurchases, whether or not made pursuant to publicly announced plans or programs;
- the average price paid per share;
- the aggregate total number of shares purchased on the open market;
- the aggregate total number of shares purchased in reliance on the safe harbor in Exchange Act Rule 10b-18; and
- the aggregate total number of shares purchased pursuant to a Rule 10b5-1 plan.

Companies also would need to furnish an amended Form SR to correct material changes to transactions previously reported on Form SR, including if an executed repurchase order fails to clear and settle.

Enhanced Periodic Disclosure

The proposed rules would also require additional disclosure regarding the structure of a company's repurchase program and its share repurchases.[7] Specifically, a company would need to disclose:

- the objective or rationale for the company's program and the process or criteria it uses to determine the amount of repurchases;
- any policies and procedures relating to purchases and sales of the company's securities by its directors and officers during a repurchase program, including any restriction on trading;
- whether the company made its repurchases pursuant to a Rule 10b5-1 plan, and if so, the date that the plan was adopted or terminated; and
- whether the company made its repurchases in reliance on the nonexclusive safe harbor under Rule 10b-18.

A new checkbox would also be added, which would be checked if any of the company's directors or officers purchased or sold shares of the same class of a company's stock that is subject to the company's repurchase program within 10 business days before or after announcement of the program.

Next Steps

The public comment period for both proposals will remain open for 45 days following publication of the proposing releases in the *Federal Register*. Companies may want to review their compensation committee calendar to consider whether they may need to revise it if the proposed rules are adopted. Companies may also want to begin to consider necessary controls and processes that will enable them to make new disclosures should the proposed rules be adopted. Finally, companies may want to assess the various circumstances in which they and their insiders utilize the affirmative defense of existing Rule 10b5-1 plans and plan for timing and other changes that may be required if the proposals are adopted in their current form.

[6] Under Rule 10b-18, a person or entity is an "affiliated purchaser" if it (i) acts, directly or indirectly, in concert with the issuer with the intent to acquire the issuer's securities; or (ii) is "an affiliate who, directly or indirectly, controls the issuer's purchases of such securities, whose purchases are controlled by the issuer, or whose purchases are under common control with those of the issuer." See our March 16, 2020, client alert "Share Repurchases" for additional information on current disclosure requirements for share repurchases.

[7] Disclosure would be required pursuant to a revised Regulation S-K Item 703. Corresponding changes would be made to Form 20-F for FPIs and Form N-CSR for registered closed-end funds.

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SEC Announces Proposed Amendments to Rule 10b5-1

December 27, 2021

In June 2021, Chairman Gary Gensler of the Securities and Exchange Commission (SEC) expressed the view that it was time to "freshen up" Exchange Act Rule 10b5-1—the rule that provides an affirmative defense to claims of insider trading for corporate insiders and companies that buy and sell company stock pursuant to an appropriately adopted trading plan—and reported that he had asked staff to review the rule and consider potential reforms.[1] On December 15, 2021, the SEC proposed those rule amendments. The amendments are "intended to reduce . . . potentially abusive practices associated with Rule 10b5-1(c)(1) trading arrangements."[2] The proposed amendments would impose significant restrictions on the adoption and use (from an affirmative defense perspective) of Rule 10b5-1 trading plans by both individuals and companies, as well as increase corporate disclosure requirements related to the use of trading plans and to trading policies and procedures more generally. On the same day, the SEC also proposed new disclosure rules concerning share repurchases, or buybacks, which we discuss further here.

The SEC has long expressed concerns that insiders can abuse Rule 10b5-1 plans given, among other things, the lack of requirements for a "cooling off" period after adoption, insiders' ability to establish multiple plans, and the fact that trading plans can be canceled at any time,[3] including when an insider is in possession of material nonpublic information (MNPI). Just last year, SEC Chair Jay Clayton raised similar concerns about Rule 10b5-1 plans, suggesting that all Rule 10b5-1 plans should have mandatory cooling-off periods, both before the establishment of a plan, between modification and resumption of trading, and between canceling and entering into a new plan.[4]

Existing Rule

The SEC adopted Rule 10b5-1 in 2000 to define when a purchase or sale constitutes trading "on the basis of" MNPI in insider trading cases brought under Securities Exchange Act Section 10(b) and Rule 10b-5.[5] 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.[6] However, the rule also provides an affirmative defense to corporate insiders and companies that trade when they are in possession of

MNPI "where it is clear that the [MNPI] was not a factor in the decision to trade."[7] Under the rule, MNPI is not a factor in the decision to trade where a trade is made in good faith pursuant to a written plan to purchase or sell the securities that was entered into when the insider or company was not aware of MNPI.[8] The trading plan must, in turn, either (1) specify the price, amount and date of the trade, (2) include a written formula or algorithm for determining the price, amount and date of the trade, or (3) not allow the adopter of the plan to influence how, when or whether a trade occurs.[9]

Proposed Amendments

The proposed amendments include:

1. ***Cooling-Off Periods***. Rule 10b5-1 currently does not require any cooling-off period between the date a plan is adopted and the date trading begins. The SEC has proposed an amendment requiring that plans for corporate insiders include a cooling-off period of 120 days between adoption and the start of trading. For company trading plans, the SEC has proposed a 30-day cooling-off period. The proposed rules would also require a cooling-off period of 120 days for insiders and 30 days for companies after modification of an existing trading plan, although it is unclear whether this cooling-off period would apply to de minimis modifications.
2. ***Certifications***. There are currently no certification requirements for Rule 10b5-1 trading plans. The SEC has proposed that insiders must personally certify that they are not aware of MNPI regarding the company or its securities and that they are adopting the trading plan in good faith. These proposed certifications would need to be kept by insiders for 10 years but would not be required to be filed publicly.
3. ***Limitations on the Number of Trading Plans***. The SEC has proposed that the affirmative defense not apply to multiple overlapping Rule 10b5-1 trading arrangements and that the availability of the affirmative defense for single-trade plans be limited to one single-trade plan during any 12-month period. Single-trade plans permit only one trading event.
4. ***Extension of Good Faith Requirement***. As noted above, the affirmative defense is available only when the written plan was entered into in good faith. The SEC has proposed to expand the current good faith requirement in Rule 10b5-1 to require that the plan also be "operated" in good faith, although the SEC did not define "operate." The proposed amendment is intended to clarify that the affirmative defense would not be available for a trader who cancels or modifies a planned trade on the basis of MNPI or improperly influences the timing of a corporate disclosure in order to benefit a planned trade.[10]
5. ***Disclosures***. There are currently no disclosures required for Rule 10b5-1 trading plans. The SEC has proposed four new disclosure requirements:
    - A quarterly disclosure by companies about adoptions or terminations of trading plans and arrangements by the company or any corporate insiders, including the date of adoption or termination, the duration of the plan or arrangement, and the number of securities to be traded.
    - An annual disclosure by companies of any insider trading policies and procedures,

or an explanation if there are no such policies or procedures.

- A requirement that insiders identify transactions made pursuant to a Rule 10b5-1 trading plan on Forms 4 and 5. Although unrelated to Rule 10b5-1 plans, the proposed amendments would require insiders to disclose any gifts of securities on Form 4 within two business days after the gift is made.
- Companies would be required to annually disclose their policies and practices regarding the timing of equity grants and the release of MNPI, including how the board determines when to make equity grants and how the board or compensation committee takes MNPI into account when determining the timing and terms of an award.[11] Companies would also be required to annually disclose, in a tabular format, any equity grants to named executive officers within 14 calendar days before or after the filing of a periodic report on Forms 10-Q or 10-K, a company share repurchase or the filing or furnishing of a current report on Form 8-K that contains MNPI. The table would disclose the market price of the underlying securities on the trading day before and after disclosure of MNPI.

Commissioner Reactions

The chair, and all four other commissioners, voted in favor of the proposal, expressing particular support for cooling-off periods for individuals. However, that is where the agreement ended, with most commissioners expressing a desire to change aspects of the proposal.

Commissioner Allison Herren Lee supported the proposed amendments, though her comments suggest that she would be open to increasing the length of cooling-off periods, prohibiting single-trade plans, and increasing the specificity of the disclosure requirements for policies and procedures.[12]

Commissioner Caroline Crenshaw supported the proposed amendments while also observing that they may not go far enough.[13] She suggested the prohibition of single-trade plans and urged continued research into 10b5-1 plans to ensure that additional modifications to the rule are made if necessary.

Commissioner Elad Roisman agreed with a cooling-off period for individuals and voted for the proposal because of this provision.[14] However, he suggested that no other amendments to the rule are likely necessary, expressing concern that, for individuals, the burdens of compliance will outweigh the benefits. Commissioner Roisman also would have preferred to exclude companies from the mandatory cooling-off period because, in his view, companies need to be able to make decisions about whether share repurchases are appropriate based on current information, and it is fairly easy to determine companies' knowledge of MNPI.

Commissioner Hester Peirce agreed with the proposed cooling-off periods for both individuals and companies, the restrictions on multiple overlapping plans, and the limitations on single-trade plans.[15] However, she questioned the necessity of certain disclosures and certifications. Among her more pointed questions:

- Is the proposed certification requirement for insiders and the required retention of those certificates for 10 years necessary? The rule already requires that all 10b5-1 trading plans be adopted in good faith and without any awareness of MNPI. What do these requirements add besides more paperwork?
- Does the requirement that the 10b5-1 trading plan be "operated" in good faith weaken the safe harbor? Will the availability of this defense be based upon judgments made in hindsight about whether the corporate insider operated in good faith throughout the life of the plan?
- Are the proposed disclosures of insider trading policies and procedures necessary?
- Are the proposed disclosure requirements related to spring-loaded equity grants designed to discourage the use of such equity-based compensation?

Looking Ahead

The SEC's proposed amendments are subject to a comment period of 45 days rather than the typical comment period of 60 or 90 days. Given the shorter-than-normal comment period, it is possible that the SEC will push to adopt final rules in the first half of 2022; however, the SEC has a busy rulemaking agenda, so it is difficult to predict timing.

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1. Chairman Gary Gensler, *Prepared Remarks CFO Network Summit*, U.S. Securities and Exchange Commission (June 7, 2021), https://www.sec.gov/news/speech/gensler-cfo-network-2021-06-07.

2. "Rule 10b5-1 and Insider Trading," U.S. Securities and Exchange Commission Release No. 33-11013 (Dec. 15, 2021), www.sec.gov/rules/proposed/2021/33-11013.pdf.

3. Exchange Act Rules Compliance and Disclosure Interpretations, 120.17–120.19 (last updated March 31, 2020), https://www.sec.gov./divisions/corpfin/guidance/exchangeactrules-interps.htm.

4. Letter from Jay Clayton, SEC Chairman, to Representative Brad Sherman, House Financial Services Committee Chairman (Sept. 14, 2020), https://www.sec.gov/files/clayton-letter-to-chairman-sherman-20200914.pdf.

5. Securities and Exchange Commission Final Rule, 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

6. 17 C.F.R. § 240.10b5-1(b) (2000).

7. *Id.* at (c).

8. *Id.*

9. *Id.* at (b).

10. "Rule 10b5-1 and Insider Trading," U.S. Securities and Exchange Commission Release No. 33-11013, Section II.A.4 (Dec. 15, 2021), www.sec.gov/rules/proposed/2021/33-11013.pdf.

11. Companies are already required to disclose this information in their CD&A if it is material. *See* 17 C.F.R. § 229.402(b)(2)(iv) and (v).

12. Commissioner Allison Herren Lee, *Stock Trading Plans Should Prevent – Not Enable – Insider Trading: Statement on Proposed Amendments to Rule 10b5-1* (Dec. 15, 2021), https://www.sec.gov/news/statement/lee-statement-proposed-amendments-rule-10b5-1-121521.

13. Commissioner Caroline Crenshaw, *Statement on the Proposed Amendments to the Availability of the Affirmative Defense to Allegations of Insider Trading Provided by Exchange Act Rule 10b5-1* (Dec. 15, 2021), https://www.sec.gov/news/statement/crenshaw-statement-10b5-1-121521.

14. Commissioner Elad Roisman, *Statement on the Proposed Rules Regarding 10b5-1 Plans* (Dec. 15, 2021), https://www.sec.gov/news/statement/roisman-10b5-1-20211215.

15. Commissioner Hester Peirce, *Statement on Rule 10b5-1 and Insider Trading Proposed Release* (Dec. 15, 2021), https://www.sec.gov/news/statement/peirce-10b5-20211215.

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December 16, 2021

Buybacks: SEC Proposes to Ramp Up Disclosure Requirements for Repurchases

At yesterday's open meeting, the SEC also issued proposed rules addressing disclosure requirements for issuer repurchases. Here's the 101-page proposing release along with the two-page fact sheet. This excerpt from the SEC's press release summarizes the proposal:

> The proposed rules would require an issuer to provide a new Form SR before the end of the first business day following the day the issuer executes a share repurchase. Form SR would require disclosure identifying the class of securities purchased, the total amount purchased, the average price paid, as well as the aggregate total amount purchased on the open market in reliance on the safe harbor in Exchange Act Rule 10b-18 or pursuant to a plan that is intended to satisfy the affirmative defense conditions of Exchange Act Rule 10b5-1(c).
>
> The proposed amendments also would enhance existing periodic disclosure requirements regarding repurchases of an issuer's equity securities. Specifically, the proposed amendments would require an issuer to disclose: the objective or rationale for the share repurchases and the process or criteria used to determine the repurchase amounts; any policies and procedures relating to purchases and sales of the issuer's securities by its officers and directors during a repurchase program, including any restriction on such transactions; and whether the issuer is making its repurchases pursuant to a plan that it intends to satisfy the affirmative defense conditions of Exchange Act Rule 10b5-1(c) and/or the conditions of the Exchange Act Rule 10b-18 non-exclusive safe harbor.

SEC Chair Gary Gensler mentioned that buybacks were on the SEC's agenda when he discussed his desire to make changes to Rule 10b5-1, but the release notes that some of the disclosure proposals date back to the 2016 Reg S-K concept release. As Broc pointed out at the time, footnote 625 of that release noted that Australia required next day disclosure of buybacks. Well, G'day America! because it looks like that requirement may be heading your way.

Unlike the Rule 10b5-1 proposal, this one prompted a dissent from Commissioner Peirce (here's her statement) and Commissioner Roisman (here's his statement). Speaking of statements, the SEC acted on the PCAOB's budget and proposed rule amendments on securities-based swaps & money market funds yesterday as well, and every commissioner issued a statement on every action. If you subscribe for updates from the SEC's website, you already noticed this, because your inbox started exploding early yesterday afternoon.

– **John Jenkins**

Posted by John Jenkins
Permalink: https://www.thecorporatecounsel.net/blog/2021/12/buybacks-sec-proposes-to-ramp-up-disclosure-requirements-for-repurchases.html

MORRISON FOERSTER

U.S. SEC Proposes Expanded Share Repurchase Disclosure

23 Dec 2021

Corporate Finance | Capital Markets, Corporate Governance, Public Companies Counseling + Compliance, and Finance

Client Alert

On December 15, 2021, the U.S. Securities and Exchange Commission (the SEC) proposed amendments which would require that a public company provide more timely disclosure on a new Form SR regarding purchases of its equity securities for each day that it, or an affiliated purchaser, makes a repurchase of its equity securities. [1] The proposed amendments would also expand the existing periodic disclosure requirements relating to share repurchases.

If adopted after a 45-day comment period, these proposed amendments would:

- Require daily repurchase disclosure on a new Form SR, which would be furnished to the SEC one business day after execution of a company's share repurchase order;
- Amend Item 703 of Regulation S-K to require additional detail regarding the structure of a company's repurchase program and its share repurchases; and
- Require information disclosed pursuant to Item 703 of Regulation S-K and pursuant to Form SR to be reported using Inline XBRL.

Background

In recent years, politicians, institutional investors, the media, academics, and governance experts have voiced sharp criticism of share repurchase programs for a variety of reasons. This criticism has become more heightened during COVID-19 and the federal government's response to the crisis. [2] Critics of share repurchase programs believe that that these programs:

- Promote the use of capital for short-term purposes (*i. e.*, near-term appreciation in a company's stock price) to the detriment of long-term initiatives like research and development, capital expenditures, and other growth prospects;
- May be used by companies to manage their reported per-share earnings metrics in an effort to meet or exceed consensus analyst estimates;

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- May benefit corporate insiders who sell their stock when share prices have appreciated after the announcement and implementation of a stock repurchase program; and
- Allocate capital that could be used to benefit employees in the form of higher wages or enhanced benefits.

Public companies are currently subject to public reporting obligations relating to share repurchases in their periodic reports. In particular, Item 703 Regulation S-K and Forms 10-Q, 10-K, and 20-F (applicable to foreign private issuers) require quarterly periodic disclosure for all repurchases of the company's own equity securities. In the event of any stock repurchase, a company must disclose in tabular form:

- The total number of shares, by month, repurchased by or on behalf of the company or any affiliated purchaser during the past fiscal quarter;
- The weighted average price paid per share;
- The number of shares that were purchased as part of a publicly announced repurchase plan or program; and
- The maximum number (or approximate dollar value) of shares that may yet be purchased under the plans or programs.

For publicly announced repurchase plans or programs, the company is also currently required to disclose (by footnotes to the table):

- The announcement date of the plan or program;
- The share or dollar amount approved;
- The expiration date (if any) of the plans or programs;
- Each plan or program that has expired during the period covered by the table; and
- Each plan or program that the company has determined to terminate prior to expiration or under which the company does not intend to make further purchases.

Certain information regarding share repurchases is also required to be disclosed in a company's financial statements, including in the statements of cash flows indicating the amount of cash paid for repurchased securities and the statements of changes in shareholders' equity indicating any reduction in securities outstanding and additional paid-in capital for the securities repurchased. Companies often disclose share repurchase activity in the "Management's Discussion and Analysis of Financial Condition and Results of Operations" section required in periodic reports under Item 303 of Regulation S-K.

In the Proposing Release, the SEC notes the high dollar volume of recent share repurchase activity (nearly $700 billion in 2020) "has been accompanied by public interest in corporate payouts in the form of share repurchases." The Proposing Release surveys studies that present both positive and negative perspectives on the practice of company share repurchases.

The SEC indicates in the Proposing Release that the proposed amendments result from an ongoing, comprehensive evaluation of the SEC's disclosure requirements regarding share repurchases. In 2016, the Commission issued a Concept Release on the business and financial disclosures required by Regulation S-K, including disclosure required pursuant to Item 703. [3] That Concept Release requested comment on, among other things, whether Item 703 disclosure is important to investors, whether the SEC should require more detailed or more frequent disclosure regarding share repurchase transactions, and whether there should be a *de minimis* monetary threshold for disclosure of share repurchases. The SEC also notes that it received a rulemaking petition expressing general support for the current regulatory regime for issuer share repurchases, but recommending revisions to the SEC's executive compensation disclosure requirements to require disclosure of whether issuer share repurchases have affected the calculation of the repricing of any options, stock appreciation rights, or option-like instruments. [4]

The SEC states in the Proposing Release that, given the growth of issuer share repurchase plans in recent years and the concerns expressed by commentators, "investors could benefit from improving the quality, relevance, and timeliness of information related to issuer share repurchases." The SEC expresses concern that, because companies are repurchasing their own securities, asymmetries may exist between companies and affiliated purchasers and investors with regard to information about the company and its future prospects. To help address these information asymmetries, the SEC proposes a new disclosure form and additional disclosure requirements relating to company share repurchases.

Proposed Form SR

The SEC is proposing new Rule 13a-21 under the Securities Exchange Act of 1934, as amended (the Exchange Act), and new Form SR, which would require a company, including a foreign private issuer and certain registered closed-end funds, to report any purchase made by or on behalf of the company or any affiliated purchaser of shares or other units of any class of the company's equity securities that is registered by the company pursuant to Exchange Act Section 12. [5]

The company would have to furnish a new Form SR before the end of the first business day following the day on which the company executes a share repurchase. The Form SR would require the following disclosure in tabular format, by date, for each class or series of securities:

- Identification of the class of securities purchased;
- The total number of shares (or units) purchased, including all company repurchases whether or not made pursuant to publicly announced plans or programs;
- The average price paid per share (or unit);
- The aggregate total number of shares (or units) purchased on the open market;
- The aggregate total number of shares (or units) purchased in reliance on the safe harbor in Exchange Act Rule 10b-18; and
- The aggregate total number of shares (or units) purchased pursuant to a plan that is intended to satisfy the affirmative defense conditions of Exchange Act Rule 10b5-1(c).

Proposed Form SR would be required to be furnished electronically on the SEC's EDGAR system. The SEC is proposing to require that companies "furnish," rather than "file," Form SR; accordingly, companies would not be subject to liability under Section 18 of the Exchange Act for the disclosure in the Form SR, and the information would not be deemed incorporated by reference into filings under the Securities Act of 1933, as amended (the Securities Act), and thus would not be subject to liability under Securities Act Section 11, unless the issuer expressly elects to incorporate such information.

Proposed Revisions to Item 703 of Regulation S-K, Form 20-F, and Form N-CSR

The SEC is proposing to revise and expand the disclosure requirements in Item 703 (with corresponding changes to Form 20-F and Form N-CSR) to require the following additional disclosure about a company's share repurchases:

- The objective or rationale for its share repurchases and process or criteria used to determine the amount of repurchases;
- Any policies and procedures relating to purchases and sales of the company's securities by its officers and directors during a repurchase program, including any restriction on such transactions;

- Whether the company made its repurchases pursuant to a plan that is intended to satisfy the affirmative defense conditions of Rule 10b5-1(c), and if so, the date that the plan was adopted or terminated; and
- Whether repurchases were made in reliance on the Rule 10b-18 non-exclusive safe harbor.

The SEC is also proposing to require that companies disclose if any of their officers or directors subject to the reporting requirements under Exchange Act Section 16(a) purchased or sold shares or other units of the class of the company's equity securities that is the subject of a company's share repurchase plan or program within 10 business days before or after the announcement of an purchase plan or program by checking a box before the tabular disclosure of company purchases of equity securities.

In addition to these proposed amendments, the SEC is proposing clarifying amendments to Item 703, Form 20-F, and Form N-CSR, including:

- To relocate certain guidance in the Instruction 1 to paragraph (b)(1) to a new paragraph (c);
- To consistently refer to "issuer" instead of "company";
- To remove Instruction 1 and 2 in the Instructions to paragraphs (b)(3) and (b)(4) and effectuate those instructions by adding "aggregate" to total number of shares for all plans or programs publicly announced in paragraph (b)(3) in lieu of Instruction 1 and adding proposed paragraph (c) to replace Instruction 2; and
- To delete the Instruction to the affected requirements as they are clear that all purchases, including those that do not satisfy the conditions of Rule 10b-18, are included.

Inline XBRL Requirement

The SEC proposes to require that companies tag information disclosed pursuant to Item 703 of Regulation S-K, Item 16E of Form 20-F, Item 9 of Form N-CSR, and Form SR in Inline XBRL in accordance with Rule 405 of Regulation S-T and the EDGAR Filer Manual. The proposed requirements would include detail tagging of quantitative amounts disclosed within the tabular disclosures in each of the forms, as well as block text tagging and detail tagging of narrative and quantitative information disclosed in the footnotes to the tables required by Item 703 of Regulation S-K, Item 16E of Form 20-F, and Item 9 of Form N-CSR.

In the Proposing Release, the SEC indicates that tagging the data in Inline XBRL "would enable automated extraction and analysis of granular data on actual repurchases, allowing investors and other market participants to more efficiently perform large-scale analysis and comparison of repurchases across issuers and time periods, including comparing repurchases to information on executive's compensation."

Next Steps

The SEC's proposed amendments are subject to a relatively short comment period of 45 days following publication of the Proposing Release in the Federal Register. We expect that given the priority placed by the SEC on addressing these issues, the SEC will act quickly to consider commenters' suggestions and adopt final rules.

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[1] Release No. 34-93783, *Share Repurchase Disclosure Modernization* (Dec. 15, 2021).

[2] See our client alert *Coronavirus (COVID-19) and Stock Repurchases* (Apr. 2, 2020).

[3] Release No. 33-10064, *Business and Financial Disclosure Required by Regulation S-K* (Apr. 13, 2016).

[4] Rulemaking Petition 4-772, Request to Amend Regulation S-K (17 C.F.R. § 229.402(d), instruction (7)) (Apr. 21, 2021).

[5] For purposes of these proposed rules, forms and rule amendments, the requirements also include affiliated purchasers and any person acting on behalf of the company or an affiliated purchaser. The term "affiliated purchaser" as used in Item 703 of Regulation is defined in Exchange Act 10b-18(a)(3).

SEC Proposes Rules to Modernize Share Repurchase Disclosures

December 27, 2021

On December 15, the same day it proposed amendments to Rule 10b5-1 under the Securities Exchange Act of 1934 (Exchange Act) that may blunt the use of the affirmative defense for insider trading, the Securities and Exchange Commission (SEC) also proposed new disclosure rules concerning share repurchases, or buybacks, which have long attracted critical political and media attention. By a 3-2 vote, over the dissents of Commissioners Elad L. Roisman and Hester M. Peirce, the SEC proposed two significant amendments to its current rules regarding disclosures about an issuer's repurchases of its equity securities: (1) a new Form SR to be furnished the first business day following a buyback and (2) amendments to current Regulation S-K Item 703 that would increase companies' periodic disclosure obligations regarding share repurchases. The proposed rules apply to purchases made by or on behalf of issuers or any "affiliated purchaser" (as defined under Exchange Act Rule 10b-18(a)(3)) of securities registered under Section 12 of the Exchange Act, including purchases by foreign private issuers and certain registered closed-end funds. Commenting on the rule proposal, Chair Gary Gensler noted that the proposed rules would serve to "lessen the information asymmetries between issuers and investors through enhanced timeliness and granularity of disclosures that today's proposal would provide."

Comments are due within 45 days after publication in the *Federal Register*.

Background

Buybacks are one way in which companies return capital to shareholders. As acknowledged in the proposing release, companies may conduct buybacks for any number of reasons, including "in a manner aligned with shareholder value maximization, such as to offset share dilution after new stock is issued, to facilitate stock- and stock option-based employee compensation programs, to help signal the issuer's view that its stock is undervalued, or because the issuer's board has otherwise determined that a repurchase program is a prudent use of the issuer's excess cash." Critics of buybacks have raised concerns that management may conduct buybacks for insider benefits, such as for purposes of earnings management (i.e., through decreasing the denominator for earnings per share (EPS) calculations), to satisfy short-term earnings objectives or to effect

short-term upward price pressure to maximize share price– or EPS-tied executive compensation arrangements. However, both Commissioner Peirce and Commissioner Roisman noted in their dissenting statements that an SEC study issued last year questioned whether most buybacks were designed to enhance executive compensation and insider stock value.

Buybacks are already subject to significant disclosure—whether voluntary, as a result of stock exchange listing requirements,[1] or as a result of SEC rules. Companies currently tend to disclose (though not in response to a bright-line reporting requirement) approval of a share repurchase authorization by a company's board of directors. Further, under exchange listing standards, companies are required to promptly disclose material new developments, and board authorization of a buyback is generally treated as requiring disclosure under these standards.

Companies are also required to disclose specific information about share repurchases on Forms 10-K and 10-Q by virtue of Item 703 of Regulation S-K and applicable generally accepted accounting principles. This includes reporting repurchase activity in their periodic reports after the repurchases have occurred (i.e., total number of shares purchased, the average price paid per share, the number of shares purchased as part of a publicly announced program and the maximum number of shares that remain available for repurchase under a program) as well as information on any publicly announced programs (i.e., the date the program was authorized, the share or dollar amount approved by the board of directors, the expiration date (if any) of the program, each program that has expired during the last fiscal quarter, and each program that the company has determined to terminate prior to expiration or under which the company does not intend to make further purchases). The Regulation S-K Item 703 disclosure dates back to 2003, at which time the disclosure requirement was intended to inform investors as to whether and to what extent an issuer "had followed through on its original [buyback] plan." This delayed disclosure via Regulation S-K Item 703 is the purported source of the information asymmetry giving rise to the rule proposal.

New Form SR

Most notably, the proposed rules would require companies to furnish a new Form SR before the end of the first business day following the day when a company "executes" a buyback, including through open market purchases, tender offers, private negotiated transactions, and accelerated share repurchases. Without much elaboration, the proposing release states that "execution" has a "commonly understood meaning." Citing a prior 1998 interpretation, the proposing release notes (at footnote 23) that "[t]he date of execution (i.e., the trade date) marks an earlier point of a securities transaction at which the parties have agreed to its terms and are contractually obligated to settle the transaction."

Information to be disclosed on the new Form SR includes:

- Class of securities purchased;
- Total number of shares (or units) purchased, including all company repurchases whether or not made pursuant to publicly announced plans or programs;
- Average price paid per share (or unit);

- Aggregate total number of shares (or units) purchased on the open market;
- Aggregate total number of shares (or units) purchased in reliance on the safe harbor in Rule 10b-18;[2] and
- Aggregate total number of shares (or units) purchased pursuant to a plan that is intended to satisfy the affirmative defense conditions of Rule 10b5-1(c).

The proposed Form SR disclosure must be presented in a tabular format, presented by date for each class or series of securities. The proposed Form SR would be furnished, rather than filed, meaning that companies would not be subject to liability under Section 18 of the Exchange Act for the disclosure in the form, and the information would not be deemed incorporated by reference into filings under the Securities Act of 1933 (Securities Act) and thus would not be subject to liability under Section 11 of the Securities Act, unless the company expressly incorporated such information.

The proposing release requests comment on a number of potential alternatives, including reporting less frequently on Form SR, requiring reporting on Form 8-K as opposed to a new Form SR, requiring disclosure of a proposed share repurchase program at least 30 days in advance and continuing to require periodic reporting of share repurchase activity, adding a new exhibit requirement to report share repurchase activity, applying a de minimis reporting exception, and excluding certain smaller issuers from the reporting requirement.

Amended Regulation S-K Item 703 Disclosures

In addition to the new Form SR, the proposed rules would amend Regulation S-K Item 703, thereby expanding companies' periodic disclosure obligations regarding share repurchases in Forms 10-Q and 10-K (and Form 20-F for foreign private issuers). Specifically, a company's disclosure obligations would be expanded to include:

- The objective or rationale for the company's share repurchases and process or criteria used to determine the amount of repurchases;
- Any policies and procedures relating to purchases and sales of the company's securities by its officers and directors during a repurchase program, including any restriction on such transactions;
- Whether the company made repurchases pursuant to a plan that is intended to satisfy the affirmative defense conditions of Rule 10b5-1(c), and if so, the date that the plan was adopted or terminated; and
- Whether purchases were made in reliance on the Rule 10b-18 nonexclusive safe harbor.

Consistent with the concerns described above regarding potential managerial self-interest, the proposed rules also would require companies to check a box above the Regulation S-K Item 703 share repurchase table indicating whether any of the company's Section 16 officers or directors purchased or sold shares or other units of the class of the company's equity securities that is the subject of a company share repurchase plan or program within 10 business days before or after the announcement of such plan or program.

Both the disclosures on new Form SR and under amended Regulation S-K Item 703 would be required to be reported using Inline XBRL.

The SEC is of the view that, taken together, the additional daily detail proposed with respect to the new Form SR and the additional disclosure in periodic reports, along with other information available about the company (e.g., existing executive compensation, Section 16 and financial statement disclosures), "would help investors to assess whether the issuer or its insiders are potentially engaged in self-interested or otherwise inefficient repurchases and thereby help mitigate some of the potential harms associated with issuer repurchases." The proposing release also solicits comments on how investors would benefit from the proposed rules as compared with existing disclosures. Commissioner Roisman specifically raised concerns about the efficacy of the rule as proposed, especially compared with burdens inherently associated with such granular and frequent disclosure obligations. As part of the economic analysis, the SEC notes that to the extent buyback decisions predict future price changes, more timely information about these decisions may better guide investors' buy or sell decisions. However, the SEC concedes that such "benefits would be more modest to the extent that many issuers already make public announcements of repurchase plans, which alleviate some information asymmetries, and there is evidence that investors on aggregate draw accurate inferences about the likely program completion rate."

Potential Implications for Companies

Companies would be required to implement a number of changes to comply with the proposed requirements if adopted as proposed. For example, reporting systems and controls would need to be implemented to track and timely report information required on the new Form SR, which might require amendments to existing repurchase plans and modifications to existing reporting systems. Similarly, additional processes and controls would be required to prepare the augmented disclosures proposed under Regulation S-K Item 703.

In general, the proposed rule's daily reporting obligation would dramatically change the regulatory landscape for buybacks, increasing costs for companies and potentially causing market reactions that are unwarranted and that make use of buybacks much less attractive as a means of returning capital to shareholders. Companies looking to mitigate the additional reporting burden and potential market reactions to these disclosures might consider adopting other changes, including changes to the company's use of share buybacks. As the proposing release discusses, the proposed rules could have any number of economic impacts on companies, depending on their share repurchase programs. As an example, the requirement to provide daily disclosure on a new Form SR could result in higher repurchase costs for some companies by boosting the price of their shares following disclosure on the new Form SR, which could be particularly impactful for companies that conduct open market repurchases over multiple days on a highly predictable periodic schedule (such as under a Rule 10b5-1 or similar trading plan) or that conduct recurring trades outside of a trading plan). Similarly, companies that conduct large repurchases over a compressed time period would likely experience greater price impact from large trades. By contrast, companies that conduct one-time repurchases outside the open market (such as in a privately

negotiated transaction, an accelerated share repurchase or a tender offer) may be less affected by boosts in the stock price, as the trade would typically be executed at once before any such boost in share price would affect the cost of the trade. And, notably, if a company that typically repurchases daily stops its repurchase activity, the market could react in any number of ways based on pure speculation—for example, the price may jump because the markets assume the company has material positive information, leading it to stop repurchasing, or the price may drop because of concerns that there is negative news that has not been disclosed.

Other company reactions to the new disclosure requirements could affect the liquidity of the company's shares. If companies sought to limit disclosure by limiting repurchase activity, liquidity in their shares could be reduced if the market had depended in part on company repurchases for liquidity. The proposed requirement to disclose the timing of transactions by Section 16 officers and directors in relation to buybacks likely would lead companies to consider further restrictions on transactions by officers and directors around the time companies announce repurchases. Since company repurchases and insider transactions are only permissible when the purchaser or seller does not have material nonpublic information, this could further reduce any opportunity for insiders to achieve liquidity in their securities.

We expect this proposal to garner significant comments from both the issuer and investor communities. The proposed move from quarterly to daily reporting—and the signaling that would be caused by this type of reporting—is a substantial shift that could materially impact company buyback activity. Companies should continue to monitor for rulemaking developments to assess whether new capital allocation strategies are necessitated by the SEC's actions in this space.

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1. *See* Nasdaq Listing Rule 5250 and NYSE Listed Company Manual, Section 202.05.

2. Rule 10b-18 provides a company and its affiliated purchasers with a nonexclusive "safe harbor" from liability for manipulation under Section 9(a)(2) and Rule 10b-5 of the Exchange Act when repurchases of the company's common stock satisfy certain conditions regarding the manner, time, volume and price of stock repurchases.

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