"The SEC's Rule 10b5-1 Amendments: What Issuers & Insiders Need to Know"

Tuesday, January 24, 2023

Course Materials

"The SEC's Rule 10b5-1 Amendments: What Issuers & Insiders Need to Know"

Tuesday, January 24, 2023

2 to 3 p.m. Eastern [archive and transcript to follow]

The SEC has adopted significant changes to the rules governing insider trading plans and corporate repurchases. For insiders, these include cooling-off periods, limits on the use of multiple overlapping and single trade plans, and certification requirements. For issuers, the rules will impose new disclosure obligations relating to insider trading policies, the use of Rule 10b5-1 plans and certain other matters. This webcast will highlight significant aspects of the rule changes, 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
- **Dave Lynn**, Partner, Morrison Foerster LLP and Senior Editor, TheCorporateCounsel.net and CompensationStandards.com
- **Ron Mueller**, Partner, Gibson Dunn & Crutcher LLP

Topics include:

- Overview of the New Requirements
- Cooling-Off Periods for Individual Trades
- Limitations on Plans & Certification Requirements
- New Issuer Disclosures
- Employee Benefit Issues
- New Practices for Gifts
- What Companies & Insiders Should Do Now

“The SEC’s Rule 10b5-1 Amendments: What Issuers & Insiders Need to Know”

Course Outline/Notes

1. Overview of the New Requirements

2. Cooling-Off Periods for Individual Trades

3. Limitations on Plans & Certification Requirements

4. New Issuer Disclosures

5. Employee Benefit Issues

6. New Practices for Gifts

7. What Companies & Insiders Should Do Now

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Davis Polk

SEC adopts major changes for insider transactions

December 19, 2022 | Client Update | 14-minute read

In a significant and welcome change from the SEC's proposal, the agency will not mandate cooling-off periods for 10b5-1 plans used for corporate stock buybacks. For plan use by directors, officers and other insiders, the rules add cooling-off periods and mandate new disclosures. The rules also include new disclosure requirements for option grants and stock gifts.

On December 14, 2022, the Securities and Exchange Commission adopted new rules focused on Rule 10b5-1 trading arrangements and other securities transactions involving corporate insiders, including directors and officers. In many respects the new rules track the agency's proposals from a year ago, although the SEC responded to certain concerns raised by commenters, yielding what we consider to be an improved set of changes to its rulebook over the original version. In particular, the SEC did not adopt changes that would have unnecessarily interfered with corporate stock repurchase programs, such as a proposed 30-day cooling-off period for issuer use of the Rule 10b5-1 safe harbor.

Chair Gensler deserves credit for shepherding the proposals through a constructive rulemaking process and achieving unanimous support from his fellow commissioners on a complex subject that easily could have splintered along partisan lines. Heading into the new year, we are optimistic that the SEC may take a similarly pragmatic approach to some of the other consequential items pending on its rulemaking agenda, including additional rules governing stock buybacks and climate risk disclosures.

Compliance dates

The final rules are effective 60 days following publication in the Federal Register (likely early March 2023). Except where noted below, the rules apply to all SEC registrants, including foreign private issuers.

- **New rules on 10b5-1 plans.** The amendments to Rule 10b5-1 do not affect plans adopted prior to the effective date. A plan that is modified after the effective date would be treated as if it were adopted after the effective date and therefore would be subject to the amended rule. Accordingly, companies and shareholders can continue to adopt plans under the existing rules until the effective date.
- **Disclosure and tagging requirements.** Companies (other than smaller reporting companies) will be required to comply with new disclosure and XBRL tagging requirements in their reports on Forms 10-Q, 10-K and 20-F as well as proxy or information statements in the first filing that covers the first full fiscal period that begins on or after April 1, 2023, or the second quarter 10-Q for calendar-year companies. Smaller reporting companies on the calendar year will be required to comply by the 2023 10-K.
- **Forms 4 and 5.** Section 16 insiders will be required to comply with the new form requirements for beneficial ownership reports filed on or after April 1, 2023.

What to do now. Companies should consider revising their Rule 10b5-1 guidelines and insider trading policies to

account for the new mandated cooling-off periods, restrictions and certification requirements discussed below.

Rule 10b5-1 trading plans

Rule 10b5-1 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 adopting the following major changes to make sure it doesn't happen.

Mandatory cooling-off periods for insiders (but not for companies)

Rule 10b5-1 as currently in effect does not impose any waiting period between the time a plan is adopted or amended and the date of the first trade under the plan. The amended rule changes that as follows:

- **At least 90 days for directors and officers.** The amendments include a mandatory cooling-off period following adoption or modification of a plan, the length of which is somewhat more flexible than the 120 days originally proposed. Under the final rule, the cooling-off period begins on the date of plan adoption or modification and ends the *later* of (1) 90 days thereafter and (2) two business days following filing of a Form 10-Q or 10-K (or 6-K or 20-F) covering the financial reporting period in which the plan was adopted or modified, but in no event later than 120 days. The SEC concluded that an earnings release alone is not sufficient to satisfy the second prong, and so for 10b5-1 plans entered after third quarter earnings, the cooling-off period may be closer to 120 days.
- **30 days for traders other than directors and officers.** In a departure from the proposal, the final rule also adds a cooling-off period of 30 days for traders other than directors and officers.
- **No cooling-off period for companies.** The SEC did not adopt a proposed 30-day cooling-off period for plans adopted by companies. This is a welcome change from the proposal given that a cooling-off period for companies would have substantially interfered with ordinary corporate buyback programs and would have been especially problematic for accelerated share repurchases (ASRs), as we noted in our comment letter to the SEC.

In another helpful change from the original proposal, only certain types of plan modifications will trigger a new cooling-off period. Modifications that do not change the pricing, amount of securities or timing of trades will not trigger a new cooling-off period. The final rule would also not treat as a modification instances where a broker executing trades on behalf of the insider under Rule 10b5-1 is substituted by a different broker so long as the purchase or sales instructions remain the same.

Prohibition on overlapping plans and limitation on single-trade plans (but not for companies)

The final rule restricts anyone other than companies themselves from using multiple overlapping plans, although the SEC improved its original proposal in several ways, including the following:

- **Series of contracts treated as a single plan.** A series of separate contracts with different brokers may be treated as a single plan so long as the contracts taken together meet the conditions under the rule (but a modification of any contract would be treated as a modification of each other contract under the plan).
- **Overlapping plans that do not authorize trading during same period allowed under certain circumstances.** The final rule permits multiple concurrent Rule 10b5-1 plans if trading under a later commencing plan is not authorized until all trades under earlier-commencing plans are completed. However, where the first trade under a later-commencing plan is scheduled during what would have been the cooling-off period for that plan assuming the termination date of the earlier-commencing plan were deemed to be the date of adoption of the later-commencing plan, then Rule 10b5-1 would not be available for the later-commencing plan. The SEC reasons that this is to avoid an insider doing an end run around the cooling-off requirement since otherwise the insider could cancel the earlier plan before its scheduled termination and begin trading under the later plan before the end of the cooling-off period that is required for a new plan that is adopted after a plan termination.
- **"Sell-to-cover" tax withholding plans allowed.** In another welcome change from the rule proposal, the final rule authorizes a separate plan for purposes of "sell-to-cover" transactions under which the insider instructs their broker to sell securities to satisfy tax withholding obligations in connection with the vesting of incentive compensation. Notably, this exception does not apply to sell-to-cover in connection with option exercises, which the SEC views as subject to the insider's control.

Rule 10b5-1 would be available for only one "single trade" plan entered into by an insider during any 12-month period. In support of the limitation, the SEC cited a study that found that trades under such a plan "avoid losses that appear statistically unlikely to be avoided by uninformed traders" even where the trade occurs more than 120 days after plan adoption. The single-trade limitation also allows sell-to-cover transactions, mirroring the accommodation described above in the context of overlapping plans.

The SEC did not adopt limitations as proposed on multiple plans and single-trade plans for companies themselves.

Officer and director representations

Consistent with the proposed rule, the final rule provides that 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 that they are adopting the plan in good faith and not as part of a plan to evade the prohibition against illegal insider trading. Unlike the proposed rule, however, the final rule requires these certifications to be included as representations under the Rule 10b5-1 plan rather than a separate document provided to the issuer, and does away with a problematic recordkeeping requirement that was included in the proposed rule.

Good faith requirement

Currently Rule 10b5-1 trading plans must be adopted in good faith. The proposed rule would have added a requirement that they also be "operated" in good faith. The final rule requires instead that the person (including an issuer) who has adopted a Rule 10b5-1 plan must act in good faith with respect to the plan, and applies the requirement from the time of adoption through the duration of the plan. But because the distinction between operation of a plan in good faith and acting in good faith with respect to a plan is not clear, we think that this nevertheless raises questions around an insider's ability to terminate a plan, as well as the insider's later participation in authorizing corporate disclosure decisions.

Mandatory disclosure of trading plans and insider-trading policies

There is currently no requirement to publicly disclose the adoption, amendment or termination of a trading plan, and

disclosure 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 final rule adds disclosure requirements for both and applies whether or not trading plans are entered into pursuant to Rule 10b5-1.

- **Quarterly disclosure of trading plans (but not pricing terms).** Consistent with the proposed rule, under the final rule a company would be required to disclose in its periodic reports (Forms 10-K and 10-Q, but not 20-F) any trading plans adopted or terminated by any officer or director during the previous quarter, whether or not adopted under Rule 10b5-1, along with a description of the material terms of the plans. The required disclosures include:
  - the name and title of officer or director,
  - 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.

Unlike the rule proposal, the final rule does not require disclosure of pricing terms.

The final rule also requires a company to disclose whether a trading arrangement is a Rule 10b5-1 trading arrangement or not, defines what qualifies as a non-Rule 10b5-1 trading arrangement and requires disclosure of the adoption or termination of such arrangements. The SEC definition of a non-Rule 10b5-1 trading arrangement is broad, and could potentially pick up any sale of securities by such officer or director.

In line with other aspects of the final rule, the SEC did not adopt its proposal to require disclosure of the use of trading arrangements by the company, and the disclosure obligations do not extend to traders other than officers or directors. However, the final rule does not exempt officers and directors of smaller reporting companies from the disclosure requirements.

- **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). These disclosures will be required in annual reports on Form 10-K, proxy and information statements on Schedules 14A and 14C and in Form 20-F. But rather than requiring disclosure of the issuer's policies and procedures within the body of the relevant report or statement, it requires the issuer to file a copy of their insider trading policies and procedures as an exhibit to the relevant form.

Although the quarterly disclosure of trading plans discussed above does not apply to foreign private issuers, the annual disclosure of insider-trading policies does. The SEC also highlighted in the adopting release that these disclosures will be subject to the certifications required by the Sarbanes-Oxley Act of 2002, requiring principal executive and financial officers to attest to the accuracy of the statements in Form 10-K or Form 20-F, as applicable (although the SEC does not reference Form 10-Q, the same point can be made for quarterly reports).

Gift reporting rules and other Form 4 and 5 changes

Reporting stock gifts on Form 4

Under existing rules, 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, by filing a Form 5.

The final rule, which was adopted as proposed, instead requires Section 16 insiders to report the donation (but not receipt) of company equity securities on Form 4 within two business days. The requirement covers all recipients, including family members, trusts and other estate planning vehicles and Section 501(c)(3) charitable organizations. The SEC reiterated its view that the reporting change is to allow investors to evaluate gift transactions in light of potential "problematic" practices, including stock gifts while the donor is in possession of MNPI, or backdating stock gifts to maximize the donor's tax benefit. Insiders may wish to plan their year-end gift-giving for 2023 early to manage the associated compliance and administrative burdens.

Although we had raised this concern in our comment letter, the SEC did not address its claim in the proposing release that a donor of securities violates insider trading laws if the donor, "in fraudulent breach of a duty of trust and confidence," gifts securities when the donor was aware of MNPI and knew or was reckless in not knowing that the donee would sell the securities prior to the public disclosure of the MNPI. This language appears to represent an extension of existing insider trading law that calls into question the commonplace activity of year-end gifting while in a company blackout period, and the SEC does not cite judicial precedent or other authority for this proposition. While the SEC suggests that the affirmative defense is available when a donor gifts under a Rule 10b5-1 plan, it still leaves unclear what it believes to be a violation, or a gift "in fraudulent breach of a duty of trust and confidence." Absent future clarification on the point, we are left wondering if the SEC's view is that a gift outside a Rule 10b5-1 plan but in compliance with a company's insider trading policy by a donor who may be aware of MNPI could potentially violate insider trading laws.

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 views of the company's near-term prospects.

The final rule adds a mandatory checkbox to Forms 4 and 5 indicating whether the transaction was *intended to satisfy the affirmative defense conditions* under, rather than *made* (as formulated in the proposal), pursuant to a Rule 10b5-1 trading plan to address a concern around reporting persons having to make the determination about whether the transaction was in fact made pursuant to the plan. The SEC did not adopt the 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 as it was persuaded by commenters that such an optional checkbox would not add to the information already disclosed in the relevant form.

Option grant disclosure

As proposed, the final rule targets company practices that time option grants around the release of MNPI, with a focus on so-called "spring-loaded" and "bullet-dodging" option grants. The final rule requires a company to provide narrative disclosure in 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.

The final rule requires 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 made in the four business days before the filing of a periodic report (Form 10-K or 10-Q) or reporting of MNPI on Form 8-K (including earnings, but excluding a Form 8-K that is filed to disclose a material option grant under Item 5.02(e)) and

ending one business day after a triggering event (narrowing the 14 calendar-day window before or after such filing or reporting in the proposed rule, or what was effectively a period of 28 calendar days for each issuance of MNPI).

Disclosure will still be required in tabular format (though somewhat more simplified than in the proposed rule), tagged in Inline XBRL, and must include for each named executive officer, on an-award-by-award basis:

- the date of grant,
- the number of shares underlying the award,
- the exercise price,
- the grant date fair value of the award, and
- the percentage change in the market price of the underlying shares between the closing market price on the trading day before and the trading day after disclosure of the MNPI (combining the final two columns in the proposed rule into a single column).

Unlike the rule proposal, the final rule removes adoption of a stock buyback plan as a disclosure trigger.

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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GIBSON DUNN

December 16, 2022

SEC APPROVES NEW INSIDER TRADING RULES

To Our Clients and Friends:

On December 14, 2022, the Securities and Exchange Commission ("SEC" or "Commission"), in a rare unanimous vote, adopted final rules on the affirmative defense to insider trading liability and new disclosures related to insider trading. The final rules: (i) add new conditions to the affirmative defense to insider trading pursuant to a contract, instruction, or plan intended to satisfy the conditions of Exchange Act Rule 10b5-1(c) (a "Rule 10b5-1 plan"), (ii) introduce new periodic disclosure requirements related to insider trading, including with respect to company insider trading policies and procedures and the adoption and termination of Rule 10b5-1 plans by directors and officers, and director and officer equity compensation awards made close in time to the company's disclosure of material nonpublic information ("MNPI"), and (iii) require identification of transactions made pursuant to a Rule 10b5-1 plan on Forms 4 and 5, and require that *bona fide* gifts be reported on Form 4 within two business days rather than after year-end on Form 5. The final rules are thematically aligned with the rule proposal issued by the Commission in December of last year[i] – also in a unanimous vote – but with meaningful changes and the addition of several carve outs, particularly for companies.

The adopting release is available here and a Fact Sheet is available here. The final rules will become effective 60 days after publication in the Federal Register (the "Effective Date"), at which point any Rule 10b5-1 plan thereafter adopted or modified should comply with the new requirements. Companies will be required to comply with the new periodic disclosure requirements in the first filing that covers the first full fiscal period that begins on or after April 1, 2023 (i.e., the second-quarter Form 10-Q for a company with a December 31 fiscal year-end). Smaller reporting companies have until the first filing covering a period that begins on or after October 1, 2023 to comply (i.e., the fiscal 2023 Form 10-K for a company with a December 31 fiscal year-end). Section 16 insiders will be required to comply with the amendments to Form 4 beginning with reports filed on or after April 1, 2023. Set forth below is a summary of the final rules and some considerations for companies and insiders.

Summary of Final Rules

New Conditions for Rule 10b5-1 Plans. The rules introduce new conditions on the availability of the affirmative defense to Rule 10b-5 liability pursuant to a Rule 10b5-1 plan. Any plans adopted after the Effective Date must comply with the new conditions or the person adopting the plan will not be able to rely on the affirmative defense. Note that these changes do not affect the affirmative defense available under an existing Rule 10b5-1 plan that was entered into prior to the Effective Date, unless it is modified in a manner that is treated as an adoption of a new plan (described below) after the Effective Date.[ii] The new conditions for Rule 10b5-1 plans consist of the following:

1. *Cooling-Off Period*. In a significant change from the rule proposal, the final rules do not require any cooling-off period for companies. Rule 10b5-1 plans adopted by directors and officers[iii] must provide that trading under the plan cannot begin until the later of: (a) 90 days after the adoption of the Rule 10b5-1 plan; or (b) two business days following the disclosure of the company's financial results in a Form 10-Q or 10-K for the fiscal quarter in which the plan was adopted, or, for foreign private issuers, in a Form 20-F or 6-K that discloses the company's financial results. The required cooling-off period for directors and officers is capped at a maximum of 120 days after the Rule 10b5-1 plan's adoption. Persons other than directors and officers are subject to a 30 day cooling-off period following a Rule 10b5-1 plan's adoption.Notably, certain changes to Rule 10b5-1 plans are treated as the adoption of a new plan. The final rules codify that any change to the amount, price, or timing of the purchase or sale of the securities (including a change to a written formula or algorithm, or computer program affecting these terms, the "Essential Terms") underlying a Rule 10b5-1 plan constitutes a termination of such plan and the adoption of a new plan, triggering the same cooling-off period described above. Other changes that do not alter the Essential Terms, such as an adjustment for stock splits or a change in account information, will not trigger a new cooling-off period.[iv]The cooling-off period requirements of the final rules appear less burdensome on directors and officers as compared to the proposed rules, but they are more complex and introduce uncertainty as to when the first purchase or sale under the plan can occur. The proposed rules contemplated an inflexible 120 day cooling-off period for the Rule 10b5-1 plans of directors and officers.[v] Under the final rules, the cooling-off period for directors and officers will vary between 90 and 120 days, depending on when/whether a Form 10-K or Form 10-Q is filed during this period.

2. *Director and Officer Certifications*. When adopting a Rule 10b5-1 plan, directors and officers must include a representation in the Rule 10b5-1 plan certifying, at the time of the adoption of a new or modified plan, that: (a) they are not aware of MNPI about the company or its securities; and (b) they are adopting the plan in good faith and not as part of a plan or scheme to evade the prohibitions of Rule 10b-5. Because the plan is typically a form document prepared by the broker-dealer, counsel for directors and officers should review the plan to ensure that this new representation is included in any new or modified Rule 10b5-1 plan entered into after the Effective Date.

3. *Prohibition on Overlapping Plans*. A person (other than the company) may not have another outstanding (and may not subsequently enter into any additional) Rule 10b5-1 plan for purchases or sales of any class of securities of the company on the open market during the same period. Unlike the proposed rules, the final rules permit several exceptions. A person may have two separate Rule 10b5-1 plans so long as (a) the later-commencing plan does not begin trading during the cooling-off period that would have applied if the later-commencing plan was adopted on the date the earlier-commencing plan terminates, and (b) the plans meet all other conditions applicable to Rule 10b5-1 plans.In addition, the final rules provide an exception to allow for separate Rule 10b5-1 plans for "sell-to-cover" transactions in which an insider instructs their agent to sell securities in order to satisfy tax withholding obligations at the time an equity award vests. An insider may maintain additional eligible Rule 10b5-1 plans so long as the additional plans only authorize qualified sell-to-cover transactions, where the plan authorizes an agent to

sell only such securities as are necessary to satisfy tax withholding obligations in connection with the vesting of a compensatory award, such as restricted stock or restricted stock units, and the insider does not otherwise exercise control over the timing of such sales. It is important to note that this exception does not extend to sales incident to the exercise of option awards, as the SEC posits that option exercises create a risk of opportunistic trading.[vi]The final rules clarify that a series of separate contracts with different broker-dealers or other agents acting on behalf of the person (other than the company) may be treated as a single Rule 10b5-1 plan, provided that the contracts with each broker-dealer or other agent, when taken together as a whole, meet all of the applicable conditions of, and remain collectively subject to, Rule 10b5-1(c)(1). In such a scenario, the modification of any of the individual contracts will be considered a modification of the other contracts constituting the Rule 10b5-1 plan. Substituting a broker-dealer or other agent with another broker-dealer or other agent would not be considered a modification so long as the Essential Terms are not changed.Although the final rules introduced these exceptions, it also expanded the scope of the prohibition relative to the proposed rules. Under the proposed rules, the prohibition would have only applied to the *same class* of the company's securities,[vii] whereas the final rules prohibit overlapping plans for *any class* of the company's securities. In the adopting release, the SEC recognized that, given the likelihood that the values of different classes of a given company's securities are highly correlated, allowing the use of multiple plans for trading in the securities of a company would allow for opportunistic behavior.[viii]

4. *Restrictions on* S*ingle-Trade Plans*. A person (other than the company) may not have more than one single-trade Rule 10b5-1 plan during any 12-month period. The defense will only be available for a single-trade plan if such a person had not, during the preceding 12-month period, adopted another single-trade plan that qualified for the affirmative defense, meaning that an ineligible plan does not preclude the availability of the affirmative defense for another plan.[ix] As with the prohibition on overlapping plans, the final rules introduce an exception to this restriction for "sell-to-cover" plans.A single-trade plan is one "designed to effect" (e.g., has the practical effect of requiring) the purchase or sale of securities as a single transaction. A plan is not designed to effect a single transaction where the plan (a) leaves the person's agent discretion over whether to execute the plan as a single transaction, or (b) provides that the agent's future acts will depend on events or data not known at the time the plan is entered into (such as a plan to execute specified sales or purchases at each of several given future stock prices) and it is reasonably foreseeable at the time the plan is entered into that it may result in multiple transactions.[x]

5. *Act in Good Faith*. The person entering into a Rule 10b5-1 plan must act in good faith with respect to the Rule 10b5-1 plan. This requirement extends the existing requirement – i.e., to enter into the Rule 10b5-1 plan in good faith – from the time of adoption through the duration of the Rule 10b5-1 plan. This departs from the proposed rules, which would have required the Rule 10b5-1 plan to be "operated" in good faith,[xi] a term that many commentators found ambiguous.

New Periodic Reporting Requirements. The final rules introduce the following new periodic reporting requirements:

1. *Quarterly Disclosure of Trading Arrangements*. In Forms 10-Q and 10-K, companies will be required to disclose whether, during the company's last fiscal quarter, any director or officer adopted or terminated (i) any contract, instruction or written plan for the purchase or sale of securities of the company that is intended to satisfy the affirmative defense conditions of Rule 10b5-1(c) (e.g., a Rule 10b5-1 plan), or (ii) a "non-Rule 10b5-1 trading arrangement." A non-Rule 10b5-1 trading arrangement is a written trading arrangement that complies with the old Rule 10b5-1 affirmative defense (circa 2000 to 2022) but does not comply with the new affirmative defense conditions of Rule 10b5-1(c). The SEC requires disclosure for these arrangements to make clear that one cannot avoid disclosure of trading plans that are structured to comply with alternative liability defenses other than the Rule 10b5-1 affirmative defense.[xii]Companies will also be required to indicate whether the arrangement is a Rule 10b5-1 plan or non-Rule 10b5-1 trading arrangement and provide a description of the material terms, other than with respect to price, such as:

    - The name and title of the director or officer;
    - The date of adoption or termination of the trading arrangement;
    - The duration of the trading arrangement; and
    - The aggregate number of securities to be sold or purchased under the trading arrangement.

Unlike the proposed rules, the final rules do not require disclosure of whether the company adopted a Rule 10b5-1 plan or non-Rule 10b5-1 trading arrangement.[xiii] The proposed rules also did not specifically carve out price from the material terms of Rule 10b5-1 plans or non-Rule 10b5-1 trading arrangements that are required to be disclosed.[xiv]

2. *Annual Disclosure of Insider Trading Policies and Procedures*. Companies will be required to disclose in Forms 10-K or 20-F and proxy and information statements whether they have adopted insider trading policies and procedures governing the purchase, sale, and other dispositions of their securities by directors, officers, and employees, or the company itself that are reasonably designed to promote compliance with insider trading laws, rules, and regulations, and any listing standards applicable to the company. If a company has not adopted such insider trading policies and procedures, it must explain why it has not done so. The disclosure may be incorporated by reference from the proxy statement into the Form 10-K if the proxy statement is filed within 120 days of the fiscal year-end. A copy of the insider trading policies and procedures must be filed as an exhibit to Form 10-K and 20-F.

3. *Disclosure of Certain Equity Awards Close in Time to Release of MNPI*. In their discussions of executive compensation (i.e., in Part III of Form 10-K or a proxy statement), companies will be required to discuss their policies and practices on the timing of awards of stock options, stock appreciation rights ("SARs") or similar option-like instruments in relation to the disclosure of MNPI by the company, including how the board determines when to grant such awards (e.g., whether the awards are granted according to a predetermined schedule). Companies must also discuss whether, and if so, how, the board or compensation committee takes MNPI into account

when determining the timing and terms of an award, and whether the company has timed the disclosure of MNPI for the purpose of affecting the value of executive compensation.In addition, if, during the last completed fiscal year, stock options, SARs or similar option-like instruments were awarded to a named executive officer ("NEO") within a period beginning four business days before the filing of a periodic report, or the filing or furnishing of a current report on Form 8-K that discloses MNPI (including earnings information), and ending one business day after the filing of such report, the company must provide information concerning each such award for the NEO on an aggregated basis in the following tabular format:

Name	Grant date	Number of securities underlying the award	Exercise price of the award ($/Sh)	Grant date fair value of the award	Percentage change in the closing market price of the securities underlying the award between the trading day ending immediately prior to the disclosure of material nonpublic information and the trading day beginning immediately following the disclosure of material nonpublic information
PEO					
PFO					
A					
B					
C					

The window in which awards will trigger disclosure is significantly reduced from the proposed rules, which would have covered 14 days both before and after the relevant filing.[xv] The final rules also clarify that a Form 8-K reporting a material new option award grant under Item 5.02(e) would not trigger the disclosure requirement, and removes company share repurchases as events that would trigger disclosure.

This new disclosure requirement will not affect foreign private issuers.

4. *Inline XBRL Tagging*. The periodic disclosure requirements outlined above will be required to be tagged in Inline XBRL.

New Beneficial Ownership Reporting Requirements. The amendments add a checkbox to Forms 4 and 5 for insiders to indicate whether the reported transaction is pursuant to a plan that is "intended to satisfy the affirmative defense conditions" of Rule 10b5-1(c). In addition, insiders will be required to report dispositions of *bona fide* gifts of equity securities on Form 4 (rather than Form 5), thereby shortening the deadline to report gifts from 45 days after fiscal year-end to two business days following the date of execution. The final rules do not adopt the proposed second checkbox for indicating a transaction was made pursuant to a plan that did not qualify for Rule 10b5-1(c).[xvi]

Importantly, the adopting release builds on the note from the proposing release that opined that gifts are subject to Section 10(b) liability, and the SEC reiterated that the affirmative defense of Rule 10b5-1(c)(1) is available for any *bona fide* gift of securities.[xvii]

Observations and Considerations for Companies and Insiders

Insider trading policies should be updated as of the Effective Date, but existing Rule 10b5-1 plans do not need to be amended unless any Essential Terms are modified after the Effective Date. Companies should update their current insider trading policies and procedures (including any separate Rule 10b5-1 plan guidelines), to amend any provisions that conflict with the final rules. For example, many companies already require their employees' Rule 10b5-1 plans to have cooling-off periods. If the cooling-off periods permissible under a company's policy are shorter than those under the final rules, the policy should be updated to reflect the required cooling-off periods, subject to the grandfathering accommodations for Rule 10b5-1 plans existing prior to the Effective Date. Companies may consider removing policy provisions requiring insiders to trade only through Rule 10b5-1 plans in light of the final rules, which will require disclosure of the number of shares insiders intend to sell under such plans. This disclosure could cause an unfavorable market price reaction and become a topic of discussion in shareholder engagement or a point of contention for shareholder activists, causing a chilling effect on the use of Rule 10b5-1 plans by insiders. Some companies may determine to instead encourage insiders to trade during ordinary open window periods after pre-clearance from the company's general counsel, at least with respect to transactions other than sell-to-cover trades. In addition, with the new requirement to file insider trading policies and procedures as an exhibit to the Form 10-K, companies may want to revisit their policies to make sure they are sufficiently robust.

Companies should consider waiting at least two business days following the release of MNPI to make equity compensation awards. The new disclosure requirement regarding equity awards made close in time to the release of MNPI is meant to combat the practice of "spring-loading," in which equity grants are made immediately before positive MNPI is released so that executives benefit from the increased share price when the MNPI is made public. Companies should be aware of the optics of making awards close to the public release of MNPI, and can mitigate potential concerns by waiting at least two business days following the release of MNPI before making equity awards. This will entail coordinating board and board committee meeting and/or schedules with the reporting calendar for periodic reports and any planned Form 8-K filings.

Corporate insiders should be cautious when gifting while aware of MNPI. The SEC has historically been silent with respect to the liability of gifts under Section 10(b). With the Commission's reaffirmations in the adopting release, corporate insiders who are aware of MNPI should proceed with caution when gifting company securities, as they could be liable if they gift securities when they are aware of MNPI and while knowing (or being reckless in not knowing) that the donee would sell the securities prior to the disclosure of the MNPI. Many, if not most, non-profit organizations have a policy of immediately selling any securities received as a gift, as they are not in the business of holding securities. Companies also may want to revisit how their insider trading policies apply to gifts.

There are no new share repurchase requirements for companies, but this is likely to change. The single new condition on Rule 10b5-1 plans applicable to companies is the requirement to act in good faith, as companies are carved out from the other new conditions, allowing them to implement overlapping and multiple single-trade plans, all without cooling-off periods. Although the proposed rules contemplated periodic disclosure requirements with respect to a company's adoption and termination of Rule 10b5-1 plans, these provisions were removed in the final rules. However, the Commission noted in the adopting release that it is continuing to consider whether regulatory action is needed to mitigate the risk of misuse of Rule 10b5-1 plans by companies, such as in the share repurchase context.[xviii] The SEC is still working on final rules for share repurchase disclosure, which were originally proposed alongside the insider trading rules last year. The SEC recently reopened the comment period for the share repurchase rule proposal so that commenters could consider a SEC Staff memorandum analyzing the impact of the new excise tax on share repurchases on the potential economic effects of the SEC's rule proposal.[xix]

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[i] For our discussion of the proposed rules, *see* Gibson Dunn Client Alert, SEC Proposes Rules on Insider Trading, Rule 10b5-1 and Share Repurchases (Dec. 23, 2021).

[ii] Insider Trading Arrangements and Related Disclosures, Exchange Act Release No. 96492 (Dec. 14, 2022) (the "Adopting Release") at III, available at https://www.sec.gov/rules/final/2022/33-11138.pdf.

[iii] The term "officer" refers to how that term is defined in Exchange Act Rule 16a-1(f).

[iv] Adopting Release at II.A.1.c.

[v] *See* Rule 10b5-1 and Insider Trading, Exchange Act Release No. 93782 (Dec. 15, 2021) (the "Proposing Release"), at II.A.1, available at https://www.sec.gov/rules/proposed/2022/33-11013.pdf

[vi] Adopting Release at II.A.3.c.

[vii] Proposing Release at II.A.3.

[viii] *See* Adopting Release at II.A.3.c.

[ix] *Id*.

[x] *Id.*

[xi] Proposing Release at II.A.4.

[xii] *See* Adopting Release at II.B.1.c.

[xiii] *See Id.*

[xiv] *See* Proposing Release at II.B.1.

[xv] Proposing Release at II.C.

[xvi] *See* Proposing Release at II.B.4.

[xvii] *See* Proposing Release at II.B.2.; Adopting Release at II.E.3.

[xviii] Adopting Release at II.A.1.c.

[xix] Reopening of Comment Period for Share Repurchase Disclosure Modernization, Exchange Act Release No. 96458 (Dec. 7, 2022), available at https://www.sec.gov/rules/proposed/2022/34-96458.pdf.

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U.S. SEC Adopts Amendments to Rule 10b5-1 and Requires Related Disclosures

22 Dec 2022

Corporate Finance | Capital Markets Corporate Governance Public Companies Counseling + Compliance Securities Enforcement and **Securities Litigation**

Client Alert

On December 14, 2022, the U.S. Securities and Exchange Commission (the SEC) adopted amendments to the affirmative defense in Rule 10b5-1(c) under the Securities Exchange Act of 1934, as amended (the Exchange Act), and adopted a number of changes to disclosure requirements applicable to issuers and insiders.**[1]**

The amendments adopted by the SEC:

- Update the requirements for the affirmative defense by:
  - Imposing a cooling-off period before trading can commence under a Rule 10b5-1 plan as follows:
    - For directors or officers, the later of (1) 90 days after the adoption of the Rule 10b5-1 plan or (2) two business days following the disclosure of the issuer's financial results in a Form 10-Q or Form 10-K for the fiscal quarter in which the plan was adopted or, for foreign private issuers, in a Form 20-F or Form 6-K that discloses the issuer's financial results (but in any event, the required cooling-off period is subject to a maximum of 120 days after adoption of the plan); and
    - For persons other than directors, officers or the issuer, 30 days following the adoption or modification of a Rule 10b5-1 plan;
  - Prohibiting overlapping Rule 10b5-1 plans; and
  - Limiting single-trade Rule 10b5-1 plans to one trading plan per 12-month period.
- Require directors and officers to include a representation in their Rule 10b5-1 plan certifying that: (i) they are not aware of any material nonpublic information; and (ii) they are adopting the trading plan in good faith and not as part of a plan or scheme to evade the prohibitions in Rule 10b-5.
- Impose a condition that all persons entering into a Rule 10b5-1 plan must act in good faith with respect to that plan.
- Require issuers to provide:
  - Quarterly disclosure regarding the use of Rule 10b5-1 plans and certain other written trading arrangements by an issuer's directors and officers for the trading of securities;
  - Annual disclosure of an issuer's insider trading policies and procedures.
  - Certain tabular and narrative disclosures regarding awards of options close in time to the release of material nonpublic information and related policies and procedures; and
  - Tagging of the required disclosures using Inline XBRL;
- Require that Form 4 and Form 5 filers indicate by checkbox that a reported transaction was intended to satisfy the affirmative defense conditions of Rule 10b5-1(c); and
- 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.

The final amendments will be effective 60 days following publication of the Adopting Release in the Federal Register. Issuers must comply with the new disclosure requirements in Form 10-Q and Form 10-K filings that cover the first full fiscal period that begins on or after April 1, 2023.

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Section 16 reporting persons will be required to comply with the amendments to Form 4 and Form 5 for reports filed on or after April 1, 2023. The amendments to Rule 10b5-1(c)(1) will not affect the affirmative defense available under an existing Rule 10b5-1 plan that was entered into prior to the revised rule's effective date, except to the extent that such a plan is modified.

Background

Rule 10b5-1 provides an affirmative defense against allegations of insider trading for engaging in transactions in securities, even while in possession of material nonpublic information at the time of trading, through plans that are set up in advance. In the over two decades since Rule 10b5-1 was adopted, 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 especially profitable transactions pursuant to Rule 10b5-1 plans, created negative perceptions about the use of Rule 10b5-1 plans by issuers and insiders, which resulted in calls for change to the rule.

On January 13, 2022, the SEC proposed amendments to the affirmative defense in Rule 10b5-1(c), and proposed a number of changes to disclosure requirements applicable to issuers and insiders.**[2]** 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."

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. Both historically and as amended, 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.

Cooling-Off Period

Prior to the SEC's amendments, Rule 10b5-1(c)(1) did not impose any cooling-off 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. In practice, many insiders include a cooling-off period in their Rule 10b5-1 plans, although the term of the prescribed cooling-off period varies.

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

- A director or "officer" (as defined in Exchange Act Rule 16a-1(f)) who adopts (including a modification of) a Rule 10b5-1 plan would not be able to rely on the Rule 10b5-1 affirmative defense unless the plan provides that trading under the plan will not begin until the later of (1) 90 days after the adoption of the Rule 10b5-1 plan or (2) two business days following the disclosure of the issuer's financial results in a Form 10-Q or Form 10-K for the fiscal quarter in which the plan was adopted or, for foreign private issuers, in a Form 20-F or Form 6-K

that discloses the issuer's financial results (but in any event, the required cooling-off period is subject to a maximum of 120 days after adoption of the plan); and

- For persons other than directors, officers or the issuer, the cooling off period is 30 days following the adoption or modification of a Rule 10b5-1 plan.

In a change from the proposed amendments, the final amendments do not require a cooling-off period for an issuer when it enters into or modifies a Rule 10b5-1 plan to trade in its own securities. In the Adopting Release, the SEC indicates that it will continue to consider whether a cooling-off period should be required for issuers. Further, the SEC did not adopt a proposed 120-day cooling off period that would have applied to officers and directors.

Rule 10b5-1 was amended to note that any modification or change to the amount, price, or timing of the purchase or sale of the securities underlying a contract, instruction, or written plan is a termination of such contract, instruction, or written plan, and the adoption of a new contract, instruction, or written plan. A plan modification, such as the substitution or removal of a broker that is executing trades pursuant to a Rule 10b5-1 arrangement on behalf of the person, that changes the price or date on which purchases or sales are to be executed, is deemed to be a termination of such plan and the adoption of a new plan.

Director and Officer Certifications

The SEC amended Rule 10b5-1(c) to specify that, if a director or officer of the issuer of the securities adopts a Rule 10b5-1 plan, as a condition to the availability of the affirmative defense, such director or officer is required to include a representation in the plan certifying that, at the time of the adoption of a new or modified Rule 10b5-1 plan: (i) they are not aware of material nonpublic information about the issuer or its securities; and (ii) 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 Rule 10b-5.

In the Adopting Release, the SEC notes:

The certification condition is intended to reinforce directors' and officers' cognizance of their obligation not to trade or enter into a trading plan while aware of material nonpublic information about the issuer or its securities, that it is their responsibility to determine whether they are aware of material non-public 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 SEC modified the final amendment to require that the certifications be included in the Rule 10b5-1 plan as representations, rather than prepared as a separate document to be presented to the issuer. In addition, the SEC did not adopt the proposed 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.

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

With respect to multiple overlapping Rule 10b5-1 plans, the final amendments add a condition to the Rule 10b5-1(c)(1) affirmative defense that persons, other than issuers, may not have another outstanding (and may not subsequently enter into any additional) contract, instruction or plan that would qualify for the affirmative defense under the amended Rule 10b5-1 for purchases or sales of any class of securities of the issuer on the open market during the same period.

In a change from the proposal, the SEC modified this condition to address an insider's use of multiple brokers to execute trades pursuant to a single Rule 10b5-1 plan that covers securities held in different accounts. Specifically, a series of separate contracts with different broker-dealers or other agents acting on behalf of the person (other than the issuer) to execute trades thereunder may be treated as a single "plan," provided that the contracts with each broker-dealer or other agent, when taken together as a whole, meet all of the applicable conditions of and remain collectively subject to the provisions of Rule 10b5-1(c)(1). A modification of any such contract will be a modification of each other contract or instruction under such single plan.

Further, the final amendment provides that a broker-dealer or other agent executing trades on behalf of the insider pursuant to the Rule 10b5-1 plan may be substituted by a different broker-dealer or other agent as long as the purchase or sales instructions applicable to the substituted broker and the substitute are identical, including with respect to the prices of securities to be

purchased or sold, dates of the purchases or sales to be executed, and amount of securities to be purchased or sold. However, a plan modification, such as the substitution or removal of a broker that is executing trades pursuant to a Rule 10b5-1 arrangement on behalf of the insider that changes the purchase or sale amount, price or date on which purchases or sales are to be executed is a termination of such plan and the adoption of a new plan.

The SEC also adopted a provision that permits persons to maintain two separate Rule 10b5-1 plans at the same time, so long as trading under the later-commencing plan is not authorized to begin until after all trades under the earlier-commencing plan are completed or expire without execution. This provision is not available for the later-commencing plan, however, if the first trade under the later-commencing plan is scheduled to begin during the "effective cooling-off period" if the date of adoption of the later-commencing plan were deemed to be the date of termination of the earlier-commencing plan.

The SEC also adopted a modification in the final rules for plans authorizing certain "sell-to-cover" transactions, in which an insider instructs their agent to sell securities in order to satisfy tax withholding obligations at the time an award vests. Under this provision, an insider will not lose the benefit of the affirmative defense with respect to an otherwise eligible Rule 10b5-1 plan if the insider has in place another plan that would qualify for the affirmative defense, so long as the additional plan or plans only authorize qualified sell-to-cover transactions. A plan authorizing sell-to-cover transactions is qualified for this provision where the plan authorizes an agent to sell only such securities as are necessary to satisfy tax withholding obligations incident to the vesting of a compensatory award, such as restricted stock or stock appreciation rights, and the insider does not otherwise exercise control over the timing of such sales. This provision does not include sales incident to the exercise of option awards.

The SEC also adopted amendments limiting the use of single-trade Rule 10b5-1 plans. As amended, Rule 10b5-1 specifies that if the plan is designed to effect the open-market purchase or sale of the total amount of securities as a single transaction, the plan may not qualify for the affirmative defense unless:

- The person who entered into the plan has not, during the prior 12-month period, adopted another plan that was designed to effect the open-market purchase or sale of the total amount of securities subject to that plan in a single transaction; and
- Such other plan in fact was eligible for the affirmative defense under Rule 10b5-1.

A person (other than the issuer) will be able to rely on the Rule 10b5-1(c)(1)(ii) affirmative defense for only one single-trade plan during any 12-month period. The defense will only be available for a single-trade plan if the person had not, during the preceding 12-month period, adopted another single-trade plan, where the other plan qualified for the affirmative defense under Rule 10b5-1.

For this purpose, a plan is "designed to effect" the purchase or sale of securities as a single transaction when the contract, instruction, or plan has the practical effect of requiring such a result. In contrast, a plan is not designed to effect a single transaction where the plan leaves the person's agent discretion over whether to execute the contract, instruction, or plan as a single transaction. Similarly, a plan is also not designed to effect the purchase or sale of securities as a single transaction when:

- The contract, instruction, or plan does not leave discretion to the agent, but instead provides that the agent's future acts will depend on events or data not known at the time the plan is entered into, such as a plan providing for the agent to conduct a certain volume of sales or purchases at each of several given future stock prices; and
- It is reasonably foreseeable at the time the plan is entered into that the contract, plan, or instruction might result in multiple transactions.

For reasons that are similar to those with respect to multiple overlapping trades, the SEC modified the single-trade limitation as it was proposed with respect to qualified sell-to-cover transactions. This modification applies to the same plans eligible for the sell-to-cover provision of the overlapping trade limitation.

Good Faith Condition

The SEC amended Rule 10b5-1 to add the condition that the person who entered into the Rule 10b5-1 contract, instruction, or plan "has acted in good faith with respect to" the contract, instruction, or plan. This amendment was adopted based on a concern that corporate insiders "may take actions after adopting a Rule 10b5-1 plan to benefit from material nonpublic information the insider acquires after establishment of the plan."

Additional Disclosures Regarding Rule 10b5-1 Trading Arrangements

The SEC adopted 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 also adopted Item 16J to Form 20-F to require annual disclosure of a foreign private issuer's insider trading policies and procedures.

As adopted, Item 408(a) of Regulation S-K will 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), any director or officer has adopted or terminated:
  - any contract, instruction or written plan for the purchase or sale of securities of the registrant that is intended to satisfy the affirmative defense conditions of Rule 10b5-1(c), referred to as a "Rule 10b5-1(c) trading arrangement," and/or
  - any written trading arrangement for the purchase or sale of securities of the registrant that meets the requirements of a non-Rule 10b5-1 trading arrangement as defined in Item 408(c), referred to as a "non-Rule 10b5-1 trading arrangement," as discussed below; and
- Provide a description of the material terms of the Rule 10b5-1 trading arrangement or non-Rule 10b5-1 trading arrangement other than terms with respect to the price at which the individual executing the respective trading arrangement is authorized to trade, such as:
  - The name and title of the director or officer;
  - The date of adoption or termination of the trading arrangement;
  - The duration of the trading arrangement; and
  - The aggregate number of securities to be sold or purchased under the trading arrangement.

With respect to any given trading arrangement subject to disclosure under Item 408(a), the issuer must indicate whether such trading arrangement is a Rule 10b5-1 trading arrangement or is a non-Rule 10b5-1 trading arrangement. In addition, any modification or change to a Rule 10b5-1 plan by a director or officer that falls within the meaning of new Rule 10b5-1(c)(1)(iv) would also be required to be disclosed under Item 408(a), as it constitutes the termination of an existing plan and the adoption of a new contract, instruction, or written plan. In a change from the proposal, Item 408(a) as adopted does not require disclosure of the price at which the individual executing the trading arrangement is authorized to trade. Further, the SEC decided to not require corresponding disclosure regarding the use of trading arrangements by the issuer.

Under the final rule, a trading arrangement with respect to a director or officer would be a "non-Rule 10b5-1 trading arrangement" where the director or officer asserts that, at a time when they were not aware of material nonpublic information about the security or the issuer of the security, they:

- Adopted a written arrangement for trading the securities; and
- The trading arrangement:

- Specified the amount of securities to be purchased or sold and the price at which and the date on which the securities were to be subsequently purchased or sold;
- Included a written formula or algorithm, or computer program, for determining the amount of securities to be purchased or sold and the price at which the securities were to be purchased or sold; or
- Did not permit the covered person to exercise any subsequent influence over how, when, or whether to effect purchases or sales; provided, in addition, that any other person who, pursuant to the trading arrangement did exercise such influence must not have been aware of material nonpublic information when doing so.

As adopted, Item 408(b) of Regulation S-K will require issuers to disclose whether they have adopted insider trading policies and procedures governing the purchase, sale, and other dispositions of their 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 an issuer has not adopted such insider trading policies and procedures, it must explain why it has not done so. These disclosures will be required in annual reports on Form 10-K and proxy and information statements on Schedules 14A and 14C. Pursuant to new Item 16J in Form 20-F, foreign private issuers will be required to provide analogous disclosure in their annual reports on Form 20-F. The SEC notes in the Adopting Release that, under General Instruction G to Form 10-K, an issuer can incorporate by reference the information required by Item 408(b) from a definitive proxy or information statement involving the election of directors, if the proxy or information statement is filed within 120 days of the end of the fiscal year.

In a modification from the proposal, the final rules do not require separate disclosure of the issuer's policies and procedures within the body of the annual report, proxy statement or information statement. Instead, the SEC adopted amendments to Item 601 of Regulation S-K and Form 20-F that require issuers to file a copy of their insider trading policies and procedures as an exhibit to Form 10-K and Form 20-F. If all of the issuer's insider trading policies and procedures are included in its code of ethics (as defined in Item 406(b) of Regulation S-K) and the code of ethics is filed as an exhibit pursuant to Item 406(c)(1), a hyperlink to that exhibit accompanying the issuer's disclosure as to whether it has insider trading policies and procedures would satisfy this component of the disclosure requirement.

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

The SEC has added a Rule 10b5-1(c) checkbox as a new mandatory disclosure requirement in Forms 4 and 5. This checkbox would require a Form 4 or Form 5 filer to indicate "that a transaction was made pursuant to a contract, instruction or written plan that is intended to satisfy the affirmative defense conditions of Rule 10b5-1(c)." Filers are also required to provide the date of adoption of the Rule 10b5-1 trading arrangement in the "Explanation of Responses" section, and filers have the option to provide additional relevant information about the reported transaction in the "Explanation of Responses" section.

The SEC did not adopt a second, optional checkbox that was proposed. This optional checkbox would have allowed 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 with respect to stock option awards timed to precede or follow the release of material nonpublic information, the SEC adopted a new paragraph (x) to Item 402 of Regulation S-K. Under this new disclosure requirement, issuers must provide narrative disclosure discussing the issuer's policies and practices on the timing of awards of stock options, stock appreciation rights (SARs) and/or similar option-like instructions in relation to the disclosure of material nonpublic information by the issuer, including:

- How the board determines when to grant such awards;
- Whether, and if so, how, the board or compensation committee considers material nonpublic information when determining the timing and terms of an award; and

- Whether the issuer has timed the disclosure of material nonpublic information for the purpose of affecting the value of executive compensation.

If, during the last completed fiscal year, stock options, SARs and/or similar option-like instruments were awarded to a named executive officer (NEO) within a period starting four business days before the filing of a periodic report on Form 10-Q or Form 10-K, or the filing or furnishing of a current report on Form 8-K that discloses material nonpublic information, which includes earnings information, and ending one business day after a triggering event, the issuer must provide the following information concerning each such award for the NEO on an aggregated basis in the tabular format set forth in the rule:

- The name of the NEO;
- The grant date of the award;
- The number of securities underlying the award;
- The per-share exercise price;
- The grant date fair value of each award computed using the same methodology as used for the issuer's financial statements under generally accepted accounting principles; and
- The percentage change in the market price of the underlying securities between the closing market price of the security one trading day prior to and one trading day following the disclosure of material nonpublic information.

The SEC notes in the Adopting Release that "the purpose of the new table is to highlight for investors options award grants that may be more likely than most to have been made at a time that the board of directors was aware of material nonpublic information affecting the value of the award."

In a modification from the proposal, the SEC is requiring that the table include only option awards granted in the period beginning four business days preceding a triggering event and ending one business day after a triggering event, rather than the proposed 14-day disclosure window. In addition, the SEC removed the share repurchase triggering event and provided a limited exception from the tabular disclosure of option awards based on the filing or furnishing of a Form 8-K. In the final rules, the SEC also combined the final two columns of the proposed table into a single column that now requires disclosure of the percentage change in the market value of the securities underlying the award between the closing market price of the securities one trading day prior to the disclosure of material nonpublic information and one trading day following the disclosure of material nonpublic information.

Reporting of Gifts on Form 4

Prior to the SEC's amendments, Section 16 reporting persons were 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 were eligible for delayed reporting on Form 5 pursuant to Rule 16a-3(f)(1).

The SEC amended Exchange Act Rule 16a-3(f)(1) to now 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.

Notably, in footnote 55 of the Proposing Release, the SEC had also stated:

> The Exchange Act does not require that a "sale" of securities be for value, and instead provides that the "terms 'sale' or 'sell' each include any contract to sell or otherwise dispose of." Exchange Act Section 3(a)(14) [15 U.S.C. 78c(a)(14)] compare with Securities Act Section 2(a)(3) [15 U.S.C. 77b(a)(3)] ("the terms 'sale' or 'sell' shall include every contract of sale or disposition of a security or interest in a security, for value."). 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. The affirmative defense under Rule 10b5-1(c)(1) is available for planned securities gifts.

A commenter expressed concern that the language in the Proposing Release purporting to illustrate the application of Section 10(b) to gifts of securities appeared to represent an extension or modification of insider trading law. In the Adopting Release, the SEC did not revisit this guidance, but clarified that the affirmative defense of Rule 10b5-1(c)(1) is available for any *bona fide* gift of securities, including a gift that might otherwise cause the donor to be subject to liability under Section 10(b), because, when making the gift, the donor was aware of material nonpublic information about the security or issuer and knew or was reckless in not knowing that the donee would sell the securities prior to the disclosure of such information. The SEC expressed its view that the terms "trade" and "sale" in Rule 10b5-1(c)(1) include *bona fide* gifts of securities. The SEC noted in the Adopting Release: "For example, a covered individual may enter into a binding arrangement instructing their attorney or tax advisor to gift shares to a charitable organization, with the amount of shares gifted determined according to a traditional algorithm or formula, or instead according to some tax objective, such as the amount of shares that would maximize the individual's annual charitable contribution deduction."

Structured Data Requirements

The SEC requires that issuers tag the disclosure provided in response to Item 408, Item 402(x) and Item 16J(a) of Form 20-F using Inline XBRL in accordance with Rule 405 of Regulation S-T and the EDGAR Filer Manual. The requirements include block text tagging of narrative disclosures, as well as detail tagging of quantitative amounts disclosed within the narrative disclosures. Issuers must comply with the Inline XBRL tagging requirements in Forms 10-Q, 10-K and 20-F, and any proxy or information statements that are required to include the Item 408 and/or Item 402(x) disclosures, beginning with the first such filing that covers the first full fiscal period beginning on or after April 1, 2023, for companies other than smaller reporting companies. Smaller reporting companies will be required to provide and tag the disclosures after an additional six-month transition period.

Compliance Dates

The final amendments will be effective 60 days following publication of the Adopting Release in the Federal Register. The SEC provided the following compliance schedule for the final rules:

- Section 16 reporting persons will be required to comply with the amendments to Forms 4 and 5 for beneficial ownership reports filed on or after April 1, 2023;
- Issuers that are smaller reporting companies will be required to comply with the new disclosure and tagging requirements in Exchange Act periodic reports on Forms 10-Q, 10-K and 20-F and in any proxy or information statements that are required to include the Item 408, Item 402(x), and/or Item 16J disclosures in the first filing that covers the first full fiscal period that begins on or after October 1, 2023; and
- All other issuers will be required to comply with the new disclosure and tagging requirements in Exchange Act periodic reports on Forms 10-Q, 10-K and 20-F and in any proxy or information statements that are required to include the Item 408, Item 402(x), and/or Item 16J disclosures in the first filing that covers the first full fiscal period that begins on or after April 1, 2023.

The SEC notes in the Adopting Release:

> The amendments to Rule 10b5-1(c)(1) would not affect the affirmative defense available under an existing Rule 10b5-1 plan that was entered into prior to the revised rule's effective date, except to the extent that such a plan is modified or changed in the manner described in [Rule 10b5-1(c)(1)(iv)] after the effective date of the final rules. In that case, the modification or change would be equivalent to adopting a new trading arrangement, and, thus, amended Rule 10b5-1(c)(1) would be the applicable regulatory affirmative defense that would be available for that modified arrangement. (citation omitted)

With the adoption of the final rules, issuers should begin examining their insider trading policies and procedures and Rule 10b5-1 plan guidelines to reflect the changes to the affirmative defense contemplated by the amendments. Issuers should also carefully consider their approach to *bona fide* gifts under their insider trading policies and procedures, given the SEC's interpretive

positions articulated in the Proposing Release and the Adopting Release. Issuers should also revise their disclosure controls and procedures to address the new disclosure requirements in Item 408 and Item 402(x) of Regulation S-K, as well as Item 16J of Form 20-F.

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[1] Release No. 33-11138, *Insider Trading Arrangements and Related Disclosures* (Dec. 14, 2022), available at https://www.sec.gov/rules/final/2022/33-11138.pdf (the "Adopting Release").

[2] Release No. 33-11013, *Rule 10b5-1 and Insider Trading* (Jan. 13, 2022), available at https://www.sec.gov/rules/proposed/2022/33-11013.pdf (the "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 Amends Rules for Rule 10b5-1 Trading Plans and Adds New Disclosure Requirements

On December 14, 2022, the U.S. Securities and Exchange Commission (SEC) adopted several amendments and new disclosure requirements intended to address what it perceives may be abusive practices relating to Rule 10b5-1 trading plans, certain equity awards and gifts of securities. Significant new provisions include:

- "cooling-off" periods delaying the first trades after a plan is adopted or amended;
- limitations on the number of Rule 10b5-1 plans an insider may have and on single-trade arrangements; and
- new required disclosures by issuers about Rule 10b5-1 plans, insider trading policies and option grant practices.

Notably, the amendments do not address issuer Rule 10b5-1 plans for share repurchases by issuers. The SEC proposed rules on issuer share repurchases in December 2021,[1] and final rules are expected to be adopted in 2023.

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 issuers that trade stocks under plans entered into in good faith at a time when the individual or issuer does not possess material nonpublic information. The amendments add new conditions that also must be satisfied to avail oneself of the affirmative defense:

Cooling-off Period

The amendments will require a minimum "cooling-off period" between the date a Rule 10b5-1 trading plan is adopted or modified and when trading under the plan commences.[2]

Directors and officers. With respect to directors and officers,[3] the applicable cooling-off period is the later of (i) 90 days after the adoption or modification of the trading plan or

[1] See our December 21, 2021 client alert, "SEC Announces Proposals Relating to Rule 10b5-1, Share Repurchases and Other Matters."

[2] Modifications that do not change the sales or purchase prices or price ranges, the amount of securities to be sold or purchased or the timing of transactions under a Rule 10b5-1 trading plan will not trigger a new cooling-off period. Examples of such non-triggering modifications include an adjustment for stock splits or a change in account information.

[3] "Officers" refer to those defined in Exchange Act Rule 16a-1(f), also known as section 16 officers, for purposes of these rules.

(ii) two business days following the filing of the Form 10-Q or Form 10-K for the fiscal quarter in which the plan was adopted or modified. In any event, the required cooling-off period is not to exceed 120 days following adoption or modification of the plan.

Other persons. With respect to persons other than issuers, directors or officers, the applicable cooling-off period is 30 days after the adoption or modification of the trading plan.

The SEC refrained for now from adopting a cooling-off period for issuers' share repurchase plans, and is still considering whether one is warranted.

Director and Officer Representations

When adopting a new or modified Rule 10b5-1 trading plan, a director or officer will be required to include in the plan written representations certifying that he or she (i) is not aware of material nonpublic information about the issuer or its securities and (ii) is adopting or modifying the plan in good faith and not as part of a plan or scheme to evade the prohibitions of Exchange Act Rule 10b-5.

Prohibitions Against Multiple, Overlapping Plans

Persons, other than issuers, generally will be prohibited from having more than one Rule 10b5-1 trading plan for open market purchases or sales of an issuer's securities.

This prohibition does not apply where a person transacts directly with the issuer, such as participating in employee stock ownership plans (ESOPs) or dividend reinvestment plans (DRIPs), which are not executed on the open market. Also, the prohibition does not apply to plans authorizing an agent to sell only enough securities as are necessary to satisfy tax withholding obligations arising exclusively from the vesting of a compensatory award, such as on the vesting and settlement of restricted stock units ("sell-to-cover" Rule 10b5-1 plans), provided that the award holder is not permitted to exercise control over the timing of such sales.[4]

The amendments also make clear that a series of separate contracts with different broker-dealers to execute trades pursuant to a single Rule 10b5-1 trading plan would be treated as a single plan.

Also, a person, other than an issuer, may maintain two separate Rule 10b5-1 plans for open market purchases or sales of an issuer's securities if trading under the later-commencing plan is not authorized to begin until after all trades under the earlier-commencing plan are completed or expire without execution. If the first plan is terminated early, the first trade under the later-commencing plan, however, must not be scheduled to occur until after the effective cooling-off period following the termination of the earlier plan.

Limitations on Single-Trade Arrangements

In any 12-month period, a person other than an issuer is limited to one "single-trade plan" — one designed to effect the open market purchase or sale of the total amount of the securities subject to the plan as a single transaction.

A plan will not be treated as a single-trade plan if, for example, it gives the person's agent discretion over whether to execute the plan as a single transaction, or provides that the agent's future acts will depend on events or data not known at the time the plan is entered into and it is reasonably foreseeable at the time the plan is entered into that the plan might result in multiple trades. Also, sell-to-cover Rule 10b5-1 plans are exempt from this limitation.

As with the cooling-off period, the SEC refrained for now from adopting prohibitions against multiple, overlapping plans and applying limitations to single-trade plans for issuers, and is still considering whether those are warranted.

Expanded Good Faith Requirement

The current Rule 10b5-1 requires that plans be entered into in good faith. The amendments add to that a requirement that the person who entered into the Rule 10b5-1 plan "has acted in good faith with respect to" the plan, thus extending the good faith requirement throughout the duration of the plan. As an example, the SEC notes that influencing the timing of an issuer's disclosure so that trades under a plan are more profitable would run afoul of this ongoing good faith requirement.

The amendments would not affect the affirmative defense available under a Rule 10b5-1 plan that was entered into prior to the amendment's effective date, unless that plan is modified after the effective date of the amendments.

Issuer Disclosures

The amendments introduce the following new disclosure requirements for issuers:

Insider Trading Policies and Procedures Exhibit

Under new Regulation S-K Item 408(b), an issuer will be required to disclose on Form 10-K or in the annual meeting proxy statement whether it has adopted insider trading policies and procedures governing the purchase, sale and/or 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 regula-

[4] This exemption does not apply to sales incident to the exercise of option awards, because the person exercising the option controls the timing of such sales.

tions, as well as applicable listing standards. If it has, it will be required to file a copy of them as an exhibit to its annual report on Form 10-K. If no such policies or procedures are in place, the issuer will need to explain why.

Foreign private issuers will be required to provide analogous disclosure, including filing a copy of their insider trading policies and procedures as an exhibit, in their annual reports pursuant to new Item 16J in Form 20-F.

Adoption, Modification and Termination of Rule 10b5-1 Plans and Certain Other Trading Arrangements

Under new Regulation S-K Item 408(a), issuers will be required to provide quarterly disclosure on Forms 10-Q and 10-K of (i) whether any director or officer has adopted, modified or terminated a Rule 10b5-1 plan or non-Rule 10b5-1 trading arrangement[5] and (ii) a description of the material terms of each plan, including the name and title of the director or officer; 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. Issuers will not be required to disclose pricing terms.

The SEC refrained for now from requiring corresponding disclosures from issuers about their trading arrangements and is still considering whether such disclosure requirements are warranted.

Options Granted Close in Time to the Release of Material Nonpublic Information

Under new Regulation S-K Item 402(x), issuers (including smaller reporting companies and emerging growth companies) will be required to disclose on Form 10-K or in the annual meeting proxy statement the issuer's policies and practices regarding the timing of awards of options in relation to the disclosure of material nonpublic information.[6] Issuers will need to discuss (i) how the timing of awards is decided, (ii) how material nonpublic information is considered, if at all, when determining the timing and terms of awards, and (iii) whether disclosure of such information is timed to affect the value of awards.

Issuers also will be required to disclose in a new table any options granted in the last completed fiscal year to named executive officers that were granted within four business days before or one business day after the (i) filing of a periodic report on Form 10-Q or 10-K or (ii) filing or furnishing of a current report on Form 8-K that contains material nonpublic information (other than disclosure of a material new option award grant under Form 8-K Item 5.02(e)). The table would provide the following:

- each award (including the grantee's name, 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 percentage change in market price of the securities underlying each award on the trading day before and after disclosure of the material nonpublic information.

Inline XBRL Tagging

The amendments will require issuers to tag the information specified by new Regulation S-K Items 402(x), 408(a) and 408(b)(1) in Inline XBRL.

Section 16 Reporting

The amendments will impose the following new disclosure requirements for Section 16 filers:

Rule 10b5-1 Checkbox

A mandatory checkbox will be added to Forms 4 and 5, where filers will have to indicate whether a transaction reported on that form was made under a plan intended to satisfy the affirmative defense conditions of Rule 10b5-1. If so, filers would need to provide the date the plan was adopted.

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. Acquisitions of gifts are still eligible to be reported on a Form 5 or any time earlier on a Form 4, voluntarily.

Next Steps

Issuers should consider what controls and processes will be necessary to enable them to make the new disclosures required under the rules.

Issuers also may want to assess the various circumstances in which their insiders utilize the affirmative defense of existing Rule 10b5-1 plans and plan for timing and other changes — including, if necessary, amending their Rule 10b5-1 policies and guidelines — that will be required in light of the new rules.

Finally, issuers may want to review their compensation committee calendar to consider whether it needs to be revised in light of the new disclosure rules applicable to options granted close in time to the release of material nonpublic information.

[5] A "non-Rule 10b5-1 trading arrangement" is defined in new Regulation S-K Item 408(c), and includes certain pre-planned trading arrangements that do not meet the conditions of the Rule 10b5-1(c)(1) affirmative defense.

[6] The term "option" is defined in Regulation S-K Item 402(a)(6) and includes stock options, stock appreciations rights (SARs) and similar instruments with option-like features.

Transition Periods / Effective Date

Final Rules	Compliance Date	First Filing for 12/31 Fiscal Year-End Issuers
Amendments to Rule 10b5-1	60 days after publication in the Federal Register	N/A
Amendments to Forms 4 and 5	Forms 4 or 5 filed on or after April 1, 2023[7]	N/A
Disclosure of Adoption, Modification or Termination of Rule 10b5-1 Plans by Directors or Officers (Reg. S-K Item 408(a))	The first filing that covers the first full fiscal quarter beginning on or after April 1, 2023[7]	Form 10-Q for quarter ending June 30, 2023[8]
Disclosure of the Issuer's Insider Trading Policies and Procedures (Reg. S-K Item 408(b)(1); Form 20-F Item 16J)	The first filing that covers the first full fiscal year beginning on or after April 1, 2023[7]	Proxy Statement for 2025 Annual Meeting (or Form 10-K or 20-F for fiscal year ending December 31, 2024)[9]
Insider Trading Policies and Procedures Exhibit (Reg. S-K Items 408(b)(2) and 601(b)(19); Form 20-F Item 16J)	The first filing that covers the first full fiscal year beginning on or after April 1, 2023[7]	Form 10-K or 20-F for fiscal year ending December 31, 2024[9]
Tabular and Narrative Disclosure of Certain Options Awarded Close in Time to the Release of Material Nonpublic Information and Related Policies and Procedures (Reg. S-K Item 402(x))	The first filing that covers the first full fiscal year beginning on or after April 1, 2023[7]	Proxy Statement for 2025 Annual Meeting (or Form 10-K for fiscal year ending December 31, 2024)[9]

[7] October 1, 2023, for smaller reporting companies.

[8] Form 10-K for fiscal year ending December 31, 2024, for smaller reporting companies.

[9] Although the SEC's release indicates this timing, we have asked the SEC staff to confirm this delayed reporting was intended.

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

DECEMBER 29, 2022

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

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

Background

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

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

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

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

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

Amendments to Rule 10b5-1

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

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

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

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

(i) 90 days following plan adoption or modification or

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

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

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

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

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

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

Changes that do not modify the sales or purchase prices or price ranges, the amount of securities to be sold or purchased, or the timing of transactions under a Rule 10b5-1 plan will not trigger a new cooling-off period. For example, changes in account information, substitution of the executing broker-dealer or agent, or adjustments for stock splits are not considered modifications of the plan.

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

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

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

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

[9] *Id.* at 37.

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

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

New Disclosure Requirements

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

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

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

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

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

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

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

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

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

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

Section 16 Reporting Changes

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

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

SEC Interpretations Regarding Treatment of Gifts for Insider Trading Purposes

The adopting release articulates the SEC's position that the terms "trade" and "sale" in Rule 10b5-1(c)(1) include bona fide gifts of securities and that the Rule 10b5-1(c) affirmative defense is available to such gifts, a position that the SEC began to lay out when the Rule 10b5-1 amendments were proposed. In this regard, the adopting release quotes footnote 55 to the proposing release, in which the SEC stated that "a donor of securities violates Section 10(b) if the donor gifts a security of an issuer in fraudulent breach of a duty of trust and confidence when the donor was aware of material nonpublic information about the security or issuer, and knew or was reckless in not knowing that the donee would sell the securities prior to the disclosure of such information."[12] The

[12] Adopting Release at 110.

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

This position may require issuers to revisit their insider trading policies and treatment of gifts. For instance, more issuers may begin to treat bona fide gifts of securities the same as market sales of securities under their insider trading policies. This could present complications for insiders who have traditionally made gifts around year end, particularly if issuers subject such gifts to company blackout periods, which often are in effect in the days and weeks leading up to year end. The SEC acknowledged this point and noted that the Rule 10b5-1(c) affirmative defense is available for bona fide gifts of securities, "including a gift that might otherwise cause the donor to be subject to liability under Section 10(b), because when making the gift the donor was aware of material nonpublic information about the security or issuer and knew or was reckless in not knowing that the donee would sell the securities prior to the disclosure of such information."[16]

Timing and Treatment of Legacy Rule 10b5-1 Plans

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

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

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

Select Departures from the Proposing Release

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

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

Practical Considerations

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

Policy Changes

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

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

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

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

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

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

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

Section 16

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

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

Option Granting Practices

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

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

Education and Coordination

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

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