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Securities Law ADVISORY ■

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SEC Issues New Proposed Amendments to Rule 10b5-1

On December 15, 2021, the Securities and Exchange Commission (SEC) proposed amendments to Rule 10b5-1 under the Securities Exchange Act of 1934 that would:

- Add new conditions to the availability of the affirmative defense under Rule 10b5-1(c)(1).
- Create new disclosure requirements relating to insider trading policies and the adoption of 10b5-1 plans by issuers, officers, and directors.
- Create new disclosure requirements relating to the timing of certain equity awards for executive and director compensation.
- Update Forms 4 and 5 to require the identification of transactions made pursuant to Rule 10b5-1 plans and the disclosure of all gifts of securities on Form 4.

Background

Section 10(b) of the Exchange Act prohibits the use of "any manipulative or deceptive device or contrivance" in connection with the purchase or sale of a security. Rule 10b5-1 stipulates that the sale or purchase of a security is made on the basis of material nonpublic information if the person making the purchase or sale was aware of the material nonpublic information at the time of the trade.

Rule 10b5-1(c) established an affirmative defense to insider trading liability in circumstances where the trade was made pursuant to a trading agreement that was established at a time the trader was not aware of the material nonpublic information. Rule 10b5-1 also offers an affirmative defense for non-natural persons engaged in trading.

Despite the current requirements, there is a market perception among some investors that the Rule 10b5-1 affirmative defenses allow insiders to take advantage of the liability protections against insider trading. In response to these concerns, the SEC proposed rule and form amendments to address certain practices associated with Rule 10b5-1 trading agreements, grants of options, and the gifting of securities.

Highlights of the Proposed Amendments

Cooling-off period

Officers (as that term is defined for purposes of the Section 16 reporting rules under Exchange Act Rule 16a-1(f)) and directors entering into a Rule 10b5-1 trading arrangement would be subject to a 120-day mandatory cooling-off period from the day the arrangement is adopted before any trading can start under the arrangement.

In addition, issuers that structure a share repurchase plan as a Rule 10b5-1(c)(1)(i) trading arrangement, including stock repurchasing plans, would be subject to a 30-day mandatory cooling-off period from the day the arrangement is adopted before any trading can start under the arrangement.

Modifications to existing Rule 10b5-1 trading arrangements would be treated as equivalent to creating a new trading arrangement, triggering a new mandatory cooling-off period.

Written certifications

To maintain the availability of a Rule 10b5-1 affirmative defense, officers and directors would be required to provide a certification to the issuer that they are not aware of material nonpublic information about the issuer or security at the time they adopt a 10b5-1 trading arrangement and that the arrangement was adopted in good faith and not as a part of a plan or scheme to avoid the prohibitions of Section 10(b) and Rule 10b-5. The proposed rules would require that an officer or director seeking to rely on the affirmative defense retain a copy of the certification for 10 years.

No overlapping plans

The affirmative defense under Rule 10b5-1(c)(1), which provides a defense for liability if the trade was made pursuant to a trading agreement, would not apply to multiple overlapping Rule 10b5-1 trading arrangements for open market trades in the same class of securities. This would not apply to transactions made directly with the issuer.

Limitations on single-trade plans

The affirmative defense under Rule 10b5-1(c)(1) would only be available for one single-trade plan during any 12-month period.

New disclosure requirements

The proposed rules would introduce several new disclosure requirements.

- An issuer would be required to provide in its quarterly reports on Form 10-Q or annual report on Form 10-K whether, during the quarterly period covered by the report, the issuer, or any officer or director who is required to file reports under Section 16, adopted or terminated a Rule 10b5-1(c) trading plan.
- An issuer would be required to disclose in its Form 10-K or Form 20-F whether or not it has adopted insider trading policies and, if they do maintain such policies, to describe them. If the issuer does not have an insider trading policy, it would be required to provide justification for not having a policy.
- Section 16 reporting persons would be required to indicate on the applicable Form 4 or Form 5 whether a sale or purchase reported on that form was made pursuant to a Rule 10b5-1(c) trading arrangement. Filers would also be required to provide the date of adoption of the trading arrangement and would have the option to provide additional relevant information about the reported transaction.

- To increase transparency around the timing of certain compensatory stock awards, an issuer would be required to include tabular disclosure of each option award granted within 14 calendar days before or after the filing of a periodic report, an issuer share repurchase, or the filing or furnishing of a current report on Form 8-K that contains material nonpublic information; the market price of the underlying securities the trading day before disclosure of the material nonpublic information; and the market price of the underlying securities the trading day after disclosure of the material nonpublic information. This disclosure would be required in annual reports on Form 10- K, as well as in proxy statements and information statements related to the election of directors, shareholder approval of new compensation plans, and solicitations of advisory votes to approve executive compensation.

Section 16 reporting of gifts

Gift transactions by Section 16 filers would no longer be eligible for delayed reporting on Form 5 and, instead, would be required to be reported on Form 4 within two business days following the transaction.

Next Steps

Interested parties have 45 days to submit comments to the SEC electronically or via mail. We anticipate significant comments from both issuers and investors to these proposed rules.

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