December 15, 2022

SEC Adopts Amendments to Rule 10b5-1 and Issuer Disclosure Requirements Relating to Insider Transactions

On December 14, almost precisely a year after publication of the related proposed rules, the Securities and Exchange Commission adopted a suite of amendments to the Rule 10b5-1 affirmative defense to insider trading liability. The changes apply to both substantive requirements for the defense to be available and to disclosure-related matters. The rules will likely require issuers and insiders who use 10b5-1 plans to change the forms, policies and practices they currently employ. Notably, the new rules generally do *not* implement the previously proposed rules that would have further restricted and regulated the use of Rule 10b5-1 plans by issuers themselves (rather than corporate insiders), which the SEC notes it is continuing to consider.

A number of the new rules now make mandatory certain practices that were previously included as a prudential matter in some companies' policies and practices, but were far from universal—such as limitations on single trade plans, mandatory cooling-off periods and whether to treat significant plan modifications as equivalent to entering into a new plan. Others, such as the significant new disclosure requirements and the 90-day minimum cooling-off period for corporate insiders (which will be a significant constraint on personal financial planning), are a starker departure from existing prevailing practices.

The primary changes include the following:

Changes to requirements for Rule 10b5-1 plans: All plans designed to qualify under Rule 10b5-1 (other than plans adopted by the issuer) will be subject to a mandatory "cooling-off" period of at least 30 days following adoption of the plan before trading may begin. Directors and Section 16 officers of the issuer will be subject to an *extended* cooling-off period of at least 90 days, or until two business days following the disclosure of the issuer's financial results in a Form 10-K or Form 10-Q relating to the fiscal quarter in which the plan was adopted, whichever is longer (but not to exceed 120 days). A *new* cooling-off period will also be triggered by a modification to the amount, price or timing of a purchase or sale (including changes to related formulas or algorithms) under an existing plan, which is treated as a cancellation of the existing plan and the adoption of a replacement. The final rules also require that plans adopted by Section 16 persons include a representation from the individual certifying that they are not aware of any material non-public information about the issuer or its securities, and that they are acting in good faith and not as part of any plan or scheme to evade the prohibitions of Rule 10b-5.

Prohibition of multiple overlapping Rule 10b5-1 plans: The amendments impose a condition to the availability of the affirmative defense under Rule 10b5-1(c)(1) that the adopting person (other than the issuer) not have another outstanding qualifying plan, contract or instruction for transactions of any class of securities of the issuer on the open market during the relevant period. Limited exceptions to this prohibition apply, primarily to accommodate the fact that an individual may need to trade from multiple accounts under a single plan for logistical reasons, and to facilitate "sell-to-cover" plans designed only to provide liquidity to fund tax withholding obligations in connection with award-vesting events.

Limitation on single-trade plans: Single-trade plans (*i.e.*, plans that are designed to effect only a single transaction) may only qualify for the affirmative defense one time in any 12-month period. This limitation does not apply to issuers and is also subject to a narrow exception to permit sell-to-cover plans.

Amended good-faith condition: In addition to the existing requirement that a qualifying plan be entered into in good faith, adopting persons (including issuers) must now also "act[ ] in good faith with respect to" the plan.

Issuer Disclosure Requirements: The rules adopt a number of new affirmative disclosure requirements applicable to issuers relating to trading by insiders and equity-based compensation. Issuers will be required to disclose the adoption, termination or (in certain circumstances) modification of a Rule 10b5-1 plan or certain other pre-planned trading arrangements by any Section 16 person in their applicable periodic Exchange Act reports, including a description of the material non-price terms of the arrangements. In addition, issuers will be required to disclose in SEC filings their insider trading policies and procedures, or explain why they have not adopted such policies. Finally, significant new disclosure requirements are being imposed relating to equity compensation practices. The new disclosure must include a discussion of policies and practices around timing of grants of option-like securities, whether the existence of material nonpublic information is taken into account, and whether disclosures have been timed to impact the value of equity grants, as well as required tabular disclosure (with XBRL tagging) relating to such grants to named executive officers within a period starting four business days before (and ending one business day after) the filing of a periodic Exchange Act report or of a Form 8-K (including furnished 8-Ks) that discloses material non-public information. Triggering non-public information for purposes of this requirement includes, but is not limited to, earnings information (requiring an issuer to potentially take a public position on whether certain information constituted material non-public information).

Individual Disclosure Requirements: Section 16 filers will be required to indicate on their Forms 4 and 5 whether a reported trade was made under a Rule 10b5-1 plan, and to report "bona fide gifts" on a Form 4 within two business days (rather than being permitted to disclose on a Form 5, as under current rules).

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The new rules will become effective 60 days after publication of the adopting release in the Federal Register. Compliance with the amendments to Forms 4 and 5 will be required with respect to reports filed on or after April 1, 2023, and the new issuer disclosure requirements will apply with respect to periodic reports, information statements and proxy statements under the Exchange Act that cover the first full fiscal period that begins on or after April 1, 2023 (with delayed application to smaller reporting companies).

Given the nature and extent of the changes, the importance of the new rules for insiders seeking to manage their financial position through transactions in issuer equity, and the relatively short period prior to implementation, most issuers should promptly make their insiders aware of the pending changes and begin to implement procedures to ensure compliance. While the new rules will impose additional hurdles on the ability to rely on the Rule 10b5-1 affirmative defense, the strength of the protection offered by the defense will continue to be significant, and direct trading in open windows will also remain an available tool. Accordingly, for corporate insiders seeking liquidity, it will continue to be worth evaluating whether to implement 10b5-1 plans where circumstances permit.

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