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New Proposals Regarding 10b5-1 Plans

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On December 15, 2021, the U.S. Securities and Exchange Commission, or the SEC, published proposals designed to address potentially abusive practices by public issuers, directors and officers, especially relating to Rule 10b5-1 trading plans. The public comment period for the proposals will remain open for 45 days following publication.

I. Background to 10b5-1 plans

10b5-1plans are widely used by officers and directors of public companies, who regularly are aware of material nonpublic information but still wish to purchase or, more typically, to sell shares. 10b5-1plans are also used by public companies in connection with planned purchases and sales of their securities. They provide an affirmative defense from insider trading liability for trades even when the insider is aware of material nonpublic information, but only if certain requirements are met, including:

- The plan has to be a **written, binding agreement**. Plans typically take the form of a contract between the insider and the broker.
- Plans have to specify the amount, price and date of transactions, specifically or by formula.
- Plans have to be entered into when the insider is **not aware of material nonpublic information**.
- Plans can be amended only when the insider is not aware of material nonpublic information, but they can be terminated at any time.
- Terminations, however, could call into question whether the plan was entered into in **good faith**, which is another important requirement.
- Trading under 10b5-1 plans may commence on the same day the plan is executed, but most plans include a **cooling-off period**. Brokers, as well as companies, have their own requirements for waiting periods. Initially, a one-week waiting period was standard, which period has lengthened . The minimum waiting period over the years gravitated towards a cooling-off period of 30 to 60 days.
- While not required, many companies adopted policies requiring that their insiders trade *only* through 10b5-1 plans.

II. Proposed Amendments

The SEC indicated that the proposed "common-sense" amendments are aimed at curbing potential abuses of the rules and to enhance transparency for investors, while not unduly restricting trading in a company's securities by individuals and companies for foreseeable, appropriate purposes.

The main proposed amendments are:

1. Cooling-off Periods

There will be a mandatory minimum cooling-off period between when a plan is adopted or modified and when trading commences. The proposed cooling-off period is 120 days for directors and officers and 30 days for companies. A 120-day cooling-off period means that trading under a 10b5-1 plan generally will not begin until the results for the quarter in which the plan was adopted were announced.

2. Restriction of the Use of Multiple Overlapping Plans and Single-Trade Plans

Adopting more than one Rule 10b5-1 plan for trading in the same class of securities (for open market purchases) will be prohibited. Sellers will also be limited to just one "single trade" 10b5-1 plan (where all the shares covered by the plan are sold in one transaction) in any 12-month period.

3. D&O Certifications

Directors and officers will be required to certify they are adopting plans in good faith and not as part of a plan or scheme to evade the prohibitions of the Exchange Act, and that they are not aware of material nonpublic information. These certifications must be retained by the companies for 10 years. While this was already required by many brokers, it will now be codified.

4. New Disclosure Requirements in Quarterly and Annual Reports

In Forms 10-Q and Forms 10-K, companies will be required to disclose the adoption or termination of any Rule 10b5-1 plans if they occurred during the quarter covered by such report. Companies will also need to describe the material terms of such plans.

5. Disclosure of Insider Trading Policies and Procedures

Companies, including foreign private issuers, will be required to disclose their insider trading policies and procedures in their Form 10-K (or 20-F). If a company has not adopted insider trading policies and procedures, it must explain the reasons why it has not. If the proposal is adopted, the disclosure in the Form 20-F will be made by a new "Item 16J – Insider trading policies".

6. Disclosure in Section 16 filings

An additional checkbox on Forms 4 and 5 will be added to indicate whether a reported transaction was made pursuant to a Rule 10b5-1 plan and the date that such plan was adopted. A second checkbox will allow filers to indicate whether a reported transaction was made under a plan not intended to qualify for the Rule 10b5-1 affirmative defense.

7. Other New Disclosures

Additional new disclosures will be required regarding grants of equity compensation awards such as stock options and stock appreciation rights (SARs) close in time to the company's disclosure of material nonpublic information (including earnings releases and other major announcements) and that the quantitative disclosure be reported using Inline XBRL, and prompt disclosure of dispositions by gifts of securities by insiders on Form 4 will be required within two business days after such a gift is made.

III. Conclusion

While the final amendments may reflect additional modifications in response to the comments received on the proposed amendments, it is clear that the proposals reflect the heightened scrutiny that the SEC is devoting to 10b5-1 plans. Companies will need to analyze their current 10b5-1 plans for compliance, especially the cooling-off periods, and prepare for the enhanced disclosure requirements.

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