

SEC Releases New Proposed Rules for Rule 10b5-1 Plans

JOHN ELLERMAN AND MIKE KESNER

Introduction

Rule 10b5-1, established by the Securities and Exchange Commission (SEC) in the year 2000, permits executive officers and directors of publicly traded companies to establish a trading plan for the sale or purchase of company stock and provides these individuals an “affirmative defense” against claims that shares were traded based on material non-public information (MNPI). A typical Rule 10b5-1 plan specifies the sale or purchase of a predetermined number of shares at a specified price (or prices) over the term of the plan.

Companies (i.e., issuers) may also establish Rule 10b5-1 plans for stock buybacks.

It is important to note, neither executive officers and directors nor companies are required to use a Rule 10b5-1 trading plan to execute company stock transactions, and many trades are completed without such plans.

Currently, there are no disclosure requirements when a 10b5-1 trading plan is adopted, modified, or terminated. And, although such plans must be adopted when the participant is not aware of any MNPI, under present rules there is no waiting period before a stock transaction can take place. Thus, it is possible to adopt a trading plan and sell shares on the same day, although in our experience many plans include a 30-day “cooling-off” period before the first stock transaction can be completed.

On December 15, 2021, the SEC released proposed rules that significantly change both the plan provisions and disclosure requirements that must be met for executive officers, directors, and issuers to avail themselves of the affirmative defense afforded such plans. The SEC cites several concerns with the current rules including the potential for abuse and lack of transparency. The proposed rules are currently subject to a 45-day comment period, and public companies and other interested parties are encouraged to offer responses to some, or all of the 72 issues raised by the SEC staff in the release.¹

Proposed Rules

The SEC’s proposals for Rule 10b5-1 plans are extensive and a major departure from current rules governing such plans. The major changes are divided into two parts: the proposed plan requirements that must be met for the affirmative defense to be available and the proposed disclosure requirements, which are intended to improve transparency.

PARTNERS

Aubrey Bout	Donald S. Kokoskie	Lane T. Ringlee
Chris Brindisi	Brian Lane	Brian Scheiring
John R. Ellerman	Joe Mallin	John R. Sinkular
John D. England	Jack Marsteller	Christine O. Skizas
R. David Fitt	Richard Meisheid	Bentham W. Stradley
Patrick Haggerty	Sandra Pace	Tara Tays
Jeffrey W. Joyce	Steve Pakela	Olivia Wakefield
Ira T. Kay	Jaime Pludo	Jon Weinstein
Mike Kesner	Matt Quarles	

Proposed Plan Requirements

- Rule 10b5-1 trading plans entered into by executive officers and directors must include a 120-day cooling off period before any trading activity may be executed under the plan;
- Rule 10b5-1 trading plans entered into by issuers must include a 30-day cooling off period before any trading activity may be executed under the plan;
- Officers and directors will be required to personally certify to the issuer that they are not aware of MNPI and that they are adopting the plan in good faith and not trying to circumvent the insider trading rules when adopting a Rule 10b5-1 plan;
- The affirmative defense under Rule 10b5-1(c)(1) will not apply to multiple overlapping Rule 10b5-1 trading plans for open market trades in the same class of securities;
- The affirmative defense under Rule 10b5-1(c)(1) for a single-trade plan will only be available if it is the only trade during any 12-month period; and
- Rule 10b5-1 trading plans must be entered into and operated in good faith.

The SEC indicates that executive officers and directors will likely need to consult with legal counsel before attesting to the issuer that they are not in possession of MNPI. The SEC also expressed concern that an executive officer might influence the release of positive MNPI just before a scheduled trade date or conversely, delay the release of negative MNPI until after the scheduled trade date, which is why they added the “operated in good faith” requirement.

Proposed Disclosure Requirements

- Issuers must disclose in the 10-K whether the company has adopted insider trading policies and procedures, and if not, why. If the issuer has such policies and procedures, the issuer is required to “provide detailed and meaningful information,” including:
 - The process for determining if an insider has MNPI;
 - The process for documenting such a determination and the approval of such requests; and
 - How the issuer ensures compliance.
- Issuers must disclose their stock option (and stock appreciation right [SAR]) grant policies and practices, and how the Board considers MNPI prior to the grant, in the 10-K and Compensation Discussion & Analysis. Issuers also must provide a tabular disclosure of option (and SAR) awards made within 14 days of the release of MNPI as well as the company share price on the trading day before and after the release of such information;
- Issuers must disclose the adoption and termination (including modifications) of all Rule 10b5-1 trading plans in the 10-Q or 10-K. And because the SEC is concerned that trading plans may be established to evade the new reporting requirements, the proposed rules also apply to any non-qualified trading plan or arrangement. The required disclosure for both Rule 10b5-1 eligible and non-eligible trading plans includes:

- The name and title of the director or officer;
 - The date on which the director or officer adopted or terminated the contract instruction or written plan;
 - The duration of the contract instruction or written plan; and
 - The aggregate number of securities to be sold or purchased pursuant to the contract, instruction or written plan.
- Executive officers and directors must disclose on Forms 4 and 5 whether a reported transaction was executed pursuant to a Rule 10b5-1 trading plan (note, such disclosure is customary, and the SEC will add a check box to Forms 4 and 5 to facilitate this reporting requirement); and
 - Executive officers and directors must promptly report any *bona fide* gifts of company securities on Form 4.²

The new rules apply to all domestic and foreign issuers; there is no exemption for small reporting companies or emerging growth companies. In addition, the proposed disclosures required in Forms 10-Q and 10-K would be subject to the certifications required by Section 302 of the Sarbanes-Oxley Act.

Pay Governance Comments

Some members of Congress and certain courts have commented that the affirmative defense under Rule 10b5-1(c)(1) has allowed corporate insiders to use MNPI to trade company shares on an advantaged basis. Further, several academics (e.g., Alan D. Jagolinzer, M. Todd Henderson, Taylan Mavruk, Artur Hugon and Yen-Jung Lee) have prepared studies attempting to show that executive officers and directors utilizing Rule 10b5-1 plans have outperformed executive officers and directors that did not use a Rule 10b5-1 plan. While the SEC proposal has tried to affirmatively address these concerns, the proposed rules, if finalized in their current form, may also lead to a significant reduction in the use of such plans.

We encourage companies to review the SEC proposal and consider how the proposed rules might impact the company's insider trading policies as well as any requirements that executive officers and directors must use Rule 10b5-1 trading plans when buying or selling company stock. The SEC has published a brief Fact Sheet, "Rule 10b5-1 and Insider Trading: Proposed Rules" on its website, which provides a two-page summary of the principal rules and procedures proposed.²

General questions about this Viewpoint can be directed to John Ellerman at john.ellerman@paygovernance.com or Mike Kesner at mike.kesner@paygovernance.com.

¹ "SEC Proposes Amendments Regarding Rule 10b5-1 Insider Trading Plans and Related Disclosures." U.S. Securities and Exchange Commission. December 15, 2021. <https://www.sec.gov/news/press-release/2021-256>

² "Rule 10b5-1 and Insider Trading: Proposed Rules." U.S. Securities and Exchange Commission. December 15, 2021. <https://www.sec.gov/files/10b5-1-fact-sheet.pdf>