SEC Finalizes Amendments to Rule 10b5-1 Trading Plans

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On December 14, 2022, the Securities and Exchange Commission (Commission) unanimously adopted amendments[1] to the affirmative defense under Rule 10b5-1 for Rule 10b5-1 trading plans. The Commission also adopted new rules requiring disclosure of insider trading policies and practices, director and officer trading arrangements, option grant timing policies and practices and certain option grants to named executive officers.

Amendments to Rule 10b5-1

In 2000, the Commission adopted Rule 10b5-1 under the Securities Exchange Act of 1934 (Exchange Act) to provide clarity regarding its established prohibition on insider trading and whether a trade is made on the basis of material non-public information.

Rule 10b5-1 provides an affirmative defense to any trader, including issuers, affiliates of issuers and "insiders" (typically an issuer's directors and officers), against liability for insider trading where the trader's purchase or sale is made pursuant to a trading plan (a binding contract to purchase or sell a security, an instruction to another person to purchase or sell a security for the instructing person's account, or a written plan for trading securities) entered into in good faith when the trader was not aware of material non-public information.

In response to longstanding concerns from the courts, commentators and legislators that the Rule 10b5-1 affirmative defense allows corporate insiders to manipulate the use of a Rule 10b5-1 plan and opportunistically take advantage of the affirmative defense by trading on the basis of material non-public information, the Commission amended Rule 10b5-1 to establish the following new requirements applicable to the affirmative defense.

Cooling-Off Periods

Trading under Rule 10b5-1 plans entered into by an officer or a director of an issuer may not begin until the later of (i) 90 days after the adoption of the Rule 10b5-1 plan or (ii) two business days following the

filing 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, subject to a maximum cooling-off period of 120 days. Trading under Rule 10b5-1 plans entered into by persons other than an officer, director or an issuer may not begin until 30 days after the adoption of the plan. Certain plan modifications, including changes in the amount, price or timing of the purchase or sale of securities also trigger a new cooling-off period. Rule 10b5-1 plans entered into by an issuer are not required to include any cooling-off period.

Limitation on Single-Trade Plans

The Rule 10b5-1 affirmative defense generally may only apply to one single-trade plan within any 12-month period.

Officer and Director Rule 10b5-1 Plan Representations

Officers and directors entering into or modifying a Rule 10b5-1 plan must include a representation in the plan certifying that they (i) are not aware of material non-public information about the issuer or its securities, and (ii) are adopting the plan in good faith and not as part of a plan or scheme to evade the prohibitions of Exchange Act Section 10(b) and Exchange Act Rule 10b-5.

Continuing Good Faith Obligation

A trader entering into a Rule 10b5-1 plan must also act in good faith with respect to the plan, which extends the existing requirement to enter into Rule 10b5-1 plans in good faith throughout the duration of the plan. This requirement only relates to activities within the control of the trader and does not relate to activities outside of the control of the trader, such as if an issuer cancels a plan entered into by an insider.

Restrictions on Multiple Overlapping Rule 10b5-1 Plans

The Rule 10b5-1 affirmative defense will not apply to trades made pursuant to multiple overlapping Rule 10b5-1 plans for purchases or sales of any class of securities of an issuer on the open market during the same period, subject to the following limited exceptions:

- 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);
- persons (other than the issuer) that 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 (subject to certain exceptions); and
- certain "sell-to-cover" transactions in which an insider instructs their agent to sell securities to satisfy tax withholding obligations at the time a compensatory award vests, 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. Notably, this exception does not apply to "sell-to-cover-" transactions in connection with the exercise of options.

Insider Trading Policy and Director and Officer Trading Arrangement Disclosure Requirements

In addition, the Commission's final rules adopted new Item 408 of Regulation S-K, which requires issuers to disclose the following information:

- in its Form 10-K and annual proxy statement, whether the issuer has an insider trading policy (and, if so, file a copy of such policy as an exhibit to Form 10-K), or if there is no policy in place, an explanation regarding why the issuer has not adopted an insider trading policy; and
- in its Forms 10-Q and 10-K, whether during the last completed fiscal quarter any director or officer adopted or terminated any "Rule 10b5-1(c) trading arrangement"[2] or "non-Rule 10b5-1 trading arrangement"[3] and a description of the material terms of such trading arrangements, including:
  - 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;
  - the aggregate number of securities to be sold or purchased under the plan (but such descriptions do not need to disclose the pricing terms of the plan); and
  - whether the trading arrangement is a Rule 10b5-1 trading arrangement or a non-Rule 10b5-1 trading arrangement.

New Option Grant Disclosure Requirements

The Commission also adopted new Item 402(x) of Regulation S-K, which requires issuers to describe in Form 10-Ks and annual proxy statements their policies and practices relating to the timing of awards of options and SARs in relation to the disclosure of material non-public information, including (i) how the timing of awards is determined, (ii) how such information is taken into account, if at all, when determining the timing and terms of awards, and (iii) whether the issuer timed the disclosure of such information to affect the value of executive compensation.

Item 402(x) will also require tabular disclosure in Form 10-Ks and proxy statements of option grants (including options and SARs) made to named executive officers during the last completed fiscal year in the period beginning four business days before the filing of a Form 10-Q or 10-K or the filing or furnishing of a Form 8-K that discloses material non-public information and ending one business day after the triggering event. The table must include the following information:

- the name of the named executive officer;
- the grant date of the award;
- the number of securities underlying the award;
- the per share exercise price of the award;
- the grant date fair value of the award; and
- the percentage change in the market price of the underlying securities between the closing market price of the security on the trading day before and on the trading day after the release of such

information.

New Section 16 Reporting Requirements

New Form 4 and Form 5 Checkbox

To increase the frequency of disclosure and transparency into Rule 10b5-1 plans, the Commission's final rules impose additional reporting requirements for Section 16 insiders. The new rules subject Section 16 insiders to a new check-the-box disclosure requirement indicating whether the transaction reported on a Form 4 or a Form 5 was made pursuant to a plan that is intended to satisfy the affirmative defense conditions of Rule 10b5-1(c).

Gifts

In addition, Section 16 insiders must report donations (but not receipt) of securities on Form 4 (due within two business days after the reported transaction) instead of on Form 5 (due on or before the 45th day after the end of the issuer's fiscal year).

Compliance Dates

These final amendments are subject to the following compliance dates:

- The amendments to Rule 10b5-1 become effective 60 days after they are published in the Federal Register.
- Section 16 reporting persons must comply with the amendments to Forms 4 and 5 for reports filed on or after April 1, 2023.
- Issuers must comply with the new Regulation S-K Item 402(x) and Item 408 disclosure requirements in the first filing that covers the first full fiscal period that begins on or after April 1, 2023.
- Smaller reporting companies must comply with all final amendments in the first filing that covers the full fiscal period beginning on or after October 1, 2023.

[1] The Commission's final rule release is available at https://www.sec.gov/rules/final/2022/33-11138.pdf.

[2] Item 408 defines a Rule 10b5-1 trading arrangement as "any contract, instruction or written plan for the purchase or sale of securities of the registrant intended to satisfy the affirmative defense conditions of Rule 10b5-1(c)."

[3] Item 408 provides that a director or officer "has entered into a non-Rule 10b5-1 trading arrangement where: (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) the trading arrangement: (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."