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Securities Alert

DECEMBER 21, 2021

SEC proposes new requirements regarding Rule 10b5-1 plans, insider trading, and share repurchases

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The SEC's proposed amendments would tighten various rules governing Rule 10b5-1 plans, insider trading, and share repurchases.

What's the Impact?

- The proposed Rule 10b5-1 and insider trading amendments would impose significant new conditions on Rule 10b5-1 plans and disclosure requirements related to compensatory option grants and insider trading
- The proposed share repurchase amendments would require frequent granular reporting and expand required disclosures relating to issuer share repurchases
- Each of the proposals discussed in this alert will be open to public comment for 45 days upon publication in the *Federal Register*

On December 15, 2021, the Securities and Exchange Commission ("SEC" or the "Commission") proposed four sets of amendments to the Commission's rules and forms, including amendments relating to insider trading, share repurchases, money market funds, and security-based swaps transactions.

This alert focuses on two proposals recommended by the staff of the SEC's Division of Corporation Finance (the "Staff") which would (a) amend Rule 10b5-1 under the Securities Exchange Act of 1934 (the "Exchange Act") to introduce additional conditions to the availability of the affirmative defense afforded by Exchange Act Rule 10b5-1(c)(1) and impose new disclosure and reporting requirements related to insider trading, certain equity compensation awards to executive officers and directors, and gifts of equity securities by officers and directors (the "Rule 10b5-1 and Insider Trading Proposal"), and (b) establish new reporting requirements for issuer share repurchases (the "Share Repurchase Proposal").

Rule 10b5-1 and Insider Trading Proposal[1]

The Rule 10b5-1 and Insider Trading Proposal targets "potentially abusive practices" associated with Rule 10b5-1 plans (which permit, under certain circumstances, trading of securities at times that would not otherwise be permissible), grants of options and other equity instruments with similar features to directors and officers made close in time to the release of material nonpublic information, and insider gifts of securities. Specifically, the proposal includes a variety of rule and form amendments designed to address "concerns about abuse of the rule to opportunistically trade securities on the basis of material nonpublic information in ways that harm investors and undermine the integrity of the securities markets." As proposed, the amendments would codify certain "best practices" which have evolved since the adoption of Rule 10b5-1 in August 2000, but also impose new disclosure requirements and substantive restrictions for both companies and directors and officers conducting transactions under Rule 10b5-1 plans and other trading arrangements.

Insider trading and company share repurchases under Rule 10b5-1 plans have attracted media scrutiny and congressional attention for many years, and rulemaking to close perceived gaps in the current SEC rules concerning these activities has been widely anticipated. Potentially abusive practices cited by the Commission include: use of multiple overlapping plans to selectively cancel individual trades on the basis of material nonpublic information; commencing trades soon after the adoption of a new plan or the modification of an existing plan, trading arrangements that are terminated shortly after adoption; company share repurchases conducted to raise the price of the company's stock in advance of sales by corporate insiders, grants of spring-loaded options and similar equity awards to directors and officers prior to the release of material nonpublic information, and gifts made by insiders while aware of material nonpublic information.

Section 10(b) of the Exchange Act and Rule 10b-5 thereunder prohibit purchases or sales of company securities on the basis of (i.e., when aware of) material nonpublic information in breach of a duty owed to the company, its shareholders, or any person who is the source of the material nonpublic information. Rule 10b5-1(c) provides an affirmative defense to liability for insider trading where certain conditions are satisfied. Conducting transactions pursuant to a written trading plan entered into in compliance with the conditions specified in Rule 10b5-1(c) significantly reduces the risk of insider trading liability, making Rule 10b5-1 plans a popular and

[1] See the full text of the Rule 10b5-1 and Insider Trading Proposal.

widely used arrangement for trading of company securities by, in addition to companies themselves, directors, officers, and other company insiders who may regularly have access to material nonpublic information.

Rule 10b5-1(c)'s conditions for use of a Rule 10b5-1 plan that affords the benefits of the affirmative defense currently include:

- A binding contract, instruction, or written plan for trading securities, entered into at a time the person is not aware of the material nonpublic information, which:
  - specifies the amount of securities to be purchased or sold, the price, and the date;
  - provides a written formula, algorithm, or computer program for determining the amount of securities to be purchased or sold, the price, and the date; or
  - does not permit the person to exercise any subsequent influence over how, when, or whether to effect purchases or sales; provided, in addition, that any other person who exercises such influence is not aware of the material nonpublic information when doing so; and
- The purchase or sale that occurred was pursuant to the contract, instruction, or plan; and
- The contract, instruction, or plan was entered into in good faith and not as part of a plan or scheme to evade the prohibitions of Exchange Act Section 10(b) and Rule10b-5.

Additionally, Rule 10b5-1 provides that a company seeking to claim the affirmative defense may demonstrate that a purchase or sale of securities is not made on the basis of material nonpublic information by showing that (a) the individual making the investment decision on behalf of the company was not aware of the material nonpublic information and (b) the company had implemented reasonable policies and procedures to prevent trading on the basis of material nonpublic information.

The proposed amendments to Rule 10b5-1 would add the following conditions and restrictions:

Minimum cooling-off periods:

- For company directors or Section 16 officers (i.e., the president, principal financial officer, principal accounting officer, any vice-president in charge of a principal business unit, division or function, any other officer who performs a policy-making function, or any other person who performs similar policy-making functions), a 120-day minimum waiting period after adoption of the plan or other trading arrangement before any trading can commence, including after adoption of any modifications of the plan or other trading arrangement.
- For the company, a 30-day minimum waiting period after plan adoption of the plan or other trading arrangement before any trading can commence, including after adoption of any modifications of the plan or other trading arrangement.
- Modification of an existing Rule 10b5-1 plan or other trading arrangement, including cancelling one or more trades, would be deemed equivalent to terminating the plan in its entirety. As a result, a new cooling-off period would apply after a modification before any new trades could commence.

Certification requirement:

- A director or Section 16 officer adopting a10b5-1 plan or other trading arrangement would be required to personally certify to the issuer, in writing, that they are not aware of material nonpublic information about the issuer or security and that they are adopting the new or modified plan or other trading arrangement 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.

A director or Section 16 officer seeking to rely on the affirmative defense would be instructed to retain a copy of the certification for a period of ten years. However, as proposed, the amendments would not require a director, officer, or the issuer to file the certification with the Commission and the certification would not be an independent basis of liability for directors or officers under Exchange Act Section 10(b) and Rule 10b-5.

Restrictions on multiple overlapping Rule 10b5-1 trading arrangements and single-trade arrangements:

- The affirmative defense would not be available for multiple overlapping plans or other trading arrangements for open market purchases or sales of the same class of securities. The Commission indicates that this proposed restriction, which would not apply to transactions directly with the issuer (for example, through an employee stock plan or dividend reinvestment plan), is designed to eliminate the ability of insiders to use multiple plans to strategically execute trades based on material nonpublic information and then claim the protection of the affirmative defense for such trades.
- The affirmative defense would be available for only one single-trade plan during any 12-month period.

Good faith operation:

- In addition to the existing requirement that a plan must be entered into in good faith and not as part of a plan or scheme to evade the prohibitions of Rule 10b-5, proposed amendments to Rule 10b5-1(c) would impose a requirement that the plan or other trading arrangement must be operated in good faith. The Commission indicates in the proposing release that this additional condition is intended to clarify that the affirmative defense will not protect an insider from liability if the insider cancels or modifies a plan in an effort to evade the prohibitions of the rule or influences the timing of a corporate disclosure to occur before or after a planned trade under a plan to make that trade more profitable or to avoid or reduce a loss.

The proposed rules would also expand the Commission's disclosure requirements relating to Rule 10b5-1 trading arrangements, director and officer options grants, and company insider trading policies and procedures. These enhanced disclosure requirements, intended to provide greater transparency to investors and the Commission and to reduce potential abuse, would include:

Quarterly reporting of trading plans and other trading arrangements:

- As proposed, new Item 408(a) of Regulation S-K would require disclosure of the adoption and termination (including a modification) of any Rule 10b5-1 trading arrangements or non-Rule 10b5-1 trading arrangements covering transactions in company securities by the company, its directors, or its Section 16 officers, and the material terms of the arrangements, including the name and title of the director or officer (if applicable), the date of adoption or termination, the duration, and the aggregate number of securities to be purchased or sold.
- These disclosures (tagged using inline XBRL) would be required in the company's Form 10-Q and Form 10-K or Form 20-F for the reporting period in which the relevant plan is entered into, modified, or terminated.

Disclosure of insider trading policies and procedures:

- As proposed, new Item 408(b) of Regulation S-K would require a reporting company to disclose whether or not (and if not, why not) the company has adopted insider trading policies and procedures, and, if adopted, to disclose policies and procedures (or, if applicable, provide a cross reference to the relevant components of the company's code of ethics).
- These disclosures (tagged using inline XBRL) would be required in the company's annual reports on Form 10-K or Form 20-F and proxy and information statements on Schedule 14A and 14C.

Identification of trading plan transactions on Forms 4 and 5:

- Section 16 officers and directors would be required to indicate in Form 4 and Form 5 filings that a reported transaction was made pursuant to a Rule 10b5-1(c) trading arrangement and to provide the date of adoption of the arrangement.
- Amended Forms 4 and 5 would provide an additional checkbox for voluntary indication that a reported transaction was made pursuant to a non-Rule 10b5-1(c) pre-planned contract, instruction, or written plan.

Disclosure regarding the timing of certain grants of options and similar equity instruments:

- As proposed, new Item 402(x) of Regulation S-K would require tabular disclosure (with quantitative information tagged in inline XBRL) of each option award granted within 14 calendar days of 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 and the market price of the underlying securities on the trading day before and the trading day after the release of the material nonpublic information.
- Additionally, Item 402(x) would require narrative disclosure (in the Compensation Discussion & Analysis (CD&A) or elsewhere) about the company's option grant policies and practices regarding the timing of option grants and the release of material nonpublic information,

including how the board determines when to grant options and whether, and if so, how, the board or compensation committee takes material nonpublic information into account when determining the timing and terms of an award.

- These disclosures, which the Commission indicates are intended to provide shareholders a full and complete picture of "spring-loaded" or "bullet-dodging" option grants during the fiscal year, would be required in the company's annual reports on Form 10-K and proxy and information statements related to the election of directors, shareholder approval of new compensation plans, and solicitations of advisory say-on-pay votes. Smaller reporting companies and emerging growth companies would be subject to the Item 402(x) reporting requirements.

Form 4 reporting of gifts:

- As proposed, bona fide gift transfers by Section 16 reporting persons (i.e., Section 16 officer, directors and 10%+ shareholders), currently reportable on Form 5 unless earlier reported voluntarily on Form 4, would be required to be reported within two business days of the transfer on Form 4.

Share Repurchase Proposal[2]

The Share Repurchase Proposal would require, among other things discussed below, more timely and granular disclosures of company and affiliated purchaser share repurchases, including next-day reporting of class, number of shares, and average price paid. The proposal includes amendments to several Commission rules and forms, as well as a new Form SR, which the Commission indicates would modernize and improve disclosure about issuer share repurchase activities. Currently, outside of the financial statements, the Commission's rules mandate disclosure of share repurchase activity on a quarterly basis in a company's Form 10-Q and Form 10-K filings.[3]

The Commission states in the proposing release that the proposal "results from an ongoing, comprehensive evaluation of our disclosure requirements," referencing back to the Commission 2016 Concept Release on the business and financial disclosure required by Regulation S-K, including issuer and affiliated purchaser stock purchase disclosure required under Regulation S-K Item 703 and various studies, articles, and public testimony since 2010 relating to the regulation and conduct of stock buybacks. The Commission further indicates that the proposed new disclosure requirements would address "information asymmetries between issuers and affiliated purchasers and investors" and would allow investors to better understand the extent of an issuer's activity in the market, motivation for its share repurchases, and how the issuer is executing its purchase plan. Additionally, the enhanced disclosures would allow investors to gain potential insight into any relationship between share repurchases and executive compensation

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[2] See the full text of the Shareholder Repurchase Proposal.

[3] Foreign private issuers are required to report repurchase activity on an annual basis in Form 20-F; certain closed-end funds are required to report similar information on a semi-annual basis in Form N-CSR.

and stock sales and "could also improve the ability of investors to identify repurchases that are more likely to be driven by managerial self-interest."

The amendments propose to add the following new and expanded disclosure requirements for company and affiliated purchaser share purchases:

Next-day reporting of purchase transactions on Form SR:

- As proposed, new Exchange Act Rule 13a-21 and Form SR would require companies to report any purchase of equity securities registered under Section 12 of the Exchange Act made by or on behalf of the company or any affiliated purchaser. This disclosure would be required to be furnished to the Commission via EDGAR on new Form SR (tagged using inline XBRL) before the end of the first business day following the trade date of any company share repurchase.
- New Form SR would require disclosure in tabular format, by date, for each applicable class or series of securities:
  - identification of the class of securities purchased,
  - total number of shares (or units) purchased (whether or not made pursuant to a publicly announced plan or programs),
  - the average price paid per share (or unit),
  - the aggregate total number of shares (or units) purchased on the open market,
  - the aggregate total number of shares (or units) purchased in reliance on the Rule 10b-18 safe harbor, and
  - the aggregate total number of shares (or units) purchased pursuant to a Rule 10b5-1(c) plan.
- As proposed, Form SR would be furnished and not filed. Issuers therefore would not be subject to liability under Section 18 of the Exchange Act for the disclosure in the form, and the information would not be deemed incorporated by reference into filings under the Securities Act and thus would not be subject to liability under Section 11 of the Securities Act, unless expressly incorporated by the issuer.

Expanded disclosure requirements under Item 703:

- Item 703 is proposed to be revised and expanded (with corresponding changes to Form 20-F and Form N-CSR) to require additional Form 10-Q and Form 10-K disclosure of:
  - the objective or rationale for the company's share repurchases and its process or criteria used to determine the amount of repurchases;
  - any company policies and procedures relating to purchases and sales of its securities by its officers and directors during a repurchase program, including any restriction on such transactions;
  - whether the company's repurchases were effected under a Rule 10b5-1 plan, and if so, the date that the plan was adopted or terminated;
  - whether purchases were made in reliance on the Rule 10b-18 safe harbor; and
  - whether any of its Section 16 officers or directors purchased or sold shares or other units of the class of the same issuer's equity securities that is the subject of the company's share repurchase plan or program within 10 business days before or after the announcement of the

company's purchase plan or program; this proposed disclosure would be in check box format accompanying the Item 703 disclosure.

XBRL tagging requirements and technical amendments:

- The Shareholder Repurchase Proposal also would require companies to tag all information reported under Item 703 and in Form SR (as well as corresponding disclosures in Form 20-F and Form N-CSR) in inline XBRL.
- The Shareholder Repurchase Proposal also includes a number of technical clarifying amendments to Item 703, Form 20-F, and Form N-CSR.

Each of the proposals discussed in this alert will be open to public comment for a relatively brief 45 days upon publication in the *Federal Register*.

For more information on the content of this alert, please contact your Nixon Peabody attorney or:

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