Harvard Law School Forum on Corporate Governance

Amendments to Rules Governing Trading Plans and Insider Filings

Posted by Eleazer Klein, Adriana Schwartz, Daniel A. Goldstein, Schulte Roth & Zabel LLP, on Thursday, January 26, 2023

Editor's note: Eleazer Klein and Adriana Schwartz are Partners, and Daniel A. Goldstein is an Associate at Schulte Roth & Zabel LLP. This post is based on their SRZ memorandum. Related Program research includes Insider Trading Via the Corporation (discussed on the Forum here) by Jesse Fried.

On Dec. 14, 2022, the Securities and Exchange Commission (the "SEC") adopted amendments to Rule 10b5-1 under the Securities Exchange Act of 1934 (the "Exchange Act"), that include, among other things, changes to Rule 10b5-1(c)(1)'s affirmative defense to insider trading liability under Section 10(b) and Rule 10b-5 under the Exchange Act. These changes are aimed at addressing concerns that have long been raised as to whether corporate insiders purport to utilize 10b5-1 plans under the affirmative defense in situations that in fact involve opportunistic trading while in possession of material non-public information ("MNPI"). As discussed below, the amendments may impact fund managers who have board representation or otherwise have access to MNPI. The SEC also adopted amendments to Forms 4 and 5 filed under Section 16 of the Exchange Act to require that filers identify transaction that have been executed pursuant to 10b5-1 plans as well requiring Forms 4 to be filed to report gifts of securities (and no longer allow for deferred reporting of gifts on Form 5).

1. Changes to Plan Requirements: Mandatory Cooling Off Periods and Certifications

A. *Mandatory Cooling-Off Periods*: The SEC's most prominent change to Rule 10b5-1 is the new requirement for mandatory cooling-off periods. Though many issuers already require cooling-off periods under their insider trading policies.[1] Rule 10b5-1 will now mandate that no trading under a newly-adopted or modified 10b5-1 plan can take place until:

> (i) For directors and "officers,"[2] the later of: (1) 90 days after the date the plan was adopted or modified and (2) two business days following the issuer's filing of a Form 10-K

[1] As indicated in footnote 448 of the Adopting Release, cooling off periods tend to range from 30 to 60 days under current industry practice.

[2] As defined in Rule 16a-1(f) under the Exchange Act: "an issuer's president, principal financial officer, principal accounting officer (or, if there is no such accounting officer, the controller), any vice-president of the issuer in charge of a principal business unit, division or function (such as sales, administration or finance), any other officer who performs a policy-making function, or any other person who performs similar policy-making functions for the issuer. Officers of the issuer's parent(s) or subsidiaries shall be deemed officers of the issuer if they perform such policy-making functions for the issuer. In addition, when the issuer is a limited partnership, officers or employees of the general partner(s) who perform policy-making functions for the limited partnership are deemed officers of the limited partnership. When the issuer

or Form 10-Q[3] disclosing the issuer's financial results for the fiscal quarter in which the plan was adopted or modified (but not to exceed 120 days following plan adoption or modification); and

(ii) For non-directors or officers (other than the issuer)[4], 30 days after the plan was adopted or modified.

The Adopting Release indicates that the mandated cooling-off period is aimed at "reducing information asymmetries" and providing "separation[s] in time" so that insiders are less likely to be trading on MNPI.

B. *Director and Officer Certifications*: Rule 10b5-1 has always required that persons "demonstrate[]" that they adopted their trading plan in good faith and at a time that they were not aware of material non-public information. Now, an amendment to Rule 10b5-1(c)(1)(ii) will impose a certification requirement in order to help ensure directors and officers are cognizant of their responsibilities *at the adoption of a plan* and to assess if they are in possession of material non-public information before adopting a 10b5-1 plan. Accordingly, the amendments require that directors and officers provide in the plan itself a written certification or representation stating that, at the time the 10b5-1 plan is adopted or an existing plan is modified, the director or officer:

(i) Is not aware of material non-public information about the issuer or its securities, and

(ii) That the director or officer is adopting the contract, instruction or plan in good faith and not as part of a plan or scheme to evade the prohibitions of Rule 10b-5.

This amendment does not require the certification to be filed with the SEC and would not be an independent basis of liability for directors or officers under Section 10(b) or Rule 10b-5.

2. Restrictions on Types of Plans, Trading Arrangements and Use of Plans

A. *Prohibition on Overlapping Plans*: The new amendments to Rule 10b5-1's affirmative defense will provide that persons (other than issuers) may not have more than one outstanding (and may not subsequently enter into any additional) contract, instruction or plan that would qualify for the affirmative defense under Rule 10b5-1 for purchases or sales of any class of securities of the issuer on the open market during the same period. Despite the fact that the SEC originally proposed limiting the restriction to only the "same class of securities" of an issuer, the SEC ultimately decided to broaden the restriction to apply to all "contracts, instructions or plans for any class of securities of the issuer." It is worth noting that:

(i) In general, plan participants cannot circumvent these restrictions by trading through multiple brokers.

---

is a trust, officers or employees of the trustee(s) who perform policy-making functions for the trust are deemed officers of the trust."

[3] Or, for foreign private issuers, in a Form 20-F or Form 6-K.

[4] A cooling off period is not required for issuer 10b5-1 plans.

(ii) Persons may, however, maintain two separate 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.

(iii) Certain "sell-to-cover" transactions will still be permitted.

(iv) The restriction on the availability of the affirmative defense for multiple overlapping trading arrangements will not apply to plans not involving open-market transactions, such as employee benefit plans, ESOPs or DRIPs.

B. Limitations *on Single-Trade Plans*: Given the SEC's concerns that single-trade plans may be used to trade based on MNPI, Rule 10b5-1(c)'s affirmative defense will no longer be available to persons (other than the issuer) who, during a 12-month period, purchased or sold securities pursuant to another single-trade plan.

C. *Plans Must Be "Operated" in Good Faith*: In an attempt to "discourage insiders from attempting to evade the prohibitions of the rule," the amendments also expand the existing requirement that a Rule 10b5-1 trading arrangement must be "given or entered into" in good faith to add the condition that the trader "act in good faith" with respect to the trading arrangement during the life of the plan. This requirement is aimed at activities related to plan cancellations and the timing of corporate disclosures when plans are in place.

3. Additional Disclosure Requirements

Finally, the amendments to Rule 10b5-1 impose additional disclosure requirements on insiders and issuers. Those subject to the reporting requirements under Section 16 of the Exchange Act will be required to:

(i) Indicate using checkboxes on Forms 4 or 5 if a reported transaction was intended to satisfy the affirmative defense conditions of Rule 10b5-1(c) and to disclose the date of adoption of the trading plan; and

(ii) Report dispositions of bona fide gifts of equity securities on Form 4 (rather than on Form 5) in accordance with Form 4's two business day filing deadline.

In addition, issuers will be required to make annual disclosure regarding insider trading policies and procedures in corresponding amendments to Form 10-K, quarterly disclosure regarding the use of 10b5-1 plans and certain other trading arrangements under amendments to Form 10-Q, make period disclosures under Form 8-K regarding the timing of options grants and the release of material non-public information as well as other disclosures, and abide by additional information tagging requirements under Items 402 and 408 or Regulation S-K, as such information may be disclosed in proxy statements or other materials.

Will These Amendments Affect Fund Managers?

Fund managers with employees on boards of public companies will be most impacted by the new mandatory 90-120 day cooling-off period. Under the cooling-off period, trading isn't likely to be

permitted to commence prior to the next open trading window following plan adoption or modification. It remains to be seen whether these insiders will find a material benefit to using a 10b5-1 plan versus conducting their trading during open trading windows.

The 30 day cooling-off period for shareholders other than officers and directors will likely be less impactful, as many shareholders who use 10b5-1 plans, as well as brokers, have imposed their own cooling-off periods (unusually in the range of 30 days) as a matter of best practice. The other amendments will likely be similarly less impactful as the use of multiple overlapping plans and the focus on adopting and administering plans in good faith are issues that fund managers have been sensitive to for some time.

The final rules will become effective 60 days following publication of the adopting release in the Federal Register (on or about Feb. 12, 2023). Section 16 reporting persons will be required to comply with the amendments to Forms 4 and 5 for beneficial ownership reports filed on or after April 1, 2023 and issuers will be required to comply with the new Exchange Act disclosure requirements on or after April 1, 2023 as well.