January 5, 2022

SEC proposes significant changes to rules and reporting requirements regarding trading by insiders, share repurchases and option grants

On December 15, 2021, the Securities and Exchange Commission (the "SEC") proposed amendments to Rule 10b5-1 that could have a significant impact on trading by individuals who have access to material nonpublic information ("MNPI") about an issuer.[1] The proposed rule would also impose additional restrictions on the ability of issuers to buy back securities and additional disclosure requirements. Also on December 15, 2021, the SEC issued a second release proposing new disclosure requirements for issuers repurchasing equity securities.[2] Comments on both proposals will be due 45 days after it is published in the federal register.

Rule 10b5-1(c) provides a widely used method for insiders to sell securities and for issuers to repurchase securities, permitting them to adopt a plan that would trigger trades at some point in the future based on pre-established criteria, so long as they are not in possession of MNPI at the time that they adopt the plan.[3] The rule provides an affirmative defense to liability under Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act"), and Rule 10b-5 thereunder, for trades pursuant to a properly established 10b5-1 trading plan.[4] The new rules proposed by the SEC would impose additional requirements that must be met in order to rely on Rule 10b5-1(c). The proposed requirements differ based on who is engaged in the transactions and are coupled with additional proposed disclosure requirements.

- All persons. Several of the amendments to Rule 10b5-1(c) would apply to all 10b5-1 plans. These amendments are generally intended to mitigate the risk that Rule 10b5-1(c) is abused through the selective termination or modification of a plan on the basis of MNPI[5] or influence over an issuer to time corporate announcements with transactions scheduled to occur under a 10b5-1 plan.
    - *Multiple plans.* The proposed amendments would make Rule 10b5-1(c) unavailable to any person "who has established multiple overlapping trading arrangements for open market repurchases or sales of the same class of securities."[6] The amendment is intended to prevent selective termination of overlapping plans in order to take advantage of MNPI (for example, entering into plans to purchase and sell a security and terminating the sale plan if the person becomes aware of MNPI indicating the price is likely to increase)
    - *Single purchase plans.* The proposed amendments also limit the availability of the affirmative defense for plans that only contemplate a single trade. The affirmative defense would only be available for such a plan only once during any 12-month period. The SEC proposed that limitation based on "[r]ecent research that indicates that single-trade plans are consistently loss avoiding and often precede stock price declines."[7]
    - *Expanded "good faith" requirement.* Rule 10b5-1(c) currently requires that a plan be entered into in good faith. The proposed rule would expand that requirement to also require that the plan be "operated" in good faith. The SEC stated that the proposed change "is intended to make clear that the affirmative defense would not be available to a trader that cancels or modifies his or her plan in an effort to evade the prohibitions of the rule or uses his or her influence to affect the timing of a corporate disclosure to occur before or after a planned trade."[8] A practical effect of this proposed change would be to increase the likelihood that termination of a plan while in possession of MNPI results in the affirmative defense becoming unavailable for transactions previously executed under that plan.[9]
- Directors and officers. The SEC's proposed amendments would impose additional restrictions on directors and officers. The SEC's rationale for imposing these additional restrictions is that "such individuals are more likely than others to be aware of material nonpublic information in the general course of events, and also more likely to

be involved in making or overseeing key corporate decisions that have the potential to affect the issuer's stock price, including decisions about the timing of the disclosure of such information."

- *Cooling-off period.* The proposed amendments would require a 120-day cooling-off period between when a 10b5-1 plan is adopted or modified and the first transaction. The purpose of the cooling-off period is to prevent directors and officers who enter into 10b5-1 plans while potentially in possession of MNPI (which would itself, if that were the case, make the affirmative defense unavailable) from being able to transact under that 10b5-1 plan before the potential MNPI becomes stale. While cooling-off periods are a common feature of 10b5-1 plans today, they are not currently required by Rule 10b5-1(c) and are often substantially shorter than 120 days.[10]
- *Certification requirement.* The SEC has proposed that, in order to utilize Rule 10b5-1(c), directors and officers must provide the issuer with a certification at the time the director or officer adopts a 10b5-1 plan. In that certification, the director or officer would represent that the director or officer is not aware of MNPI and is adopting the 10b5-1 plan in good faith. Under the proposal, such certifications must be retained for 10 years.
- *Disclosure.*
  - **Disclosure of the adoption or termination of trading plans.**
    - Currently, there is no requirement to publicly disclose the adoption, modification or termination of a 10b5-1 plan.
    - The proposed amendments would require each issuer (other than foreign private issuers that file on Form 20-F) to disclose on a quarterly basis the name and title of each director and officer who has adopted, modified, or terminated "any contract, instruction or written plan for the purchase or sale of equity securities of the registrant," regardless of whether such plan meets the requirements of Rule 10b5-1.[11]
    - That disclosure would include "a description of the material terms of the contract." The 10b5-1 Proposing Release states that the duration of the 10b5-1 plan, the date it was entered into, modified or terminated and the aggregate number of securities to be purchased or sold would need to be disclosed. The 10b5-1 Proposing Release does not address if other potentially sensitive information, such as price triggers or when transactions are scheduled to occur, also would be treated as "material terms of the contract."[12]
  - **Form 4 and Form 5 reporting by directors, officers and greater than 10% holders.**
    - The SEC also proposed requiring persons filing Section 16 reports (including persons who are only subject to Section 16 because they are greater than 10% holders and, therefore, would not be subject to the cooling-off and disclosure requirements described above) to identify transactions executed under a 10b5-1 plan by ticking a checkbox.[13] The SEC also proposed adding a second checkbox that filers could voluntarily use to identify transactions executed under a pre-planned trading plan that was not intended to meet the conditions of Rule 10b5-1(c).
    - The SEC also proposed a change to the Section 16 reporting requirements for gifts by mandating disclosure on Form 4 within two business days, rather than allowing the current alternative of delayed reporting of gifts on Form 5 by the 45th day after the end of year in which the gift was made.

- Issuers. The 10b5-1 Proposing Release also includes amendments that would impose cooling-off periods on issuers who wish to use 10b5-1 plans to repurchase securities, disclosure requirements regarding those 10b5-1 plans, and disclosure requirements regarding insider trading policies.
  - *Cooling-off periods.* Issuer repurchase plans intended to benefit from the affirmative defense of Rule 10b5-1 would be subject to a 30-day cooling-off period.
  - *Disclosure of 10b5-1 plans for repurchases, insider trading policies and option grants.*
    - **Disclosure of the adoption or termination of trading plans.** The proposal would require issuers (other than foreign private issuers that file on Form 20-F) to disclose the adoption, modification or termination of "any contract, instruction or written plan for the purchase or sale of" its own equity securities, regardless of whether or not those plans meet the requirements of Rule 10b5-1.[14] Like the analogous disclosure proposed for trading plans adopted by directors and officers, it would be required to include "material terms" of the trading plan, including the duration, date of adoption, modification or termination and number of securities subject to the plan.
    - **Insider trading policies.** In the 10b5-1 Proposing Release, the SEC also proposed requiring an issuer to disclose whether it has adopted an insider trading policy, to describe the policy, and to make it publicly available. While the 10b5-1 Proposing Release is not prescriptive with respect to the content of insider trading policies, it suggests that the disclosure discuss the issuer's policies and procedures for determining if persons have MNPI and how compliance with the insider trading policy is enforced.

      Notably, the SEC specifically suggests that insider trading policies address gifts of securities. In discussing gifts, the SEC stated that "a donor of securities violates Exchange Act Section 10(b) if the donor gifts a security of an issuer in fraudulent breach of a duty of trust and confidence when the donor was aware of material nonpublic information about the security or issuer, and knew or was reckless in not knowing that the donee would sell the securities prior to the disclosure of such information."[15] Chair Gensler also noted the application of insider trading laws to gifts in his statement regarding the 10b5-1 Proposing Release, stating that "charitable gifts of securities are subject to insider trading laws."[16]

      Issuers who do not currently address gifts in their insider trading policies should consider appropriate revisions.
  - **Disclosure of "spring-loaded" options.** The 10b5-1 Proposing Release also would amend Item 402 of Regulation S-K to require disclosure regarding options granted to named executive officers (NEOs) or directors within 14 calendar days before or after (i) a share repurchase, (ii) filing of a quarterly or annual report or (iii) filing or furnishing a Form 8-K that includes MNPI. The disclosure would need to include the number of shares underlying the award, the date of the grant, the grant date fair value, the exercise price and the market price of the underlying securities on the trading days before and after the relevant disclosure of MNPI.

    The 10b5-1 Proposing Release would also require that issuers provide narrative disclosure "about an issuer'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."[17]

- *Disclosure of Repurchase Activity.* In addition to the 10b5-1 Proposing Release, on December 15, 2021 the SEC issued the Equity Repurchase Proposing Release, which proposed additional disclosure requirements for repurchase activity.
    - **Disclosure at the time of repurchases of equity securities.** That proposal would require issuers to publicly submit on EDGAR a new SEC form (Form SR)[18] within one business day after the execution of a share repurchase order. Form SR would require an issuer to disclose:
        - The number of securities repurchased;
        - The average price;
        - The aggregate number repurchased in reliance on the Rule 10b-18 safe harbor; and
        - The aggregate number repurchased pursuant to a 10b5-1(c) plan.
    - **Disclosure in annual and quarterly reports.** The Equity Repurchase Proposing Release also would require expanded repurchase disclosure in quarterly and annual reports, including:
        - "The objective or rationale for its share repurchases and process or criteria used to determine the amount of repurchases;
        - Any policies and procedures relating to purchases and sales of the issuer's securities by its officers and directors during a repurchase program, including any restriction on such transactions;" and
        - If any officers or directors purchased or sold other securities of the relevant class within 10 business days before or after the announcement of an issuer purchase plan or program.[19]

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If you would like to follow up regarding any of the matters covered by this Alert, please contact your usual Ropes & Gray attorney.

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1. SEC Release No. 33-11013 (December 15, 2021) (the "10b5-1 Proposing Release"). The 10b5-1 Proposing Release is *available at* https://www.sec.gov/rules/proposed/2021/33-11013.pdf
2. SEC Release No. Release Nos. 34-93783 (Dec. 15, 2021) (the "Equity Repurchase Proposing Release"). The Equity Repurchase Proposing Release is *available at* https://www.sec.gov/rules/proposed/2021/34-93783.pdf.
3. Issuers typically only allow 10b5-1 trading plans to be entered into during open trading windows.
4. Exchange Act Rule 10b5-1(c).
5. The SEC staff has previously stated that a decision not to transact in securities cannot give rise to liability for insider trading. Following from that principle, the SEC staff has confirmed that terminating a plan while aware of MNPI and thereby not engaging in a planned transaction does not, by itself, create insider trading liability under Section 10(b) of the Exchange Act or Rule 10b-5. See Exchange Act Rules Compliance and Disclosure Interpretations, Question 120.17, *available at* https://www.sec.gov/divisions/corpfin/guidance/exchangeactrules-interps.htm.

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6. 10b5-1 Proposing Release at 24.
7. 10b5-1 Proposing Release at 25.
8. 10b5-1 Proposing Release at 26 – 27.
9. The SEC staff has previously stated that termination or modification of a 10b5-1 plan while in possession of MNPI may "call into question whether the plan was 'entered into in good faith and not as part of a plan or scheme to evade' the insider trading rules within the meaning of Rule 10b5-1(c)(1)(ii). The absence of good faith or presence of a scheme to evade would eliminate the Rule 10b5-1(c) defense for prior transactions under the plan." The proposed change would represent an expansion of that position – focusing the question on the intent of the trader at the time of the termination or modification rather than their intent at the time the 10b5-1 plan was entered into. Exchange Act Rules Compliance and Disclosure Interpretations, Question 120.18, *available at* https://www.sec.gov/divisions/corpfin/guidance/exchangeactrules-interps.htm.
10. See 10b5-1 Proposing Release at 65 – 66.
11. 10b5-1 Proposing Release at 31.
12. 10b5-1 Proposing Release at 31.
13. In December 2020, the SEC proposed adding a checkbox to Form 4 and Form 5 that would allow filers to voluntarily identify transactions executed under 10b5-1 plans. SEC Release No. 33-10911 (Dec. 22, 2020). The amendments discussed in the 10b5-1 Proposing Release would similarly add a checkbox, but unlike the December 2020 proposal would require its use to identify transactions executed under 10b5-1 plans.
14. 10b5-1 Proposing Release at 30 – 31.
15. 10b5-1 Proposing Release at n.55.
16. Chair Gensler, Statement on Rule 10b5-1 and Insider Trading (Dec. 15, 2021), *available at* https://www.sec.gov/news/statement/gensler-10b5-20211215
17. 10b5-1 Proposing Release at 46.
18. Proposed Form SR would be furnished with the SEC, rather than filed. As such, Form SRs would not be automatically incorporated into registration statements or subject to liability under Section 18 of the Exchange Act.
19. Equity Repurchase Proposing Release at 22. Additionally, the issuer would be required to disclose if the repurchases were pursuant to a 10b5-1 plan and, if so, when the relevant plan was adopted or terminated, as well as whether the repurchases were made in reliance on Exchange Act Rule 10b-18.

This alert should not be construed as legal advice or a legal opinion on any specific facts or circumstances. This alert is not intended to create, and receipt of it does not constitute, a lawyer-client relationship. The contents are intended for general informational purposes only, and you are urged to consult your attorney concerning any particular situation and any specific legal question you may have. © 2021 Ropes & Gray LLP

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