

December 16, 2022

SEC Adopts Significant Changes to Rules and Reporting Requirements Regarding Trading by Insiders

Overview

On December 14, 2022, the Securities and Exchange Commission (the “SEC”) adopted amendments to Rule 10b5-1(c) under the Securities Exchange Act of 1934 (the “Exchange Act”) and certain other rules and regulations that will have a significant impact on the trading of securities by persons who have access to material nonpublic information (“MNPI”) about the security or the issuer of the security.¹

Rule 10b5-1(c) provides a widely used affirmative defense against insider trading liability under Section 10(b) of the Exchange Act and Rule 10b-5 thereunder for corporate 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. The amendments to Rule 10b5-1(c) adopted by the SEC impose additional requirements that must be met in order to benefit from the affirmative defense under Rule 10b5-1(c). The requirements differ based on who is engaged in the transactions and are coupled with additional disclosure requirements, including disclosures by officers and directors on beneficial ownership reports on Forms 4 and 5, quarterly disclosure by domestic issuers of trading plans adopted by directors and officers, annual disclosure by domestic issuers of certain option grants and annual disclosure by domestic issuers and foreign private issuers of insider trading policies. In general, the amendments, particularly the amendments to Rule 10b5-1(c), are designed to limit situations where “an insider’s awareness of MNPI may still ‘factor into the trading decision,’ even if the insider’s plans appear to satisfy the requirements of Rule 10b5-1(c)(1) [as currently in effect].”²

Effective Dates

While the amendments adopted by the SEC, including the amendments to Rule 10b5-1(c), will become effective 60 days after the Adopting Release is published in the Federal Register, the amendments to Rule 10b5-1(c) will not apply to 10b5-1 plans entered into before the effective date of the new rules unless such plans are modified after such effective date and such modification is deemed to be the adoption of a new plan under the new rules as discussed below under “Modifications of 10b5-1 Plans.” In addition, the new disclosure requirements are subject to phase-in rules. Filings of Forms 4 and 5 will be required to comply with the new disclosures (discussed below) starting April 1, 2023, and issuers will be required to comply with the new disclosure requirements (including the disclosure requirements regarding trading plans adopted by directors and officers) in Forms 10-Q, 10-K, 20-F and proxy or information statements (discussed below) in the filing that covers the first full fiscal period that begins on or after April 1, 2023. For domestic calendar year issuers, that will be the Form 10-Q for the period ending June 30, 2023.³

Amendments to Rule 10b5-1 and Related Disclosure Requirements

The key requirements of the amendments, categorized by the groups of persons they apply to, are discussed below.

- **All Persons.** One of the amendments to Rule 10b5-1(c), the expanded “good faith” requirement, would apply to all 10b5-1 plans. This amendment is generally intended to prevent Rule 10b5-1(c) from being abused through the selective termination or modification of a plan on the basis of MNPI or influence over an issuer to time corporate announcements with transactions scheduled to occur under a 10b5-1 plan.
 - *Expanded “good faith” requirement.* Currently, Rule 10b5-1(c) only requires that a plan be entered into in good faith. The recent amendments expand that requirement by providing that the person entering into the plan must also act in good faith with respect to the plan. That is, the good faith

requirement would now apply throughout the duration of the plan. The SEC notes in the Adopting Release that this change means, for example, that an insider that “directly or indirectly induces the issuer to publicly disclose [MNPI] in a manner that makes their trades under a Rule 10b5-1 plan more profitable (or less unprofitable)” would not be able to rely on Rule 10b5-1(c) for trading under that plan.⁴ Another practical effect of this change is 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 (or, potentially, under future plans).⁵ The SEC notes in the Adopting Release, however, that “cancellations [of trades under a 10b5-1 plan] directed by the issuer where such cancellations are outside the control or influence of the insider may not, by themselves, implicate the good faith condition.”⁶

- *Modifications of 10b5-1 Plans.* The amendments clarify when a modification of a 10b5-1 plan will constitute the adoption of a new plan by providing that any modification or change to the amount, price or timing of a trade under the plan would be treated as a termination of such plan and the adoption of a new plan on the modified terms. This means not only that issuers and insiders must satisfy the good faith requirement at the time of such modification or change, but also that, in the case of 10b5-1 plans of persons other than the issuer, the cooling-off periods discussed below will begin to run from the time such modification or change is adopted.
- All Persons other than the Issuer. Two of the amendments to Rule 10b5-1(c) would apply to all 10b5-1 plans entered into by persons other than the issuer. Like the expanded “good faith” requirement, 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.
 - *Multiple plans.* The amendments would make Rule 10b5-1(c) unavailable to any person that has “multiple overlapping plans” for trading securities of the issuer on the open market, subject to a few exceptions. 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). The prohibition would apply to such open market trading plans for any securities of the issuer rather than separately to plans for each class of securities of the issuer.

The SEC adopted three limited exceptions to the prohibition on multiple overlapping plans.

- *Multiple brokers.* The first exception makes clear the use of multiple brokers is not prohibited, even if the insider “enter[s] into a formally distinct contract or agreement with each agent authorized to conduct trades,” provided that “taken together the contracts otherwise satisfy the conditions of the rule.”⁷ A modification of any such contract would be treated as a modification of all contracts that constitute the “plan.” The exception also allows an insider to substitute one broker-dealer or agent for another, provided that “purchase or sale instructions applicable to the substituted broker and the substitute are identical.”⁸ The exception recognizes the fact that an insider may have securities held in different accounts and thus may need to use multiple brokers to execute trades under a single 10b5-1 plan.
- *Later-commencing plans.* The second exception allows insiders to maintain two separate 10b5-1 plans at the same time so long as trading under the later-commencing plan cannot (in accordance with such plan’s terms) begin until after all trades under the earlier-commencing plan have been completed or expire without completion, and the

relevant cooling-off period (treating the date on which the earlier-commencing plan has been terminated as the adoption date for the later-commencing plan) has been satisfied. While not free from doubt, it would appear that the better reading of the reference to “termination” in this cooling-off period condition is to an early termination of the plan, as opposed to both a scheduled termination and an early termination. The SEC’s note in the Adopting Release that “[a]bsent [the cooling-off period condition], an insider might cancel the earlier-commencing plan before its scheduled completion but still trade under the later-commencing plan in fewer than the minimum [number of days] that would otherwise be required for a new plan that is established after a plan termination,”⁹ as well as the fact-pattern used by the SEC in the Adopting Release to illustrate this cooling-off period condition, appears to suggest that that is the intention. This is one aspect of the amendments that would benefit from further clarification from the SEC staff.

- *Sell-to-cover plans.* The final exception exempts plans that allow only sales that are necessary to satisfy tax withholding obligations that arise from the vesting of a compensatory award. This exception is available only to the extent the insider does not exercise control over the timing of such sales.
 - *Single-trade plans.* The amendments also limit the availability of the affirmative defense for plans that contemplate only a single trade. The affirmative defense would be available for such a plan only if the plan was adopted at least 12 months after the insider’s last-adopted single-trade plan was adopted. Sell-to-cover plans are also exempted from this prohibition.
- All Persons other than Issuers, Directors and Officers. In addition to the new requirements noted above, the amendments provide that, for a plan adopted by a person other than an issuer to qualify for the affirmative defense available under Rule 10b5-1, no trade may occur under the plan for a specified period (the “cooling-off period”) after the adoption of the plan (including certain modifications to a plan described above under “Modifications of 10b5-1 Plans”). The length of the cooling-off period varies depending on whether the person is a director, officer or other person, as discussed below. The SEC stated that it adopted the cooling-off period with an aim toward “reducing information asymmetries in general as well as providing separation in time between adoption of the plan and trading under the plan so as to reduce the ability of corporate insiders to trade on material nonpublic information.”¹⁰
 - *Cooling-off period.* For persons other than issuers, directors and officers, the amendments require a 30-day cooling-off period.
- Directors and officers. The SEC’s amendments impose additional restrictions on directors and officers.
 - *Cooling-off period.* For directors and officers, the cooling-off period will run for a minimum of 90 days and a maximum of 120 days. If the issuer files a 10-K, 10-Q, 20-F or furnishes a 6-K, as applicable, with financial results between day 90 and day 120 (covering financial results for the period that includes the date of adoption of the 10b5-1 plan), trading under the 10b5-1 plan may begin after the 2nd business day after such filing.

The approach taken by the SEC is different than that commonly taken in insider trading policies adopted by issuers, which often open trading windows one or two business days after earnings releases are published rather than after annual or quarterly reports are filed. Issuers may consider

revisiting their insider trading policies in light of the amendments and discussion in the Adopting Release.

- *Required representations in Rule 10b5-1 plans.* The amendments require that in order to benefit from the affirmative defense under Rule 10b5-1(c), directors and officers must represent in the trading plan that, on the date of the plan’s adoption (including certain plan modifications), they are not aware of any MNPI about the security or issuer and are adopting the plan in good faith and not as part of a scheme to evade the federal securities law’s insider trading prohibitions.
- *Disclosure.*
 - **Disclosure of the adoption or termination of trading plans.**
 - Currently, there is no requirement to publicly disclose the adoption or termination of a 10b5-1 plan.
 - The amendments will require each issuer that files annual reports on Form 10-K and quarterly reports on Form 10-Q to disclose on a quarterly basis the name and title of each director and officer who has adopted or terminated “any contract, instruction or written plan for the purchase or sale of equity securities of the registrant” intended to satisfy the requirements of Rule 10b5-1(c), referred to in the amendments as a “Rule 10b5-1 trading arrangement.”

Such quarterly disclosure as to adoption or termination is also required for other written trading arrangements entered into by a director or officer that (i) provide for future trades based on pre-established criteria, (ii) do not allow the director or officer to exercise subsequent influence over how, when or whether to effect purchases or sales and (iii) were adopted when the director or officer was not aware of MNPI about the security or the issuer, such trading arrangements being referred to in the amendments as “non-Rule 10b5-1 trading arrangements.” For example, plans that do not satisfy the cooling-off period described above but that would otherwise comply with Rule 10b5-1 would be captured by this disclosure requirement.
 - The disclosure is required to include “a description of the material terms of the trading arrangement,” including the duration of the trading arrangement, the date it was entered into or terminated and the aggregate number of securities to be purchased or sold under it. The amendments expressly state that pricing information need not be disclosed; however, the amendments and Adopting Release are silent as to whether or not other potentially sensitive terms (such as the timing of trades under the plan) would be considered “material terms” that must be made public.
 - **Form 4 and Form 5 reporting by directors, officers and greater than 10% holders.**
 - The amendments require persons filing Section 16 reports (including persons who are only subject to Section 16 because they are greater than 10% holders and whose trading arrangements would not be required to be disclosed by the

issuer as described above) to identify transactions executed under a 10b5-1 plan by ticking a new checkbox.

- The SEC also adopted 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 until the 45th day after the end of year in which the gift was made.
- **Issuers.** The SEC’s proposed rules had included a number of additional requirements that issuers had to meet to satisfy the requirements of Rule 10b5-1(c), as well as additional disclosure requirements. In a change from the proposal, however, in the amendments, the SEC significantly scaled back the additional issuer requirements under Rule 10b5-1(c), imposing only the expanded good faith requirement on issuers (no cooling-off period will apply to issuer plans), and made certain modifications to the additional disclosure requirements applicable to issuers. The additional disclosure requirements applicable to issuer are discussed below.

○ *Disclosure of insider trading policies and option grants.*

- **Insider trading policies.** The amendments require each issuer to disclose in its annual report if it has adopted insider trading policies (including those governing trading by the issuer itself) and if not, why it has not done so. In a change from the proposal, the amended rules do not require issuers to describe their policy in the body of the Form 10-K or Form 20-F. Rather, issuers are only required to file a copy of its insider trading policy as an exhibit to its Form 10-K or Form 20-F. If all of an issuer’s insider trading policies are included in its code of ethics, the filing of the code of ethics will satisfy this requirement.
- **Disclosure of “spring-loaded” and “bullet-dodging” options.** The SEC also amended Item 402 of Regulation S-K to require issuers (other than foreign private issuers) to annually disclose certain information regarding options, stock appreciation rights and similar instruments (collectively, “options”) granted to named executive officers (NEOs) (with scaled disclosure requirements for emerging growth companies and smaller reporting companies) within four business days before or one business day after, (i) filing of a quarterly or annual report or (ii) filing or furnishing a Form 8-K (other than a Form 8-K reporting only the grant of a material new option award under Item 5.02(e)) 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 percentage change in the closing price of the shares underlying the award between the trading day before and after the relevant disclosure of MNPI.

The amendments also require that such issuers provide narrative disclosure regarding “policies and practices on the timing of awards of options in relation to the disclosure of material nonpublic information by the registrant, including ... whether the board or compensation committee takes material nonpublic information into account when determining the timing and terms of such an award and, if so, how ...”¹¹

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

1. SEC Release No. 33-11138 (December 14, 2022) (the “Adopting Release”). The Adopting Release is *available* at <https://www.sec.gov/rules/final/2022/33-11138.pdf>.
2. Adopting Release at 14.
3. The compliance date for the disclosure requirements applicable to issuers is deferred by six months for smaller reporting issuers.
4. Adopting Release at 67.
5. 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 change represents 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 of entry into the 10b5-1 plan. Exchange Act Rules Compliance and Disclosure Interpretations, Question 120.18, *available* at <https://www.sec.gov/divisions/corpfin/guidance/exchangeactrules-interps.htm>.
6. Adopting Release at 67 – 68.
7. Adopting Release at 56.
8. Adopting Release at 57.
9. Adopting Release at 58.
10. Adopting Release at 29.
11. Adopting Release at 46.