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Filling the Gaps: SEC Adopts Final Rules on 10b5-1 Trading Plans and Related Disclosures

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- The Securities and Exchange Commission adopted final rules that impose new conditions on the availability of the Rule 10b5-1 affirmative defense to insider trading and require enhanced disclosures regarding the adoption, modification and termination of Rule 10b5-1 plans and other trading arrangements, issuers' insider trading policies and procedures, and certain equity awards granted close in time to the release of material nonpublic information.
- New cooling-off periods will be required for all 10b5-1 plans entered into by anyone other than issuers, with a longer cooling-off period for directors and officers.
- Limitations will apply to overlapping and single-trade 10b5-1 plans, unless the plan is incidental to satisfying income tax withholding obligations in connection with certain equity compensation awards (i.e., a sell-to-cover plan).
- Issuer 10b5-1 stock repurchase plans will not be subject to a cooling-off period or the limitations on overlapping and single-trade plans.
- Gifts of equity securities will now be reportable on Form 4, rather than Form 5, under Section 16.
- New Item 402(x) will require narrative disclosure of an issuer's policies and practices in connection with the timing of the grant of certain equity awards in relation to the issuer's disclosure of material nonpublic information.
- The amendments to Rule 10b5-1 and the new disclosure obligations will be effective 60 days after the publication of the final rules in the Federal Register. Issuers, other than smaller reporting companies, will be required to comply with the new disclosure requirements in Exchange Act periodic reports on Forms 10-Q and 10-K (or, as applicable, 20-F) and in any proxy or information statements in the first filing that covers the first full fiscal period beginning on or after April 1, 2023; smaller reporting companies will be required to comply in Exchange Act periodic reports on Forms 10-Q and 10-K and in any proxy or information statements in the first filing that covers the first full fiscal period beginning on or after October 1, 2023.

On December 14, 2022, the SEC unanimously voted at an open meeting to adopt final rules regarding Rule 10b5-1 insider trading plans and related disclosures under the Securities Exchange Act of 1934, as amended. The amended rules impose new conditions on the availability of the Rule 10b5-1 affirmative defense, as well as new disclosure and reporting obligations on issuers, directors and officers regarding adoption, modification and termination of trading plans in reliance on Rule 10b5-1 (10b5-1 plans), issuer insider trading policies and procedures, the timing of certain awards of stock options, stock appreciation rights or instruments with option-like features and bona fide gifts. In a press release following the SEC's open meeting, the commission stated that, "[c]ollectively, the final rules aim to strengthen investor protections concerning insider trading and to help shareholders understand when and how insiders are trading in securities for which they may at times have material nonpublic information." The full release for the final rules is available here, and the condensed fact sheet is available here.

The amended rules will be effective 60 days after publication in the Federal Register. For Section 16 reporting persons, compliance will begin with beneficial ownership disclosures on Forms 4 and 5 filed on or after April 1, 2023. Issuers, other than smaller reporting companies, will be required to comply with the new disclosure requirements in Exchange Act periodic reports on Forms 10-Q and 10-K (or, as applicable, 20-F) and in any proxy or information statements in the first filing that covers the first full fiscal period beginning on or after April 1, 2023. Smaller reporting companies will be required to comply in Exchange Act periodic reports on Forms 10-Q and 10-K and in any proxy or information statements in the first filing that covers the first full fiscal period beginning on or after October 1, 2023.

Importantly, the SEC has clarified that the amendments to Rule 10b5-1 will not affect the affirmative defense available under an existing Rule 10b5-1 plan that was entered into prior to the effective date of the amendments to Rule 10b5-1, except to the extent that such a plan is modified or changed in the manner described in the amendments to Rule 10b5-1 after the effective date of the amended rules. Modifications that trigger the application of the new requirements are described under the "Mandatory cooling-off periods" heading below.

For information on the SEC commissioners' views and statements regarding the amendments, refer to this December 15 Cooley PubCo blog post.

Overview of amendments

Although the final rules differ from the proposed rules in meaningful ways, the final rules substantially expand the Rule 10b5-1 safe harbor requirements and impose new reporting and disclosure obligations for issuers, directors, officers and others who implement 10b5-1 plans. Specifically, the final rules:

- Impose a cooling-off period for individuals who adopt 10b5-1 plans.
- Condition the adoption of a 10b5-1 plan on the requirement to act in good faith.
- Require directors and officers to include specific representations in 10b5-1 plans regarding possession of material nonpublic information and intention to act in good faith.
- Restrict the use by anyone, other than issuers, of multiple overlapping plans.
- Limit single-trade plans to one per every 12-month period (subject to certain exceptions).
- Require issuers to disclose information regarding their policies and procedures related to insider trading and timing of certain equity grants around the release of material nonpublic information.
- Require issuers to disclose the use of 10b5-1 plans by certain insiders.
- Require new disclosures on Forms 4 and 5 by Section 16 reporting persons relating to bona fide gifts as well as trades pursuant to a 10b5-1 plan.

Amendments to Rule 10b5-1 plans

Historically, persons wanting to establish a 10b5-1 plan had flexibility in how they designed the plan in order to ensure the affirmative defense under Rule 10b5-1 was available. This flexibility – coupled with regulatory focus on 10b5-1 plans and public perception of these plans – caused many companies, directors, officers and other employees to follow perceived best practices for satisfying the good faith standard when adopting a 10b5-1 plan. Many of the amended rules, which include five new conditions to the availability of the affirmative defense, formally adopt or amend such best practices into new safe harbor reporting or disclosure requirements as discussed below.

Mandatory cooling-off periods

A "cooling-off" period is the time between the adoption (or modification) of the 10b5-1 plan and when the first trade under the 10b5-1 plan may occur. Rule 10b5-1, as currently in effect, does not impose any waiting period between the date that a trading plan is adopted, or modified, and the date of the first trade under the plan. The amended rules impose a mandatory cooling-off period on all individuals, other than issuers, who adopt or modify a 10b5-1 plan.

Under the amended rules, the mandatory cooling-off period imposed on directors and officers[1] will be the later of 90 days after the adoption of a 10b5-1 plan or two business days following the disclosure of the issuer's financial results in a Form 10-Q or 10-K (or, for foreign private issuers, disclosure of financial results in a Form 20-F or 6-K) for the fiscal quarter in which the 10b5-1 plan was adopted, not to exceed 120 days. For other individuals, the required cooling-off period will be 30 days after the adoption of a 10b5-1 plan. In addition, in certain circumstances, a modification to a plan under the amended rules is considered a termination of the 10b5-1 plan and adoption of a new plan, triggering a new cooling-off period. Modifications or changes to the number of securities to be purchased or sold, price or timing of the purchase or sale of securities, or a modification or change to the formula, algorithm, or computer program that affects the amount, price, or timing of the purchase or sale of securities will be considered a termination of the original plan and adoption of a new 10b5-1 plan, triggering a new cooling-off period. Administrative changes to a 10b5-1 plan that do not affect the price, number, or timing of a purchase or sale, such as adjustments for a stock split, will not be deemed a termination that triggers a new cooling-off period.

Director and officer certifications

The amended rules require directors and officers to certify in the 10b5-1 plan that at the time of the plan's adoption or modification that they are not aware of material nonpublic information about the issuer or its

securities, and that they are 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 is a departure from the proposed rules that would have required a separate certification to be executed and retained for a significant period of time. Because most brokerage firms already require similar representations in broker trading plans, the amended rules are essentially a codification of existing industry practice.

Restrictions on overlapping plans

Next to cooling-off periods, the restriction on using more than one 10b5-1 plan at a time is one of the most significant changes to the current regime. The amended rules provide that the affirmative defense under Rule 10b5-1 would be unavailable for any trade by individuals (other than issuers) who have established multiple overlapping trading arrangements for open-market purchases or sales of any class of securities of the issuer during the same period.

In an important change from the proposed rules, the restriction on overlapping plans will not prohibit traders from having a separate plan that instructs their broker or agent to sell securities to satisfy income tax withholding obligations arising in connection with the vesting (and settlement) of certain compensatory equity awards, including restricted stock and restricted stock units, often referred to as “sell-to-cover” plans, where the individual does not otherwise exercise control over the timing of such sales. Note that this exception to the general prohibition on overlapping plans does not extend to stock options.

In the final rules, the SEC made certain other clarifications to the restriction on having multiple overlapping plans. First, a person may enter into more than one plan with different broker-dealers or other agents, provided that, when taken together, the contracts with multiple brokers collectively meet the conditions of Rule 10b5-1. Similarly, a person will not lose the benefit of the affirmative defense when the person transfers securities to a new financial institution or broker, unless that modification also changes the price, amount or timing of the purchase or sale of securities. A modification to the price, amount or timing of the purchase or sale of securities would be deemed a termination of such a plan and the adoption of a new plan as discussed above.

In addition, a person is permitted to maintain two 10b5-1 plans at the same time so long as there is no overlap in timing of trades between the two plans, and trading under the earlier-commencing 10b5-1 plan concludes or expires before trading is authorized under the later-commencing plan. Importantly, the adoption of a later-commencing plan does not change the cooling-off period for the later-commencing plan. However, if the earlier-commencing plan is terminated before its originally scheduled completion date, then the required cooling-off period for the later-commencing plan will run from the date of such earlier termination (and not from the date the later-commencing plan was adopted). The SEC noted that, without this qualification, it would be possible to avoid the required cooling-off period that would otherwise be required for a new 10b5-1 plan established after a prior plan termination. As a result, although further clarification from SEC staff would be helpful, it initially appears that it may be possible to avoid gaps in trading under successive 10b5-1 plans as long as the earlier-commencing plan is not terminated before its scheduled completion date. Whether the SEC intended the cooling-off period to work in this way is subject to additional clarification.

Finally, the adopting release indicates that the restriction on overlapping 10b5-1 plans will not apply to plans that do not involve open-market transactions, such as employee stock ownership plans or dividend reinvestment plans.

Restrictions on single-trade plans

The amended rules also limit the availability of the affirmative defense under Rule 10b5-1 to one single-trade plan involving open-market transactions during any rolling 12-month period. Similar to the exception for overlapping plans, the single-trade plan limitation will not apply to issuers, or to “sell-to-cover” plans entered into by individuals, for the purpose of selling securities to cover tax-withholding obligations related to the vesting of equity compensation.

Good faith requirement

Although the current rules require that persons entering into a 10b5-1 plan enter into the plan in good faith, the amended rules go a step further to require that individuals and issuers act in good faith with respect to the contract, instruction or plan, which includes not only the adoption of, but also any modification to, the plan and actions related to the plan. This requirement is intended to prevent attempts to influence the timing of corporate disclosures to benefit trades under a 10b5-1 plan, such as by delaying or accelerating the release of material

nonpublic information.

Differences in the application of new conditions to Rule 10b5-1 affirmative defense

Amended affirmative defense requirements	Directors and officers	All other individuals
New minimum 90-day cooling-off period	Required	Not applicable
New 30-day cooling-off period	Not applicable	Required
New plan representations	Required	Not required
Limits on multiple overlapping plans	Limits imposed	Limits imposed
Limits on multiple single-use plans	Limits imposed	Limits imposed
Expanded good faith requirement	Applicable	Applicable

In a departure from the proposed rules, the SEC will not impose all the additional conditions in the amended rule on issuers. Issuers are only required to comply with the expanded good faith requirement.

Disclosure regarding Rule 10b5-1 trading arrangements

New periodic reporting by issuers

Currently, there are no mandatory disclosure requirements concerning the use of 10b5-1 trading arrangements or other trading arrangements. However, the amended rules impose new quarterly and annual disclosure requirements on issuers, including smaller reporting companies and emerging growth companies, related to the adoption, modification and termination of 10b5-1 plans by directors and officers.

Quarterly disclosures

The SEC adopted new Item 408(a) of Regulation S-K that requires issuers to (1) disclose in Form 10-Q (or Form 10-K for the fourth fiscal quarter) whether, during the most recently completed fiscal quarter any director or officer has adopted, modified or terminated a Rule 10b5-1 plan and/or any non-Rule 10b5-1 trading arrangement (as defined in Item 408(c) of Regulation S-K),[2] and (2) provide a description of the material terms of the Rule 10b5-1 plan or non-Rule 10b5-1 trading arrangement, other than pricing terms, such as:

- The name and title of the director or officer.
- The date of adoption or termination of the trading plan or arrangement (which includes covered modifications to existing trading arrangements).
- The duration of the trading plan or arrangement.
- The aggregate number of securities to be sold or purchased under the trading plan or arrangement.
- Whether the trading plan or arrangement is a Rule 10b5-1 trading plan or a non-Rule 10b5-1 trading arrangement.

Notably, although “sell-to-cover” plans are not subject to the restrictions on overlapping and single-trade plans, they are not expressly carved out of the quarterly disclosure requirements and may be an area for further clarification by SEC staff as the amended rules are being put into practice. As a result, issuers will want to review their existing sell-to-cover arrangements to determine whether periodic disclosure would be required for equity award agreements or other sell-to-cover instructions.

New Item 408(a) will be added to Part II, Item 5, “Other Information” of Form 10-Q and Part III, Item 10, “Directors, Executive Officers and Corporate Governance” of Form 10-K, and the disclosures will be subject to the officer certifications required by Section 302 of the Sarbanes-Oxley Act of 2002. The disclosure will also be subject to tagging in Inline XBRL. The Item 408(a) disclosure requirements will not apply to foreign private issuers.

Annual disclosures

Under new Item 408(b) of Regulation S-K, the issuer will be required to disclose in its Form 10-K and proxy or information statement – or pursuant to Item 16J of Form 20-F, as applicable – whether it has adopted insider trading policies and procedures governing the purchase, sale and other dispositions of its securities by directors, officers and employees, or by the issuer itself, that are reasonably designed to promote compliance with insider trading laws, rules and regulations, and any applicable listing standards.

If the issuer has not adopted these policies and procedures, then it will be required to explain why it has not done so. However, the amended rules changed course from the proposed rules with respect to how an issuer will be required to disclose these policies. Rather than describing the material terms in the body of the annual report, an issuer will be required to file a copy of its insider trading policies and procedures as an exhibit to its Form 10-K or 20-F, as applicable. If an issuer’s trading policies and procedures are included in its code of ethics, then filing the code of ethics as an exhibit will satisfy this requirement.

New Item 408(b) will be added to Part III, Item 10, “Directors, Executive Officers and Corporate Governance” of Form 10-K, Item 7 of Schedule 14A and Item 16J of Form 20-F. The new annual disclosure requirement will be applicable to both domestic issuers and foreign private issuers and will be subject to the officer certifications required by Section 302 of the Sarbanes-Oxley Act of 2002. Like other Part III information required by Form 10-K, under Instruction G to Form 10-K, the disclosure required by Item 408(b) may be forward incorporated by reference from an issuer’s annual meeting proxy statement. The disclosure will also be subject to tagging in Inline XBRL in accordance with Regulation S-T and the EDGAR Filer Manual.

Section 16 reports

The amended rules add a mandatory checkbox to Forms 4 and 5 requiring a Section 16 reporting person to indicate whether a reported transaction is pursuant to a plan that is “intended to satisfy the affirmative defense conditions” of Rule 10b5-1(c) and to provide the date of adoption of the 10b5-1 plan.

Bona fide gifts

To address concerns that the current ability to delay reporting of gifts on Form 5 may allow insiders to engage in problematic practices involving gifts, such as making gifts of equity securities while in possession of material nonpublic information where the value of the security at the time of donation and sale results in tax or other benefits for the donor and/or donee, the amended rules require the reporting of bona fide gifts of equity securities on Form 4, rather than Form 5. This means that Section 16 reporting persons will need to report bona fide gifts within two business days of the transaction.

New 402(x) disclosures of stock option grant timing

The amended rules add new subsection (x) to Item 402 of Regulation S-K, requiring narrative disclosure about the issuer’s timing of awards of options. Specifically, the narrative disclosure must describe the issuer’s policies and practices in connection with the timing of stock options, stock appreciation rights or instruments with option-like features and must include:

- How the board of directors determines when to grant such equity awards (e.g., whether awards are granted on a predetermined schedule).
- Whether and, if so, how the board or compensation committee considers material nonpublic information when determining

the timing and terms of an award.
- Whether the issuer has timed the disclosure of material nonpublic information for the purpose of affecting the value of executive compensation.

New Item 402(x) also requires tabular disclosure if any such equity awards were granted, during the last completed fiscal year, to any named executive officer (NEO) within **four business days before or one business day after** the filing of a periodic report on Form 10-Q or Form 10-K, or the filing or furnishing of a Form 8-K that contains material nonpublic information (including earnings releases, but excluding any Form 8-K disclosing a new material option award under Item 5.02(e)). If required, the table must include the following information on an award-by-award basis, as applicable:

- The name of the NEO.
- The grant date.
- The number of securities underlying the award.
- The per-share exercise price.
- The grant date fair value of the award.
- The percentage change in the market value of the securities underlying the award between one trading day before and one trading day after disclosure of the material nonpublic information.

Importantly, these new disclosure requirements do not apply to restricted stock or restricted stock units.

Observations and commentary

Although many issuers may have already implemented at least some of the features of the amended rules in their insider trading policies and procedures, issuers should evaluate their current policies and practices to prepare for the upcoming changes, including:

- Issuers should review, and amend as necessary, existing policies and procedures with respect to 10b5-1 plans to ensure they are consistent with the amended rules, including the new mandatory cooling-off periods.
- Issuers should consider requiring compliance with the new requirements for any 10b5-1 plans being adopted prior to the effective date of the new rules, especially in light of recent SEC enforcement activity related to use of 10b5-1 plans.
- Issuers should also review their insider trading policies and procedures, in particular regarding trading windows, pre-clearance procedures, treatment of gifts and any consequences related to noncompliance with such policies. The new requirement to publicly file insider trading policies and procedures as an exhibit to Forms 10-K and 20-F will for many issuers be the first time their insider trading policy and procedures are publicly disclosed. As a result, issuers should consider whether any amendments may be desirable to strengthen or add clarity to existing provisions prior to such public disclosure.
- With respect to the mandated disclosure on the timing of option awards, issuers should consider whether any changes to their current grant policies and practices are appropriate in order to, among other things, avoid having to provide the required narrative and tabular disclosure and any implication that the awards were timed to take advantage of material nonpublic information. Even if regular option grants are set to occur outside of the disclosure window with respect to the filing date for an issuer's Form 10-Qs and Form 10-K, issuers will need to adopt appropriate controls in order to monitor any grants that are made within four business days before or one business day after Form 8-K filings in order to determine whether disclosure under Item 402(x) will be required.

Cooley associate Stephanie Gambino also contributed to this alert.

Notes:

1. "Officer" means any Section 16 officer as defined in Exchange Act Rule 16a-1(f).
2. To help issuers determine what qualifies as a non-Rule 10b5-1 trading arrangement, the SEC adopted the following definition of "non-Rule 10b5-1 trading arrangement": A trading plan where the director or officer asserts that, at a time when they were not aware of material nonpublic information, such person adopted a written arrangement for trading the securities, and the trading arrangement specified (1) the amount, price and date upon which the securities are to be purchased or sold, (2) a written formula or algorithm for determining the amount and price for purchasing or selling, or (3) did not permit the covered person to exercise any subsequent influence over how, when or whether to effect purchases or sales, provided that

any person acting on behalf of such covered person does not have access to material nonpublic information.

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