Rule 10b5-1 Plans: SEC Proposes

Client Advisories

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On December 15, 2021, the Securities and Exchange Commission proposed amending Rule 10b5-1 of the Securities Exchange Act of 1934. Rule 10b5-1 is a safe harbor from insider trading prohibitions. A company's director, officer or other insider may trade such company's securities while in possession of material non-public information provided that such trade is executed under a Rule 10b5-1 trading plan. The insider must create a 10b5-1 plan during the company's open trading window and such insider is not otherwise in possession of material non-public information. The 10b5-1 plan typically gives authority to a third party, such as a broker, to then trade in such company's securities.

Rule 10b5-1 Safe Harbor Changes

Rule 10b5-1 has been criticized that the current safe harbor can be manipulated and abused by insiders. The SEC, in response to such criticism, made the following proposals to change the availability of the safe harbor:

- **Cooling-off Period**. Currently, Rule 10b5-1 does not impose any waiting period between the date the 10b5-1 plan is adopted and the date of the first transaction to be executed under such plan. The proposed amendments provide that 10b5-1 plans of executive officers and directors include a 120-day mandatory cooling-off period. A modification of a plan by the executive officer or director would also create a new 120-day cooling-off period.
- **Director and Officer Certification**. Although almost universal in public company insider trading policies, executive officers and directors must get pre-trade approval from the company and, as part of such approval, certify such insider is not in possession of material non-public information. The proposed rule change would mandate such executive officer or director certify at the time of the adoption of the 10b5-1 plan that:
    - They are not aware of material nonpublic information about the company or its securities; and
    - They are adopting the 10b5-1 plan in good faith and not as part of a plan or scheme to evade the prohibitions of Rule 10b-5.

- **Overlapping Plans**. Under the proposed amendments, the safe harbor would not be available for trades under a 10b5-1 plan when the insider maintains another 10b5-1 plan, or subsequently enters into an additional overlapping trading arrangement, for open market purchases or sales of the same class of the company's securities.
- **Single Trade Plans**. The amendments propose to limit the availability of a 10b5-1 plan designed to cover a single trade. Under the proposed amendments, the safe harbor would not be available for a single-trade plan if the insider had, within a 12-month period, purchased or sold securities pursuant to another single-trade plan.
- **Operation in Good Faith**. Currently, a 10b5-1 plan must be entered into in good faith. The proposed amendments expand the requirement such that the plan must also be operated in good faith. For example, the insider may not use his influence to affect the timing of a corporate disclosure to occur before or after a planned trade under a 10b5-1 plan to make such trade more profitable.

Rule 10b5-1 Disclosure Changes

The SEC's proposed rule changes include expanding disclosure requirements in connection with such 10b5-1 plans, including:

- **Disclosure of 10b5-1 Plans**. Companies would be required to disclose quarterly (on Form 10-K or 10-Q) the adoption and termination of 10b5-1 plans.
- **Insider Trading Policies Disclosure**. The proposed amendments would require companies to disclose in their Forms 10-K and proxy statements whether they have adopted insider trading policies and procedures and, if not, why it has not done so.
- **Section 16 Filings**. Forms 4 and 5 to include a mandatory box to be checked to identify reportable transactions were made pursuant to a 10b5-1 plan.

Option and Equity Grant Timing

The SEC also proposes rule changes to address timing of option and equity grants shortly before or after the release of material non-public information. The SEC cited as concerns "spring-loading," or timing option grants to occur immediately before the release of positive material nonpublic information so an option award will likely be in-the-money right after the release of such information, and "bullet-dodging," or delaying grant of options until after the release of negative material non-public information.

A new subsection, Item 402(x) of Regulation S-K, would require companies to disclose grants of stock options and other equity compensation granted within 14 calendar days before or after the filing of a Form 10-K or 10-Q, a company's share repurchase, or the filing a Form 8-K disclosing material nonpublic information, including earnings information.

Final Rules

The proposed amendments are subject to a 45-day comment period. Whether these proposed amendments are ultimately adopted, and whether existing 10b5-1 plans will be granted any grandfather exceptions, companies should plan now for pending changes.

If you have any questions or would like more information, please contact James Smith at 646-863-4301 or jsmith@archerlaw.com, or Corinne Chen at 212-682-5327 or cchen@archerlaw.com, or any member of Archer's Business Counseling Group.

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