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SEC adopts new rules for Rule 10b5-1 insider trading plans

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On December 14, 2022, the U.S. Securities and Exchange Commission (SEC) adopted new rules regarding the use of Rule 10b5-1 trading plans, which are similar to automatic securities disposition plans (ASDPs) and automatic securities purchase plans in Canada (ASPPs)[1], and related disclosure requirements[2].

The substantive amendments in respect of the implementation and administration of Rule 10b5-1 trading plans will primarily affect director, officer and other third-party insider plans, with limited changes to issuer trading plans pending the outcome of the SEC's continuing consideration of its proposed share repurchase rules[3].

What you need to know

The amendments to Rule 10b5-1 apply to trading plans in respect of all securities that are listed on a U.S. national securities exchange or are otherwise registered under section 12 of the Securities Exchange Act of 1934 (Exchange Act), including those issued by Canadian companies relying on the multijurisdictional disclosure system (MJDS) and other foreign private issuers. However, the new disclosure requirements described below apply only to U.S. domestic reporting companies and non-MJDS foreign private issuers.

Under the amendments to Rule 10b5-1, directors and officers will be subject to mandatory cooling-off periods of at least 90 days (subject to a maximum 120 days) before they can execute any trade under a new or modified 10b5-1 trading plan. Other insiders will be subject to a mandatory cooling-off period of at least 30 days. The amendments to Rule 10b5-1 also prohibit multiple, overlapping trading plans by directors, officers and other insiders.

Unlike the proposed rules, the final rules do not impose a cooling-off period on issuer trading plans or prohibit issuers from maintaining multiple overlapping plans, as the SEC has indicated that it is continuing to consider the application of these limitations in the context of its pending regulations on share repurchases.

The new restrictions on 10b5-1 trading plans may make it more complicated for directors, officers and other insiders to sell or buy securities under such plans. Among other things, the restrictions could impose liquidity costs on insiders and make it more difficult for them to achieve optimal portfolio diversification.

SEC reporting companies (other than MJDS issuers) will also be subject to new disclosure requirements regarding their insider trading policies and procedures. U.S. domestic reporting companies will also be subject to additional disclosure requirements regarding the timing of certain equity compensation awards to directors and officers around the time of material corporate announcements.

The final rules will become effective on February 27, 2023. The rule changes will apply to Rule 10b5-1 trading plans entered into or materially modified after the effective date. The new disclosure requirements will be subject to a phase-in timeline, beginning with reports covering fiscal periods commencing on or after April 1, 2023.

Changes affecting 10b5-1 trading plans

Section 10(b) of the Exchange Act and Rule 10b-5 prohibit the purchase or sale of a security on the basis of material non-public information (MNPI) and form the basis of U.S. insider trading regulation. Rule 10b5-1 under the Exchange Act was established to provide companies and corporate insiders with an affirmative defense against Rule 10b-5 insider trading liability for securities transactions executed according to a plan or arrangement that was adopted in good faith when the company or insider was not aware of MNPI, much like an ASDP or ASPP in Canada. The affirmative defense is available even if actual trades made pursuant to a 10b5-1 trading plan are executed when the individual may be aware of MNPI that would otherwise subject that person to insider trading liability under Rule 10b-5.

The SEC has now amended Rule 10b5-1 to add new conditions to the availability of the affirmative defense, primarily affecting directors, officers and other corporate insiders of all SEC reporting companies (including MJDS issuers and other foreign private issuers). These new rules will apply to all 10b5-1 trading plans that are established or modified (in a manner that would be deemed a "new" plan as described below) on or after the effective date for the new rules.

The new conditions under the amendments include the following:

- **Cooling-off periods.**
  - **Directors and officers:** Directors and "officers" (as defined in Rule 16a-1(f) under the Exchange Act[4]) seeking to rely on Rule 10b5-1 as an affirmative defense to insider trading will not be able to execute any trade under a new or modified 10b5-1 trading plan until the later of (1) 90 days after the adoption of the Rule 10b5-1 plan or (2) two business days following the disclosure of the issuer's financial results in a Form 10-Q or Form 10-K for the fiscal quarter in which the plan was adopted or, for foreign private issuers, in a Form 20-F or Form 6-K that discloses the issuer's financial results (but in any event, the required cooling-off period is subject to a maximum of 120 days after adoption or modification of the plan).
  - **All other insiders:** All other persons seeking to rely on Rule 10b5-1 as an affirmative defense to insider trading (e.g., other corporate insiders or third-party shareholders with access to MNPI) will only be subject to a mandatory cooling-off period of 30 days under the new rules.
  - **Issuers:** Unlike the proposed rules, the final rules do not include a cooling-off period for the issuer trading plans under Rule 10b5-1. However, in its adopting release, the SEC indicated that it is continuing to consider whether any regulatory action is needed for issuer trading plans, such as in a share repurchase context.
- **Limitations on multiple overlapping plans.** Under the amended rules, persons (other than the issuer) may only have one trading plan for any class of securities of the issuer on the open market during the same period. However, such persons can have multiple contracts with different brokers, provided that all such contracts are treated as a single "plan" that complies with Rule 10b5-1. They also can establish a later-commencing plan for which trading is not authorized until after (1) all trades under the earlier plan have ceased and (2) the applicable cooling-off period for the later plan, which is deemed to commence upon termination or expiration of the earlier plan. In addition, the SEC provided an exception that would permit entry into a separate 10b5-1 trading plan relating solely to certain "sell-to-cover" transactions (e.g., to cover tax withholding obligations arising solely from the vesting of a compensatory award, but not in connection with option exercises made at the discretion of the insider).
- **Limitations on single-transaction plans.** Under the amended rules, 10b5-1 trading plans for persons (other than issuers) that are designed to execute a single transaction will be limited to one plan per 12-month period. The SEC adopting release clarified that trading plans that contemplate or permit multiple transactions will not be deemed to have been "designed to" execute a single transaction.

- **Acting in "good faith" with respect to the plan.** Currently, to take advantage of the defense in Rule 10b5-1, the trade in question must have been executed under a plan that was adopted in good faith and not as part of a plan or scheme to evade the prohibitions of Rule 10b-5. The SEC has extended this condition to require that the persons establishing the plan must also have "acted in good faith with respect to" the plan. This amendment is intended to deter fraudulent or manipulative conduct, e.g., by an insider cancelling or modifying a plan to avoid the prohibitions in the rule or attempting to make a trade more profitable or reduce a loss by manipulating the timing of corporate disclosures. This requirement applies to all 10b5-1 plans, including those established by issuers.

- **Director and officer certifications.** As a condition to the availability of the affirmative defense provided by Rule 10b5-1, officers and directors will have to certify at the time of the adoption of a new or modified Rule 10b5-1 plan that: (1) they are not aware of any MNPI about the issuer or its securities; and (2) they are adopting the plan in good faith and not as part of a plan or scheme to evade the prohibitions of Rule 10b-5. Under the final rules, the certification must be included as representations in the trading plan.

- **Clarification of what constitutes a "new" trading plan.** The new rules also clarify that any modification or change to the amount, price or timing of the purchase or sale of securities is deemed a termination of the existing plan and the establishment of a new plan[5]. In such instances, persons engaged in any such modification that is deemed a "new" trading plan would need to comply with the requirements of Rule 10b5-1 at the time of such modification, including, for example, confirming that such person is not in possession of MNPI at the time and imposing the applicable cooling-off period.

New disclosure requirements for U.S. domestic issuers and non-MJDS foreign private issuers

- **Disclosure of insider trading policies (non-MJDS issuers only).** The final rules will require all SEC reporting companies (other than MJDS issuers) to disclose, in their annual reports on Form 10-K or 20-F, as applicable, as well as in proxy and information statements on Schedules 14A and 14C, whether or not (and if not, why not) they have adopted insider trading policies and procedures reasonably designed to promote compliance with insider trading laws and to disclose any such policies and procedures. These disclosures will be subject to the officer certification requirements in Section 302 of the Sarbanes-Oxley Act of 2002. In addition, Form 10-K and 20-F filers will be required to file their insider trading policies as an exhibit to the applicable annual report[6]. The SEC did not amend Form 40-F (which is filed by MJDS issuers) to require such disclosures or exhibit filing requirements.

- **Reporting of director and officer 10b5-1 plans (U.S. domestic reporting issuers only).** U.S. domestic issuers will also be required to disclose on Form 10-Q and Form 10-K whether, in the issuer's last fiscal quarter, any of its directors or officers had adopted or terminated[7] any 10b5-1 trading plan or any other contract, instruction or written plan to buy or sell the issuer's securities that constitutes a "non-Rule 10b5-1 trading arrangement"[8], and if so, to describe the material terms of any such arrangement, including (1) the name of the director or officer; (2) the date of adoption or termination; (3) the duration of the contract, instruction or written plan; (4) the aggregate amount of securities to be sold or purchased thereunder (without requiring disclosure of pricing parameters); and (5) whether the plan is or is not intended to qualify as a Rule 10b5-1 trading plan. The SEC did not ultimately adopt its original proposal to require corresponding disclosure regarding the use of trading arrangements by the issuer, but is continuing to consider whether such disclosures may be appropriate for share repurchases. This reporting requirement will not apply to foreign private issuers that file annual reports pursuant to Form 20-F or MJDS issuers that file annual reports on Form 40-F.

- **Disclosure regarding awards made close in time to release of MNPI (U.S. domestic reporting issuers only).** U.S. domestic issuers (but not MJDS issuers or other foreign private issuers) will also have to disclose in their annual reports on Form 10-K and/or annual meeting proxy statements their policies and practices regarding stock options, stock appreciation rights and similar instruments, including a discussion of whether or not the issuer has taken into account the timing of the release of any MNPI when determining the terms or timing of an award. Such issuers will also have to include tabular disclosure disclosing any such grants that were made within four business days before or one business day after the filing of a periodic report on Form 10-Q or 10-K or the filing or furnishing of a current report on Form 8-K that contained MNPI (including earnings information)[9]. The required disclosures in the table include basic information about the applicable award(s) as well as (1) the grant date fair value of the award(s) computed using the same methodology as used by the issuer for its financial statements under GAAP; and (2) the percentage change in the market value of the securities underlying the award(s) between the trading day before and the trading day after the release of the MNPI.

- **Phase-in timeline for 10b5-1 disclosures.** Non-MJDS issuers will be required to comply with the new disclosure requirements in Exchange Act periodic reports on Forms 10-Q, 10-K and 20-F and in any proxy or information statements beginning with the filing that covers the first full fiscal period commencing on or after April 1, 2023 (or October 1, 2023, for smaller reporting companies).

- **Form 4 and 5 disclosures (U.S. domestic reporting issuers only).** U.S. domestic companies' section 16 insiders[10] will have to check a box on Form 4 or 5, as applicable, if the transaction they are reporting was made pursuant to a plan that is intended to qualify as a Rule 10b5-1 trading plan. In addition, section 16 insiders will have to promptly disclose any *bona fide* gifts of securities on Form 4, which is due within 2 business days of the execution date of the transaction. Previously, such gifts were only required to be reported on Form 5, which is not due until 45 days after calendar year-end. The SEC amendments relating to Forms 4 and 5 will go into effect for filings made on or after April 1, 2023.

Impact of the SEC rules in Canada

While certain of the new SEC requirements, such as the cooling-off periods and reporting of director and officer 10b5-1 plans, will become mandatory, the Canadian securities regulators have only provided "guidance" and recommended practices for Canadian reporting issuers' ASDPs. The SEC's rules may, in that respect, influence Canadian market practice going forward or further rulemaking by the Canadian securities regulators.

FOOTNOTES

To discuss these issues, please contact the author(s).