HAYNES BOONE

February 27, 2023

SEC Adopts Amendments to Modernize Rule 10b5-1 Insider Trading Plans and Related Disclosures

By Bruce Newsome, Sawyer Smith, and Camden Brown

The Securities and Exchange Commission (the "SEC") recently approved final rules introducing new amendments and disclosure requirements under Rule 10b5-1 of the Securities Exchange Act of 1934 (the "Exchange Act"). The final rules, which begin to take effect today, include updates that significantly tighten access to the Rule 10b5-1(c)(1) affirmative defense to insider trading liability for those insiders in possession of material nonpublic information.

Rule 10b5-1 was initially adopted in August 2000, implementing an affirmative defense to insider trading liability in circumstances where trading was made pursuant to a contract, trading instructions to a third party, or a written plan adopted when the trader was unaware of material nonpublic information. The current amendments to Rule 10b5-1 and related disclosure requirements were adopted by the SEC in an effort to expand investor protections concerning insider trading. Highlights from the amendments include:

- New conditions for the availability of the Rule 10b5-1(c)(1) affirmative defense, including cooling-off periods for directors, officers, and persons other than issuers;
- New requirements for issuers to disclose insider trading policies and procedures, and the adoption, termination, and modification of Rule 10b5-1 and certain other trading arrangements made by directors and officers;
- New issuer disclosure requirements of executive and director compensation regarding equity compensation awards made close in time to the issuer's disclosure of material nonpublic information; and
- Updates to Forms 4 and 5 requiring filers to (1) identify transactions made pursuant to a plan that is intended to satisfy the affirmative defense conditions of Rule 10b5-1(c)(1), and (2) disclose all bona fide gifts of securities on Form 4.

Companies must comply with the new Rule 10b5-1 disclosure requirements in Forms 10-Q, 10-K, 20-F and in proxy and information statements in the first filing that covers the first full fiscal period that begins on or after April 1, 2023. Smaller reporting companies must report the new disclosures in the first filing that covers the first full fiscal period that begins on or after October 1, 2023. Section 16 reporting persons must comply with changes to Forms 4 and 5 beginning on April 1, 2023, except that reporting of gifts on Form 4 begins on February 27, 2023.

Amendments to Affirmative Defense to Insider Trading Liability

Cooling-Off Period

To address concerns associated with corporate insiders trading on the basis of material nonpublic information while avoiding liability under Section 10(b) and Rule 10b-5, the SEC amended the Rule 10b5-1(c)(1) affirmative defense to insider trading liability to include a cooling-off period prior to trades taking place under the plan. Directors and officers are subject to a cooling-off period of the later of:

(1) 90 days following plan adoption or modification; or

(2) two business days following the disclosure in periodic reports on Forms 10-Q or 10-K of the issuer's financial results for the fiscal quarter in which the plan was adopted or modified.

Note that the maximum required cooling-off period for directors and officers is 120 days after the adoption or modification of a plan.

Persons other than directors and officers are subject to a cooling-off period of 30 days from the adoption or modification of a plan.

Modifications to a trading plan that do not change the sales or purchase prices or price ranges, the amount of securities to be sold or purchased, or the timing of transactions under a Rule 10b5-1 plan will not trigger a new cooling-off period.

Director and Officer Certifications

To ensure that a Rule 10b5-1(c)(1) affirmative defense is only available in circumstances in which insiders were not aware of material nonpublic information when adopting a Rule 10b5-1 plan, the final rules require directors and officers to include a representation in their plan certifying, at the time of the adoption, that:

(1) they are not aware of material nonpublic information 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.

Good Faith

All persons entering into a Rule 10b5-1 plan must act in good faith with respect to that plan in order to rely on the Rule 10b5-1(c)(1) affirmative defense. The good faith requirement extends from the time of adoption through the duration of the Rule 10b5-1 plan. Pursuant to the amendments, an insider will not be deemed to be operating a Rule 10b5-1 plan in good faith if the insider, while aware of material nonpublic information, directly or indirectly induces the issuer to publicly disclose that information in a manner that makes the insider's trades under a Rule 10b5-1 plan more profitable or less unprofitable. In such circumstances the insider would not be entitled to the Rule 10b5-1(c)(1) affirmative defense, regardless of whether the Rule 10b5-1 plan was initially entered into in good faith.

Multiple Overlapping Plans

In order to prevent selective alteration or cancellation of Rule 10b5-1 plans to achieve a particular trading outcome when an insider is aware of material nonpublic information, the final rules provide for a limitation on the ability of anyone other than issuers to use multiple overlapping Rule 10b5-1 plans. Specifically, as a condition to the Rule 10b5-1(c)(1) affirmative defense, the amendments provide that persons, other than issuers, may not have another outstanding contract, instruction or plan (and may not later enter into any additional contract, instruction or plan), for the purchase or sale of any class of securities of the issuer on the open market that would qualify for the affirmative defense at the same time.

This provision does not prohibit the adoption of a new Rule 10b5-1 plan while an existing plan is in effect, so long as trading under the new plan does not begin until after all trades under the existing plan are completed or the existing plan expires. Trading may not begin under any plan until the mandatory cooling-off period has concluded. Consecutive plans may be established in which the cooling-off period for the new plan runs during the trading period of the existing plan.

Single-Trade Plans

In addition to limitations on multiple overlapping trading arrangements, the final rules provide that a person other than the issuer may rely on the Rule 10b5-1(c)(1) affirmative defense for only one single-trade plan during any 12-month period. The affirmative defense is only available for a single-trade plan if the person had not, during the prior 12-month period, adopted another single-trade plan that also qualified for the affirmative defense under Rule 10b5-1.

A 10b5-1 plan is not considered a single-trade plan when (i) it allows the insider's agent to exercise discretion over whether or not to exercise the plan in a single transaction, or (ii) when the plan does not allow the agent such discretion, but provides that the agent's future decisions will depend on events or data unknown at the time the plan was adopted (i.e., a plan providing for sales or purchases at several potential future stock prices), and it is reasonably foreseeable at the time the plan is adopted that exercise of the plan by the agent may result in multiple transactions.

The final rules do not apply to transactions effected through Rule 10b5-1 plans where a person purchases or sells securities through participation in employee stock ownership plans or dividend reinvestment plans, which are not executed by an individual on the open market. The SEC has determined such plans are less likely to result in insider trading because these transactions are directly with the issuer.

New Disclosure Requirements

Quarterly Disclosure – New Item 408(a) of Regulation S-K

The final rules create for issuers new quarterly disclosure requirements regarding the use of Rule 10b5-1 plans and certain other written trading arrangements by the issuer's directors and officers during the issuer's last fiscal quarter. New Item 408(a) requires issuers to disclose on Forms 10-Q and 10-K whether any director or officer has adopted or terminated in the applicable quarter any contract, instruction or written plan for the trade of securities that is intended to rely on Rule 10b5-1(c)(1) affirmative defense conditions, or any written trading arrangement that meets the requirements of a non-Rule 10b5-1 trading arrangement as defined in Item 408(c).

The issuer must indicate whether such trading arrangement is a Rule 10b5-1 trading arrangement or is a non-Rule 10b5-1 trading arrangement and must provide a description of the material terms of the arrangement, such as name and title of the director of officer, date of adoption or termination of the plan, the duration of the plan, and the aggregate number of securities to be sold or purchased under the trading arrangement. Terms with respect to price are not required to be disclosed. However, any modification or change to a Rule 10b5-1 plan that falls within the meaning of Rule 10b5-1(c)(1)(iv) is required to be disclosed under Item 408(a) as it constitutes the termination of an existing plan and the adoption of a new plan.

Annual Disclosure – New Item 408(b) of Regulation S-K

New Item 408(b) requires issuers to provide annual disclosure of insider trading policies and procedures on Form 10-K and proxy and information statements. Disclosures must state whether issuers have adopted insider trading policies and procedures governing the purchase, sale, and other dispositions of their securities by directors, officers, and employees, or the issuer itself that are reasonably designed to promote compliance with insider trading laws, rules, and regulations. If an issuer has not adopted such insider trading policies and procedures, it must explain why it has not done so. Foreign private issuers are required to provide similar disclosure in their annual reports on Form 20-F pursuant to new Item 16J.

Issuers are not required to disclose their insider trading policies and procedures within the body of the annual report or statement but may instead file copies as an exhibit to Forms 10-K and 20-F, respectively. If the entirety of the issuer's policies and procedures are included in its code of ethics (as defined in Item 406(b)) and the code of ethics is filed as an exhibit pursuant to Item 406(c)(1), a hyperlink to that exhibit accompanying the issuer's disclosure as to whether it has insider trading policies and procedures would satisfy this component of the disclosure requirement.

Option Grants – New Item 402(x) of Regulation S-K

Under new Item 402(x), issuers are required to disclose on Form 10-K or proxy and information statements information regarding awards of options close in time to the release of material nonpublic information. Issuers are required to discuss, in narrative format, their policies and practices on the timing of awards of stock options, stock appreciation rights, or similar option-like instruments, including: (i) how the board determines when to grant such awards, (ii) whether and how the board or compensation committee takes material nonpublic information into account when determining the timing and terms of an award, and (iii) whether the issuer has timed the disclosure of material nonpublic information in order to affect the value of executive compensation.

Issuers are also required to disclose, in tabular format, any awards granted during the last completed fiscal year to named executive officers ("NEOs") that were granted 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 current report on Form 8-K that discloses material nonpublic information. For each award so granted, the table must include: (i) the name of the NEO, (ii) the grant date of the award, (iii) the number of securities underlying the award, (iv) the per-share exercise price, (v) the grant date fair value of each award, and (vi) the percentage change in the market price of the underlying securities between the closing market price of the security one trading day prior to and one trading day following the disclosure of material nonpublic information. However, Form 8-Ks reporting only the grant of a material new option award under Item 5.02(e) do not trigger the new Item 402(x) disclosure requirements.

Tagging

The final rules require issuers to tag the information specified by new Items 402(x), 408(a), and 408(b) of Regulation S-K, and new Item 16J(a) of Form 20-F, in Inline XBRL. Beginning with the first filing that covers the first full fiscal period beginning on or after April 1, 2023, issuers must comply with the Inline XBRL tagging requirements on Forms 10-Q, 10-K and 20-F, and any proxy or information statements that are required to include the Item 408 or Item 402(x) disclosures. Smaller reporting companies are required to provide and tag the disclosures in the first filing that covers the first full fiscal period beginning on or after October 1, 2023.

Forms 4 and 5

The final rules require that Section 16 reporting persons indicate by checkbox on Forms 4 and 5 that a reported transaction was intended to satisfy the affirmative defense conditions of the revised Rule 10b5-1(c)(1). This checkbox is intended to assist the public in better understanding how trading plans that rely on the revised Rule 10b5-1(c)(1) affirmative defense are being used by insiders.

Gifts

Section 16 reporting persons are now required to report bona fide gifts of equity securities on Form 4, rather than Form 5, before the end of the second business day following the date of execution of the transaction. Based on the strict reading of the adopting release, and unless the SEC further clarifies, Section 16 reporting persons should begin complying with the Form 4 filing requirements for gifts beginning on February 27, 2023.

Effectiveness of the New Rule

The final rules will become effective on February 27, 2023. Section 16 reporting persons will be required to comply with the amendments to Forms 4 and 5 for beneficial ownership reports filed on or after April 1, 2023. Issuers will be required to comply with the new disclosure requirements in periodic reports on Forms 10-Q, 10-K, and 20-F, and in any proxy or information statements in the first filing that covers the first full fiscal period that begins on or after April 1, 2023. Smaller reporting companies must report the new disclosures in the first filing that covers the first full fiscal period beginning on or after October 1, 2023.

The final rules do not affect the availability of the Rule 10b5-1(c)(1) affirmative defense for plans already in effect prior to February 27, 2023. However, if an existing plan is modified or amended after February 27, 2023, the existing plan will be deemed to have been terminated and replaced with a new plan subject to compliance with the new rules.

Conclusion

The final rules significantly affect the adoption and use of Rule 10b5-1 trading plans, tighten access to the Rule 10b5-1(c)(1) affirmative defense to insider trading liability and impose significant disclosure burdens on issuers. In light of these changes, issuers should consider amending their insider trading policies to match the new restrictions on Rule 10b5-1 trading plans, request director and officer questionnaires on a quarterly basis to determine if any director or officer has entered into any trading plans, and reevaluate their timing of option grants.

The final rules release adopting the amendments can be found here.

For further information, please feel free to contact a member of the Haynes Boone Capital Markets and Securities Practice Group.