Akin®

New Proposed Rules Affecting 10b5-1 Trading Plans and Share Repurchase Programs

Mar 3, 2022

Reading Time : **5 min**

By: Kerry E. Berchem, Rosa A. Testani, Garrett A. DeVries, John Patrick Clayton, Mary Kate Thompson

New Proposed Rules Affecting 10b5-1 Plans

In 2000, the SEC adopted Rule 10b5-1 to provide more clarity on what was prohibited with respect to trading on the basis of material non-public information (MNPI) and to provide insiders, who typically hold MNPI, an affirmative defense when trading public company securities. Rule 10b5-1(c) established an affirmative defense whereby insiders can set up future trades pursuant to a binding contract or plan adopted in good faith while the insider does not have MNPI, and the plan can be carried out even if the insider later acquires MNPI. This affirmative defense shifts the insider trading analysis (i.e., whether the insider has MNPI) from the time the securities are purchased or sold to the time when the Rule 10b5-1 agreement or plan is put into place. However, the rule has been criticized by some for leaving gaps that can be manipulated.

For example, the current rule does not prohibit overlapping plans or require the absence of MNPI at the time of termination of Rule 10b5-1 plans or trades. Terminations are not "the purchase or sale of a security" subject to the rule. Nevertheless, terminations of upcoming trades can have just as much economic benefit to the insider as a purchase or sale. For instance, an executive could have two standing Rule 10b5-1 plans, one for periodic purchases and one for periodic sales and cancel only one of the plans once they learn of MNPI, such as undisclosed earnings results. As further discussed below the proposed rules prohibit overlapping plans and would require disclosure of terminations, discouraging the use of terminations to game the system.

The SEC proposal for amendments to Rule 10b5-1 would add new conditions to the Rule 10b5-1 affirmative defense to address what the SEC and others perceive as gaps. Under the new rules, the following additional conditions would have to be met in order to claim the affirmative defense:

- Mandatory cooling-off periods for directors, officers and issuers following newly adopted or modified Rule 10b5-1 plans.
- Certifications from directors and officers in their personal capacity that they are not aware of MNPI when adopting a Rule 10b5-1 plan.
- No overlapping plans.
- Only one single-trade plan in a 12 month period.
- Good faith operation by insiders.

A cooling-off period is a specified time period during which insiders cannot trade under a Rule 10b5-1 plan after it is adopted or modified. As proposed, a "modification" would include the cancellation of one or more trades. Under the proposed amendments, Rule 10b5-1 plans of directors and officers would require a 120-day cooling-off period and Rule 10b5-1 plans of issuers would require a 30-day cooling-off period. The cooling-off periods are intended to ensure that even if an insider holds information not known to investors at the time of a plan adoption or modification, that information will be stale by the time trades are made under the plan.

The proposed rule also prohibits overlapping plans and more than one single-trade plan during a 12-month period. In its proposing release, the SEC notes that concerns have been raised that corporate insiders use multiple overlapping plans to selectively cancel individual trades on the basis of MNPI, commence trades after the adoption of a new plan or otherwise unfairly exploit informational asymmetries. This proposed change is intended to prevent such practices.

Finally, under the proposed amendments, Rule 10b5-1 trading arrangements must be operated in good faith, not just entered into in good faith and directors and Section 16 officers would be required to certify in their personal capacity at adoption of a plan that they do not currently hold MNPI and are acting in good faith.

In addition to the additional Rule 10b5-1 conditions, the proposed rules also contemplate additional disclosure including:

- Additional disclosure on Forms 4 or 5.

- Quarterly disclosure of Rule 10b5-1 plans.
- Insider trading policy disclosure.
- Stock options and similar awards disclosure.
- More timely disclosure of securities as gifts on Form 4.

Under the proposed rules, Section 16 officers would be required to indicate on Form 4 or 5 whether the disclosed transactions are pursuant to a Rule 10b5-1 or other trading plan. Issuers would also be required to disclose in their periodic reports on a quarterly basis the adoption or termination of Rule 10b5-1 or other trading plans, including material terms of the plan, date of adoption or termination, name and title of any director or officer involved, duration of the plan and aggregate amount of securities subject to the plan. Additionally, issuers would be required in their annual report to disclose if they have adopted an insider trading policy and, if so, to disclose those policies and procedures. If issuers have not adopted an insider trading policy, they will be required to disclose why not.

Additionally, companies would be required to disclose a table of options granted within 14 days before or after the filing of a periodic report, an issuer share repurchase or the release of MNPI on Form 8-K and the price of the underlying securities the trading day before and after the disclosure. This proposal is intended to address the practice of granting stock options and other similar awards with option-like features to insiders in coordination with the release of MNPI, which the SEC perceives as a potential misuse of MNPI.

Finally, the proposed rules would require Section 16 insiders to report gifts of securities on Form 4 before the end of the second business day following the date of the execution of the transaction. Currently, insiders can delay the reporting of bona fide gifts on Form 5. This new disclosure requirement is intended to address the concern of insiders gifting securities while they hold MNPI or backdating a stock gift in order to maximize a donor's tax benefit. In its release, the SEC notes that the majority of insiders already report gift transactions on Form 4.

New Proposed Rules Affecting Share Repurchases

The proposed amendments regarding disclosure of repurchases by a public company of its equity securities are intended to significantly accelerate the timing of and enhance the required disclosure.

Under the current S-K Item 703, issuers are required to disclose information about share repurchases in their quarterly reports including (i) a breakdown by month of the number of

shares repurchased by the issuer or an affiliate, (ii) the average price paid per share, (iii) the maximum number of shares that can be repurchased under the program or plan in the future and (iv) the principal terms of publically announced repurchase plans.

Under the proposed rules, timing of this disclosure would be significantly accelerated, as issuers would be required to disclose share repurchases within one business day on a new Form SR. Form SR would require disclosure of (i) the date of the repurchase, (ii) the class of securities repurchased, (iii) the total amount repurchased, (iv) the average price paid per share, (v) the total amount of shares repurchased on the open market and (vi) the total amount of shares repurchased in reliance on the Rule 10b-18 safe harbor or pursuant to a Rule 10b5-1 plan. The proposed requirement for next day reporting on Form SR is a significant change to the existing stock repurchase disclosure regime, which some issuers may find to create a substantial burden.

In addition to the new Form SR, issuers would be required to add disclosure to their quarterly reports regarding the objective or rationale for the share repurchases and the criteria used to determine repurchase amounts, including any policies, procedures or restrictions followed by the officers and directors in carrying out the share repurchase plan.

Categories

Corporate Governance | Policy & Regulation | Compliance

other associated entities under which the Akin Gump network operates worldwide, please see our Legal Notices page.