Client Alert

December 2022

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

On December 14, 2022, the U.S. Securities and Exchange Commission (the "SEC") adopted amendments to Rule 10b5-1 under the Securities Exchange Act of 1934 (the "Exchange Act"), which provides an affirmative defense to trading on the basis of material nonpublic information in insider trading cases. The adopted amendments add new conditions to the availability of the affirmative defense available under Rule 10b5-1, create new disclosure requirements for issuers regarding insider trading policies and executive and director compensation, and update the Section 16 rules to require Section 16 filers to identify transactions made pursuant to a Rule 10b5-1 plan that is intended to satisfy the affirmative defense conditions of Rule 10b5-1(c). The adopted amendments are designed to strengthen investor protections concerning insider trading and to "help shareholders understand when and how insiders are trading in securities" with respect to which they may at times possess material nonpublic information.

Updates to Rule 10b5-1 Affirmative Defense; Rule 10b5-1 Plans

Rule 10b5-1(c) establishes an affirmative defense to Rule 10b-5 liability for insider trading in circumstances where it is apparent that the trading was not made on the basis of material nonpublic information because the trade was made pursuant to a binding contract, an instruction to another person to execute the trade for the instructing person's account or a written plan adopted when the trader was not aware of material nonpublic information. Since the adoption of Rule 10b5-1, there has been concern that the affirmative defense under Rule 10b5-1(c)(1)(i) has allowed traders to take advantage of the liability protections provided by the rule to opportunistically trade securities on the basis of material nonpublic information. There has also been concern that issuers abuse Rule 10b5-1 plans to conduct share repurchases to boost the price of the issuer's stock before sales by corporate insiders. To address these concerns and others related to Rule 10b5-1(c), the SEC has adopted these amendments.

"Cooling-Off" Periods

Prior to the adoption of these amendments, Rule 10b5-1(c)(1) did not impose any "cooling-off" period between the date a Rule 10b5-1 plan is adopted or modified and the date of the first transaction under the plan. Under the

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recently adopted amendments, directors and Section 16 "officers" will not be able to rely on the Rule 10b5-1 affirmative defense unless the Rule 10b5-1 plan imposes a cooling-off period that trading under such plan will not begin until the later of (1) 90 days following adoption or modification of such 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 modified (but not to exceed 120 days following adoption or modification of such plan).[1] In addition, there will now be a 30 day cooling-off period requirement for persons other than directors, "officers" or the issuer before any trading can commence following the adoption or modification of a Rule 10b5-1 plan. A change to the amount, price or timing of the purchase or sale of securities pursuant to a Rule 10b5-1 plan will be deemed a modification to the plan, triggering the applicable cooling-off period described above. Even though some issuers impose their own cooling-off periods, the SEC noted that such periods are imposed voluntarily and vary in duration.

Director and Officer Representations

The amendments also add a condition that directors and "officers" must include representations in their Rule 10b5-1 plans certifying that at the time of the adoption of a new or modified plan (1) they are not aware of any 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 Condition

The amendments also specifically require that all persons entering into a Rule 10b5-1 plan must act in good faith with respect to that plan. This good faith condition is intended to help deter corporate insiders from trading opportunistically in connection with their plans and from inappropriately influencing the timing of company disclosures to benefit their trades under such plans.

Multiple Overlapping Plans

The amendments prohibit insiders from using multiple Rule 10b5-1 plans during the same period, subject to certain exceptions. This is intended to address concerns with insiders who adopt multiple overlapping plans and subsequently selectively cancel certain trades under one plan while they are aware of material nonpublic information, thereby allowing them to transact under the other plan(s) that provide the most beneficial price.

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[1] In a footnote to the adopting release, the SEC specifically declined to carve out from the definition of "officers or directors" certain "venture capital funds whose partners may serve as a director on the board of an issuer." We interpret this to mean that the SEC would likely take the position that an investment fund (such as an activist fund) who is or may be deemed to be a "director by deputization" by virtue of having representation on a board will be subject to this cooling-off period requirement.

Single Trade Plans

There is also a new limitation on the availability of the affirmative defense for a single trade plan (i.e., a plan "designed to effect" the purchase or sale of the total amount of securities in a single transaction) to one such single trade plan during any consecutive 12-month period for all persons other than the issuer, subject to certain exceptions.

Enhanced Issuer Disclosure Requirements

Prior to the adoption of these amendments, there were no mandatory disclosure requirements concerning the use of Rule 10b5-1 trading arrangements or other trading arrangements by issuers or insiders. The SEC has expressed concern that the lack of disclosure deprives investors of the ability to assess whether those parties may be misusing their access to material nonpublic information. The amendments adopted by the SEC create new disclosure requirements with which issuers and Section 16 filers will need to comply.

Quarterly Disclosures

Issuers will be required to disclose in their Forms 10-Q and 10-K (1) whether, during the most recently completed fiscal quarter, any director or Section 16 "officer" has adopted or terminated (a) any contract, instruction or written plan for the purchase or sale of securities that is intended to satisfy the affirmative defense conditions of Rule 10b5-1, and/or (b) any written trading arrangement for the purchase or sale of securities that meets the requirements of a non-Rule 10b5-1 trading arrangement, and (2) a description of the material terms, other than pricing terms, of the Rule 10b5-1 trading arrangement or non-Rule 10b5-1 trading arrangement. Certain modifications of Rule 10b5-1 plans that constitute a termination of the existing plan and adoption of a new plan will also be required to be disclosed.

Insider Trading Policy Disclosures

Issuers will also now be required to disclose in their Forms 10-K and proxy statements whether the issuer has adopted insider trading policies and procedures and, if they have not adopted such policies and procedures, an explanation why they have not done so. If the issuer has adopted insider trading policies and procedures, it must file a copy of such policies and procedures as exhibits to the Form 10-K.

Equity Award and Option Grant Disclosures

In addition, issuers will now be required to provide tabular disclosure in their Forms 10-K and proxy statements of each award of stock options, SARs or similar option-like instruments granted to named executive officers during a window beginning four business days before the filing of a Form 10-Q or Form 10-K or the filing or furnishing of a Form 8-K that discloses material nonpublic information (including earnings information), other than a Form 8-K disclosing a material new option award grant, and ending one business day

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after the filing or furnishing of such report. The tabular disclosure must be accompanied by narrative disclosure describing the issuer's policies and practices regarding the timing of the grants in relation to the issuer's disclosure of material nonpublic information and whether the issuer has timed the disclosure of material nonpublic information for the purpose of affecting the value of executive compensation. Such tabular information will require XBRL tagging.

Modified Forms 4 and 5 Disclosures

Insiders who are Section 16 filers will now be required to indicate via a checkbox on the applicable Form 4 or 5 whether a reported transaction was made pursuant to a trading plan that is intended to satisfy the affirmative defense conditions of Rule 10b5-1(c) and disclose the date of adoption of the trading plan.

Finally, bona fide gifts of securities by insiders that were previously permitted to be reported on a deferred basis on a year-end Form 5 will now be required to be reported on a Form 4 within two business days of the date such gift is made.

Effective Dates

The amendments will become effective 60 days following publication of the adopting release in the Federal Register. Issuers must comply with the new disclosure requirements in Exchange Act periodic reports and in any proxy or information statements beginning with the first filing that covers the first full fiscal period that begins on or after April 1, 2023 (October 1, 2023 for smaller reporting companies). Section 16 filers must comply with the applicable amendments for beneficial ownership reports filed on or after April 1, 2023.

Please contact the Olshan attorney with whom you regularly work or one of the attorneys listed below if you would like to discuss further or have questions with respect to this matter.

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