

SEC Rule 10b5-1 Trading Plans — Update on Potential Reforms

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At its September 9, 2021 meeting, the U.S. Securities and Exchange Commission's (SEC) Investor Advisory Committee (IAC) announced recommendations to the SEC for updating rules governing Rule 10b5-1 trading plans. When speaking at the IAC meeting, SEC Chairman Gary Gensler stated that 10b5-1 plans "have exposed potential gaps in our insider trading enforcement regime" and noted that the IAC recommendations have "pointed out some important areas that are in line with what [he] asked staff to consider in a proposed rulemaking." The areas Gensler previously identified as critical areas of SEC staff attention "to freshen up" Rule 10b5-1 and that the IAC addressed include (i) a mandatory cooling off period between adoption of a plan and the first trades under the plan; (ii) prohibitions against an insider having multiple plans at the same time; and (iii) enhanced public disclosure of 10b5-1 plans.

On July 20, 2021, we published an [article](#) discussing the history behind the Rule 10b5-1 plan requirements for establishing an affirmative defense to insider trading for trades executed pursuant to such plan, as well as recent media, legislative and SEC enforcement interest in Rule 10b5-1 plans, and changes we may see under Gensler's administration. Each of the IAC's recommended requirements for "affirmative defense" protection were included in our previous analysis of anticipated reforms. Although the IAC is an advisory committee and the SEC is not required to adopt its recommendations, it appears likely that the SEC will implement many of the IAC's recommendations in some form. Indeed, during SEC Speaks 2021, held last week, the staff confirmed that it was considering recommending modifications to Rule 10b5-1 plans including mandatory cooling off periods, limits on the number of plans an insider may have, and increased disclosure of trading pursuant to such plans – some of the same modifications the IAC recommended. It remains to be seen, however, whether the SEC will limit its proposed changes to the IAC recommendations or impose further limitations on the ability of insiders and businesses to use Rule 10b5-1 plans as a shield against allegations of insider trading.

IAC Recommendations

The IAC recommends that the SEC "take the necessary steps to establish meaningful guardrails around the adoption, modification, and cancellation of Rule 10b5-1 trading plans." The IAC's written recommendations note that the initial purpose of Rule 10b5-1(c) was to create an "affirmative defense" to insider trading for insiders who adopted securities trading plans and strategies, so long as the insiders adhered to certain enumerated conditions regarding the establishment and use of such plans. Based on various concerns raised by academics, lawmakers, investors and other key market participants, it is apparent that the SEC and IAC believe the time is right to institute reforms to Rule 10b5-1.

The IAC hosted a public panel on June 10, 2021 to discuss whether, and to what extent, reforms to Rule 10b5-1 are needed. On September 9, 2021, it issued a total of six recommendations. The first two recommendations, which address the use of 10b5-1 plans as an affirmative defense to insider trading, are as follows:

1. Require a "cooling off" period of at least four months between the adoption or modification of a Rule 10b5-1 plan and the execution of the first trade under the newly adopted or newly modified plan.
2. Do not allow overlapping plans (i.e., a single person or entity may not have more than one Rule 10b5-1 plan operative at a time).

Under the IAC's recommendations, insiders with multiple plans in place or trading pursuant to a plan without a cooling off period of at least four months would not have the benefit of the affirmative defense to insider trading allegations provided by the rule.

The IAC explained that recent research regarding abuse of Rule 10b5-1 plans identified that the most opportunistic trading behavior occurs in plans (i) with a short cooling off period, (ii) with only a single trade; and (iii) adopted in a given quarter that begin trading before that quarter's earnings announcement. These two requirements proposed by the IAC are designed to prevent such opportunistic trading by extending the length of time between execution of a plan and the commencement of trading pursuant to that plan, and by reducing the likelihood that a plan would be enacted for only a single trade. The IAC noted that "a cooling off period of at least four months would ensure that insiders could not adopt a plan that executes a trade in the same quarter—the trade would necessarily be in the following quarter." The IAC also noted that limiting individuals to a single active plan "would signal to the market that a plan was entered into in good faith."

The other IAC recommendations would require enhanced public disclosure of Rule 10b5-1 plans as follows:

3. Require electronic submission of Form 144;
4. Require enhanced public disclosure of Rule 10b5-1 plans, including;
 - a. proxy statement disclosure of the number of shares covered (i.e., scheduled for sale) under any Rule 10b5-1 trading plans adopted by the issuer's Named Executive Officers;
 - b. proxy statement disclosure of the total number of shares covered (i.e., scheduled for sale) under "corporate" Rule 10b5-1 trading plans (i.e., Rule 10b5-1 plans established by the issuer itself for the purpose of selling treasury shares)¹
 - c. disclosure on Form 8-K of the adoption, modification or cancellation of a Rule 10b5-1 plan and the number of shares covered, on a timely basis (i.e., change 8-K rules to include changes to plans by affiliates as material non-public information requiring the filing of a Form 8-K);
5. Enhance disclosure of 10b5-1 trades, including the modification of Form 4 to include the following new, required fields:
 - a. Checkbox to indicate whether a specific trade was pursuant to a Rule 10b5-1 plan
 - b. A new field to indicate the date of associated Rule 10b5-1 plan adoption or modification
6. Ensure all companies with any securities listed on U.S. exchanges (including ADRs and ADSs filing Form 20-Fs) are subject to Form 4 reporting requirements.

Should the SEC choose to adopt all of the IAC recommendations regarding public disclosure, the level of increased transparency into trading by company insiders would be significant. In addition, the level of corporate responsibility for implementing new policies and continuously reporting on trading by company insiders would materially increase.

The IAC did not address potential restrictions on modifying or canceling a Rule 10b5-1 plan. We previously suggested that the SEC may require that plans be modified, suspended or cancelled only during open trading windows under the issuer's insider trading policy and/or require a cooling-off period before trading can resume. Such change would seek to prevent an insider from manipulating an existing plan based on contemporaneous material nonpublic developments that could

¹ We note that use of Rule 10b5-1 by an issuer for sales would be extremely unusual and present significant execution challenges, and so as a practical matter any adoption around this point is not likely to impact existing practices.

impact the issuer's stock price. The SEC may also seek to limit any broker discretion in implementing a Rule 10b5-1 plan. Whether the SEC decides to implement these additional restrictions remains to be seen.

Impact on Corporate Buybacks

Interestingly, the IAC indicates in a footnote that it did not consider issuer share buybacks in its recommendations and believes any changes to the regulations of these programs should be addressed separately. The absence of recommendations from the IAC does not mean the SEC will not specifically address the application of Rule 10b5-1 to issuer buybacks in future rulemaking. In the interim, we believe companies using or planning to use Rule 10b5-1 plans for executing share buybacks will want to be mindful of the IAC's recommendations as those changes may very well end up applying in the context of issuer 10b5-1 plans.

If you have any questions regarding the topics discussed in this article, please contact **Matthew A. Rossi** at +1 (202) 312 3020, **Brooke E. Conner** at +1 (312) 609 7529 or any Vedder Price attorney with whom you have worked.

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