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SEC Tightens Insider Trading Rules for Executives with Amendments to Rule 10b5-1

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On December 14, 2022, the SEC adopted amendments to Rule 10b5-1 under the Securities Exchange Act of 1934 and imposed new disclosure requirements intended to address perceived abuses of the Rule.

Rule 10b5-1 provides an affirmative defense to insider trading for insiders—defined as executives, directors, and large shareholders—whose compensation is often tied up in company shares but who regularly have access to material nonpublic information about their companies. Rule 10b5-1 allows these insiders to sell their company stock without violating Rule 10b-5's prohibition on insider trading so long as any trades are made pursuant to predetermined trading plans, known as Rule 10b5-1 plans, entered into at a time when the insider is not aware of material nonpublic information.[1] In theory, such trades would not be based on inside information even if at the time of a subsequent purchase or sale pursuant to that plan, the insider was, in fact, in possession of material nonpublic information. However, Rule 10b5-1 has been criticized for containing loopholes that permit opportunistic trading, as we have previously detailed.[2]

The SEC's new amendments seek to fill in these gaps by updating the conditions that must be met for the Rule 10b5-1 affirmative defense. Specifically, the amendments impose the following:

- Cooling-off periods for persons other than issuers before trading can commence under a Rule 10b5-1 plan. Before these amendments, an executive could trade the same day a plan was adopted. A *Wall Street Journal* analysis found that insiders often benefitted by establishing a preset trading plan and then selling immediately thereafter.[3] The new amendment imposes a cooling-off period for officers and directors until the later of (1) 90 days following plan adoption or modification or (2) two business days following the disclosure of certain periodic reports of the issuer's financial results for the fiscal quarter in which the plan was adopted or modified (but not to exceed 120 days). The amendments provide that the cooling-off period for company employees who are not officers or directors is 30 days. These cooling-off periods are shorter than expected. The SEC's previously proposed amendments to Rule 10b5-1 included a mandatory 120-day cooling-off period for officers and directors.
- Representations certifying good faith. Officers and directors must certify at the time of the adoption of a new or modified Rule 10b5-1 plan that: (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.
- A limitation on the ability of anyone other than issuers to use multiple overlapping Rule 10b5-1 plans. Prior to these amendments, insiders could adopt numerous plans incorporating various strategies and then cancel the

[1] 17 C.F.R. § 240.10b5-1.

[2] *See* Matthew A. Rossi & Brooke E. Conner, *SEC Rule 10b5-1 Trading Plans: Recent Lessons and Likely Reforms to Come*, VEDDER PRICE (July 20, 2021), https://www.vedderprice.com/sec-rule-10b5-1-trading-plans-recent-lessons-and-likely-reforms-to-come#overview; Matthew A. Rossi & Brooke E. Conner, *SEC Rule 10b5-1 Trading Plans: Update on Potential Reforms*, VEDDER PRICE (Oct. 18, 2021), https://www.vedderprice.com/sec-rule-10b5-1-trading-plans-update-on-potential-reforms#overview.

[3] Tom McGinty, *Methodology: How the Journal Analyzed the Data on Insider Stock Sales*, WALL ST. J. (June 29, 2022), https://www.wsj.com/articles/methodology-how-the-journal-analyzed-the-data-on-insider-stock-sales-11656514208.

plans for which the predetermined trades would have unfavorable results before those trades were executed. The amendment disallows overlapping plans altogether. Now, insiders may not have another outstanding plan that would qualify for the Rule 10b5-1 affirmative defense during the same period. However, the amendment is primarily concerned with *overlap*—insiders can still maintain two separate Rule 10b5-1 plans at the same time, so long as trading under the later plan is not authorized to begin until after all trades under the earlier plan are completed or expire without execution (and subject to cooling-off periods).

- A limitation on the ability of anyone other than issuers to rely on the affirmative defense for a single-trade plan to one such plan during any consecutive 12-month period. In addition to restricting the use of multiple overlapping trading arrangements, the amendments limit the availability of the affirmative defense for a trading arrangement designed to effect the open-market purchase or sale of a total amount of securities as a single transaction. This amendment restricts insiders to one such single-trade plan per year, as academic research has found that single-trade plans are consistently loss-avoiding regardless of the timing.[4] The change is meant to encourage 10b5-1 plans that steadily sell predetermined amounts of shares over multiple years.
- A condition that all persons entering into a Rule 10b5-1 plan must act in good faith with respect to the plan.
- Comprehensive disclosure requirements. Prior to the amendments, insiders were not required to inform the SEC about modifications to Rule 10b5-1 plans, which could include the volume, frequency, and price targets of trades. To address these information gaps, the Commission adopted new Item 408 under Regulation S-K and corresponding amendments to Forms 10-Q and 10-K to require: (1) quarterly disclosure of the use of Rule 10b5-1 and other trading arrangements by a registrant and its directors and officers for the trading of the issuer's securities; and (2) annual disclosure of a registrant's insider trading policies and procedures. Moreover, the amendments require disclosures regarding awards of options close in time to the release of material nonpublic information; XBRL tagging of the required disclosures; and a requirement that Form 4 and 5 filers indicate by a checkbox that a reported transaction was intended to satisfy the affirmative defense conditions of Rule 10b5-1(c). This change significantly increases upfront transparency for regulators and investors into insider transactions.

The final rules will become effective 60 days following publication of the adopting release in the Federal Register. In light of heightened SEC and DOJ interest in investigating and enforcing potential abuses of Rule 10b5-1, companies and corporate insiders should be mindful of increased scrutiny and consult with counsel to reduce the risk of potential regulatory concerns when adopting Rule 10b5-1 plans.

The SEC's press release is available here, a related fact sheet is available here, and the SEC's final rule is available here.

If you have any questions regarding the topics discussed in this article, please contact **Michael J. Quinn** at mquinn@vedderprice.com, **Maura L. Riley** at mriley@vedderprice.com, or any Vedder Price attorney with whom you have worked.

[4] *See, e.g.*, David F. Larcker et al., *Gaming the System: Three "Red Flags" of Potential 10b5-1 Abuse*, STANFORD CLOSER LOOK SERIES (Jan. 19, 2021), https://www.gsb.stanford.edu/sites/default/files/publication-pdf/cgri-closer-look-88-gaming-the-system.pdf.