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New SEC Rules Put Spotlight On Exec Trading Plans

By **Sarah Jarvis**

Law360 (February 24, 2023, 10:47 PM EST) -- The U.S. Securities and Exchange Commission's new rules to crack down on executive insider trading take effect Monday, and they bring some confusion and a host of new requirements that may have companies rethinking their use of Rule 10b5-1 trading plans.

Corporate insiders may not use these plans as much in part because of a new requirement imposing a cooling-off period before insiders can trade that's up to four times as long as many companies currently impose, experts told Law360. The commission unanimously adopted the amendments in December.

Aaron K. Briggs, a securities regulation and corporate governance partner at Gibson Dunn & Crutcher LLP, said that in many cases, companies may disclose their trading plans in financial filings with the SEC before the first trades are even made, leading to potentially adverse implications for the company's stock price.

"For those companies that mandated that all of their employees enter into 10b5-1 plans, I think some of them will be thinking about changing their strategy and instead just requiring trades on the open market during an open trading window, and potentially subject to preclearance," Briggs said.

Rule 10b5-1 of the Securities Exchange Act of 1934 includes a so-called affirmative defense that allows companies and their insiders to buy and sell stock as long as they adopt trading plans in good faith before becoming aware of material nonpublic information.

When the agency adopted the amendments in December, SEC Chair Gary Gensler noted the commission had heard from courts, commenters and lawmakers that insiders have tried to benefit from the rule's liability protections while trading securities "opportunistically on the basis of material nonpublic information," or engaging in insider trading. Gensler touted the amendments as filling in potential gaps in the law.

The amendments — which were initially proposed in late 2021 and revised before the commission adopted them about a year later — hold corporate officers and directors entering into Rule 10b5-1 trading arrangements to a cooling-off period of up to 120 days before they can commence trading. And people other than issuers, directors or officers are subject to a 30-day cooling-off period for trading arrangements.

The final amendments also prohibit overlapping trading plans, addressing concerns over the practice of corporate insiders using multiple plans to selectively cancel individual trades because of material nonpublic information.

Issuers also have to report annually if they have adopted insider trading policies and procedures — or explain why they haven't — while officers and directors would need to disclose whether a reported transaction was made under an affirmative defense arrangement.

And directors and managers adopting a new plan or modifying an existing one must certify that they aren't aware of any material nonpublic information about a company or its securities and that they are adopting the plan in good faith.

Issuers will be required to comply with the new disclosure requirements in financial reports and information statements that cover the first full fiscal period on or after April 1, 2023.

Briggs of Gibson Dunn, who was previously executive counsel at General Electric Co., said that while many companies impose their own cooling-off periods on 10b5-1 plans, the one adopted by the SEC for officers and directors goes beyond any period he has seen a company use, which are generally 30 to 60 days.

Other requirements under the amendments may be new for companies, including restrictions on overlapping plans and single-trade plans, underscoring that it's important for companies to examine their current 10b5-1 plan practices, conduct a gap analysis and update their guidelines where they need to.

Briggs said he is also working with clients on their policies and practices regarding equity grant timing, since the rules include new disclosure requirements for when companies grant stock options to certain executives ahead of releasing nonmaterial public information.

He added that companies may be worried about the market impact of disclosures about their 10b5-1 plans, noting that "enterprising people" may, in some cases, be able to use the disclosures in quarterly reports and so-called Form 4 filings detailing an executive's actual trades to determine the pricing information under the plans.

"It could pose a whole host of potential [investor relations and public relations] challenges for some companies," Briggs said. "It could result in questions from investors as a part of the engagement between management and shareholders."

He added that some companies might try to dissuade their employees from entering into those plans and promote other compliance alternatives instead.

Crowell & Moring LLP partner Daniel Zelenko noted that companies previously did not have to report on executives who use 10b5-1 plans, adding that the additional information under the new amendments will be helpful for investors and regulators who will now have more information about the plans.

Zelenko, a former federal prosecutor and SEC enforcement lawyer, said that after companies release material nonpublic information, they might want to consider waiting to make compensation awards, saying there are optical issues around doling out awards too close to the disclosure of such information, known as MNPI.

Additionally, he said the commission's mandate that directors and managers certify that they are adopting plans in good faith will be a difficult measure to enforce. In voting for the amendments, Commissioner Mark T. Uyeda also flagged the good faith determination, calling it "inherently subjective."

"Overall, I do think it's going to be important for clients to take a fresh look at how they were using their 10b5-1 plans in the first place," Zelenko said.

He added that the same thoughtful analysis that spurred the SEC to implement these amendments will be useful going forward in analyzing the efficacy of the rules in practice.

Attorneys also told Law360 that under the new amendments, the exact definition of a "non-Rule 10b5-1 trading arrangement" — as opposed to a Rule 10b5-1 plan — is opaque.

In addition to reporting Rule 10b5-1 trading arrangements, the new rules require companies to disclose when their officers or directors adopt or terminate a non-Rule 10b5-1 trading arrangement. The SEC said in its final rule that it adopted a definition of the latter arrangement in response to feedback that the term was confusing and overly broad.

The final rule defines a non-Rule 10b5-1 trading arrangement as an officer or director who isn't aware of MNPI adopting a written arrangement for trading securities that specifies the amount and price of securities to be purchased or sold as well as the date when they will be purchased or sold. The arrangements also include a written formula or algorithm for determining the amount and price of the securities and don't allow the officer or director to exercise subsequent influence over how, when or whether to purchase or sell the securities.

For Gary Brown, a securities compliance and corporate governance partner at Nelson Mullins Riley & Scarborough LLP, and Charles Vaughn, co-chair of the firm's securities practice, the difference between those arrangements and Rule 10b5-1 plans is unclear.

"If, for example, you — without material nonpublic information — instructed your broker to sell securities two weeks from now, would that be a non-10b5-1 trading arrangement? I think so." Brown said.

Brown said that until the SEC comes out with different guidance or changes the rule, he is advising companies to be conservative about their reporting in this area and check if their executives are doing anything in addition to the trades listed on their Form 4s, such as limit orders.

Brown and Vaughn said the SEC is trying to shame companies into following the agency's more prescriptive approach to company disclosures, and the pair cited the newly mandated quarterly reports on the trading plans of officers and directors as the biggest change firms will have to grapple with.

Vaughn said that much of what's in the new amendments is good, including a cooling-off period and a new box executives must check on their Form 4s if they are trading under a Rule 10b5-1 plan. But he said the SEC got a bit carried away with this rule, and with other rulemaking the commission is working on, including its climate proposal, among others.

"Many of our clients are smaller reporting companies, and the cumulative effect of these rules over the past 18 months — particularly if the climate change regulations are adopted — is enormous," he said.

Vaughn said he would be curious to see if implementing the longer cooling-off period alone, without "a lot of needless complexity and disclosure and cost," would have gotten the agency the results it sought.

Considering the studies the SEC cited showing misuse of 10b5-1 plans, the amendments could be a gap filler, Brown said. But some provisions appear more stringent than necessary, including the cooling-off period of up to 120 days and the restriction on immediate trading for those not in possession of MNPI.

Ultimately, time will tell how effective the amendments are, he said.

"The proof is always in the pudding, shall we say, when it's put into practice," Brown said. "We'll see whether all they've done is create some additional sort of unwieldy disclosure for companies, or whether they've solved a true problem."

--Additional reporting by Al Barbarino. Editing by Jill Coffey and Emily Kokoll.
