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

On December 14, 2022, the Securities and Exchange Commission (the "SEC" or the "Commission") adopted final rules (the "Final Rules")[1] which add a number of new requirements to Rule 10b5-1 that significantly limit the availability of the affirmative defense provided by that rule to violations of Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act") and Rule 10b-5 thereunder. The Final Rules also include new disclosure requirements that will require public companies (1) to describe and file their insider trading policies, (2) to provide additional narrative and tabular disclosure about compensatory incentive awards in certain situations and (3) on a quarterly basis, to disclose information about the use of Rule 10b5-1 plans and other trading arrangements by their officers and directors. The Final Rules also add a mandatory check box to Forms 4 and 5 requiring insiders who must file those reports to indicate whether the reported transaction is pursuant to a plan intended to satisfy the Rule 10b5-1 affirmative defense, and requires bona fide gifts of securities to be reported on Form 4 in accordance with that form's filing deadline.

HISTORICAL BACKGROUND

Rule 10b5-1 was adopted by the SEC in 2000 to provide an affirmative defense against charges of insider trading when transactions in the company's stock are executed at times that the insider may be in possession of material non-public information.[2] In the years since the rule was adopted, various SEC commissioners, academics and institutional investors have questioned whether existing Rule 10b5-1 is an adequate safeguard against insiders' potential abuse of material nonpublic information. On December 15, 2021, the Commission unanimously proposed amendments to Rule 10b5-1, as well as enhanced disclosure and reporting requirements for companies and insiders required to file reports under Section 16 of the Exchange Act (the "Proposal").

The SEC adopted the Final Rules on December 14, 2022 in a 5-0 vote. The Final Rules differ in a number of important ways from the Proposal, in many cases consistent with feedback Cravath submitted to the SEC on the Proposal.[3]

IMPORTANT THINGS TO KNOW

Below are questions highlighting issues of note for companies, directors, executives, and advisors about the Final Rules:

Compliance Dates

1. When do affected companies, directors, and officers need to comply with the Final Rules?

- *Rule 10b5-1* – The amendments to Rule 10b5-1 will be effective 60 days after publication in the federal register (expected in the first quarter of 2023).
- *Section 16 Reports* – Section 16 reporting persons must comply with the amendments to Forms 4 and 5 for beneficial ownership reports filed on or after April 1, 2023.
- *Items 408 and 402(x) of Regulation S-K* – New Item 408 of Regulation S-K will require disclosure about insiders' use of Rule 10b5-1 plans and disclosure of issuers' insider trading policies, and new Item 402(x) will require certain disclosures related to compensatory incentive awards. All registrants other than smaller reporting companies ("SRCs") must comply with these new disclosure requirements in Exchange Act reports and any proxy or information statements in the first filing that covers the first full fiscal period that begins on or after April 1, 2023.[4] For companies with calendar year ends, this means that the new Item 408(a) disclosure about insiders' use of Rule 10b5-1 plans will first be required in the Form 10-Q filed for the second quarter of 2023, and the new Item 408(b) disclosure of issuers' insider trading policies and Item 402(x) disclosure related to compensatory incentive awards will first be required in the Form 10-K covering fiscal year 2023 and the 2024 proxy statement, in each case to be filed in 2024.[5]

Amendments to Rule 10b5-1

2. Are existing Rule 10b5-1 plans affected by the Final Rules?

No. The Final Rules do not affect the affirmative defense available under an *existing* Rule 10b5-1 plan unless there is any modification or change to the amount, price or price range or timing of the purchase or sale of securities under the plan after the Final Rules are effective (*see question 5*).

Rule 10b5-1 plans, other than issuer 10b5-1 plans, entered into or modified in a manner described in new Rule 10b5-1(c)(iv)[6] after the Final Rules are effective (*see question 1*) must comply with the new conditions (*see question 4*) to be eligible for the rule's affirmative defense.

3. Do the Final Rules affect issuer Rule 10b5-1 programs?

The conditions to the affirmative defense added by the Final Rules do not apply to issuers, with the exception of the "acted in good faith" requirement (*see questions 4 and 7*). Companies are not required to include in the new quarterly disclosures required by Item 408(a) (*see question 8*) information about issuer Rule 10b5-1 plans. If a company has insider trading policies and procedures governing the purchase or sale of securities applicable to the company's purchase and sale of its own securities, it *will* be required to disclose those policies and procedures under Item 408(b) (*see question 10*). The application of the Final Rules to shareholders who are not directors or officers (for example, controlling shareholders) varies depending on whether the condition is applicable only to officers and directors or to insiders more broadly.

While the SEC proposed new disclosure and reporting requirements for issuer share repurchases ("Share Repurchase Disclosure Modernization Proposal") at the same meeting as the Proposal, the SEC has not yet adopted final rules for such requirements. The SEC announced on December 7, 2022 that it was reopening the comment period for the Share Repurchase Disclosure Modernization Proposal in light of new staff analysis about the impact of the excise tax contained in the Inflation Reduction Act of 2022 on the proposal's economic analysis.[7] The comment period is now open until January 11, 2023.

4. What new conditions do insiders wishing to rely on the amended Rule 10b5-1 affirmative defense need to include in their Rule 10b5-1 plans or otherwise comply with?

COOLING-OFF PERIODS

- Directors and officers (as defined in Rule 16a-1(f)) (hereinafter "officers")[8] must include in any Rule 10b5-1 plan a cooling-off period that

extends until the later of: (1) 90 days after the plan is adopted; and (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.[9] Amended Rule 10b5-1 uses the more expansive definition of "officer" in Section 16, which is broader than the definition of "executive officer" in Rule 3b-7 under the Exchange Act. Note also that the Commission considered tying the end of the cooling-off period to an issuer's earnings release under Item 2.02 of Form 8-K but expressly determined that was inadequate and that the filing of the periodic report was a more appropriate date.

- All persons other than directors, officers or issuers must include a 30-day cooling-off period in their Rule 10b5-1 plans.

GOOD FAITH REPRESENTATION

- Directors and officers must include in any plan a representation certifying that at the time of the adoption of a new or modified Rule 10b5-1 plan: (1) they are not aware of material non-public information about the issuer or its securities; and (2) they are adopting the plan in good faith. Unlike the proposal, the required representation need only be included in the plan documentation and not provided to the registrant separately.

"ACTED IN GOOD FAITH" REQUIREMENT

- The affirmative defense will only be available if a person has "acted in good faith" with respect to their Rule 10b5-1 plan.

LIMITS ON OVERLAPPING PLANS

- A person other than the issuer may have only one Rule 10b5-1 plan outstanding at a time, with limited exceptions for:
  - A new Rule 10b5-1 trading plan under which trades do not begin until sales under the earlier plan are complete or expire without execution.[10] This addition from the Proposal, consistent with Cravath's comment letter, should make it possible for directors and officers to maintain continuous coverage of at least one operating trading plan.
  - Plans authorizing "sell-to-cover" transactions to satisfy tax withholding obligations incident to the vesting of certain compensatory awards, such as restricted stock or stock appreciation rights, so long as the plan holder does not otherwise exercise control over the timing of such sales.[11]

LIMITS ON SINGLE-TRADE PLANS

- For persons other than the issuer, the affirmative defense will only be available for one single-trade plan in a consecutive twelve-month period.[12] Note that the SEC considers a trade to be a single trade plan if it is "designed to effect" a trade in a single transaction. Plans that may give a broker discretion over sales or tie triggers to several different stock prices will not be deemed single-trade plans, even if they happen to execute in only a single trade.

5. Are the new conditions applicable to plan modifications?

Yes. Under the Final Rules, modifications described in new Rule 10b5-1(c)(1)(iv), which include changes to the amount, price or price range or timing of purchases or sales will constitute the termination of an existing plan and an adoption of a new plan. This means that any modification to the amount, price or price range or timing of purchases or sales will trigger a new cooling-off period and, if the plan holder is a director or officer, a new "good faith" representation.[13]

6. How do the Final Rules affect plans using multiple brokers?

A series of separate contracts between a person (other than the issuer) and different brokers to execute trades under a plan may be treated as a single plan under the Final Rules so long as the different contracts, taken together, meet all applicable conditions of the affirmative defense.[14] Under the Final Rules, a person may substitute a broker or other agent executing trades pursuant to a Rule 10b5-1 plan with another broker or agent, as long as the instructions to the new broker are identical with respect to the prices of securities to be purchased or sold, dates of the purchases or sales and the amount of securities to be sold.

7. What does it mean to "act in good faith" with respect to operation of a Rule 10b5-1 plan?

The new requirement is intended to deter insiders from influencing the timing of disclosures to benefit trades scheduled under an insider's Rule 10b5-1 plan. For example, delaying the release of negative information until after scheduled sales have occurred under a plan could call into question whether the person acted in good faith with respect to operating the plan. The Adopting Release particularly notes an insider would not be acting in good faith if he or she "directly or indirectly induces the issuer to publicly disclose . . . information in a manner that makes their trades under a Rule 10b5-1 plan more profitable (or less unprofitable)".

The new condition is intended to focus on the activities of a particular person, so issuer-imposed cancellations and blackout periods that are *outside of an individual's control or influence* should not implicate the "act in good faith" condition of that particular individual. However, directors and officers may need to be cautious about how their positions in internal deliberations around disclosure decisions will be perceived with the benefit of hindsight, and issuers should similarly be mindful of how any planned issuer 10b5-1 activity will be perceived.

Issuer Disclosures

8. Do companies need to provide additional disclosure about officers' and directors' trading plans?

Yes. On a *quarterly basis*, companies other than FPIs must disclose the material terms, other than price-related information, of any Rule 10b5-1 plan or similar trading arrangement that directors or officers entered into or terminated during the preceding quarter. New Item 408(a) includes the following non-exhaustive list of required disclosures:

- the name and title of each director or officer;
- the date of adoption or termination of the trading arrangement;
- the duration of the trading arrangement; and
- the aggregate number of securities to be purchased or sold.

Companies must also disclose whether each plan is a Rule 10b5-1 plan or a "non-Rule 10b5-1 trading arrangement".[15] This disclosure will be required in Forms 10-Q for the first three fiscal quarters, and in Form 10-K for the fourth fiscal quarter.

9. Does Item 408(a) require companies to disclose director or officer plan modifications?

Yes. Any changes to the amount, price or price range or timing of purchases or sales will constitute the termination of an existing plan and an adoption of new plan, requiring disclosure in the appropriate quarter.

10. What information is required about a company's insider trading policies and practices?

On an *annual basis*, new Item 408(b) will require companies (including FPIs)[16] to disclose whether the company has policies and procedures governing the purchase, sale and/or other dispositions of the company's securities by directors, officers and employees or the registrant itself reasonably designed to promote compliance with insider trading laws, rules, regulations, and any listing standards applicable to the company. If so, the applicable policies and procedures must be filed as an exhibit to the company's annual report. If the company has not adopted such policies and procedures, then it must explain why it has not done so. In our experience, many issuers' insider trading policies do not apply to the issuer itself. In light of this new disclosure requirement, companies may want to consider updating their policies to apply to the company as well.

11. Can companies put applicable insider trading policies on their website instead of filing them as exhibits?

No. Companies must file any policies and procedures required by Item 408(b) with the SEC as an exhibit to Form 10-K or 20-F.

12. What are the new compensation-related disclosure requirements?

New Item 402(x) requires additional narrative and tabular disclosure about a company's policies and practices related to the grant of certain equity awards close in time to the release of material non-public information.[17] New Item 402(x) does not apply to FPIs, and emerging growth companies (EGCs) and SRCs can limit the new disclosures to the same individuals for whom disclosure is required pursuant to existing Item 402(m)(2).

The new narrative disclosure includes disclosure about (1) how the board determines when to grant awards, (2) whether and how the compensation committee takes material non-public information into account when determining the timing and award terms and (3) whether a company has timed the disclosure of material non-public information for the purpose of affecting the value of the compensation.

The new tabular disclosure must take the following form:

Name	Grant date	Number of securities underlying the award	Exercise price of the award ($/Sh)	Grant date fair value of the award	Percentage change in the closing market price of the securities underlying the award between the trading day ending immediately prior to the disclosure of material nonpublic information and the trading day beginning immediately following the disclosure of material nonpublic information
PEO					
PFO					
A					
B					
C					

13. What time period does the tabular disclosure in new Item 402(x) cover?

The table must include any stock options, SARs or similar instruments awarded to a named executive officer within the last completed fiscal year that were awarded in the period between (a) four business days before the filing of a periodic report or the filing or furnishing of a current report that discloses material non-public information, and (b) one business day after the filing or furnishing of such report. The new disclosure is limited to option-like instruments and will not require disclosure of grants of restricted stock or RSUs.

14. Does this disclosure need to be tagged for interactive data purposes?

Yes. Companies will be required to use Inline XBRL to tag the new disclosures required by Items 408(a), 408(b)(1) and 402(x).

Section 16 Reports

15. When and how are bona fide gifts of securities to be reported?

Beginning April 1, 2023, bona fide gifts of securities by directors and officers will need to be reported on Form 4 within two business days of the transaction, rather than annually on Form 5 as currently permitted.

Recommendations

The adoption of the Final Rules will likely result in a number of operational changes related to Rule 10b5-1 plans and insider trading policies more generally. Accordingly, we recommend:

- Companies should act now to review and update their insider trading policies and procedures. This review should include updating any certification requirements and provisions related to non-Rule 10b5-1 trading arrangements and gifts, particularly ensuring that gifts will be reported in real-time to those responsible for Section 16 filings and ensuring that policies are consistent with amended Rule 10b5-1.
- Companies should also carefully review policies for other general best practices and recent areas of focus (such as the heightened focus on cybersecurity matters) since policies will soon be subject to direct investor scrutiny and potential investor engagement.
- We also encourage companies to prepare to engage with brokerage firms who will likely change their standard Rule 10b5-1 plan agreements.
- Boards and compensation committees should discuss existing option grant practices in light of the new disclosures required by Item 402(x), likely continuing similar discussions that occurred after the release of Staff Accounting Bulletin 120.[18]
- Finally, companies should discuss with directors and officers the new disclosure requirements that will affect them, as well as the new cooling-off periods and limitations on overlapping and single-trade plans. Companies should also be mindful of the new "act in good faith" condition and discuss with directors and officers the new condition and the need to be cautious about how their positions in any deliberations around disclosure decisions will be viewed in hindsight.

1 The text of the final rule and the Commission's related adopting release (the "Adopting Release") can be found on the SEC's website at https://www.sec.gov/rules/final/2022/33-11138.pdf.

2 Rule 10b5-1(b) specifies that subject to its affirmative defense, trades are made "on the basis of material nonpublic information for purposes of Section 10(b) and Rule 10b-5 if the person making the purchase or sale was aware of the material nonpublic information when the person made the purchase or sale." This regulatory language was intended to undercut certain courts that had ruled that Section 10(b) and Rule 10b-1 could only be violated if an insider made the trade "on the basis of" material nonpublic information, not merely while in possession of such information.

3 The firm's comment letter suggested, among other things, that the amendments to Rule 10b5-1 not apply to issuers, that any final rules expressly grandfather existing plans, that any required certifications be included as a representation in a Rule 10b5-1 plan itself and shortening the proposed 14-day window that would trigger disclosure of certain option awards under proposed Item 402(x) to three to five days.

4 SRCs must comply in the first filing that covers the first full fiscal period that begins on or after October 1, 2023.

5 Foreign private issuers ("FPIs") will first need to include disclosures pursuant to Item 16J, which is analogous to Item 408(b), in the first Form 20-F that covers the first full fiscal period that begins on or after April 1, 2023 or October 1, 2023 if the FPI is an SRC. There is no analogous provision to Items 408(a) or 402(x) applicable to FPIs. The disclosure provisions in the Final Rules do not apply to Canadian issuers filing under the multijurisdictional disclosure system ("MJDS issuers").

6 New Rule 10b5-1(c)(iv) states that "[a]ny modification or change to the amount, price, or timing of the purchase or sale of the securities underlying a contract, instruction, or written plan as described in paragraph (c)(1)(i)(A) of this section is a termination of such contract, instruction, or written plan, and the adoption of a new contract, instruction, or written plan. A plan modification, such as the substitution or removal of a broker that is executing trades pursuant to a Rule 10b5-1 arrangement on behalf of the person, that changes the price or date on which purchases or sales are to be executed, is a termination of such plan and the adoption of a new plan."

7 The text of the reopening release can be found on the SEC's website at https://www.sec.gov/rules/proposed/2022/34-96458.pdf. The staff memo is available here https://www.sec.gov/comments/s7-21-21/s72121-20152424-320317.pdf.

8 The officers that will be required to comply with the provisions of the affirmative defense applicable to directors and officers include a company's president, principal financial officer, principal accounting officer (or if there is no such accounting officer, the controller), any vice president of the company in charge of a principal business unit, division or function (such as sales, administration or finance), any other officer who performs a policy-making function or any other person who performs similar policy-making functions for the company, i.e., the officers who are required to file Form 4s.

9 The maximum required cooling-off period is 120 days after adoption of the plan. This maximum may be of particular relevance for FPIs which are not required to report their financial results on a quarterly basis.

10 However, the affirmative defense will only be available in this scenario if an insider does not modify or terminate the earlier Rule 10b5-1 plan in a way that would operate to shorten the required cooling-off period for the later-adopted plan. The Adopting Release provides this example:

"An insider who is not an officer or director has in place an existing Rule 10b5-1 plan with a scheduled date for the latest authorized trade of May 31, 2023. On May 1, 2023, that insider adopts a later-commencing plan, intended to qualify for the affirmative defense under Rule 10b5-1, with a scheduled date for the first authorized trade of June 1, 2023. If the insider terminates the earlier-commencing plan on May 15, the later-commencing plan will not receive the benefit of the affirmative defense, because June 1 is within 30 days of May 15, the date of termination of the earlier-commencing plan, and thus June 1 is during the 'effective cooling-off period.' However, if the later-commencing plan were scheduled to begin trading on July 1, 2023, it could still receive the benefit of the affirmative defense because July 1, 2023 is more than 30 days after May 15 and thus is outside the 'effective cooling-off period.'"

11 In light of the discretion involved in deciding when to exercise options, option exercises are not included in the limited exception provided in amended Rule 10b5-1.

12 If someone enters into a single-trade plan that is not intended to qualify for the affirmative defense in Rule 10b5-1(c), the affirmative defense will remain available for one single trade plan that is intended to qualify.

13 The Adopting Release states that "modifications that do not change the sales or purchase prices or price ranges, the amount of securities to be sold or purchased, or the timing of transactions under a Rule 10b5-1 plan (such as an adjustment for stock splits or a change in account information) will not trigger a new cooling-off period".

14 However, any modification of a contract with any broker that meets the definition in amended Rule 10b5-1(c)(vii) will be considered a modification of all contracts comprising the plan.

15 Requiring disclosure about "non-Rule 10b5-1 trading arrangements" is designed to deter directors and officers from choosing to rely on defenses other than Rule 10b5-1 to avoid providing the new Item 408 disclosure. For the purposes of Item 408, a "non-Rule 10b5-1 trading arrangement" is one where:

(1) The covered person asserts at a time when they were not aware of material nonpublic information about the security or the issuer of the security they had adopted a written arrangement for trading the securities; and

(2) The trading arrangement:

(i) specified the amount of securities to be purchased or sold and the price at which and the date on which the securities were to be purchased or sold;

(ii) included a written formula or algorithm, or computer program, for determining the amount of securities to be purchased or sold and the price and the date on which the securities were to be sold; or

(iii) did not permit the covered person to exercise any subsequent influence over how, when, or whether to effect purchases or sale; provided, in addition, that any other person who, pursuant to the trading arrangement, did exercise such influence must not have been aware of material non-public information while doing so.

16 FPIs, other than MJDS issuers, will be required to provide analogous disclosures in new Item 16J of Form 20-F.

17 For these purposes, the filing of a Form 10-K or Form 10-Q or the release of earnings information on Form 8-K is deemed to constitute the release of material nonpublic information. An issuer will need to assess each Form 8-K that it files or furnishes to determine whether it includes material nonpublic information. A Form 8-K reporting *only* the grant of a material new option award under Item 5.02(e) does not trigger disclosure under Item 402(x).

18 Last December, Cravath provided an update regarding Staff Accounting Bulletin 120, available here.

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