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Skadden

SEC Reporting & Compliance Alert

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SEC Announces Proposals Relating to Rule 10b5-1, Share Repurchases and Other Matters

On December 15, 2021, the U.S. Securities and Exchange Commission (SEC) proposed several amendments and new disclosure requirements intended to address what it perceives as potentially abusive practices engaged in by public companies, directors and officers relating to Rule 10b5-1 trading plans, certain equity awards and gifts of securities. The SEC also proposed new disclosure rules for company share repurchases (which are often executed pursuant to Rule 10b5-1 trading plans), citing its view of the potential for opportunistic and harmful use of repurchases by company insiders. If adopted, these rules could significantly impact many of the common practices that public companies and their insiders have come to rely on to manage equity award programs and conduct share repurchases and personal trading.

Proposed Changes to Rule 10b5-1, Related Company Disclosures and Section 16 Reporting

Amendments to Rule 10b5-1

Rule 10b5-1 under the Securities Exchange Act of 1934 (Exchange Act) provides an affirmative defense to insider trading for individuals and companies that trade stocks under plans entered into in good faith and at a time when the individual or company does not possess material nonpublic information. The amendments to Rule 10b5-1 proposed by the SEC would add new conditions to the availability of the affirmative defense to insider trading liability provided by Rule 10b5-1 trading plans, including:

- **Cooling-Off Period:** The proposed amendments would require a minimum cooling-off period between when a plan is adopted or modified and when trading commences.[1] The proposed cooling-off period is 120 days for directors and officers[2] and 30 days for companies.
- **Director and Officer Certifications:** When adopting or modifying a Rule 10b5-1 plan, directors and officers would need to provide the company with a written certification stating that they are not aware of material nonpublic information about the company or its securities and that they are adopting or modifying the plan in good faith. The

[1] The proposed rules do not specify what constitutes "a modification" to an existing Rule 10b5-1 plan; however, the proposed amendments include a note clarifying that a modification, including canceling one or more trades under an existing plan, is the equivalent of terminating the existing plan and adopting a new one, which would trigger, in turn, a new cooling-off period.

[2] "Officers" refer to those defined in Exchange Act Rule 16a-1, for purposes of these proposed rules.

certifications are not filed with the SEC, but would need to be retained for 10 years.

- **Multiple, Overlapping Plans:** Having more than one Rule 10b5-1 plan for trading in the same class of securities would be prohibited. This prohibition would not apply where a person transacts directly with the company, such as participation in employee stock ownership plans or dividend reinvestment plans, which are not executed on the open market. Notwithstanding that exception, this proposed amendment would seem to significantly reduce the existing flexibility allowing insiders to preplan cashless option exercises and sell-to-cover programs, among others, which typically rely on a Rule 10b5-1 affirmative defense and therefore could be at risk for any insider who seeks to implement another type of Rule 10b5-1 trading plan for an overlapping period. In addition, as proposed, this prohibition, along with the cooling-off periods, would limit the ability of companies to conduct continuous repurchase programs under Rule 10b5-1 plans.
- **Single-Trade Arrangements:** Single-trade plans would be limited to one in any 12-month period.
- **Expanded Good Faith Requirement:** In addition to the current requirement that the Rule 10b5-1 plan be entered into in good faith, the proposed amendments would add the condition that the plan be operated in good faith. For example, the SEC notes that canceling or modifying a plan on the basis of material nonpublic information or influencing the timing of a company disclosure to make trades under a plan more profitable could run afoul of this ongoing good faith requirement.

Company Disclosures

The proposed rules would introduce the following new disclosure requirements for companies:

- **Insider Trading Policies and Procedures:** Companies, including foreign private issuers (FPIs), would be required to disclose, on an annual basis, the company's insider trading policies and procedures. If no such policies or procedures are in place, the company would need to explain why.[3]
- **Adoption, Modification and Termination of Rule 10b5-1 Plans and Other Trading Arrangements:** Companies would be required to provide quarterly disclosure of the adoption, modification and termination of the company's Rule 10b5-1 plans and other preplanned trading arrangements, as well as those of its directors and officers.[4] Companies would need to describe the material terms of each plan, including the name and title of the director or officer, if not a company plan; the date the plan was adopted, modified or terminated; the plan's duration; and the total amount of securities to be purchased or sold under the plan. Companies would not be required to disclose pricing terms.
- **Options and Similar Equity Grants:** Companies would be required to disclose policies and practices on the timing of awards of options, stock appreciation rights (SARs) and similar instruments with option-like features in relation to the disclosure of material nonpublic information.[5] Companies would need to discuss (i) how the timing of awards is decided, (ii) how material nonpublic information is considered, if it all, when determining the timing and terms of awards and (iii) whether disclosure of such information is timed to impact the value of awards.

  Companies also would be required to annually disclose in a new table any options, SARs or similar instruments granted to named executive officers within 14 calendar days before or after the filing of a periodic report on Form 10-Q or 10-K, a company share repurchase or the filing or furnishing of a current report on Form 8-K that contains material nonpublic information (including earnings releases). The table would provide the following:

  - each option award (including the number of securities underlying the award, the date of the grant, the grant date fair value and the option's exercise price); and
  - the market price of the underlying securities on the trading day before and after disclosure of the material nonpublic information.

Section 16 Reporting

The proposed amendments would also impose the following new disclosure requirements for Section 16 filers:

- **Rule 10b5-1(c) Checkbox:** A mandatory checkbox would be added to Forms 4 and 5, where filers would have to indicate whether a reported transaction was made under a Rule 10b5-1 plan. If so, filers would also need to provide the date the plan was adopted. A second, optional checkbox would allow filers to indicate whether a reported transaction was made under a plan not intended to qualify for the Rule 10b5-1 affirmative defense.
- **Gifts:** Bona fide gifts of equity securities would no longer be reported on Form 5, but instead would have to be reported on Form 4 and filed before the end of the second business day following the date of the gift.

[3] Disclosure would be required pursuant to new Regulation S-K Item 408(b). FPIs also would be required to provide analogous disclosure in their annual reports pursuant to a new proposed Item 16J of Form 20-F.

[4] Disclosure would be required pursuant to new Regulation S-K Item 408(a). As proposed, such disclosures would not be required for FPIs.

[5] A new paragraph (x) added to Regulation S-K Item 402 would require narrative and tabular disclosure for options and similar equity grants.

Proposed Share Repurchase Disclosure Rules

Currently, companies are required to make periodic disclosures of all open market and private repurchases of equity securities by the company or an affiliated purchaser.[6] The proposal would significantly alter the current disclosure framework for companies, including FPIs and certain registered closed-end funds, requiring next-business-day disclosure of repurchases on a new Form SR and enhancing the existing disclosure requirements.

Form SR Next-Business-Day Reporting

The proposed rules would require companies to report any repurchases of equity securities made by or on behalf of the company or any affiliated purchaser on a new Form SR before the end of the first business day after the repurchase is executed. Companies would furnish, not file, the Form SR with the SEC, and would use it to disclose:

- the repurchase date;
- the class of securities purchased;
- the total number of shares purchased, including all company repurchases, whether or not made pursuant to publicly announced plans or programs;
- the average price paid per share;
- the aggregate total number of shares purchased on the open market;
- the aggregate total number of shares purchased in reliance on the safe harbor in Exchange Act Rule 10b-18; and
- the aggregate total number of shares purchased pursuant to a Rule 10b5-1 plan.

Companies also would need to furnish an amended Form SR to correct material changes to transactions previously reported on Form SR, including if an executed repurchase order fails to clear and settle.

Enhanced Periodic Disclosure

The proposed rules would also require additional disclosure regarding the structure of a company's repurchase program and its share repurchases.[7] Specifically, a company would need to disclose:

- the objective or rationale for the company's program and the process or criteria it uses to determine the amount of repurchases;
- any policies and procedures relating to purchases and sales of the company's securities by its directors and officers during a repurchase program, including any restriction on trading;
- whether the company made its repurchases pursuant to a Rule 10b5-1 plan, and if so, the date that the plan was adopted or terminated; and
- whether the company made its repurchases in reliance on the nonexclusive safe harbor under Rule 10b-18.

A new checkbox would also be added, which would be checked if any of the company's directors or officers purchased or sold shares of the same class of a company's stock that is subject to the company's repurchase program within 10 business days before or after announcement of the program.

Next Steps

The public comment period for both proposals will remain open for 45 days following publication of the proposing releases in the *Federal Register*. Companies may want to review their compensation committee calendar to consider whether they may need to revise it if the proposed rules are adopted. Companies may also want to begin to consider necessary controls and processes that will enable them to make new disclosures should the proposed rules be adopted. Finally, companies may want to assess the various circumstances in which they and their insiders utilize the affirmative defense of existing Rule 10b5-1 plans and plan for timing and other changes that may be required if the proposals are adopted in their current form.

[6] Under Rule 10b-18, a person or entity is an "affiliated purchaser" if it (i) acts, directly or indirectly, in concert with the issuer with the intent to acquire the issuer's securities; or (ii) is "an affiliate who, directly or indirectly, controls the issuer's purchases of such securities, whose purchases are controlled by the issuer, or whose purchases are under common control with those of the issuer." See our March 16, 2020, client alert "Share Repurchases" for additional information on current disclosure requirements for share repurchases.

[7] Disclosure would be required pursuant to a revised Regulation S-K Item 703. Corresponding changes would be made to Form 20-F for FPIs and Form N-CSR for registered closed-end funds.

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