

**SECURITIES AND EXCHANGE COMMISSION**

**17 CFR Parts 229, 232, 240 and 249**

**[Release No. 33-11013; 34-93782; File No. S7-20-21]**

**RIN 3235-AM86**

**Rule 10b5-1 and Insider Trading**

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Proposed rule.

**SUMMARY:** The Securities and Exchange Commission (“Commission”) is proposing amendments to Rule 10b5-1 under the Securities Exchange Act of 1934. The proposed amendments would add new conditions to the availability of the affirmative defense under Exchange Act Rule 10b5-1(c)(1) that are designed to address concerns about abuse of the rule to opportunistically trade securities on the basis of material nonpublic information in ways that harm investors and undermine the integrity of the securities markets. The Commission is also proposing new disclosure requirements regarding the insider trading policies of issuers, and the adoption and termination (including modification) of Rule 10b5-1 and certain other trading arrangements by directors, officers, and issuers. In addition, the Commission is proposing amendments to the disclosure requirements for executive and director compensation regarding the timing of equity compensation awards made in close proximity in time to the issuer’s disclosure of material nonpublic information. Finally, the Commission is proposing amendments to Forms 4 and 5 to require corporate insiders subject to the reporting requirements of Exchange Act Section 16 to identify transactions made pursuant to a Rule 10b5-1(c)(1) trading arrangement, and to disclose all gifts of securities on Form 4.

**DATES:** Comments should be received on or before [insert date 45 days after publication in the Federal Register].

**ADDRESSES:** Comments may be submitted by any of the following methods:

*Electronic comments:*

- Use our Internet comment form (<https://www.sec.gov/regulatory-actions/how-to-submit-comments>); or
- Send an email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number S7-20-21 on the subject line.

*Paper comments:*

- Send paper comments to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number S7-20-21. This file number should be included on the subject line if email is used. To help us process and review your comments more efficiently, please use only one method of submission. We will post all comments on our website (<http://www.sec.gov/rules/proposed.shtml>). Comments also are available for website viewing and printing in our Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. Operating conditions may limit access to the Commission's public reference room. All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make publicly available.

We or the staff may add studies, memoranda, or other substantive items to the comment file during this rulemaking. A notification of the inclusion in the comment file of any such

materials will be made available on our website. To ensure direct electronic receipt of such notifications, sign up through the “Stay Connected” option at [www.sec.gov](http://www.sec.gov) to receive notifications by e-mail.

**FOR FURTHER INFORMATION CONTACT:** Sean Harrison, Special Counsel, or Felicia Kung, Office Chief, Office of Rulemaking, at (202) 551-3430, Division of Corporation Finance, 100 F Street NE, Washington, DC 20549.

**SUPPLEMENTARY INFORMATION:** The Commission is proposing amendments to:

Commission Reference		CFR Citation (17 CFR)
Regulation S-K [17 CFR 229.10 through 229.1305]		
	Item 402	§ 229.402
	Item 408	§ 229.408
Regulation S-T [17 CFR 232.11 through 232.903]		
	Item 405	§ 232.405
Securities Exchange Act of 1934 (Exchange Act) [15 U.S.C. 78a <i>et seq.</i> ]		
	Rule 10b5-1	§ 240.10b5-1
	Schedule 14A	§ 240.14a-101
	Schedule 14C	§ 240.14c-101
	Rule 16a-3	§240.16a-3
	Form 4	§ 249.104
	Form 5	§ 249.105
	Form 20-F	§249.220f
	Form 10-Q	§ 249.308a
	Form 10-K	§ 249.310

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## **I. Introduction**

Congress enacted the federal securities laws to promote fair and transparent securities markets, “avoid[] frauds,” and “substitute a philosophy of full disclosure for the philosophy of caveat emptor and thus to achieve a high standard of business ethics in the securities industry.”<sup>1</sup> The securities laws’ antifraud provisions that proscribe insider trading play an essential role in maintaining the fairness and integrity of our markets. We have long recognized that insider trading and the fraudulent use of material nonpublic information by corporate insiders<sup>2</sup> not only harm individual investors but also undermine the foundations of our markets by eroding investor confidence.<sup>3</sup> Congress has recognized the harmful impact of insider trading on multiple

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<sup>1</sup> *Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 151 (1972); accord *Lorenzo v. SEC*, 139 S. Ct. 1094, 1103 (2019).

<sup>2</sup> The term “corporate insider” as used in this release, refers to officers and directors of an issuer.

<sup>3</sup> See *In re Cady, Roberts & Co.*, 40 S.E.C. 907, 1961 WL 60638, at \*4 n.15 (1961) (“A significant purpose of the Exchange Act was to eliminate the idea that use of inside information for personal advantage was a normal emolument of corporate office.”); see also *United States v. O’Hagan*, 521 U.S. 642, 658 (1997) (The insider

occasions and has authorized enhanced civil penalties specifically for insider trading.<sup>4</sup>

Section 10(b) of the Exchange Act is one of the securities laws' primary antifraud provisions.<sup>5</sup> Section 10(b) makes it unlawful to use or employ, in connection with the purchase or sale of any security, "any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe."<sup>6</sup> The "manipulative or deceptive device[s] or contrivance[s]" prohibited by Section 10(b) and Rule 10b-5 (adopted thereunder) include the purchase or sale of a security of any issuer on the basis of material nonpublic information about that security or its issuer, in breach of a duty owed directly, indirectly, or derivatively, to the issuer of that security or the shareholders of that issuer, or to any person who is the source of the material nonpublic information.<sup>7</sup>

The Commission adopted Rule 10b5-1 in August 2000 to provide more clarity on the meaning of "manipulative or deceptive device[s] or contrivance[s]" prohibited by Exchange Act

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trading prohibition is consistent with the "animating purpose" of the federal securities laws: "to insure honest securities markets and thereby promote investor confidence.").

<sup>4</sup> See Insider Trading Sanctions Act of 1984, Pub. L. No. 98-376, 98 Stat. 1264; Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No. 100-704, 102 Stat. 4677, codified at Section 21A of the Exchange Act, 15 U.S.C. 78u-1. Congress has enacted other laws that build on the insider trading prohibition. See, e.g., Section 20(d) of the Exchange Act [15 U.S.C. 78t(d)]; Section 20A of the Exchange Act [15 U.S.C. 78t-1]; STOCK Act, Pub. L. No. 112-105, 126 Stat. 291.

<sup>5</sup> 15 U.S.C. 78j(b).

<sup>6</sup> Rule 10b-5, adopted pursuant to Section 10(b), prohibits the use of "any device, scheme, or artifice to defraud"; the making of "any untrue statement of a material fact" or the "omission" of "a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading"; or "any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person."

<sup>7</sup> See *Salman v. United States*, 137 S.Ct. 420, 425 n. 2 (2016) (an insider who trades in the securities of his corporation on the basis of material nonpublic information "breaches a duty to, and takes advantage of, the shareholders of his corporation"); *O'Hagan*, 521 U.S. at 651-53; *Chiarella v. United States*, 445 U.S. 222, 228-29 (1980); see also 15 U.S.C. 78u-1(a)(1); 17 C.F.R. 240.10b5-2 (non-exclusive definition of circumstances in which a person has the requisite duty for purposes of the "misappropriation" theory of insider trading). Liability for insider trading under Section 10(b) requires "scienter," i.e., "an intent on the part of the defendant to deceive, manipulate or defraud." *Aaron v. SEC*, 446 U.S. 680, 686 & n.5, 689-95 (1980); see also *Selective Disclosure and Insider Trading*, Release No. 33-7881 (Aug. 15, 2000) [65 FR 51716 (Aug. 24, 2000)] ("2000 Adopting Release") at 51727.

Section 10(b) and Rule 10b-5 with respect to trading on the basis of material nonpublic information.<sup>8</sup> At the time, federal appellate courts diverged on the issue of what, if any, connection must be shown between a trader’s possession of material nonpublic information and his or her trading to establish liability under Rule 10b-5. Rule 10b5-1 addressed this issue by providing that a purchase or sale of an issuer’s security is on the basis of material nonpublic information about that security or issuer for purposes of Section 10(b) if the person making the purchase or sale *was aware of* material nonpublic information when the person made the purchase or sale.<sup>9</sup> In addition, Rule 10b5-1(c) established an affirmative defense to Rule 10b-5 liability for insider trading in circumstances where it is apparent that the trading was not made on the basis of material nonpublic information because the trade was pursuant to a binding contract, an instruction to another person to execute the trade for the instructing person’s account, or a written plan (collectively or individually a “trading arrangement”) adopted when the trader was not aware of material nonpublic information.<sup>10</sup> Rule 10b5-1 also provides a separate affirmative defense designed solely for non-natural persons that trade.<sup>11</sup>

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<sup>8</sup> See 2000 Adopting Release *supra* note 7.

<sup>9</sup> A person is aware of material nonpublic information if they know, consciously avoid knowing, or are reckless in not knowing that the information is material and nonpublic. See *SEC v. Obus*, 693 F.3d 276, 286-88, 293 (2d Cir. 2012); *United States v. Gansman*, 657 F.3d 85, 91 n.7, 94 (2d Cir. 2011). Rule 10b5-1 and its awareness standard is “entitled to deference.” *United States v. Royer*, 549 F.3d 886, 899 (2d Cir. 2008) (applying *Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 843-44 (1984)), *cert. denied*, 558 U.S. 934, and 558 U.S. 935 (2009); see also *United States v. Rajaratnam*, 719 F.3d 139, 157-61 (2d Cir. 2013), *cert. denied*, 134 S. Ct. 2820 (2014). The decision in *Fried v. Stiefel Labs., Inc.*, 814 F.3d 1288, 1295 (11th Cir. 2016), erroneously suggests that a person must “use” the inside information to purchase or sell securities, but the court did not address Rule 10b5-1 in that private action. The proposed rule would not alter the “awareness” standard.

<sup>10</sup> Rule 10b5-1 does not modify or address any other aspect of insider trading law. Nor does Rule 10b5-1 provide an affirmative defense for other securities fraud claims, such as a claim under Rule 10b-5 for an “untrue statement of a material fact.” 17 CFR 240.10b-5(b).

<sup>11</sup> See Rule 10b5-1(c)(2) [17 CFR 240.10b5-1(c)(2)]. This affirmative defense is available to entities that demonstrate that the individual making the investment decision on behalf of the entity was not aware of material nonpublic information; and the entity had implemented reasonable policies and procedures to prevent insider trading.

Since the adoption of Rule 10b5-1, courts,<sup>12</sup> commentators<sup>13</sup> and members of Congress<sup>14</sup> have expressed concern that the affirmative defense under Rule 10b5-1(c)(1)(i) has allowed traders to take advantage of the liability protections provided by the rule to opportunistically trade securities on the basis of material nonpublic information. Furthermore, some academic studies of Rule 10b5-1 trading arrangements have shown that corporate insiders trading pursuant to Rule 10b5-1 consistently outperform trading of executives and directors not conducted under a Rule 10b5-1 trading arrangement.<sup>15</sup> Practices that have raised concern include corporate insiders using multiple overlapping plans to selectively cancel individual trades on the basis of material nonpublic information, or commencing trades soon after the adoption of a new plan or the

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<sup>12</sup> District courts in private securities law actions have “acknowledge[d] the possibility that a clever insider might ‘maximize’ their gain from knowledge of an impending [stock] price drop over an extended amount of time, and seek to disguise their conduct with a 10b5-1 plan.” *In re Immucor Inc. Sec. Litig.*, 2006 WL 3000133, at \*18 n.8 (N.D. Ga. Oct. 4, 2006); accord *Nguyen v. New Link Genetics Corp.*, 297 F. Supp. 3d 472, 494–96 (S.D.N.Y. 2018); *Freudenberg v. E\*Trade Fin. Corp.*, 712 F. Supp. 2d 171, 200 (S.D.N.Y. 2010); *Malin v. XL Cap. Ltd.*, 499 F. Supp. 2d 117, 156 (D. Conn. 2007), *aff’d*, 312 F. App’x 400 (2d Cir. 2009).

<sup>13</sup> In December 2020, the Commission proposed to amend Forms 4 and 5 to add a checkbox to permit filers to indicate that the reported transaction satisfied Rule 10b5-1. *See Rule 144 Holding Period and Form 144 Filings*, Release No. 33-10991 (Dec. 22, 2020) [85 FR 79936]. The Commission received several comment letters in response expressing concern about potential abuse of Rule 10b5-1. *See, e.g.*, letter from David Larcker et al. (dated Mar. 10, 2021) at <https://www.sec.gov/comments/s7-24-20/s72420-8488827-229970.pdf>; letter from Council of Institutional Investors (“CII”) (dated Apr. 22, 2021) at <https://www.sec.gov/comments/s7-14-20/s71420-8709408-236962.pdf>; letter from CII (dated Mar. 18, 2021) at <https://www.sec.gov/comments/s7-24-20/s72420-8519687-230183.pdf>. In response to the publication of its semiannual regulatory agenda, the Commission also received a letter requesting that a rulemaking project be initiated to address potential abuses of Rule 10b5-1. *See* letter from CII (dated Dec. 13, 2018) at <https://www.sec.gov/comments/s7-20-18/s72018-4766666-176839.pdf>.

<sup>14</sup> *See* letter from Senator Elizabeth Warren et al. (Feb. 10, 2021) at <https://www.warren.senate.gov/imo/media/doc/02.10.2021%20Letter%20from%20Senators%20Warren,%20Brown,%20and%20Van%20Hollen%20to%20Acting%20Chair%20Lee.pdf>.

<sup>15</sup> *See, e.g.*, Alan D. Jagolinzer, *SEC Rule 10b5-1 and Insiders' Strategic Trade*, 55 MGMT. SCI. 224 (2009); M. Todd Henderson et al., *Hiding in Plain Sight: Can Disclosure Enhance Insiders' Trade Returns*, 103 GEO. L.J. 1275 (2015); Taylan Mavruk et al., *Do SEC's 10b5-1 Safe Harbor Rules Need to be Rewritten?*, 2016 COLUM. BUS. L. REV., 133 (2016); Artur Hugon and Yen-Jung Lee, *SEC Rule 10b5-1 Plans and Strategic Trade around Earnings Announcements* (2016) at <https://ssrn.com/abstract=2880878> or <http://dx.doi.org/10.2139/ssrn.2880878>.

modification of an existing plan.<sup>16</sup> In addition, concerns have been raised about issuers abusing Rule 10b5-1(c)(1) plans to conduct share repurchases to boost the price of the issuer’s stock before sales by corporate insiders.<sup>17</sup> Recently, the Commission’s Investor Advisory Committee (“IAC”)<sup>18</sup> recommended that we consider revising Rule 10b5-1 to address apparent loopholes in the rule that allow corporate insiders to unfairly exploit informational asymmetries.<sup>19</sup>

We share the concern about the prevalence of trading practices by corporate insiders and issuers that suggest the misuse of material nonpublic information. We also understand that some issuers have engaged in a practice of granting stock options and other equity awards with option-like features to executive officers and directors in coordination with the release of material nonpublic information.<sup>20</sup> In addition, there is research indicating that some corporate insiders may be opportunistically timing gifts of securities while aware of material nonpublic information relating to such securities.<sup>21</sup> These practices can undermine the public’s confidence and

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<sup>16</sup> See, e.g., John P. Anderson, *Anticipating a Sea Change for Insider Trading Law: From Trading Plan Crisis to Rational Reform*, 2015 UTAH L. REV. 339 (2015); David F. Larecker et al., *Gaming the System: Three “Red Flags” of Potential 10b5-1 Abuse*, Stanford Closer Look Series (Jan. 19, 2021) (“Gaming the System”) (noting from their analysis of a sample of sales transactions made pursuant to Rule 10b5-1 plans between January 2016 and May 2020 that trades occurring within 30 days of adoption of a Rule 10b5-1 plan are approximately 50 percent larger than trades made six or more months later); see also *infra* note 112 and accompanying text.

<sup>17</sup> See Jesse M. Fried, *Testimony before the Investor Protection, Entrepreneurship, and Capital Markets Subcommittee, U.S. House Committee on Financial Services*, (Oct. 17, 2019) at <https://ssrn.com/abstract=3474175> (“Fried Testimony”).

<sup>18</sup> The IAC was established in April 2012 pursuant to Section 911 of the Dodd-Frank Wall Street Reform and Consumer Protection Act [Pub. L. 111-203, sec. 911, 124 Stat. 1376, 1822 (2010)] to advise and make recommendations to the Commission on regulatory priorities, the regulation of securities products, trading strategies, fee structures, the effectiveness of disclosure, initiatives to protect investor interests and to promote investor confidence and the integrity of the securities marketplace.

<sup>19</sup> See *Recommendations of the Investor Advisory Committee Regarding Rule 10b5-1 Plans* (Sept. 9, 2021) (“IAC Recommendations”), at <https://www.sec.gov/spotlight/investor-advisory-committee-2012/20210916-10b5-1-recommendation.pdf>. The IAC also held a panel discussion regarding Rule 10b5-1 plans at its June 10, 2021 meeting, at [https://www.sec.gov/video/webcast-archive-player.shtml?document\\_id=iac061021-2](https://www.sec.gov/video/webcast-archive-player.shtml?document_id=iac061021-2).

<sup>20</sup> See, e.g., William Hughes, *Stock Option Spring-loading: An Examination of Loaded Justifications and New SEC Disclosure Rules*, 33 J. CORP. L. 777 (2008); *Howland v. Kumar*, 2019 Del. Ch. LEXIS 221.

<sup>21</sup> See, e.g., S. Burcu Avci et al., *Manipulative Games of Gifts by Corporate Executives*, 18 U. PA. J. Bus. L. 1131 (2016); David Yermack, *Deductio ad absurdum: CEOs donating their own stock to their family foundations*, 94

expectations of honest and fair capital markets by creating the appearance that some insiders, by virtue of their positions, do not play by the same rules as everyone else.

We note that similar concerns about misuse of material nonpublic information have been raised in connection with an issuer's stock repurchases. In a separate release, we are proposing amendments to update the disclosure requirements for purchases of equity securities by an issuer and affiliated purchasers under Item 703 of Regulation S-K.<sup>22</sup>

In this release, we are proposing several rule and form amendments to address potentially abusive practices associated with Rule 10b5-1 trading arrangements, grants of options and other equity instruments with similar features and the gifting of securities. Specifically, our proposals would:

- Require a Rule 10b5-1 trading arrangement entered into by officers or directors to include a 120-day mandatory cooling-off period before any trading can commence under the trading arrangement after its adoption (including adoption of a modified trading arrangement);<sup>23</sup>
- Require a Rule 10b5-1 trading arrangement entered into by issuers to include a 30-day mandatory cooling-off period before any trading can commence under the trading arrangement after its adoption (including adoption of a modified trading arrangement);
- Require officers and directors to personally certify that they are not aware of material

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J. FIN. ECON. 107 (2009); S. Burcu Avci et al., *Insider Giving*, 71 DUKE L.J. (Forthcoming 2021) electronic copy available at: <https://ssrn.com/abstract=3795537>.

<sup>22</sup> See *Share Repurchase Disclosure Modernization*, Release No. 34-93783 (Dec. 15, 2021). Item 703 of Regulation S-K [17 CFR 229.703] requires disclosure about a registrant's or affiliated purchaser's purchases of any class of the registrant's equity securities that are registered under Exchange Act Section 12. Many registrants use Rule 10b5-1 trading arrangements in their repurchase programs.

<sup>23</sup> A modification of a Rule 10b5-1(c) trading arrangement, including cancelling a trade, is equivalent to terminating the prior trading arrangement and adopting a new Rule 10b5-1 trading arrangement.

- nonpublic information about the issuer or the security when they adopt a Rule 10b5-1 trading arrangement;
- Enhance existing corporate disclosures and require new quarterly disclosure regarding the adoption and termination of Rule 10b5-1 trading arrangements and other trading arrangements of directors, officers, and issuers, and the terms of such trading arrangements, and require that the disclosure be reported using a structured data language (specifically, Inline eXtensible Business Reporting Language (“Inline XBRL”));
  - Provide that the affirmative defense under Rule 10b5-1(c)(1) does not apply to multiple overlapping Rule 10b5-1 trading arrangements for open market trades in the same class of securities;
  - Limit the availability of the affirmative defense under Rule 10b5-1(c)(1) for a single-trade plan to one single-trade plan during any consecutive 12-month period;
  - Require an issuer to disclose in its Form 10-K or Form 20-F whether or not (and if not, why not) the issuer has adopted insider trading policies and procedures that govern the purchase, sale, or other disposition of the registrant’s securities by directors, officers, and employees that are reasonably designed to promote compliance with insider trading laws, rules, and regulations. If the issuer has adopted such policies and procedures, the issuer would be required to disclose such policies. Such disclosures would be subject to the principal executive and principal financial officer certifications required by Section 302 of the Sarbanes-Oxley Act,<sup>24</sup> and required to be tagged using Inline XBRL;

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<sup>24</sup> 15 U.S.C. 7241. *See infra* notes 52 and 53 and accompanying text.

- Require new disclosure regarding grants of equity compensation awards such as stock options and stock appreciation rights (“SARs”) close in time to the issuer’s disclosure of material nonpublic information (including earnings releases and other major announcements) and require that the quantitative disclosure be reported using Inline XBRL; and
- Require prompt disclosure of dispositions by gifts of securities by insiders on Form 4 within two business days after such a gift is made.

We welcome feedback and encourage interested parties to submit comments on any or all aspects of the proposed amendments. When commenting, it would be most helpful if you include the reasoning behind your position or recommendation.

## **II. Discussion of the Proposed Amendments**

### **A. Amendments to Rule 10b5-1<sup>25</sup>**

As noted above, Rule 10b5-1(c)(1) established an affirmative defense to Rule 10b-5 liability if the trade was made pursuant to a binding contract, an instruction to another person to execute the trade for the instructing person’s account, or a written plan. A person asserting a Rule 10b5-1(c)(1) defense must satisfy several conditions. First, the person must demonstrate that, before becoming aware of material nonpublic information, they had entered into a binding contract to purchase or sell the security, provided instructions to another person to execute the

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<sup>25</sup> In addition to the proposed revisions to Rule 10b5-1 discussed in this release, due to current *Federal Register* formatting requirements, we are also proposing a technical change that, as indicated, incorporates the Preliminary Note to Rule 10b5-1 into the body of the rule.<sup>26</sup> See, e.g., *SEC v. Mozilo*, 2010 WL 3656068, at \*20 (C.D. Cal. Sept. 16, 2010) (“Although [officer’s/director’s] stock sales were made pursuant to Rule 10b5-1 trading plans, the SEC has raised genuine issues of material fact that [he] was aware of material, nonpublic information at the time he adopted or amended these trading plans.”).

trade for the instructing person's account, or adopted a written plan for trading the securities.<sup>26</sup>

Second, the person must demonstrate that the applicable contract, instructions, or plan:

- Specified the amount of securities to be purchased or sold, price, and date;
- Provided a written formula or algorithm, or computer program, for determining amounts, prices, and dates; or
- Did not permit the person to exercise any subsequent influence over how, when, or whether to effect purchases or sales; provided, in addition, that any other person who exercised such influence was not aware of the material nonpublic information when doing so.

Third, the person must demonstrate that the purchase or sale was pursuant to the prior contract, instruction, or plan. Rule 10b5-1(c)(1) states that a purchase or sale is not pursuant to a contract, instruction, or plan if, among other things, the person who entered into the arrangement altered or deviated from the contract, instruction, or plan, or entered into or altered a corresponding or hedging transaction or position with respect to the securities.<sup>27</sup> Finally, the rule provides that the affirmative defense of a trading arrangement is only available if the trading arrangement was entered into “in good faith and not as part of a plan or scheme to evade the prohibitions” of the rule.<sup>28</sup>

Since the adoption of Rule 10b5-1, the use of trading arrangements under Rule 10b5-

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<sup>26</sup> See, e.g., *SEC v. Mozilo*, 2010 WL 3656068, at \*20 (C.D. Cal. Sept. 16, 2010) (“Although [officer’s/director’s] stock sales were made pursuant to Rule 10b5-1 trading plans, the SEC has raised genuine issues of material fact that [he] was aware of material, nonpublic information at the time he adopted or amended these trading plans.”).

<sup>27</sup> Rule 10b5-1(c)(1)(i)(C).

<sup>28</sup> Rule 10b5-1(c)(1)(ii).

1(c)(1) has become widespread.<sup>29</sup> Over the years concerns have arisen that the design of Rule 10b5-1(c)(1) has enabled corporate insiders to trade on material nonpublic information. Examples of potentially abusive practices include the use of multiple overlapping plans with selective cancellation of certain plans or trades on the basis of material nonpublic information, as well as initiation or resumption of trading close in time to plan adoption or modification. Furthermore, multiple studies examining Rule 10b5-1(c)(1) trading arrangements have identified potentially abusive activity where trades occur soon after the adoption of the arrangement (*e.g.*, commencing trades within the same fiscal quarter as the adoption of the arrangement), and trading arrangements that are terminated shortly after adoption.<sup>30</sup> The amendments that we are proposing to Rule 10b5-1(c)(1) are intended to reduce these potentially abusive practices associated with Rule 10b5-1(c)(1) trading arrangements.

### **1. Cooling-off Period**

Currently, Rule 10b5-1(c)(1) does not impose any waiting period between the date the trading arrangement is adopted and the date of the first transaction to be executed under the trading arrangement. Under the current rule, a trader can adopt a Rule 10b5-1(c)(1) trading

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<sup>29</sup> According to one survey, directors and executives at more than half of S&P 500 companies used Rule 10b5-1 trading arrangements in 2015. *See* Morgan Stanley, “Defining the Fine Line: Mitigating Risk with 10b5-1 Plans” (2018) at <https://advisor.morganstanley.com/austin.cornish/documents/field/a/au/austin-cornish/Mitigating%20Risk%20with%2010b5-1%20Plans.pdf>. *See also* Bonaimé et al., *Payout Policy Trade-Offs*, *infra* note 159 and accompanying text; *Skadden Insights: Share Repurchases* 4-6 (Mar. 16, 2020)(discussing the use of Rule 10b5-1 plans for issuer share repurchases) at <https://www.skadden.com/insights/publications/2020/03/share-repurchases>.

<sup>30</sup> *See, e.g.*, Alan D. Jagolinzer, *SEC Rule 10b5-1 and Insiders’ Strategic Trade*, MGMT. SCI. 224 (2009); Gaming the System *supra* note 16 (noting that Rule 10b5-1 plans with a short cooling-off period, or adopted in a given quarter that begin trading before that quarter’s earnings announcement systematically avoid losses and foreshadow considerable stock declines over the subsequent six months); and Taylan Mavruk et al., *Do SEC’s 10b5-1 Safe Harbor Rules Need to be Rewritten?*, COLUM. BUS. L. REV., 133, 165 (2016) (observing from their study that the first trade pursuant to a Rule 10b5-1 plan showed abnormal profitability and suggesting that insiders set up Rule 10b5-1 plans when in possession of material nonpublic information). *See also* discussion at *infra* Section IV.A.

arrangement and execute a trade under the arrangement on the same day. Investors and other commentators have suggested that requiring a minimum waiting period of several months between the adoption of a trading arrangement and the date on which trading can commence would reduce the risk that an insider could benefit from any material nonpublic information of which they may have been aware at the time of adopting the trading arrangement.<sup>31</sup> We propose to amend Rule 10b5-1(c)(1) to add as a condition to the availability of the affirmative defense (1) a minimum 120-day cooling-off period after the date of adoption of any Rule 10b5-1(c)(1) trading arrangement (including adoption of a modified trading arrangement) by a director or officer (as defined in Rule 16a-1(f)) before any purchases or sales under the new or modified trading arrangement; and (2) a minimum 30-day cooling-off period after the date of adoption of any Rule 10b5-1(c)(1) trading arrangement by an issuer before any purchases or sales under the new or modified trading arrangement. Under the proposed amendments, for directors and officers subject to Exchange Act Section 16 reporting, and for issuers, the Rule 10b5-1(c)(1) affirmative defense would only be available for a trading arrangement that includes a cooling-off period that delays transactions under the trading arrangement for at least 120 or 30 days (whichever is applicable) after the date of adoption of any new/modified trading arrangement. The proposed amendments also include a note that clarifies that a “modification” of an existing Rule 10b5-1(c)(1) trading arrangement, including cancelling one or more trades, would be deemed equivalent to terminating the plan in its entirety, and the cooling-off period would therefore apply after a “modification” before any new trades could commence.<sup>32</sup>

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<sup>31</sup> See Rulemaking petition regarding Rule 10b5-1 Trading Plans, File No. 4-658 (Jan. 2, 2013) (“CII Rulemaking Petition”) at <https://www.sec.gov/rules/petitions/2013/petn4-658.pdf>; Alan D. Jagolinzer, David F. Larcker, and Daniel J. Taylor, “How the SEC can and should fix insider trading rules” the Hill (Dec. 17, 2020) at <https://thehill.com/opinion/finance/530668-how-the-sec-can-and-should-fix-insider-trading-rules>; IAC Recommendations, *supra* note 19.

<sup>32</sup> See proposed note to Rule 10b5-1(c); and 2000 Adopting Release, *supra* note 8, at 51718, n 111.

We are proposing these cooling off periods to address concerns that traders are able to misuse the rule to set up trading arrangements that use material nonpublic information about an issuer prior to the disclosure of such information. In particular, evidence suggests that Rule 10b5-1(c)(1) trading arrangements that commence trades prior to an earnings announcement are more likely to result in abnormal returns.<sup>33</sup> In the case of officers and directors, a 120-day cooling off period would span an entire quarter, meaning that no trading could occur under a Rule 10b5-1(c)(1) plan adopted during a particular quarter until after that quarter's financial results are announced. The length of the proposed cooling-off period would deter insiders from seeking to capitalize on unreleased material nonpublic information for the upcoming quarter. In addition, a 120-day cooling off period and the 30-day cooling off period for issuers between adoption or modification of a Rule 10b5-1(c)(1) trading arrangement and transactions made under the arrangement align with recommendations from a wide range of commentators about the appropriate length of time for such a cooling off period.<sup>34</sup> We anticipate that, if adopted, the proposed cooling-off periods would deter officers, directors, and issuers from adopting or modifying their Rule 10b5-1 plans on the basis of material nonpublic information.

The proposed cooling-off periods would apply to directors and officers (as defined in Rule 16a-1(f) of the issuer,<sup>35</sup> as well as to an issuer that structures a share repurchase plan as a

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<sup>33</sup> See the discussion at *infra* Section IV.B.1.

<sup>34</sup> See IAC Recommendations, *supra* note 19 (recommending a cooling off period of four months); Gaming the System, *supra* note 16, at 3 (recommending a cooling off period of four to six months); SEC Targets 10b5-1 Plans, *supra* note 16 (recommendation from a law firm for a cooling off period of one fiscal quarter); letter from Senator Elizabeth Warren et al., *supra* note 14 (recommending a cooling off period of four to six months); Robert H. Friedman et al, *Navigating Public Company Equity Buybacks*, Insights: Corporate and Securities Law Advisor, (December 2011) (recommending a 30 day waiting period for issuers after a Rule 10b5-1(c)(1) plan's adoption or modification).

<sup>35</sup> Exchange Act Rule 16a-1(f) [17 CFR 240.16a-1(f)] provides that the term "officer" "shall mean an issuer's president, principal financial officer, or principal accounting officer (or, if there is no such accounting officer, the controller), any vice-president of the issuer in charge of a principal business unit, division or function (such

Rule 10b5-1(c)(1)(i) trading arrangement. This requirement would prevent directors, officers, and issuers who might be aware of material nonpublic information from adopting or modifying a Rule 10b5-1 trading arrangement and trading immediately pursuant to the arrangement. The proposed cooling off period should also discourage registrants, directors, and officers from selectively terminating or cancelling a planned trade under a Rule 10b5-1 trading arrangement because they would be subject to a cooling-off period with respect to the adoption of any new/modified plan.

Applying a cooling-off period to directors and “officers” as that term is defined in Exchange Act Rule 16a-1(f)<sup>36</sup> is appropriate because such individuals are more likely than others to be aware of material nonpublic information in the general course of events, and also more likely to be involved in making or overseeing key corporate decisions that have the potential to affect the issuer’s stock price, including decisions about the timing of the disclosure of such information.<sup>37</sup> In addition, applying a cooling-off period to issuers addresses the concern that issuers may conduct stock buybacks while aware of material nonpublic information. For example, executives of an issuer who are aware of materially positive but undisclosed developments can cause the issuer to buy its stock from current shareholders who are unaware of those developments. Once the development is publicly disclosed, the issuer’s share price may increase. Further, once the issuer repurchase program is announced, executives who initiated the buyback can economically benefit because it may allow them to sell shares at prices strategically

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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 issuer. Officers of the issuer’s parent(s) or subsidiaries shall be deemed officers of the issuer if they perform such policy-making functions for the issuer.”

<sup>36</sup> This would include anyone who performs a policy-making function for the issuer. *Id.*

<sup>37</sup> See *O’Hagan*, 521, U.S. at 651-52; *Chiarella*, 445 U.S. at 227; *Steginsky v. Xcelera Inc.*, 741 F.3d 365, 370 n.5 (2d Cir. 2014). See also, *Colby v. Klune*, 178 F.2d 872 (2d Cir. 1949).

inflated by the company buyback, in addition to the disclosed developments.<sup>38</sup> A cooling off period for issuers would reduce the likelihood of such scenarios and promote investor confidence.

### **Request for Comment**

1. Is the proposed cooling-off period an appropriate condition to the Rule 10b5-1(c)(1) affirmative defense for contracts, instructions and written plans? Would a cooling-off period effectively reduce the potential to abuse the rule, such as from selective termination of trades?
2. Should the application of a cooling-off period be limited to directors, officers (as defined in Rule 16a-1(f)) and issuers, as proposed? Should the proposed cooling-off period instead apply to all traders who rely on the Rule 10b5-1(c)(1) affirmative defense?
3. Is the Rule 16a-1(f) definition the appropriate definition of “officer” for purposes of the proposed amendment? Are there other corporate insiders or employees who also should be subject to the cooling-off period?
4. Is the proposed 120-day cooling-off period appropriate for directors and officers? Should we require a shorter or longer cooling-off period? For example, should we require a cooling-off period of sixty days after the adoption of a new/modified trading arrangement or a cooling-off period of 180 days?
5. Is the proposed 30-day cooling off period appropriate for issuers? Would a different period be more appropriate? For example, would a 60-day, 90-day, or 180-day cooling off period be more appropriate for issuers relying on the 10b5-1(c)(1) affirmative defense? If issuers were subject to the proposed requirements, how would their use of Rule 10b5-1(c)(1) trading

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<sup>38</sup> See Fried Testimony *supra* note 17.

arrangements to conduct share repurchases be affected? Would the proposed cooling-off period effect existing practices regarding when a repurchase window is “open” or “closed”?

6. Should we define “modify” or “a modification” for purposes of Rule 10b5-1(c)? If so, how should we define these terms?
7. Should there be an exception from the cooling-off period for *de minimis* changes to a Rule 10b5-1(c) trading arrangement? If so, what should be the parameters of such an exception?

## **2. Director and Officer Certifications**

We also are proposing to amend Rule 10b5-1(c)(1)(ii) to impose a certification requirement as a condition to the affirmative defense. Under the proposed amendment, if a director or officer (as defined in Rule 16a-1(f)) of the issuer of the securities adopts a Rule 10b5-1 trading arrangement, as a condition to the availability of the affirmative defense, such director or officer would be required to promptly furnish to the issuer a written certification, described below, at the time of the adoption of a new/modified trading arrangement.<sup>39</sup>

The certification would require a director or officer to certify at the time of the adoption of the trading arrangement:

- That they are not aware of material nonpublic information about the issuer or its securities; and
- That they are adopting the contract, instruction, or plan in good faith and not as part of a

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<sup>39</sup> The proposed amendment would not require these personal certifications where a director or officer terminates an existing Rule 10b5-1 trading arrangement and does not adopt a new/modified trading arrangement for which the affirmative defense is sought. However, proposed Item 408 of Regulation S-K would require registrants to disclose whether any director or officer has terminated a Rule 10b5-1 trading arrangement (or any similar trading arrangement). *See infra* Section II.B.1. An issuer’s insider trading policies and procedures may otherwise govern such plan terminations. *See infra* at Section II.B.2. Finally, whether an inference can be drawn that an individual unlawfully traded on the basis of inside information may be informed by the manner in which they trade (*see, e.g., SEC v. Warde*, 151 F.3d, 42, 47 (2d Cir.1998)), including where termination of a Rule 10b5-1 trading arrangement is soon followed by non-Rule 10b5-1 trades in the same security or issuer.

plan or scheme to evade the prohibitions of Exchange Act Section 10(b) and Exchange Act Rule 10b-5.

For purposes of the proposed amendment, the term “officer” would have the same meaning as the definition for “officer” contained in Exchange Act Rule 16a-1(f). The definition in Exchange Act Rule 16a-1(f) is appropriate for the reasons discussed above with respect to the cooling-off period, *i.e.*, these individuals are more likely to be aware of material nonpublic information regarding the issuer and its securities, as well as more likely to be involved in making or overseeing corporate decisions about whether and when to disclose information.

The proposed certification requirement is intended to reinforce directors’ and officers’ cognizance of their obligation not to trade or adopt a trading plan while aware of material nonpublic information, that it is their responsibility to determine whether they are aware of material non-public information when adopting Rule 10b5-1 plans, and that the affirmative defense under Rule 10b5-1 requires them to act in good faith and not to adopt such plans as part of a plan or scheme to evade the insider trading laws.

We recognize that this certification involves important considerations, especially because directors and officers are often aware of material nonpublic information. Subject to their confidentiality obligations, directors and officers can consult with experts to determine whether they can make this representation truthfully. Legal counsel can assist directors and officers in understanding the meaning of the terms “material” and “nonpublic information.”<sup>40</sup> However, the

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<sup>40</sup> As we have said previously, we rely on existing definitions of the terms “material” and “nonpublic” established in the case law. Information is material if “there is a substantial likelihood” that its disclosure “would have been viewed by the reasonable investor as having significantly altered the ‘total mix’ of information made available.” *see Basic v. Levinson*, 485 U.S. 224, 231 (1988) (materiality with respect to contingent or speculative events will depend on a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of company activity); *see also TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976); Securities Act Rule 405 [17 CFR 230.405]; Exchange Act Rule 12b-2 [17 CFR

issue of whether a director or officer has material nonpublic information is an inherently fact-specific analysis. Thus, a director or officer’s completion of this certification would reflect their personal determination that they do not have material nonpublic information.

The proposed amendment also includes an instruction that a director or officer seeking to rely on the affirmative defense should retain a copy of the certification for a period of ten years.<sup>41</sup> The proposed amendments would not require a director, officer, or the issuer to file the certification with the Commission. The proposed certification would not be an independent basis of liability for directors or officers under Exchange Act Section 10(b) and Rule 10b-5. Rather the proposed certification would underscore the certifiers’ awareness of their legal obligations under the federal securities law related to the trading in the issuer’s securities.<sup>42</sup>

### **Request for Comment**

8. Is the proposed certification requirement an appropriate condition to the availability of the Rule 10b5-1(c)(1)(ii) affirmative defense for directors and officers? Are there other ways that an officer or director could demonstrate that they do not possess material nonpublic information when adopting a trading arrangement?

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240.12b-2] Information is nonpublic until the information is broadly disseminated in a manner sufficient to ensure its availability to the investing public generally, without favoring any special person or group. *See Dirks v. SEC*, 463 U.S. 646, 653-54 & n.12 (1983); *Texas Gulf Sulphur*, 401 F.2d 833, 854 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969); Regulation FD [17 C.F.R. 243.101(e)]. For purposes of insider trading law, insiders must wait a “reasonable” time after disclosure before trading. What constitutes a reasonable time depends on the circumstances of the dissemination. *In re Faberge, Inc.*, 45 S.E.C. 249, 255 (1973), *citing Texas Gulf Sulphur*, 401 F.2d at 854. Under the misappropriation doctrine, a recipient of inside information must make a “full disclosure” to the sources of the information that they plan to trade on or tip the information within a reasonable time before doing so. *O’Hagan*, 521 U.S. at 655, 659 n.9; *see also SEC v. Rocklage*, 470 F.3d 1, 11-12 (1st Cir. 2006).

<sup>41</sup> *See* Proposed instruction to Rule 10b5-1(c)(1)(ii)(C). We have included a ten-year retention period in consideration of the statutes of limitations that govern the Commission’s ability to seek certain remedies for insider trading claims. *See* Exchange Act Section 21(d)(8) [15 U.S.C. 78u(d)(8)] (ten years for injunctions and disgorgement of fraud proceeds).

<sup>42</sup> *See, e.g., O’Hagan*, 521, U.S. at 651-52; *Chiarella*, 445 U.S. at 227; *Steginsky v. Xcelera Inc.*, 741 F.3d 365, 370 n.5 (2d Cir. 2014).

9. Is the proposed language of the certification appropriate? If not, what alternative formulation, would be more appropriate? Should the certification contain different or additional conditions?
10. Should the proposed certification requirement also apply to individuals who are not “officers” under Exchange Rule 16a-1(f)?
11. The proposed instruction provides guidance that a director or officer should retain the certification for ten years consistent with the ten-year statutes of limitations that govern the Commission’s insider trading actions. Should we instead require the issuer to retain the certification, either instead of or in addition to the director or officer? If so, how long should the issuer be required to retain the certification? Should we allow the individuals and issuers to develop their own retention policies for the certification?
12. Should we specifically provide in the proposed amendments to Rule 10b5-1(c)(1)(ii) that the certification does not establish an independent basis of liability for directors or officers under Exchange Act Section 10(b) and Rule 10b-5?

### **3. Restricting Multiple Overlapping Rule 10b5-1 Trading Arrangements and Single-Trade Arrangements**

Currently, Rule 10b5-1(c)(1)(i)(C) provides that a person will not be entitled to the affirmative defense for a trade if they enter into or alter a “corresponding or hedging transaction or position” with respect to the planned transactions. In the Rule 10b5-1 proposing release, the Commission explained that this requirement was designed to prevent persons from devising schemes to exploit inside information by setting up pre-existing hedged trading programs, and then canceling execution of the unfavorable side of the hedge, while permitting execution of the

favorable transaction.<sup>43</sup> The use of multiple trading arrangements can be used to simulate this kind of impermissible hedging.

As discussed above, currently, a person can adopt and employ multiple overlapping Rule 10b5-1(c)(1) trading arrangements and exploit inside information by setting up trades timed to occur around dates on which they expect the issuer will likely release material nonpublic information. We are also concerned that a person could circumvent the proposed cooling-off period by setting up multiple overlapping Rule 10b5-1(c)(1) trading arrangements, and deciding later which trades to execute and which to cancel after they become aware of material nonpublic information but before it is publicly released. We are proposing to amend Rule 10b5-1(c)(1) to eliminate the affirmative defense for any trades by a trader who has established multiple overlapping trading arrangements for open market purchases or sales of the same class of securities. Under the proposed amendment, the affirmative defense would not be available for trades under a trading arrangement when the trader maintains another trading arrangement, or subsequently enters into an additional overlapping trading arrangement, for open market purchases or sales of the same class of securities. The proposed restriction with respect to multiple overlapping Rule 10b5-1(c)(1) trading arrangements is designed to eliminate the ability of traders to use multiple plans to strategically execute trades based on material nonpublic information and still claim the protection of an affirmative defense for such trades.

The proposed amendment would not apply to transactions where a person acquires (or sells) securities directly from the issuer, such as acquiring shares through participation in employee stock ownership plans (“ESOPs”) or dividend reinvestment plans (“DRIPs”), which

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<sup>43</sup> See *Selective Disclosure and Insider Trading*, Release No. 33-7787 (Dec. 20, 1999) [64 FR 72590 (Dec. 28, 1999)].

are not executed by the director or officer on the open market. Participation in these programs is sometimes effected through Rule 10b5-1(c)(1) trading arrangements, and because the transactions are directly with the issuer, they are less likely to give rise to insider trading.<sup>44</sup> This provision is intended to preserve the benefits of flexibility for plan participants with respect to such plans.

In addition to restricting the use of multiple overlapping trading arrangements, we are also proposing to amend Rule 10b5-1(c)(1)(ii) to limit the availability of the affirmative defense for a trading arrangement designed to cover a single trade, so that the affirmative defense would only be available for one single-trade plan during any 12-month period. Under the proposed amendment, the affirmative defense would not be available for a single-trade plan if the trader had, within a 12-month period, purchased or sold securities pursuant to another single-trade plan. Recent research indicates that single-trade plans are consistently loss avoiding and often precede stock price declines.<sup>45</sup> This research suggests that insiders using single-trade plans may be executing trades based on material nonpublic information. At the same time, we recognize the legitimate use of single-trade plans to address one-time liquidity needs. The proposed limitation on single-trade plans is intended to balance this legitimate use against potential for abuse.

### **Request for Comment**

13. Are there legitimate uses of multiple, overlapping Rule 10b5-1 trade arrangements? If so, what are they? Is it appropriate to exclude from the affirmative defense multiple concurrent trading arrangements for open market purchases or sales of the same class of securities as

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<sup>44</sup> However, “fiduciaries” of employee stock ownership plans should consider the extent to which “refraining on the basis of inside information from making a planned trade. . . could conflict with the complex insider trading . . . requirement imposed by the federal securities laws or with the objectives of those laws.” See *Fifth Third Bancorp v. Dudenhoeffer*, 573 U.S. 409, 429 (2014). Officers and directors also need to follow Regulation Blackout Trading Restrictions, 17 CFR 245.100–245.104.

<sup>45</sup> See *Gaming the System*, *supra* note 16. See also *infra* Section IV.B.

proposed? Would the proposal create incentives for corporate insiders to own different classes of stock? Are there alternative approaches to addressing the concerns with multiple trading arrangements discussed above?

14. Is the proposed amendment sufficiently clear as to what types of overlapping trading arrangements a trader can maintain, while still preserving the availability of the 10b5-1(c)(1) affirmative defense? If not, how could additional clarity be provided? In particular, how would the proposed exclusion affect current practices with respect to tax qualified retirement savings plans, and tax withholding transactions with respect to equity compensation arrangements, such as stock options and restricted stock units?
15. Is it appropriate to limit the availability of the Rule 10b5-1(c)(1) affirmative defense for single-trade plans as proposed? If not, are there alternative approaches to addressing concerns about the potential abuse of single-trade plans? Would the proposed cooling-off periods sufficiently mitigate the potential to misuse single-trade plans to execute trades based on material nonpublic information? Alternatively, would the limited availability of the Rule 10b5-1(c)(1) affirmative defense for single-trade plans as proposed still allow for potential abuse? Should we consider prohibiting the use of single-trade plans entirely?

#### **4. Requiring that Trading Arrangements be Operated in Good Faith**

As discussed above, the Rule 10b5-1 affirmative defense is only available if a trading arrangement was entered into in good faith and not as part of a plan or scheme to evade the prohibitions of the rule. The ability to trade on the basis of material nonpublic information through a Rule 10b5-1(c)(1) trading arrangement may incentivize corporate insiders to improperly influence the timing of corporate disclosures to benefit their trades under the trading arrangement, for example, by delaying or accelerating the release of material nonpublic

information.<sup>46</sup> We are concerned that a trading arrangement may be canceled or modified in an attempt to evade the prohibitions of the rule without affecting the availability of the affirmative defense.

We are also concerned that a corporate insider, after entering into a Rule 10b5-1(c)(1) trading arrangement, may improperly influence the timing of the announcement of material nonpublic information in a way that benefits a planned trade under their trading arrangement. To address these concerns, we are proposing to amend Rule 10b5-1(c)(1)(ii) to add the condition that a contract, instruction, or plan be “operated” in good faith. Amending the condition that a Rule 10b5-1 trading arrangement be entered into in good faith to further require that the trading arrangement also be operated in good faith would help deter fraudulent and manipulative conduct and enhance investor protection throughout the duration of the trading arrangement. The proposed amendment is intended to make clear that the affirmative defense would not be available to a trader that cancels or modifies their plan in an effort to evade the prohibitions of the rule or uses their influence to affect the timing of a corporate disclosure to occur before or after a planned trade under a trading arrangement to make such trade more profitable or to avoid or reduce a loss.

### **Request for Comment**

16. Would the addition of “and operated” to the good faith requirement in Rule 10b5-1(c)(1)(ii), as proposed, have a meaningful impact? If not, what are alternative approaches that would address the concern over the manipulation of the timing of corporate disclosures to benefit a trade under a Rule 10b5-1(c)(1) trading arrangement?

17. Is there evidence to suggest that corporate insiders influence the timing of corporate

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<sup>46</sup> See *infra* note 106 and accompanying text.

disclosures to benefit their trades under a Rule 10b5-1 trading arrangement? Is there evidence to suggest that any efforts to time corporate disclosures would not be sufficiently mitigated by the 120-day cooling-off period?

18. Is the term “operated” or the concept of “operated in good faith” sufficiently clear as to the conduct it is meant to describe? If not, should we provide additional guidance as to its meaning in this context? Should we define the phrase “entered into and operated in good faith”? If so, how should it be defined?
19. Is there another formulation that would better address the underlying policy concern of an insider improperly influencing the timing of the release of material nonpublic information to benefit a trade under a Rule 10b5-1 trading arrangement?
20. Does requiring the trading arrangements to be operated in good faith create incentives for corporate insiders to take into account their existing Rule 10b5-1 trading arrangements when making decisions with respect to the timing of corporate disclosures?

### **B. Additional Disclosures Regarding Rule 10b5-1 Trading Arrangements**

Currently, there are no mandatory disclosure requirements concerning the use of Rule 10b5-1 trading arrangements or other trading arrangements by companies or insiders.<sup>47</sup> The lack of comprehensive public information about the use of these arrangements by officers, directors, and issuers—whether pursuant to Rule 10b5-1(c)(1) trading arrangement or otherwise—deprives investors of the ability to assess whether those parties may be misusing their access to material

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<sup>47</sup> Form 144 (17 CFR 239.144) under the Securities Act contains a representation that is used by a filer of the form to indicate whether such person has adopted a written trading plan or given trading instructions to satisfy Rule 10b5-1. Form 144 is a notice form that must be filed with the Commission by an affiliate of an issuer who intends to resell restricted or “control” securities of that issuer in reliance upon Securities Act Rule 144 (17 CFR 230.144). In 2002, the Commission proposed amendments to Form 8-K that, among other things, would have required registrants to report on the form any adoption, modification or termination of a Rule 10b5-1 trading arrangement by any director and certain officers of the registrant. *See Form 8-K Disclosure of Certain Management Transactions*, Release No. 33-8090 (Apr. 12, 2002) [67 FR 19914 (Apr. 23, 2002)].

nonpublic information. This lack of transparency may be allowing improper trading to go undetected and undermining the deterrent impact of our insider trading laws. In addition, the lack of public information about the use of these arrangements by companies and corporate insiders limits investors' ability to assess potential incentive conflicts and information asymmetries when making investment and voting decisions. Requiring more robust disclosure of particular trading arrangements should reduce potential abuse of the rule, and inform investors and the Commission regarding potential violations of Rule 10b-5.

Currently, issuers are not required to disclose their insider trading policies or procedures. We believe that information about insider trading policies and procedures is important and would help investors to understand and assess how the registrant protects material nonpublic information from misuse. While codes of ethics may address insider trading issues, they often lack the detail necessary for investors to assess actual practices surrounding potential insider trading. Accordingly, we are proposing 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. We are also proposing new Item 16J to Form 20-F to require annual disclosure of a foreign private issuer's insider trading policies and procedures. In addition, we are proposing amendments to Forms 4 and 5 to require insiders to identify whether a reported transaction was executed pursuant to a Rule 10b5-1(c) trading arrangement.

The proposed disclosures that would be required in Forms 10-Q, 10-K, and Form 20-F would be subject to the certifications required by Section 302 of the Sarbanes-Oxley Act of

2002.<sup>48</sup> Section 302 requires an issuers' principal executive officer and principal financial officer to certify, among other things, that based on their knowledge, the Form 10-K, Form 10-Q, or Form 20-F that they have signed does not contain untrue statements of material facts or omit to state material facts necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the periods covered by the reports.<sup>49</sup>

### **1. Quarterly Reporting of Rule 10b5-1(c) and non-Rule 10b5-1(c) Trading Arrangements**

Currently, issuers are not required to disclose trading arrangements by directors, officers, or the issuer itself when conducting a share buyback. Nor are issuers required to disclose terminations of, including modifications to, trading arrangements previously adopted by directors, officers, or the issuer itself. The disclosure of such information would allow investors to assess the extent to which directors, officers, and the issuer are adopting or terminating such trading arrangements during periods when they may be aware of material nonpublic information. Proposed Item 408(a) of Regulation S-K would require registrants to disclose:

- Whether, during the registrant's last fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report), the registrant has adopted or terminated any contract, instruction or written plan to purchase or sell securities of the registrant, whether or not

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<sup>48</sup> Pub. L. 107-204, 116 Stat. 745 (2002).

<sup>49</sup> In effectuating this statutory responsibility, the principal executive and financial officers of an issuer may be aided by a written representation (such as a sub-certification) from the issuer's principal legal or compliance officer (or person performing similar functions) that, based on a reasonable review, they have determined the issuer's insider trading practices and procedures comport with what the issuer is disclosing about them in its periodic reports. However, it would not be reasonable for a principal executive or financial officer to rely on such a representation if they are aware of information that is inconsistent with, or raises doubts about the reliability of, the representation.

intended to satisfy the affirmative defense conditions of Rule 10b5-1(c), and provide a description of the material terms of the contract, instruction or written plan, including:

- The date of adoption or termination;<sup>50</sup>
  - The duration of the contract, instruction or written plan; and
  - The aggregate amount of securities to be sold or purchased pursuant to the contract, instruction or written plan.
- Whether, during the registrant's last fiscal quarter, any director or officer has adopted or terminated any contract, instruction or written plan for the purchase or sale of equity securities of the registrant, whether or not intended to satisfy the affirmative defense conditions of Rule 10b5-1(c) , and provide a description of the material terms of the contract, instruction or written plan, including:
    - The name and title of the director or officer;
    - The date on which the director or officer adopted or terminated the contract instruction or written plan;
    - The duration of the contract instruction or written plan; and
    - The aggregate number of securities to be sold or purchased pursuant to the contract, instruction or written plan.

We are proposing to require these disclosures in Form 10-Q and Form 10-K. Under the proposal, a registrant would be required to provide this disclosure if during the quarterly period covered by the report, the registrant, or any director or officer who is required to file reports under Section 16 of the Exchange Act, adopted or terminated a Rule 10b5-1(c) trading

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<sup>50</sup> As discussed above, we have proposed clarifying that any modification or amendment of an existing Rule 10b5-1 trading arrangement is the equivalent of terminating the existing arrangement and adopting a new arrangement. *See supra* note 23. Accordingly, the proposal would require a description of the modification.

arrangement. Such disclosures would allow investors to assess whether, and if so, how, issuers monitor trading by their directors and officers for compliance with insider trading laws and whether their compliance programs are effective at preventing the misuse of material nonpublic information.

We recognize that as a result of the proposed amendments some issuers, directors or officers may seek to execute sales or purchases through trading arrangements that do not satisfy the conditions of Rule 10b5-1(c)(1). For this reason, we are also proposing to require similar disclosures with respect to the adoption or termination of other pre-planned trading contracts, instructions, or plans (“non-Rule 10b5-1 trading arrangements”) through which the issuer, officer or directors seek to transact in issuer securities.

Requiring quarterly disclosure of the adoption or termination of a trading arrangement by a director, officer or the issuer provides important information that would better allow investors, the Commission, and other market participants to observe how these trading arrangements are being used. For example, disclosure of the termination (including a modification) of a trading arrangement by an officer, even in the absence of subsequent trading by the officer, could provide investors or the Commission with important information about the potential misuse of inside information if the termination coincides with the release of material nonpublic information by the issuer. Making information about these arrangements public may also serve as a deterrent against potential abuses of Rule 10b5-1(c)(1) trading arrangements or other trading arrangements by making those who use these arrangements more likely to focus on following the requirements applicable to such arrangements and compliance with Rule 10b-5. In addition, requiring disclosure of these events on a quarterly basis would present this disclosure to investors in a consolidated manner in a single document.

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21. Would the disclosures in proposed Item 408(a) provide useful information to investors and the markets? Does the proposed disclosure requirement specify all of the information that should be disclosed as to registrants' trading arrangements? Does the proposed disclosure requirement specify all of the information that should be disclosed as to trading arrangements of officers and directors? Are there other disclosures that we should require that would provide more transparency into the use of Rule 10b5-1 and non-Rule 10b5-1 trading arrangements? Is there any information that we have proposed to require be disclosed that we should not require? We are proposing disclosure about trading arrangements both for registrants and for officers and directors. Should we instead require disclosure about only one of those categories of traders? Should we consider requiring disclosure of trading arrangements of insiders who are not officers or directors? If so, at what level of specificity?
22. Would a description of the material terms of a trading arrangement encourage front-running of trades under the trading arrangement? Should the required disclosures be limited to particular terms of a trading arrangement?
23. Do registrants currently have access to information about a director's or officer's adoption or termination of a non-Rule 10b5-1 trading arrangement that would allow them collect and prepare this information for disclosure in a Form 10-Q in a timely fashion? If not, what would they need to do to collect and prepare this information for disclosure?
24. Is it appropriate to require disclosures regarding both Rule 10b5-1 trading arrangements and non-Rule 10b5-1 trading arrangements? Is the scope of the term "non-Rule 10b5-1" sufficiently clear? Should we define the term?
25. Is the proposal to require disclosure in Forms 10-Q and 10-K appropriate? Should we instead

require disclosure in a different form? Should we consider a different frequency of disclosure?

26. The proposed Item 408(a) disclosure requirement would not apply to foreign private issuers that file annual reports using Form 20-F because such issuers are not required to file quarterly reports on Form 10-Q. Should the proposed amendments apply to foreign private issuers or would the information be less useful if reported annually on Form 20-F?

## **2. Disclosure of Insider Trading Policies and Procedures**

Well-designed policies and procedures that address the potential misuse of material nonpublic information can play an important role in deterring and preventing trading on the basis of material nonpublic information. Specific disclosures concerning registrants' insider trading policies and procedures would benefit investors by enabling them to assess registrants' corporate governance practices and to evaluate the extent to which those policies and procedures protect shareholders from the misuse of material nonpublic information. We are thus proposing to add new Item 408(b) to Regulation S-K, which would require registrants to:

- Disclose whether the registrant has adopted insider trading policies and procedures governing the purchase, sale, and other dispositions of the registrant's securities by directors, officers, and employees or the registrant itself that are reasonably designed to promote compliance with insider trading laws, rules, and regulations, and any listing standards applicable to the registrant. If the registrant has not adopted such insider trading policies and procedures, explain why it has not done so; and

If the registrant has adopted insider trading policies and procedures, disclose such policies and procedures. These disclosures would be required in a registrant's annual reports on Form 10-K

and proxy and information statements on Schedules 14A and 14C.<sup>51</sup> Foreign private issuers would also be required to provide analogous disclosure in their annual reports pursuant to a new Item 16J in that form.

Currently, Item 406 of Regulation S-K requires a registrant to disclose whether it has adopted a code of ethics that applies to its principal executive officer, chief financial officer, and other appropriate executives and, if it has not adopted such a code, to state why it has not done so.<sup>52</sup> Many registrants are required to maintain codes of ethics or conduct under exchange listing standards.<sup>53</sup> These codes may contain specific policies and restrictions that address insider trading.<sup>54</sup> Apart from these codes of ethics or conduct, some registrants have other policies and procedures specifically addressing insider trading. The proposed amendments are designed to provide investors with meaningful information regarding a registrant's insider trading policies and procedures to enable them to better assess the manner in which the registrant promotes compliance with insider trading laws and protects material nonpublic information from misuse.

We recognize that insider trading policies and procedures may vary from company to company and that decisions as to specific provisions of the policies and procedures are best left

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<sup>51</sup> Item 1 of Schedule 14C requires that a registrant furnish the information called for by all of the items of Schedule 14A (other than Items 1(c), 2, 4 and 5) which would be applicable to any matter to be acted upon at the meeting if proxies were to be solicited in connection with the meeting.

<sup>52</sup> 17 CFR 229.406; *see also* Section 406 of the Sarbanes-Oxley Act of 2002 ("SOX"), 15 U.S.C. 7264.

<sup>53</sup> *See e.g.*, NYSE Listed Company Manual Section 303A.10, which states in relevant part that every NYSE "listed company should proactively promote compliance with laws, rules and regulations, including insider trading laws. Insider trading is both unethical and illegal, and should be dealt with decisively." *See also* NASDAQ Listing Rule 5610 that requires every Nasdaq listed company to adopt a code of conduct that must comply with the definition of a "code of ethics" set out in SOX Section 406 (c) and that must apply to all directors, officers, and employees.

<sup>54</sup> Insider trading policies and procedures may be part of the standards that are reasonably necessary to promote: honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships; full, fair, accurate, timely, and understandable disclosure in the periodic reports required to be filed by the issuer; and compliance with applicable governmental rules and regulations. *See* 15 U.S.C. 7264(c); *see also supra* Section I.

to the company. Therefore, the proposed amendments do not specify all details that a registrant should address in its insider trading policies, nor do they prescribe any specific language that such policies must include (although this release does include some guidance as to the appropriate subject matter below). We also recognize that registrant’s existing code of ethics may contain insider trading policies. In this case, the registrant, could cross-reference to the particular components of its code of ethics that constitute insider trading policies and procedures in response to proposed Item 408(b)(2).

When making disclosure about their insider trading policies and procedures under proposed Item 408(b)(2), registrants should endeavor to provide detailed and meaningful information from which investors can assess the sufficiency of their insider trading policies and procedures. For example investors may find useful, to the extent it is included in the issuer’s relevant policies and procedures, information on the issuer’s process for analyzing whether directors, officers, employees, or the issuer itself when conducting an open-market share repurchase have material nonpublic information; the issuer’s process for documenting such analyses and approving requests to purchase or sell its securities; or how the issuer enforces compliance with any such policies and procedures it may have. Furthermore, the disclosure under proposed Item 408 could address not only policies and procedures that apply to the purchase and sale of the registrant’s securities, but also other dispositions of the issuer’s securities where material nonpublic information could be misused such as, for example, through gifts of such securities.<sup>55</sup>

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<sup>55</sup> The Exchange Act does not require that a “sale” of securities be for value, and instead provides that the “terms ‘sale’ or ‘sell’ each include any contract to sell or otherwise dispose of.” Exchange Act Section 3(a)(14) [15 U.S.C. 78c(a)(14)] *compare with* Securities Act Section 2(a)(3) [15 U.S.C. 77b(a)(3)] (“the terms ‘sale’ or ‘sell’ shall include every contract of sale or disposition of a security or interest in a security, for value.”). For example, a donor of securities violates Exchange Act Section 10(b) if the donor gifts a security of an issuer in

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27. Would the proposed disclosure requirements regarding a registrant’s insider trading policies and procedures or lack thereof provide useful information to investors? Is there other information that would be useful to include in Item 408(b)?
28. Is the proposed scope of the term “insider trading policies and procedures” sufficiently clear? Should we more specifically define the term? Are there other elements or objectives of an insider trading policy or procedure that should be included in the proposed Item?
29. Should the Item 408(b) disclosure be required in Schedules 14A and 14C, as proposed?
30. Should foreign private issuers be required to provide disclosure of their insider trading policies and procedures? Are any modifications to the proposed disclosure requirement appropriate to recognize the different legal regimes in which foreign private issuers may operate?

### 3. Structured Data Requirements

We are proposing to require registrants to tag the information specified by Item 408 in Inline XBRL in accordance with Rule 405 of Regulation S-T (17 CFR 232.405) and the EDGAR Filer Manual.<sup>56</sup> The proposed requirements would include block text tagging of narrative disclosures, as well as detail tagging of quantitative amounts disclosed within the narrative

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fraudulent breach of a duty of trust and confidence when the donor was aware of material nonpublic information about the security or issuer, and knew or was reckless in not knowing that the donee would sell the securities prior to the disclosure of such information. The affirmative defense under Rule 10b5-1(c)(1) is available for planned securities gifts.

<sup>56</sup> This tagging requirement would be implemented by including a cross-reference to Rule 405 of Regulation S-T in proposed Item 408(a)(3) and Item 408(b)(3), and by revising Rule 405(b) of Regulation S-T [17 CFR 232.405(b)] to include the Item 408 disclosure. In conjunction with the EDGAR Filer Manual, Regulation S-T governs the electronic submission of documents filed with the Commission. Rule 405 of Regulation S-T specifically governs the scope and manner of disclosure tagging requirements for operating companies and investment companies, including the requirement in Rule 405(a)(3) to use Inline XBRL as the specific structured data language to use for tagging the disclosures.

disclosures. Inline XBRL is both machine-readable and human-readable, which improves the quality and usability of XBRL data for investors.<sup>57</sup>

Requiring Inline XBRL tagging of the disclosures provided pursuant to Item 408 would benefit investors by making the disclosures more readily available and easily accessible to investors, market participants, and others for aggregation, comparison, filtering, and other analysis, as compared to requiring a non-machine readable data language such as ASCII or HTML. This would enable automated extraction and analysis of the granular data required by the proposed rules, allowing investors and other market participants to more efficiently perform large-scale analysis and comparison of this information across issuers and time periods. For narrative disclosures, an Inline XBRL requirement would allow investors to extract and search for disclosures about a registrant's insider trading policies and procedures (rather than having to manually run searches for these disclosures through entire documents), automatically compare/redline these disclosures against prior periods, and perform targeted AI/ML assessments of specific narrative disclosures rather than the entire unstructured document. At the same time, we do not expect the incremental compliance burden associated with tagging the additional information to be unduly burdensome, because issuers subject to the proposed tagging requirements are for the most part subject to similar Inline XBRL requirements in other Commission filings.

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<sup>57</sup> See *Inline XBRL Filing of Tagged Data*, Securities Act Release No. 10514 (June 28, 2018) [83 FR 40846 (Aug. 16, 2018)]. Inline XBRL allows filers to embed XBRL data directly into an HTML document, eliminating the need to tag a copy of the information in a separate XBRL exhibit. Inline XBRL is both human-readable and machine-readable for purposes of validation, aggregation, and analysis. *Id.* at 40851.

31. Should we require issuers to tag the disclosures required by Item 408 of Regulation S-K in Inline XBRL, as proposed? Are there any changes we should make to ensure accurate and consistent tagging? If so, what changes should we make?
32. Should we modify the scope of the disclosures required to be tagged? Should the narrative disclosure about a registrant's insider policies and procedures be tagged using Inline XBRL, as proposed?
33. Should we require issuers to use a different structured data language to tag these disclosures? If so, what structured data language should we require?
34. Are there any issuers, such as smaller reporting companies, emerging growth companies or foreign private issuers that we should exempt from the tagging requirement? If so, how would investors in such issuers receive the information that they need to make informed decisions regarding these issuers?

**4. Identification of Rule 10b5-1(c) and non-Rule 10b5-1(c)(1) Transactions on Forms 4 and 5**

Section 16(a) of the Exchange Act provides that every person who beneficially owns, directly or indirectly, more than 10 percent of any class of equity security (other than an exempted security) registered pursuant to Exchange Act Section 12, or who is an officer or director of the issuer of such security, shall file with the Commission an initial report disclosing the amount of all equity securities of such issuer of which the insider is the beneficial owner, and a subsequent transaction report to disclose any changes in beneficial ownership. Section 16 of the Exchange Act was designed to provide the public with information on securities transactions and holdings of corporate officers, directors, and principal shareholders, and to deter those individuals from seeking to profit from short-term trading in the securities of their corporations

while in possession of material, nonpublic information.<sup>58</sup>

Persons subject to Section 16 reporting must disclose changes in their beneficial ownership on Form 4 or 5. Exchange Act Rule 16a-3(g)<sup>59</sup> provides that a reporting person must report specified changes in beneficial ownership on Form 4 before the end of the second business day following the date of execution of the transaction. In December 2020, the Commission proposed, among other things, amendments to Form 4 and Form 5<sup>60</sup> to add a checkbox to these forms that would permit filers, at their option, to indicate whether a transaction reported on the form was made pursuant to a contract, instruction, or written trading plan for the purchase or sale of equity securities of the issuer that satisfies the conditions of Rule 10b5-1(c).<sup>61</sup> In the December 2020 Proposing Release, the Commission noted that many Form 4 and Form 5 filers voluntarily provide additional disclosure in these forms stating that a reported transaction satisfied the affirmative defenses conditions of Rule 10b5-1(c). The Commission indicated that the checkbox option would provide filers with a more efficient method to disclose this information.

In response to the December 2020 Proposing Release, the Commission received feedback from several commenters who asserted, based on analyses of sales of securities executed under Rule 10b5-1 trading arrangements, that many of these transactions were likely made on the basis

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<sup>58</sup> See *Ownership Reports and Trading By Officers, Directors and Principal Security Holders*, Release No. 34-28869 (Feb. 8, 1991) [56 FR 7242 (Feb. 21, 1991)].

<sup>59</sup> 17 CFR 240.16a-3(g).

<sup>60</sup> Form 5 is a year-end report to be used by any person who was an officer, director or a 10% beneficial owner during any portion of the issuer's fiscal year to disclose transactions and holdings that are exempt from Section 16(b) or that were required to be reported during the fiscal year, but were not.

<sup>61</sup> See *Rule 144 Holding Period and Form 144 Filings*, Release No. 33-10911 (Dec. 22, 2020) [86 FR 5063 (Jan. 19, 2021)] ("December 2020 Proposing Release").

of material nonpublic information.<sup>62</sup> These commenters recommended that the proposed Rule 10b5-1 checkbox disclosure be mandatory on Forms 4 and 5 because such disclosure would help investors and the public better discern whether Rule 10b5-1 trading arrangements are being used to engage in opportunistic trading on the basis of inside information.<sup>63</sup>

In consideration of this feedback, we are proposing to add a Rule 10b5-1(c) checkbox as a mandatory disclosure requirement on Forms 4 and 5. The checkbox would require a Form 4 or 5 filer to indicate whether a sale or purchase reported on that form was made pursuant to a Rule 10b5-1(c) trading arrangement. Filers would also be required to provide the date of adoption of the Rule 10b5-1 trading arrangement, and would have the option to provide additional relevant information about the reported transaction. Requiring this disclosure on Forms 4 and 5 would provide greater transparency around the use of Rule 10b5-1 plans and would be consistent with the primary purpose of Exchange Act Section 16.<sup>64</sup> It also would provide information that could be used by registrants to comply with their Item 408 disclosure obligations.

In addition, we are proposing to add a second, optional checkbox to both of Forms 4 and 5. This optional checkbox would allow a filer to indicate whether a transaction reported on the form was made pursuant to a pre-planned contract, instruction, or written plan that is not intended to satisfy the conditions of Rule 10b5-1(c).

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35. Should we add a mandatory checkbox on Forms 4 and 5 to indicate whether a sale or purchase was made pursuant to a Rule 10b5-1(c) plan? Should we require disclosure of the

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<sup>62</sup> See letters from Council of Institutional Investors (dated Mar. 18, 2021), Alan Jagolinzer (dated Mar. 10, 2021), and David Larcker *et al.* (dated Mar. 10, 2021), available at <https://www.sec.gov/comments/s7-24-20/s72420.htm>.

<sup>63</sup> *Id.*

<sup>64</sup> See S. Rep. No. 1455, 73d Cong., 2d Sess. 55 (1934).

date of adoption of the Rule 10b5-1 plan? Would the Rule 10b5-1(c) checkbox and disclosure of the date of adoption of the plan help provide useful information about whether a Rule 10b5-1 plan was being used to engage in opportunistic trading based on material nonpublic information? Are there alternative methods of providing this information that we should consider?

36. Should we add an optional checkbox on Forms 4 and 5 to indicate that a sale or purchase reported on these forms was made pursuant to a contract, instruction or written plan that did not satisfy the conditions of Rule 10b5-1(c), as proposed? Would such an affirmative indication provide useful information to investors and market participants? Are filers already sufficiently able to provide this information elsewhere if they choose to do so? If so, should we make the use of the checkbox mandatory?

**C. Disclosure Regarding the Timing of Option Grants and Similar Equity Instruments Shortly before or after the Release of Material Nonpublic Information**

Since the enactment of the Securities Act and the Exchange Act, the Commission has sought to enhance its rules regarding the disclosure of executive and director compensation and to improve the presentation of this information to investors.<sup>65</sup> One area of focus for the Commission has been disclosure related to equity-based compensation. Many companies use stock options as a form of compensation for their employees and executives.<sup>66</sup> In a simple stock option award, a company may grant an employee the right to purchase a specified number of shares of the company's stock at a specified price, called the exercise price, which is typically set

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<sup>65</sup> See, e.g., *Executive Compensation and Related Person Disclosure*, Release No. 33-8732A (Aug. 29, 2006) [71 FR 53158 (Sept. 8, 2006)] (hereinafter "2006 Executive Compensation Release") at 53160 at n. 45; *Proxy Disclosure Enhancements*, Release No. 33-9089 (Dec. 16, 2009) [74 FR 68334 (Dec. 24, 2009)].

<sup>66</sup> The term "option" includes stock options, SARs and similar instruments with option-like features. See 17 CFR 229.402(a)(6).

as the fair market value of the company's stock on the grant date. Stock options with exercise prices at or above the fair market value of the underlying stock are designed to motivate the recipient to work towards increasing company value, because the option holder would only benefit if the company's stock price exceeds the exercise price at the time of exercise.<sup>67</sup>

In 2006, the Commission revised its executive compensation disclosure rules to, among other things, provide investors a more complete picture of compensation to principal executive officers, principal financial officers, and the other highest paid executive officers and directors.<sup>68</sup> In the 2006 Executive Compensation Release, the Commission stated that under the principles-based compensation disclosure requirements of Item 402 of Regulation S-K, registrants may be required to disclose in their Compensation Discussion and Analysis ("CD&A") information about the timing of option grants in close proximity to the release of nonpublic information by the company.<sup>69</sup> Such disclosure should include, for example, whether a company is aware of material nonpublic information that is likely to result in an increase of its stock price, such as a product development announcement or positive earnings, and grants stock options immediately before the release of this information. Timing option grants to occur immediately before the release of positive material nonpublic information ("spring-loading") can benefit executives with an option award that will likely be in-the-money as soon as the material nonpublic information is made public.<sup>70</sup> Alternatively, if a company is aware of material nonpublic information that is

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<sup>67</sup> When the exercise price for an option is less than the fair market value of the underlying security, the option is "in the money." If the exercise price and fair market value are the same, the option is "at the money." If the exercise price is greater than the fair market value, the option is "out of the money."

<sup>68</sup> 2006 Executive Compensation Release, *supra* note 65, at 53164.

<sup>69</sup> See 17 CFR 229.402(b)(2)(iv) and 2006 Executive Compensation Release, *supra* note 65, at 53163-4.

<sup>70</sup> See Lucian A. Bebchuk and Jesse M. Fried, *Paying for Long-Term Performance*, 158 U. PA. L. REV. 1915, 1937-39 & n. 63 (2010) (noting that the practice of spring-loading may also disguise an in-the-money option award as having been granted at-the-money).

likely to decrease its stock price, it may decide to delay a planned option award until after the release of such information (“bullet-dodging”).<sup>71</sup>

In the release, the Commission noted that the existence of a program, plan or practice to select option grant dates for executive officers in coordination with the release of material nonpublic information would be material to investors and should be fully disclosed.<sup>72</sup>

We are concerned, however, that our existing disclosure requirements do not provide investors with adequate information regarding an issuer’s policies and practices on stock option awards timed to precede or follow the release of material nonpublic information. Under our current executive compensation disclosure rules, compensation-related equity interests (including options, restricted stock, and similar grants) are required to be presented in a tabular format and accompanied by appropriate narrative disclosure necessary for an understanding of the information presented in a table. Option grants that are spring-loaded or bullet-dodging are not required to be separately identified in these tables. Consequently, investors may not have a clear picture of the effect of an option award that is made close in time to the release of material nonpublic information on the executives’ or directors’ compensation and on the company’s financial statements. Understanding that issuers may have reasons for granting these types of options, but that increased transparency may be warranted, we are proposing amendments that would require registrants to disclose in a new table any option awards to named executive

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<sup>71</sup> See Allan Horwich, *The Legality of Opportunistically Timing Public Company Disclosures in the Context of SEC Rule 10b5-1*, 71 BUS. LAW. 1113, 1143 (2016) (noting that “bullet-dodging” occurs when a board delays the grant of an option until adverse material nonpublic information known to the board is disclosed, which reduces the market price and the option exercise price that is set at the time of the grant).

<sup>72</sup> 2006 Executive Compensation Release, *supra* note 65, at 53163.

officers<sup>73</sup> or directors that are made within a certain time proximity of the release of material nonpublic information such as an earnings announcement.

Under the proposal, to identify if any such timed options are granted, a new paragraph (x) would be added to Item 402 of Regulation S-K<sup>74</sup> that would require tabular disclosure of each option award (including the number of securities underlying the award, the date of grant, the grant date fair value, and the option's exercise price) granted within 14 calendar days before or after the filing of a periodic report, an issuer share repurchase, or the filing or furnishing of a current report on Form 8-K that contains material nonpublic information; the market price of the underlying securities the trading day before disclosure of the material nonpublic information; and the market price of the underlying securities the trading day after disclosure of the material nonpublic information.<sup>75</sup>

Many companies required to file Exchange Act periodic reports also voluntarily communicate material nonpublic information regarding their results of operations or financial condition for a completed fiscal quarter or annual period through an earnings release.<sup>76</sup> After

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<sup>73</sup> Named executive officers include all individuals serving as the registrant's Principal Executive Officer ("PEO") or Principal Financial Officer ("PFO") during the last completed fiscal year, the registrant's three most highly compensated officers other than the PEO and PFO who were serving as executive officers at the end of the last completed fiscal year, and up to two additional individuals for whom disclosure would have been provided but for the fact that the individual was not serving as an executive officer at fiscal year-end. *See* Item 402(a)(3) of Regulation S-K.

<sup>74</sup> In Release No. 33-9861, the Commission proposed to add paragraph (w) to Item 402. The proposed Item 402(x) designation is consistent with the new designations proposed in that release, but could change depending on Commission action to adopt those proposals. *See Listing Standards for Recovery of Erroneously Awarded Compensation*, Release No. 33-9861 (July 1, 2015) [80 FR 41144 (July 14, 2015)]. *See also Reopening of Comment Period for Listing Standards for Recovery of Erroneously Awarded Compensation*, Release No. 33-10998 (Oct. 14, 2021) [FR Cite TBA].

<sup>75</sup> Under the proposed rule, disclosure would also be required of the grant date fair value of each equity award computed in accordance with FASB ASC Topic 718.

<sup>76</sup> Commission staff estimates that approximately 63% of the Form 10-Qs filed with the Commission in calendar year 2017 were accompanied by a prior or concurrent earnings release by the issuer.

completion of a fiscal quarter, a company's board of directors will usually meet a week or two before announcing the earnings release.<sup>77</sup> During this period, the board would likely be aware of material nonpublic information that could affect the stock price of the company. The proposed fourteen day window is designed to cover the period that a company would be aware of material nonpublic information at the time that its board of directors' grants an option award. In addition, new Item 402(x) would require narrative disclosure about an issuer's option grant policies and practices regarding the timing of option grants and the release of material nonpublic information, including how the board determines when to grant options and whether, and if so, how, the board or compensation committee takes material nonpublic information into account when determining the timing and terms of an award. For companies that are subject to CD&A, the proposed narrative disclosure could be included in CD&A.

The proposed amendments are intended to provide shareholders a full and complete picture of any spring-loaded or bullet-dodging option grants during the fiscal year. It is important for shareholders to understand company practices with respect to these types of options grants as they consider their say-on-pay votes, and when approving executive compensation and electing directors. Accordingly, we are proposing to require this disclosure in annual reports on Form 10-K,<sup>78</sup> as well as in proxy statements and information statements related to the election of directors, shareholder approval of new compensation plans, and solicitations of advisory votes to

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<sup>77</sup> While some companies provide earnings releases in advance of the corresponding Form 10-Q filings, many companies also issue earnings releases concurrently with their Form 10-Q filings.

<sup>78</sup> The executive compensation disclosure requirements in Part III of Form 10-K may be incorporated by reference from a proxy or information statement involving the election of directors, if filed within 120 days of the end of the fiscal year. *See* Note 3 to General Instruction G(3) to Form 10-K.

approve executive compensation.<sup>79</sup>

We are also proposing to require registrants to tag the information required by Item 402(x) in Inline XBRL in accordance with Rule 405 of Regulation S-T (17 CFR 232.405) and the EDGAR Filer Manual.<sup>80</sup> We expect that the disclosure of this data in a structured data language would improve the usability of the data for investors, other market participants and the Commission, and facilitate the analysis of this information.

We do not propose to exempt smaller reporting companies<sup>81</sup> or emerging growth companies (“EGCs”)<sup>82</sup> from the proposed Item 402(x) disclosures. Information about grants of options awards while a board of directors is aware of material nonpublic information is material to all investors, and no less relevant to shareholders of a smaller reporting company or an EGC. Accordingly, smaller reporting companies and EGCs would be subject to the new disclosure requirement. However, consistent with the scaled approach to their executive compensation

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<sup>79</sup> Exchange Act Rule 14a-21 [17 CFR 240.14a-21] requires, among other things, companies soliciting proxies for an annual or other meeting of shareholders at which directors will be elected to include a separate resolution subject to a shareholder advisory vote to approve the compensation of named executive officers.

<sup>80</sup> This tagging requirement would be implemented by including a cross-reference to Rule 405 of Regulation S-T in proposed Item 402(x), and by revising Rule 405(b) of Regulation S-T [17 CFR 232.405(b)] to include the Item 402(x) disclosure. In conjunction with the EDGAR Filer Manual, Regulation S-T governs the electronic submission of documents filed with the Commission. Rule 405 of Regulation S-T specifically governs the scope and manner of disclosure tagging requirements for operating companies and investment companies, including the requirement in Rule 405(a)(3) to use Inline XBRL as the specific structured data language to use for tagging the disclosures.

<sup>81</sup> “Smaller reporting company” is defined in Securities Act Rule 405 and Exchange Act Rule 12b-2 as an issuer that is not an investment company, an asset-backed issuer (as defined in 17 CFR 229.1101), or a majority-owned subsidiary of a parent that is not a smaller reporting company and that: (1) Had a public float of less than \$250 million; or (2) had annual revenues of less than \$100 million and either: (a) no public float; or (b) a public float of less than \$700 million.

<sup>82</sup> An EGC is defined as a company that has total annual gross revenues of less than \$1.07 billion during its most recently completed fiscal year and, as of December 8, 2011, had not sold common equity securities under a registration statement. A company continues to be an EGC for the first five fiscal years after it completes an IPO, unless one of the following occurs: Its total annual gross revenues are \$1.07 billion or more; it has issued more than \$1 billion in non-convertible debt in the past three years; or it becomes a “large accelerated filer,” as defined in Exchange Act Rule 12b-2. *See* Securities Act Rule 405 and Exchange Act Rule 12b-2.

disclosure,<sup>83</sup> smaller reporting companies and EGCs would be permitted to limit their disclosures about specific option awards to the PEO, the two most highly compensated executive officers other than the PEO at fiscal year-end, and up to two additional individuals who would have been the most highly compensated but for not serving as executive officers at fiscal year-end.<sup>84</sup>

### **Request for Comment**

37. To what extent does the board of directors or compensation committee currently consider the impact of granting option awards made close in time to disclosure of material nonpublic information? What type of effect would the proposed disclosures have on the timing and granting of option awards if this requirement for Item 402(x) were adopted?
38. Would the proposed table in Item 402(x) provide meaningful information to shareholders regarding option awards made close in time to the disclosure of material nonpublic information? What, if any, other information should be required? Should the proposed table include a column to specify the date on which the material nonpublic information was released? Should any of the proposed disclosure elements be eliminated?
39. The proposed disclosure requirements under new Item 402(x) would apply to option awards made within a 14-day period before or after the filing of a Form 10-Q or the filing (or furnishing) of a Form 8-K containing material nonpublic information with the Commission. Is the proposed 14-day time period appropriate? Should the period be longer or shorter than 14 days, and if so, what time period would be appropriate? What percent of option grants would be included in this disclosure based on these reporting windows?

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<sup>83</sup> See Item 402(l) of Regulation S-K.

<sup>84</sup> See Item 402(m)(2) of Regulation S-K.

40. Is a one-day period after the disclosure of material nonpublic information a sufficient period for the material nonpublic information to be reflected in the market price of the issuer's securities? Is a one-day period prior to the disclosure too late to reflect the change in the share price to the extent that the material nonpublic information may have been previously disclosed to the market (*e.g.*, leaked)? Should the window for measuring the change in market price based on the release of material nonpublic information be longer or shorter?
41. Should smaller reporting companies and emerging growth companies be required to provide all of the proposed disclosure?
42. Are there material tax implications that could result from the timing of stock option grants with the release of material nonpublic information that should be disclosed?

#### **D. Reporting of Gifts on Form 4**

Currently, Section 16 reporting persons are required to report any “bona fide”<sup>85</sup> gift of equity securities registered under Exchange Act Section 12 on Form 5. Exchange Act Rule 16a-3(f) provides that every person who at any time during an issuer's fiscal year was subject to Section 16 of the Exchange Act must file a Form 5 within 45 days after the issuer's fiscal year end to disclose certain beneficial ownership transactions and holdings not reported previously on Forms 3, 4, or 5.<sup>86</sup> As transactions that are exempted from Section 16(b) by Rule 16b-5,<sup>87</sup> including both the acquisition and disposition of bona fide gifts are eligible for delayed reporting on Form 5 pursuant to Rule 16a-3(f)(1). This filing schedule, under the current rules, can permit

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<sup>85</sup> A bona fide gift is a gift that is not required or inspired by any legal duty or that is in any sense a payment to settle a debt or other obligation, and not made with the thought of reward for past services or hope for future consideration. *See Ownership Reports and Trading by Officers, Directors and Principal Stockholders*, Release No. 34-26333 (Dec. 2, 1988) [53 FR 49997 (Dec. 13, 1988)].

<sup>86</sup> 17 CFR 240.16a-3(f).

<sup>87</sup> 17 CFR 240.16b-5.

insiders to report “bona fide” gifts more than one year after the date of the gift.<sup>88</sup>

We have become aware that the length of the filing period for Form 5 may allow insiders to engage in problematic practices involving gifts of securities, such as insiders making stock gifts while in possession of material nonpublic information,<sup>89</sup> or backdating a stock gift in order to maximize a donor’s tax benefit.<sup>90</sup> To address these concerns, we are proposing to amend Exchange Act Rule 16a-3 to require the reporting of dispositions of bona fide gifts of equity securities on Form 4. Under the proposed amendment, an officer, director, or a beneficial owner of more than 10 percent of the issuer’s registered equity securities making a gift of equity securities would be required to report the gift on Form 4 before the end of the second business day following the date of execution of the transaction. This would be significantly earlier than what is required under current reporting rules. This earlier reporting deadline would help investors, other market participants, and the Commission better evaluate the actions of these insiders and the context in which equity securities gifts are being made.

### **Request for Comment**

43. Should we require dispositions by gifts of equity securities to be disclosed Form 4 instead of Form 5, as proposed?
44. Should we require disclosure of other information about gifts on Form 4 that are not already required by Form 4? If so, what information should we require?

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<sup>88</sup> Reports on Form 5 are due within 45 days after the issuer’s fiscal year end, which potentially allows a delay of up to 410 days between a reportable transaction and the filing of the Form 5.

<sup>89</sup> See Daisy Maxey, “Improper ‘Insider Charitable Giving’ Is Widespread, Study Says”, WALL ST. J., July 5, 2021, at [https://www.wsj.com/articles/insider-charitable-giving-11625418315?mod=searchresults\\_pos1&page=1](https://www.wsj.com/articles/insider-charitable-giving-11625418315?mod=searchresults_pos1&page=1). See also *supra* note 55.

<sup>90</sup> See S. Burcu Avcı et al., *Insider Giving*, *supra* note 21 (finding that insiders’ charitable gifts of securities are unusually well timed suggesting that such results are likely due to the possession of material nonpublic information and from the backdating of the stock gift).

### **III. General Request for Comment**

We request and encourage any interested person to submit comments on any aspect of the proposed amendments, other matters that might have an impact on the proposed amendments, and any suggestions for additional changes. With respect to any comments, we note that they are of greatest assistance to our rulemaking initiative if accompanied by supporting data and analysis of the issues addressed in those comments and by alternatives to our proposals where appropriate.

### **IV. Economic Analysis**

We are mindful of the costs imposed by, and the benefits obtained from, our rules. Section 2(b) of the Securities Act,<sup>91</sup> Section 3(f) of the Exchange Act,<sup>92</sup> and Section 2(c) of the Investment Company Act<sup>93</sup> require us, when engaging in rulemaking, to consider or determine whether an action is necessary or appropriate in (or, with respect to the Investment Company Act, consistent with) the public interest, and to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation. In addition, Section 23(a)(2) of the Exchange Act requires the Commission to consider the effects on competition of any rules the Commission adopts under the Exchange Act and prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.<sup>94</sup>

We have considered the economic effects of the proposed amendments, including their effects on competition, efficiency, and capital formation. Many of the effects discussed below

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<sup>91</sup> 15 U.S.C. 77b(b).

<sup>92</sup> 15 U.S.C. 78c(f).

<sup>93</sup> 15 U.S.C. 80a-2(c).

<sup>94</sup> 15 U.S.C. 78w(a)(2).

cannot be quantified. Consequently, while we have, wherever possible, attempted to quantify the economic effects expected from this proposal, much of the discussion remains qualitative in nature. Where we are unable to quantify the economic effects of the proposed amendments, we provide a qualitative assessment of the potential effects and encourage commenters to provide data and information that would help quantify the benefits, costs, and the potential impacts of the proposed amendments on efficiency, competition, and capital formation.

We request comment from all interested parties. With regard to any comments, we note that such comments are of greatest assistance to our rulemaking initiative if accompanied by supporting data and analysis of the issues addressed in those comments.

#### **A. Broad Economic Considerations**

The proposed amendments are expected to provide greater transparency to investors (*i.e.*, decrease information asymmetries between insiders and outside investors) about issuer and insider trading arrangements and restrictions, as well as insider compensation and incentives, enabling more informed decisions about investment in the company. The proposed amendments are also expected to limit the opportunity for insider trading based on material nonpublic information (“MNPI”) (referred to as “insider trading” throughout Section IV for brevity) under Rule 10b5-1 by amending the substantive conditions of the affirmative defense, resulting in benefits to investors and improvement in insiders’ incentives.

Insider trading enables certain investors who have access to inside information or who control the timing or substance of corporate disclosures to profit at the expense of other investors. Due to their access to material nonpublic information, insiders can obtain profits through the strategic timing of trades in the issuer’s securities. These profits are gained at the expense of ordinary investors, and essentially transfer wealth from other investors to the insider.

In addition, insider trading can distort the incentives of corporate insiders, which results in a loss of shareholder value, and erode investor confidence in the markets. To the extent insider trading by a company's insiders imposes reputational costs for companies, by reducing insider trading, the proposed amendments also could offer reputational benefits to companies.

**1. Insider trading harms investors, distorts insiders' incentives, and imposes economic costs on investors and capital markets.**

The proposed amendments are expected to decrease the incidence of unlawful insider trading based on MNPI.<sup>95</sup> Insider trading represents a breach of fiduciary or other similar relation of trust and confidence.<sup>96</sup> Congress, the Courts, and the Commission have concluded that such insider trading is illegal.<sup>97</sup> Before analyzing each aspect of the proposed rule, in the interest of completeness, the Commission first reviews the economic literature on the insider trading prohibition.<sup>98</sup>

Insiders have information advantages that place them in a unique position to obtain profits for themselves through strategic timing of trades. When an insider profits by trading on

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<sup>95</sup> The discussion of broad economic considerations generally focuses on insider trading in stock, except where specified otherwise. To the extent that insiders benefit from the timing of option awards and gifts of stock around MNPI, some of the economic effects associated with insider trading also may be manifested in those contexts. For a detailed discussion of the economic considerations applicable to option award timing and insider gift timing, *see infra* Sections IV.D and IV.E.

<sup>96</sup> *See infra* note 187.

<sup>97</sup> *See supra* Section I.

<sup>98</sup> *See generally* Alexandre Padilla and Brian Gardiner, Insider Trading: Is There an Economist in the Room? 24 *J. Private Enterprise* 113, 123 (2009) (noting "economists have progressively reached the same conclusion: that insider trading is harmful to investors, corporations, and stock exchanges, and, therefore, ought to be prohibited").

MNPI, those profits are obtained at other investors' expense.<sup>99</sup> Thus, reducing the incidence of insider trading would benefit investors.<sup>100</sup>

Insider trading also imposes a cost on the investors in the company by distorting managerial incentives, which results in a loss of shareholder value. Thus, whether insiders are strategically timing stock sales and purchases based on MNPI is informative about insider incentives and the value of the company. The ability of officers and directors (who are either involved in making corporate decisions or play a crucial role in the oversight of such decisions) to profit from MNPI exacerbates conflicts of interest between officers / directors and other shareholders, resulting in inefficient, value-decreasing corporate decisions. By protecting the insider from the full effects of poor corporate performance on the value of the insider's equity position, through the ability to sell ahead of negative news, insider trading weakens incentive alignment and exacerbates agency conflicts (and in turn increases the cost of monitoring insiders). The incentive distortions are discussed in greater detail below.

One incentive distortion is that an insider may prefer projects that require less effort or that yield higher private benefits, even if such projects have a negative net present value (NPV)

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<sup>99</sup> See also Michael Manove, The Harm from Insider Trading and Informed Speculation, 104(4) *Quarterly Journal of Economics*, 823–845 (1989); William K.S. Wang, Trading on Material Non-Public Information on Impersonal Stock Markets: Who is Harmed and Who Can Sue Whom Under SEC Rule 10b-5?, *Southern California Law Review* (1981).

<sup>100</sup> These arguments and those below apply to Rule 10b5-1 plans pertaining to trading in equity of other issuers as well as own company stock. Misappropriation of information may have many economic effects, including but not limited to, revealing information to the market in a manner suboptimal to the issuer, (and thus discouraging investment in information and increasing costs of keeping information private). Further, as with trading in own company stock, increased trading by insiders reduces incentives for liquidity provision through adverse selection, imposing economic costs on investors broadly. Finally, misappropriation has associated agency costs as it represents an undisclosed form of compensation, and may lead further divergence of interests between the manager and the shareholders. See Frank H. Easterbrook, Insider Trading, Secret Agents, Evidentiary Privileges, and the Production of Information, *The Supreme Court Review*, 315-16, 323, 331-34; *In re Melvin*, SEC Release No. 3682, 2015 WL 5172974, at \*4 & n.31 (Sept. 4, 2015).

and thus decrease shareholder value.<sup>101</sup> To mitigate agency conflicts and better align insider incentives with those of shareholders, insiders are often compensated with equity. The ability to sell shares in advance of negative news (to the extent the compensation has vested) protects the insider's equity position from the full effect of share price declines. This weakens incentive alignment and exacerbates the agency conflicts described above, increasing the likelihood that the insider would pursue negative-NPV projects. Downside protection also incentivizes the insider to choose riskier negative-NPV projects, due to the possibility of profiting on the upside.<sup>102</sup> Relatedly, if short-term investment projects yield more profitable MNPI (while MNPI about long-term projects arrives less frequently or is less definitive), an insider may exhibit short-termism in investment decisions, at the expense of shareholder value.<sup>103</sup>

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<sup>101</sup> See, e.g., Antonio E. Bernardo, Contractual Restrictions on Insider Trading: A Welfare Analysis, 18(1) *Economic Theory* 7–35 (2001) (showing in a model that “[f]or many reasonable parameter values, however . . . that managers may be too willing to take risky projects. In fact, managers will often choose the risky investment project when it has a lower expected return than the riskless investment project.”). In some circumstances, insider trading may remedy a manager's excess conservatism due to under diversification. See also Lucian A. Bebchuk and Chaim Fershtman, Insider Trading and the Managerial Choice among Risky Projects, 29(1) *Journal of Financial and Quantitative Analysis*, 1-14 (1994). However, Bebchuk and Fershtman (1994) similarly acknowledge that “[t]he desire to increase trading profits might lead the managers to prefer a very risky project even if it offers a lower expected return than a safer alternative.”

<sup>102</sup> See, e.g., Frank H. Easterbrook, Insider Trading, Secret Agents, Evidentiary Privileges, and the Production of Information, *The Supreme Court Review*, 309-366, 332 (1981) (stating that “[t]he opportunity to gain from insider trading also may induce managers to increase the volatility of the firm's stock prices. . . They may select riskier projects than the shareholders would prefer, because if the risk pays off they can capture a portion of the gains in insider trading and, if the project flops, the shareholders bear the loss.”). But see Alexander P. Robbins, *The Rule 10b5-1 Loophole: An Empirical Study*, 34 *Review of Quantitative, Finance and Accounting*, 199–224 (2010) (finding, in a sample of 10b5-1 plans of 81 NASDAQ-listed companies from 2004 to 2006 that “insiders do not appear to increase the volatility of their own firms' shares in order to profit by trading on the basis of material nonpublic information under the protection of the 10b5-1 affirmative defense”).

<sup>103</sup> See M. Todd Henderson, *Insider Trading and Executive Compensation: What We Can Learn from the Experience with Rule 10b5-1*, Research Handbook on Executive Pay, 299 (2012) (stating that short-termism is a cost of insider trading and that “[e]xecutives looking to maximize the value of their shares may engage in conduct that increases the stock price in the short run at the expense of the long term so that they can profit from trading in firm stock”). Such managerial short-termism/myopia reduces shareholder value. See generally, John R. Graham, Campbell R. Harvey, and Shiva Rajgopal, *The Economic Implications of Corporate Financial Reporting*, 40(1-3) *Journal of Accounting and Economics*, 3-73 (2005); Alex Edmans, Blockholder Trading, Market Efficiency, and Managerial Myopia, 64(6) *Journal of Finance*, 2481-2513 (2009).

Being able to profit from MNPI also can distort insider incentives with respect to other corporate decisions that can affect the share price (for example, repurchases in cases where such a payout is not efficient, motivated by the attempt to boost the share price in advance of an insider's sale of shares).<sup>104</sup> As another example, officers and directors engaged in insider trading may be disincentivized from sharing information efficiently within the firm if they can profit from withholding it and personally trading on it, which leads to inefficient corporate decisions and thus decreased shareholder value.<sup>105</sup>

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<sup>104</sup> See, e.g., Konan Chan, David L. Ikenberry, Inmoo Lee, and Yanzhi Wang, *Share Repurchases as a Potential Tool to Mislead Investors*, 16 *Journal of Corporate Finance* 137 (2010) (finding in 1980-2000 data that a limited number of managers may have used repurchases in a misleading way as “cheap talk”); Alice A. Bonaimé and Michael D. Ryngaert, *Insider Trading and Share Repurchases: Do Insiders and Firms Trade in the Same Direction?*, 22 *Journal of Corporate Finance*, 35-53 (2013) (finding that repurchases that coincide with net insider selling may be related to price support and/or reasons related to option exercises); Peter Cziraki, Evgeny Lyandres, and Roni Michaely, *What do Insiders Know? Evidence from Insider Trading Around Share Repurchases and SEOs*, 66 *Journal of Corporate Finance* 101544 (2021) (finding that, “[h]igher insider net buying is associated with better post-event operating performance, a reduction in undervaluation, and, for repurchases, lower post-event cost of capital. Insider trading also predicts announcement returns and long-term abnormal returns following events.” Their results suggests that “insider trades before corporate events [repurchases and SEOs] contain information about changes both in fundamentals and in investor sentiment”); Lenore Palladino, *Do Corporate Insiders Use Stock Buybacks for Personal Gain?*, 34(2) *International Review of Applied Economics*, 152-174 (2020) (finding increased insider selling in quarters where buybacks are occurring); Waqar Ahmed, *Insider Trading Around Open Market Share Repurchase Announcements*, University of Warwick Working Paper (2017) (finding that “insiders take advantage of higher post-[repurchase] announcement price and sell more heavily”, and that such selling is predictive of lower long-term returns). See also Rulemaking Petition 4-746, Jun. 25, 2019, available at <https://www.sec.gov/rules/petitions/2019/petn4-746.pdf>, at 5 and note 17 (expressing concern and citing evidence of repurchases used to increase share prices at the time when insiders sell shares); Alex Edmans, Vivian Fang, and Allen Huang, *The Long-Term Consequences of Short-Term Incentives*, *Journal of Accounting Research*, forthcoming (2021) (finding that “[v]esting equity is positively associated with the probability of a firm repurchasing shares” but that “it is also associated with more negative long-term returns over the 2–3 years following repurchases” and that “CEOs sell their own stock shortly after using company money to buy the firm's stock, also inconsistent with repurchases being motivated by undervaluation”). But see, e.g., Harrison Liu and Edward Swanson, *Is Price Support a Motive for Increasing Share Repurchases?*, 38 *Journal of Corporate Finance*, 77 (2016) (finding that “[c]orporate insiders do not sell from personal stock holdings during the price support quarter.”); Pascal Busch and Stefan Obernberger, *Actual Share Repurchases, Price Efficiency, and The Information Content Of Stock Prices*, 30 *Review of Financial Studies*, 324 (2017) (concluding, with respect to actual share repurchases, that price support provided by repurchases improves price efficiency, even when manipulation concerns might be highest, such as those that occur prior to insider sales).

<sup>105</sup> See, e.g., Robert J. Haft, *The Effect of Insider Trading Rules on the Internal Efficiency of the Large Corporation*, 80(5) *Michigan Law Review*, 1051-1071, 1055 (1982).

Another economic cost of insider trading is that it may incentivize insiders to adjust the timing or content of corporate disclosure (e.g., delay the release of MNPI).<sup>106</sup> Manipulation of corporate disclosure causes price distortions and impairs the ability of investors to make informed investment decisions. Less informed investment decisions result in less efficient allocation of capital in investor portfolios, compared to a setting with no disclosure distortions. To the extent that investors anticipate such disclosure gaming, they may commensurately increase their information gathering effort, resulting in higher information gathering costs for

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<sup>106</sup> See, e.g., Ranga Narayanan, Insider Trading and the Voluntary Disclosure of Information by Firms, 24(3) *Journal of Banking and Finance*, 395-425 (2000) (stating that “[s]tringent enforcement of insider trading regulations induces more disclosure by firms”); Qiang Cheng and Kin Lo, Insider Trading and Voluntary Disclosures, 44(5) *Journal of Accounting Research*, 815-848 (2006) (finding that when “managers plan to purchase shares, they increase the number of bad news forecasts to reduce the purchase price . . . insiders do exploit voluntary disclosure opportunities for personal gain, but only selectively, when litigation risk is sufficiently low”); Frank H. Easterbrook, Insider Trading, Secret Agents, Evidentiary Privileges, and the Production of Information, *Supreme Court Review 1981*, 309-366, 333 (1981) (stating that “[t]he prospect of insiders' gains may lead the firm to delay the release of information”). Some studies also note that an opposite effect is possible—managers concerned about litigation may provide higher-quality disclosure before selling shares. See Jonathan L. Rogers, Disclosure Quality and Management Trading Incentives, 46(5) *Journal of Accounting Research*, 1265-1296 (2008) (Finding that “[c]onsistent with a desire to reduce the probability of litigation . . . managers provide *higher quality* disclosures before selling shares than they provide in the absence of trading” but also finding that “[c]onsistent with a desire to maintain their information advantage, . . . some, albeit weaker, evidence that managers provide *lower quality* disclosures prior to purchasing shares than they provide in the absence of trading.”). In the context of Rule 10b5-1 plans, see, e.g., Stanley Veliotis, Rule 10b5-1 Trading Plans and Insiders' Incentive to Misrepresent, 47(2) *American Business Law Journal*, 313-360, at 330 & nn. 77-78 (2010) (stating that “Rule 10b5-1 plans give insiders an incentive to accelerate the release of good news ahead of planned stock sales and to delay the release of bad news until after the sales are completed. . . . As a practical matter, manipulation of the announcement's timing would be extremely difficult to prove because insiders are not required to disclose their 10b5-1 plans and firms seldom disclose a schedule for corporate announcements in advance. . . .”); Karl T. Muth, With Avarice Aforethought: Insider Trading and 10b5-1 Plans, 10(1) *U.C. Davis Business Law Journal*, 65-82, at 71 & nn. 32-33 (2009) (stating that “executives can participate in the timing of news . . . about the company. Withholding or ‘timing’ news allows the executive to (imperfectly) time market response to news. . . .”); John Shon and Stanley Veliotis, Meeting or Beating Earnings Expectations, 59(9) *Management Science*, 1988-2002 (2013) (finding that “firms with insider sales executed under Rule 10b5-1 plans exhibit a higher likelihood of meeting or beating analysts' earnings expectations (MBE) . . . [that] this relation between MBE and plan sales is more pronounced for the plan sales of chief executive officers (CEOs) and chief financial officers (CFOs) and is nonexistent for other key insiders,” and concluding that “[o]ne interpretation of [their] results is that CEOs and CFOs who sell under these plans may be more likely to engage in strategic behavior to meet or beat expectations in an effort to maximize their proceeds from plan sales”).

investors. Investors, however, have a limited ability to identify specific corporate disclosures being manipulated or to obtain timely and accurate information elsewhere.

Investor recognition of the potential incentive distortions and the risk of lower-quality corporate disclosures resulting from insider trading, as well as the risk of buying shares from a better informed inside seller, is likely to decrease investor confidence in the issuer and make investors less willing to buy or hold the issuer's shares (trading against informed insiders generates what is known as "adverse selection").<sup>107</sup> This in turn could have negative effects on capital formation and the ability to fund investments, due to challenges in raising the required amount of capital.

Turning to the effects on the market as a whole, the risk of trading against informed insiders trading on MNPI negatively affects market integrity and erodes investor confidence in

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<sup>107</sup> See, e.g., Lawrence M. Ausubel, Insider Trading in a Rational Expectations Economy, 80(5) *American Economic Review* 1022-1041 (1990) (showing in a rational expectations model that "[i]f 'outsiders' expect 'insiders' to take advantage of them in trading, outsiders will reduce their investment. The insiders' loss from this diminished investor confidence may more than offset their trading gains. Consequently, a prohibition on insider trading may effect a Pareto improvement."). Further, informed trading by insiders can reduce the incentive for outside investors to acquire information. See Michael J. Fishman and Kathleen M. Hagerty, Insider Trading and the Efficiency of Stock Prices, 23(1) *RAND Journal of Economics*, 106-122 (1992).

the secondary trading market, deterring traders that do not have the advantage of MNPI. Insider trading is also likely to adversely affect price efficiency<sup>108</sup> and liquidity.<sup>109</sup>

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<sup>108</sup> A number of studies demonstrate adverse effects of insider trading on market efficiency. See, e.g., Michael J. Fishman and Kathleen M. Hagerty, Insider Trading and the Efficiency of Stock Prices, 23(1) *RAND Journal of Economics*, 106-122 (1992) (showing that “under certain circumstances, insider trading leads to less efficient stock prices. This is because insider trading has two adverse effects on the competitiveness of the market: it deters other traders from acquiring information and trading, and it skews the distribution of information held by traders toward one trader.”); Zhihong Chen and Yuan Huang, Yuanto Kusnadi, and K.C. John Wei, The Real Effect of the Initial Enforcement of Insider Trading Laws, 45 *Journal of Corporate Finance*, 687-709 (2017) (finding evidence that the initial enforcement of insider trading laws “improves capital allocation efficiency by increasing price informativeness and reducing market frictions”); Robert M. Bushman, Joseph D. Piotroski, and Abbie J. Smith, Insider Trading Restrictions and Analysts’ Incentives to Follow Firms, 60(1) *Journal of Finance*, 35-66 (2005) (arguing that “insider trading crowds out private information acquisition by outsiders” and showing that “analyst following increases after initial enforcement of insider trading laws” in a cross-country sample); Nuno Fernandes and Miguel A. Ferreira, Insider Trading Laws and Stock Price Informativeness, 22(5) *Review of Financial Studies* 1845–1887 (2009) (finding that price informativeness increases with the enforcement of insider trading laws, but only in countries with a strong “efficiency of the judicial system, investor protection, and financial reporting”). See also Alexander P. Robbins, The Rule 10b5-1 Loophole: An Empirical Study, 34 *Review of Quantitative Finance and Accounting*, 199–224 (2010) (finding, in a sample of 10b5-1 plans of 81 NASDAQ-listed companies from 2004 to 2006 that “10b5-1 plans have a significant negative effect on the liquidity of a firm’s shares, and therefore the firm’s cost of capital”). Some studies argue that insider trading improves price efficiency. See, e.g., Hayne E. Leland, Insider Trading: Should It Be Prohibited?, 100(4) *Journal of Political Economy*, 859-887 (1992) (showing in a model that “stock prices better reflect information” when insider trading is permitted.); Utpal Bhattacharya, Hazem Daouk, Brian Jorgenson, and Carl-Heinrich Kehr, When an Event is Not an Event: The Curious Case of An Emerging Market, 55(1) *Journal of Financial Economics*, 69-101 (2000) (suggesting “that unrestricted insider trading causes prices to fully incorporate the information before its public release”); see generally Henry G. Manne, *Insider Trading and the Stock Market* (1966). A reduction in insider trading can have nuanced effects on market efficiency. For example, the conclusions about the effect on insider trading on market efficiency may depend on whether the framework is static or dynamic. See David Easley, Soeren Hvidkjaer, and Maureen O’Hara Is Information Risk a Determinant of Asset Returns? 57(5) *Journal of Finance*, 2185-2221 (2002).

<sup>109</sup> Various studies show that insider trading negatively impacts liquidity. For example, see Raymond P.H. Fische and Michel A. Robe, The Impact of Illegal Insider Trading in Dealer and Specialist Markets: Evidence From a Natural Experiment, 71(3) *Journal of Financial Economics*, 461-488 (2004); Louis Cheng, Michael Firth, T.Y. Leung, and Oliver Rui, The Effects of Insider Trading on Liquidity, 14(5) *Pacific-Basin Finance Journal* 467-483 (2006); Hayne E Leland, Insider Trading: Should It Be Prohibited? 100(4) *Journal of Political Economy*, 859-887 (1992) (showing in a model that “markets are less liquid” and “outside investors and liquidity traders will be hurt” when insider trading is permitted); Laura N. Beny, Do Insider Trading Laws Matter? Some Preliminary Comparative Evidence, 7(1) *American Law and Economics Review*, 144–183 (2005) (finding that “countries with more prohibitive insider trading laws have more diffuse equity ownership, more accurate stock prices, and more liquid stock markets”); Lawrence R. Glosten, Insider Trading, Liquidity, and the Role of the Monopolist Specialist, 62(2), *Journal of Business* 211-235 (1989) (showing in a model that insider trading reduces liquidity). However, another study does not find a negative effect of insider trading on liquidity. See e.g., Charles Cao, Laura C. Field, and Gordon Hanka, Does Insider Trading Impair Market Liquidity? Evidence from IPO Lockup Expirations, 39(1) *Journal of Financial and Quantitative Analysis*, 25-46 (2004).

## 2. Certain Rule 10b5-1 plan<sup>110</sup> trading practices may raise concerns about potential insider trading.

Over the years concerns have been raised that persons have engaged in securities trading based on MNPI while availing themselves of the Rule 10b5-1(c)(1) affirmative defense.<sup>111</sup>

Examples of practices that have raised concerns include the strategic cancellation of previously adopted plans or individual trades on the basis of MNPI,<sup>112</sup> as well as initiation or resumption of

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<sup>110</sup> For purposes of this economic analysis, the terms “Rule 10b5-1 trading arrangements” and “Rule 10b5-1 plans” are used to refer to the trading arrangements reliant upon the affirmative defense of Rule 10b5-1(c)(1), in line with the use of these terms in the academic research on this topic.

<sup>111</sup> See, e.g., See Recommendations of the Investor Advisory Committee Regarding Rule 10b5-1 Plans (Sept. 9, 2021), at <https://www.sec.gov/spotlight/investor-advisory-committee-2012/20210916-10b5-1-recommendation.pdf>; Letter from David Larcker, March 10, 2021, available at <https://www.sec.gov/comments/s7-24-20/s72420-8488827-229970.pdf>; Letter from Council of Institutional Investors (CII), April 22, 2021, available at <https://www.sec.gov/comments/s7-14-20/s71420-8709408-236962.pdf>; Letter from CII, March 18, 2021, available at <https://www.sec.gov/comments/s7-24-20/s72420-8519687-230183.pdf>; Letter from CII, September 25, 2020, available at <https://www.sec.gov/comments/s7-06-20/s70620-7843308-223819.pdf>; Letter from CII, December 13, 2018, available at <https://www.sec.gov/comments/s7-20-18/s72018-4766666-176839.pdf>; Letter from CII, July 11, 2018, available at <https://www.cii.org/files/July%2011%202018%20SEC%20Reg%20Flex%20Letter%20Final.pdf>; Letter from CII, February 12, 2018, available at <https://www.sec.gov/comments/s7-07-17/s70717-3025708-161898.pdf>; Letter from CII to The Honorable Jay Clayton, January 18, 2018, available at [http://www.cii.org/files/issues\\_and\\_advocacy/correspondence/2018/January%2018%202018%20Rule%2010b5-1%20\(final\).pdf](http://www.cii.org/files/issues_and_advocacy/correspondence/2018/January%2018%202018%20Rule%2010b5-1%20(final).pdf); Letter from CII, July 8, 2016, available at <https://www.sec.gov/comments/s7-06-16/s70616-49.pdf>; Letter from CII to The Honorable Mary Jo White, May 9, 2013, available at [http://www.cii.org/files/issues\\_and\\_advocacy/correspondence/2013/05\\_09\\_13\\_cii\\_letter\\_to\\_sec\\_rule\\_10b5-1\\_trading\\_plans.pdf](http://www.cii.org/files/issues_and_advocacy/correspondence/2013/05_09_13_cii_letter_to_sec_rule_10b5-1_trading_plans.pdf); CII Rulemaking Petition.

<sup>112</sup> See, e.g., Jill E. Fisch, Testimony before the Investor Protection, Entrepreneurship, and Capital Markets Subcommittee, U.S. House Committee on Financial Services, Insider Trading and Stock Option Grants: An Examination of Corporate Integrity in the Covid-19 Pandemic, September 17, 2020, available at <https://docs.house.gov/meetings/BA/BA16/20200917/111013/HHRG-116-BA16-Wstate-FischJ-20200917.pdf>, at p. 5; Alan D. Jagolinzer, SEC rule 10b5-1 and Insiders’ Strategic Trade, 55(2) *Management Science*, 224-239 (2009) (finding “for a sample of 54 firms for which there is public disclosure of early sales plan terminations” that “early sales plan terminations are associated with pending positive performance shifts, reducing the likelihood that insiders’ sales execute at low prices”); Stanley Veliotis, Rule 10b5-1 Trading Plans and Insiders’ Incentive to Misrepresent, 47(2) *American Business Law Journal*, 313-360, at 328-30 (2010) (discussing concerns related to selective cancellations); Taylan Mavruk and Nejat H. Seyhun, Do SEC’s 10B5-1 Safe Harbor Rules Need to Be Rewritten, *Columbia Business Law Review*, 133-183, at 165, 168-71 (2016) (discussing selective cancellation concerns, providing indirect evidence, and concluding that its findings are “consistent with the hypothesis that insiders intervene in their planned transactions to increase profitability”). See also Stephen L. Lenkey, Cancellable Insider Trading Plans: An Analysis of SEC Rule 10b5-1, 32(12) *Review of Financial Studies*, 4947-4996 (2019) (concluding, in a theoretical framework, that “[b]ecause the conditions under which the insider elects to adopt a plan often coincide with the conditions under which the termination option reduces welfare, an alternative regulatory framework wherein the insider could adopt a non-

trading close in time to plan adoption or modification.<sup>113</sup>

As discussed in detail in Section II above, the Commission is proposing several amendments to address these practices, including additional disclosure requirements for insider and issuer trading plans under Item 408 of Regulation S-K; additional disclosure of Rule 10b5-1 plan use in beneficial ownership forms; and modifications to the conditions of the affirmative defense under Rule 10b5-1(c)(1) (introducing cooling-off periods following the adoption of a new or modified plan; certification requirements; and restrictions on single-trade plans and multiple overlapping plans for open market trades in the same class of securities and single-trade plans). Disclosure requirements significantly affect the underlying behavior of insiders and issuers by drawing scrutiny of investors and other market participants to insider trading practices.<sup>114</sup>

Combined, the proposed amendments are expected to reduce the potential for insider trading through Rule 10b5-1 plans and other trading arrangements by insiders and companies. As discussed above, deterring insider trading would result in benefits for investor protection, capital formation, and orderly and efficient markets. By deterring insider trading, the amendments would disincentivize insider behavior that is likely to harm the securities markets and undermine investor confidence.

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cancellable plan (and, thereby, credibly commit to execute his planned trade) would improve the investors' welfare under a wide set of circumstances.”)

<sup>113</sup> For a discussion of the evidence of returns following insider trades occurring close to plan adoption, see *infra* notes 123-131 and accompanying and preceding text. *But see infra* notes 132-138 and accompanying and following text. Existing disclosure does not provide data on plan cancellations or plan modifications (including cancellations of planned trades).

<sup>114</sup> Studies have found evidence that changes in mandatory disclosure affect behavior. See, e.g., Elizabeth C. Chuk, Economic Consequences of Mandated Accounting Disclosures: Evidence from Pension Accounting Standards, 88(2) *Accounting Review*, 395–427 (2013); Alice Adams Bonaimé, Mandatory Disclosure and Firm Behavior: Evidence from Share Repurchases, 90(4) *Accounting Review*, 1333–1362 (2015).

**3. Current levels of disclosure about insider and issuer trading plans limit the ability of investors to identify the risk of insider trading and consider the associated incentive conflicts and information asymmetries in their investment decisions.**

Existing gaps in the disclosure framework limit the information currently available to investors and other market participants regarding the use of insider and issuer trading plans, and the extent to which trading based on MNPI potentially distorts insider incentives with respect to corporate decisions (and thus shareholder value). Besides limiting the ability of investors to correctly value the company's shares, and thus make informed investment decisions, such disclosure gaps limit the ability of the Commission staff to perform market surveillance with regard to Exchange Act Section 10(b) and Rule 10b-5, with the associated adverse consequences for investor protection.

The proposed disclosure amendments would provide greater transparency to investors and decrease information asymmetries between insiders and outside investors about insiders' and companies' trading arrangements and associated policies and procedures, enabling more informed decisions about whether to invest in the company's shares and at what valuation. This might result in more efficient capital allocation and more informationally efficient pricing. The proposed additional disclosure requirements might also indirectly yield potential capital formation benefits if they increase investor confidence in the company's governance.

**4. The economic effects of the proposed amendments are in some cases uncertain.**

The discussed economic effects of the proposed amendments may be uncertain or difficult to generalize.

An important factor contributing to the uncertainty about the magnitude of the benefits of the proposed amendments to Rule 10b5-1 is the potential for substitution between Rule 10b5-1

plans and other trading arrangements. The use of the Rule 10b5-1(c)(1) affirmative defense is voluntary. Insiders and companies may elect to pursue other trading arrangements if they perceive the costs of relying on that affirmative defense are too high. For example, companies may instead rely on the Rule 10b5-1(c)(2) affirmative defense. The application of the proposed disclosure requirements of new Item 408 of Regulation S-K to all officer, director, and company trading plans (including plans not under Rule 10b5-1) is expected to partly mitigate this concern.

The considerations presented above are generally applicable to the proposed amendments as a whole. In the sections that follow we provide a more detailed discussion of economic effects of the particular proposed amendments, including the expected costs and benefits relative to the market baseline, as well as reasonable alternatives.

#### **B. Amendments to Rule 10b5-1(c)(1)**

The Commission is proposing additional conditions that must be satisfied for a trading arrangement to be eligible for the Rule 10b5-1(c)(1) affirmative defense. These amendments are intended to protect investors by decreasing opportunities for officers, directors, and companies to profit from MNPI through such trading arrangements.

The proposed amendments would narrow the conditions under which the Rule 10b5-1(c)(1) affirmative defense would be available. First, the proposed amendments would establish mandatory cooling-off periods before any trading could commence under a Rule 10b5-1 trading arrangement by an officer, director, or issuer after the adoption of a new or modified trading arrangement. Second, the proposed amendments would eliminate the availability of the affirmative defense for multiple overlapping trading arrangements for open market transactions in the same class of securities, as well as limit single-trade plans to a maximum of one in a 12-month period. Third, the proposed amendments would impose a certification requirement as a

condition of the Rule 10b5-1(c)(1) affirmative defense for trading arrangements of officers and directors. In addition, the proposed amendments would broaden the good faith provision, which is a condition of the 10b5-1(c)(1) affirmative defense.

## **1. Baseline and Affected Parties**

We consider the economic effects of the proposed amendments in the context of the regulatory and market baseline. A lack of comprehensive disclosure of Rule 10b5-1 trading arrangements makes it more difficult to provide complete data on existing Rule 10b5-1 practices and affected plan participants. Our estimates are limited by the voluntary nature of the Rule 10b5-1 disclosure in beneficial ownership filings, where insider trades are reported, as well as the limited scope of Rule 10b5-1 trades for which Form 144 reporting is required.<sup>115</sup> Based on beneficial ownership filings (Forms 3, 4, and 5) during the 2020 calendar year, approximately 4,900 natural persons at approximately 1,400 companies reported trades under Rule 10b5-1 trading arrangements. This figure includes approximately 4,800 officers and directors at 1,400 companies; narrowing it to officers yields an estimate of approximately 3,900 officers at 1,200 companies.<sup>116</sup> Due to the data limitations mentioned above, the actual number of affected parties is likely to be larger.

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<sup>115</sup> Form 144 must be filed with the Commission by an affiliate as a notice of the proposed sale of (restricted) securities when the amount to be sold under Rule 144 during any three-month period exceeds 5,000 shares or units or has an aggregate sales price in excess of \$50,000. See <https://www.investor.gov/introduction-investing/investing-basics/glossary/form-144>. Thus, Rule 10b5-1 plan trades below that threshold are not required to be reported on Form 144 and thus may not be in our data. Further, because the vast majority of Form 144 filings are made in paper form during the considered period, we rely on information from such paper filings extracted and processed by the vendor for the Thomson Reuters / Refinitiv insiders dataset.

<sup>116</sup> The estimate is based on the data from filings on Forms 3, 4, and 5 for trades during calendar year 2020 that reported Rule 10b5-1 plan use (obtained from Thomson Reuters / Refinitiv insiders dataset). The estimate only captures natural persons with Rule 10b5-1 plans that have Section 16 reporting obligations, and thus likely represents a lower bound on the number of affected plan participants. Officers and directors are identified based on the role code (beneficial owners and affiliates are not included in the count). Combining data from Form 144 filings with planned sale dates in calendar year 2020 that reported Rule 10b5-1 plan use (also obtained from Thomson Reuters / Refinitiv insiders dataset) and the data from filings on Forms 3, 4, and 5 cited above, we

Below we discuss the available evidence on Rule 10b5-1 plans of officers, directors, and other natural persons. A recent academic study analyzed Form 144 data on insider trades under Rule 10b5-1 plans during January 2016–May 2020.<sup>117</sup> The study documents “[t]he mean (median) cooling-off period is 117.9 (76) days. Approximately 14 percent of plans commence trading within the first 30 days, and 39 percent within the first 60 days. These represent very short cooling-off periods. 82 percent of plans commence trading within 6 months.”<sup>118</sup> As a caveat, the available data do not indicate whether the trading time frames are due to an issuer’s policies (*i.e.*, whether there is a “cooling-off period” is not known—only the time between plan adoption and the first trade, which could be viewed as the “effective cooling-off period”, is calculated).

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estimate that approximately 5,800 natural persons at approximately 1,500 companies (which includes 5,000 officers and directors at 1,400 companies; or when limited to officers only, approximately 4,100 officers at 1,300 companies) reported trades under Rule 10b5-1. Due to gaps in the reporting regime, we cannot be certain whether the higher prevalence of plans reported for officers is due to their higher prevalence in general or due to greater disclosure of such plans.

<sup>117</sup> See David F. Larcker, Bradford Lynch, Philip Quinn, Brian Tayan, and Daniel J. Taylor, *Gaming the System: Three Red Flags of Potential 10b5-1 Abuse*, Stanford Closer Look Series, January 19, 2021 (“Larcker et al. (2021)”) (2021). The study presents novel data “on all sales of restricted stock filed on Form 144 between January 2016 and May 2020 and the adoption date of any corresponding 10b5-1 plans. . . . In total, we have data on 20,595 plans, which covers the trading activity by 10,123 executives at 2,140 unique firms. These plans are responsible for a total of 55,287 sales transactions totaling \$105.3 billion during our sample period. Average (median) trade size is \$1.9 million (\$0.4 million) . . .” The analysis based on Form 144 data has the advantage of not being subject to voluntary reporting bias. However, as a caveat, planned resales reported on Form 144 represent a subset of all trades and may not be representative of all Rule 10b5-1 trades by insiders (*e.g.*, of purchases, or of sales of unrestricted stock). By comparison, Mavruk and Seyhun (2016) examine a larger sample of plan trades identified by a voluntary Rule 10b5-1 checkbox on beneficial ownership forms. They examine transactions for “an average of 14,211 insiders in 3875 firms for each year between 2003 and 2013.” See Taylan Mavruk and Nejat H. Seyhun, *Do SEC’s 10B5-1 Safe Harbor Rules Need to Be Rewritten*, *Columbia Business Law Review*, 133-183 (2016). Relatedly, Hugon and Lee (2016) utilize a sample of “voluntary disclosures of 10b5-1 plan participation in SEC Form 4 filed between October 2000 and December 2010.” See Artur Hugon and Yen-Jung Lee, *SEC Rule 10b5-1 Plans and Strategic Trade around Earnings Announcements*, *Arizona State University and National Taiwan University* (Working Paper) (2016). See also Rik Sen, *Are Insider Sales Under 10b5-1 Plans Strategically Timed?*, *New York University* (Working Paper) (2008); Eliezer M. Fich, Robert Parrino, and Anh L. Tran, *When and How Are Rule 10b5-1 Plans Used for Insider Stock Sales?*, *Drexel University, University of Texas at Austin, and City University of London* (Working Paper) (2021) (also utilizing Form 4 data). Data on Rule 10b5-1 trades by issuers is not available.

<sup>118</sup> See Larcker et al. (2021).

Using Form 144 data provided by The Washington Service for a more recent period (January 2, 2018-October 19, 2021), we find that the median (mean) cooling off period is 72 (105) days, with 13.5 percent of first trades pursuant to a plan occurring within thirty days of the plan date and 40.7 percent occurring within 60 days of the plan date.<sup>119</sup> Shorter cooling off periods are also associated with higher trade sizes as trades occurring within 90 days of plan adoption have a median size of \$670,000 compared with a median size of \$378,000 for those trades occurring more than six months after plan adoption. Further, single-trade plans constitute approximately 40% of plans during the time period examined.

A 2016 industry survey also examined Rule 10b5-1 plan practices at public companies.<sup>120</sup> In the survey (i) 77 percent of the respondents had a mandatory cooling-off period of 60 days or less and a cooling-off period of 30 days was the most common cooling-off period among respondents (41 percent); (ii) 98 percent of the respondents reviewed and approved insiders' Rule 10b5-1 plans to some degree; (iii) 55 percent of the respondents allowed termination of plans and 40 percent of the respondents allowed modification of plans; and (iv) 18 percent of respondents allowed insiders to maintain multiple overlapping plans, while 82 percent disallowed multiple overlapping plans.<sup>121</sup>

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<sup>119</sup> 13.5 percent of trades occur within 0–30 days. 27.2 percent of trades occur within 31–60 days, and 22.6 percent within 61–90 days. In total, 63.3 percent of trades occur within 90 days of the plan date and 83.7 percent of plans commence trading within six months.

<sup>120</sup> See *Defining the Fine Line: Mitigating Risk with 10b5-1 Plans*, Morgan Stanley/Shearman & Sterling LLP, available at [https://advisor.morganstanley.com/capitol-wealth-management-group/documents/field/c/ca/capitol-wealth-management-group/Defining\\_the\\_Fine\\_Line\\_Locked\\_Version.pdf](https://advisor.morganstanley.com/capitol-wealth-management-group/documents/field/c/ca/capitol-wealth-management-group/Defining_the_Fine_Line_Locked_Version.pdf). The survey included public company members of the Society of Corporate Secretaries & Governance Professionals. The respondents and their practices related to Rule 10b5-1 plans are not necessarily representative of all companies subject to the proposed amendments and their Rule 10b5-1 plan policies and practices. Separately, the survey stated that that 51 percent of S&P 500 companies had Rule 10b5-1 plans in 2015.

<sup>121</sup> *Id.*

Various studies have sought to examine the potential use of MNPI for trading under Rule 10b5-1 by looking at the returns around trades under such plans (with the caveats about data availability). Larcker et al. (2021) document abnormal profits following some Rule 10b5-1(c)(1) trades, which is indicative of potential informed trading by insiders under such plans. For example, the study shows abnormal industry-adjusted returns over a six-month period following the first sale to be -2.5 percent for plans with a cooling-off period of less than 30 days and -1.5 percent for plans with a cooling-off period of between 30 and 60 days, but no evidence of such a post-insider sale price drop when the cooling-off period was longer than 60 days. The study also finds that the abnormal return is between -2 percent and -3 percent for plans that execute a sale in the window between when the plan is adopted and that quarter's earnings announcement, but no price drop is found following sales after the earnings announcement. Similarly, they find that insider sales under all single-trade plans are associated with a share price decrease after the sale.<sup>122</sup> Negative abnormal returns after insider sales under Rule 10b5-1(c)(1) plans indicate potential informed trading by insiders ahead of negative news. A lack of such negative returns after insider sales under plans with longer cooling off periods is suggestive of inside information becoming stale during the cooling off period, though it could also indicate low statistical power. Similarly, a lack of negative returns when insider sales occur after the quarter's earnings announcement may suggest less potential for informed selling once the earnings information has been made public; while this result could also indicate low power, it is intuitive that information is more evenly shared following the earnings announcement.<sup>123</sup>

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<sup>122</sup> The data does not show the dates of all scheduled trades, only the dates of executed trades. Thus, some "single-trade" plans may be multi-trade plans in progress, or multi-trade plans with all but one trade cancelled.

<sup>123</sup> As a caveat, the tests of statistical significance of the differences are not shown, so we cannot assess whether the economic differences discussed above have statistical significance.

Several other studies document abnormal returns following trading by insiders who use Rule 10b5-1 plans. For example, a 2009 study of the use of Rule 10b5-1 plans finds that “[p]articipating insiders’ sales systematically follow positive and precede negative firm performance, generating abnormal forward-looking returns larger than those earned by nonparticipating colleagues,” that “a substantive proportion of randomly drawn plan initiations are associated with pending adverse news disclosures,” and that “early sales plan terminations are associated with pending positive performance shifts.”<sup>124</sup> A 2016 study examined insider sales at financial institutions prior to the 2008 financial crisis and found that “net insider sales in the 2001Q2–2007Q2 pre-financial crisis quarters predict not-yet-reported non-performing securitized loans and securitization income for those quarters, and that net insider sales during 2006Q4 predict write-downs of securitization-related assets during the 2007Q3–2008Q4 crisis period” and, crucially for this analysis, that “insiders avoid larger stock price losses through 10b5-1 plan sales than through non-plan sales.”<sup>125</sup> A different 2016 study presents “evidence consistent with insiders using 10b5-1 plans to sell stock in advance of disappointing earnings results.”<sup>126</sup> The study further finds that some of the more aggressive insider trading on earnings information shifted into Rule 10b5-1 plans after adoption of the rule.<sup>127</sup> The study also finds that “these insiders make the following types of trades: non-routine, infrequent, one-time, close to the plan initiation date, and during traditional blackout periods.”<sup>128</sup> Another 2016 study presents

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<sup>124</sup> See Alan D. Jagolinzer, SEC Rule 10b5-1 and Insiders’ Strategic Trade, 55(2) *Management Science*, 224-239 (2009).

<sup>125</sup> See Stephen G. Ryan, Jennifer Wu Tucker, and Ying Zhou Securitization and Insider Trading, 91(2) *Accounting Review*, 649–675 (2016).

<sup>126</sup> See Artur Hugon and Yen-Jung Lee, SEC Rule 10b5-1 Plans and Strategic Trade around Earnings Announcements, Arizona State University and National Taiwan University (Working Paper) (2016).

<sup>127</sup> *Id.*

<sup>128</sup> *Id.*

evidence of “insiders selling shares prior to imminent bad earnings news through their Rule 10b5-1 trading plans.”<sup>129</sup> A 2020 study finds that “public companies disproportionately disclose positive news on days when corporate executives sell shares under predetermined Rule 10b5-1 plans,” with such disclosure of good news on Rule 10b5-1 selling days being most prevalent “in the health care sector and among mid-cap firms.”<sup>130</sup> The study further shows that “stock prices reverse after high levels of Rule 10b5-1 selling on positive news days, and that the price reversal increases with the share volume of Rule 10b5-1 selling.”<sup>131</sup>

However, a 2008 study finds “no significant difference in stock price performance following plan sales and non-plan sales.”<sup>132</sup> The study shows that “price contingent orders (*e.g.*, limit orders), a common feature in trading plans, give rise to empirical patterns that have been taken as evidence of strategic timing of sales.”<sup>133</sup> A different 2016 study finds negative abnormal returns after insider sales under Rule 10b5-1(c)(1), as well as positive abnormal returns after insider purchases under Rule 10b5-1(c)(1)(over a one-month holding period).<sup>134</sup> However, the study does not find significant differences between the abnormal returns following insider trades

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<sup>129</sup> See Jonathan A. Milian, Insider Sales Based on Short-term Earnings Information, 47 *Rev. Quant. Finan. Acc.* (2016) 47, 109-128 (examining data on insider sales under Rule 10b5-1 based on beneficial ownership filings from August 2004 through May 2010). As a caveat, the study specifies that the plan identification may be imprecise: it “use[s] the timing of insiders’ Rule 10b5-1 trades relative to each other in order to infer a sales plan,” “[g]iven the lack of disclosure requirements in SEC Rule 10b5-1 and the nature of the data.”

<sup>130</sup> See Joshua Mitts, Insider Trading and Strategic Disclosure, *Columbia University* (Working Paper) (2020).

<sup>131</sup> *Id.*

<sup>132</sup> See Rik Sen, Are Insider Sales Under 10b5-1 Plans Strategically Timed?, New York University (Working Paper) (2008). The study uses Form 4 data from January 2003 - June 2006. As an important caveat, reporting of 10b5-1 trades on Form 4 is voluntary. Thus, trades classified as “non-10b5-1” trades in the study may include 10b5-1 plan trades.

<sup>133</sup> *Id.*

<sup>134</sup> See Taylan Mavruk and Nejat H. Seyhun, Do SEC’s 10B5-1 Safe Harbor Rules Need to Be Rewritten, *Columbia Business Law Review*, 133-183 (2016).

under Rule 10b5-1(c)(1) and other insider trades.<sup>135</sup> Finally, a 2021 study finds that “non-plan sales are, on average, preceded by a larger price run-up (3.0 percent versus 1.4 percent) and followed by a larger price decline (-1.6 percent versus -1.0 percent) than plan sales . . . consistent with greater opportunistic behavior by CEOs who trade outside of Rule 10b5-1 plans.”<sup>136</sup> Further, focusing on “the 25 percent of sales with the largest ratio of transaction value to the CEO’s most recent total annual compensation . . . the average cumulative abnormal return (“CAR”) during the 40 trading days before the sale is 3.68 percent for non-plan sales and 1.77 percent for plan sales . . . the average CAR for the 40 trading days after the sale is -2.24 percent for non-plan sales and -2.41 percent for plan sales.”<sup>137</sup> The study concludes that “the overall level of opportunistic behavior is smaller for sales within Rule 10b5-1 plans than for sales outside of such plans” but that “CEOs who have a lot of money at stake are able to trade opportunistically even if the transaction is executed under a Rule 10b5-1 plan.”<sup>138</sup> The findings of these studies differ in part because of differences in the sample used for analysis (sample period and whether the data is based on beneficial ownership forms or Form 144 filings) and methodology (including, among other assumptions, whether insider trading under Rule 10b5-1(c)(1) is examined in isolation or in comparison with other insider sales and purchases). As noted above, the lack of data on Rule 10b5-1 plans can make it difficult to extrapolate from the

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<sup>135</sup> *Id.* As noted above, due to voluntary reporting of the Rule 10b5-1 flag on beneficial ownership forms, trades classified as “non-10b5-1” trades in the study may include Rule 10b5-1 plan trades.

<sup>136</sup> *See* Eliezer M. Fich, Robert Parrino, and Anh L. Tran, *When and How Are Rule 10b5-1 Plans Used for Insider Stock Sales?*, Drexel University, University of Texas at Austin, and City University of London (Working Paper) (2021). This study examines “11,250 stock sales by 1,514 CEOs at 1,312 different public firms during the 2013 to 2018 period. Of these stock sales, 6,953 are identified in SEC Form 4 filings as executed through Rule 10b5-1 plans.” As noted above, due to voluntary reporting of the Rule 10b5-1 flag on beneficial ownership forms, trades classified as “non-10b5-1” trades in the study may include Rule 10b5-1 plan trades.

<sup>137</sup> *Id.* Cumulative abnormal returns are returns in excess of returns that would be expected given the security’s systematic risk over the period of time in question.

<sup>138</sup> *Id.*

available evidence to all trading under Rule 10b5-1(c)(1). However, overall, the evidence on the use of Rule 10b5-1 plans in the discussed studies raises concerns about informed trading by insiders.

Data on companies' use of Rule 10b5-1 plans are very limited. Some companies voluntarily disclose on Form 8-K their use of Rule 10b5-1 plans to carry out stock repurchases. One study examining different repurchase methods documented "at least 200 announcements of repurchases using Rule 10b5-1 per year from 2011 to 2014. . . [In 2014] 29% [of repurchase announcements] included a 10b5-1 plan."<sup>139</sup> While the use of Rule 10b5-1 plans by issuers can fluctuate year to year, the study suggests that approximately 200 companies could be affected by the proposed amendments. Based on a textual search of calendar year 2020 filings, we similarly estimate that approximately 220 companies disclosed share repurchase programs executed under a Rule 10b5-1 plan.<sup>140</sup> Due to a lack of a trade reporting requirement similar to that for officers and directors, we are not aware of data or studies on companies' actual trading under Rule 10b5-1 plans.

Companies also may use Rule 10b5-1 plans for sales of securities. Due to a lack of reporting, we cannot estimate the prevalence of such plans.

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<sup>139</sup> See Alice Bonaimé, Jarrad Harford, and David Moore, Payout Policy Trade-Offs and the Rise of 10b5-1 Preset Repurchase Plans, 66(6) *Management Science*, 2762-2786 (2020). The study does not provide evidence of companies' use of such plans for insider trading through issuer repurchases. The study focuses on such plans being less flexible and representing a stronger pre-commitment than open market repurchases. The study finds that, "[c]onsistent with [such] plans signaling commitment, Rule 10b5-1 repurchase announcements are associated with greater and faster completion rates, with more positive market reactions, and with more dividend substitution than open market repurchases."

<sup>140</sup> The estimate is based on a textual search of calendar year 2020 filings of Forms 10-K, 10-Q, 8-K, as well as amendments and exhibits thereto in Intelligize, using keywords "10b5-1 repurchases" or a combination of keywords "repurchase plan" and "10b5-1". Due to a lack of standardized presentation and the unstructured (*i.e.*, non-machine-readable) nature of the disclosure, this estimate is approximate and may be over- or under-inclusive.

## 2. Benefits

The main benefit of the proposed amendments to Rule 10b5-1(c)(1) is a reduction in the potential for insider trading based on MNPI by officers, directors, and companies (discussed in greater detail in Section IV.A above). Below we discuss how each of the proposed amendments to Rule 10b5-1(c)(1) is expected to reduce such insider trading. Crucially, we expect the proposed provisions to work in tandem to substantially reduce or eliminate insider trading through Rule 10b5-1 plans. In particular, the safeguards provided by the proposed certification requirement are expected to reinforce the effects of the proposed cooling-off periods and the restrictions on multiple overlapping and single-trade plans. The cooling-off period is expected to work in tandem with the exclusion of multiple overlapping plans from Rule 10b5-1(c)(1) in addressing opportunistic plan cancellations based on MNPI. Thus, while we separately discuss below the benefits of each individual provision for reducing insider trading, in combination the proposed amendments should also generate synergies.

As discussed in Section IV.A above, because the Rule 10b5-1(c)(1) affirmative defense is elective, if officers, directors, or companies find the provisions as amended to be overly burdensome, they may elect not to rely on it.<sup>141</sup> To the extent the migration of trading outside of Rule 10b5-1 plans results, in some instances, in an increase, or no change, in the incidence of insider trading, the benefits of the proposed amendments may be attenuated or offset. The magnitude of the described effect would depend on the extent to which other mechanisms (such as legal liability, enforcement actions, listing standards, reputational concerns, as well as corporate governance mechanisms) counteract insider trading incentives and any changes that companies implement to their insider trading policies. Companies may make changes in response

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<sup>141</sup> *But see infra* note 157.

to the proposed disclosure requirements of Item 408 of Regulation S-K, discussed in detail in Section IV.C below.

In the subsections below we discuss the individual benefits of these proposed conditions. In Section IV.B.2.v below, we discuss the proposed amendments as they apply to companies' plans.

#### **i. Cooling-off Period for Officers and Directors<sup>142</sup>**

The Commission is proposing as a condition to the availability of the affirmative defenses under Rule 10b5-1(c)(1) to officers and directors a 120-day cooling-off period before any purchases or sales under the trading arrangement may commence after the date of adoption of a new or modified trading arrangement. The cooling-off period would prevent officers and directors aware of MNPI from being able to trade under the Rule 10b5-1 plan immediately after adopting or modifying such a plan. This would substantially weaken insider incentives to enter or modify Rule 10b5-1 plans based on any MNPI with a horizon that is shorter than the proposed cooling-off period. The 120-day length of the proposed cooling-off period would largely prevent officers and directors from capitalizing on unreleased MNPI for the upcoming quarter.<sup>143</sup> It also is consistent with, or exceeds, several recommendations regarding such cooling-off periods.<sup>144</sup>

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<sup>142</sup> The cooling-off periods proposed for Rule 10b5-1 trading arrangements of issuers are discussed in Sections IV.B.2.v and IV.B.3.v below.

<sup>143</sup> *See, e.g.*, Larcker et al. (2021); *see also supra* note 126 and accompanying text.

<sup>144</sup> *See, e.g.*, Council of Institutional Investors, Request for rulemaking concerning amending Rule 10b5-1 or further interpretive guidance regarding the circumstances under which Rule 10b5-1 trading plans may be adopted, modified, or cancelled, December 28, 2012, at p. 3, *available at* <https://www.sec.gov/rules/petitions/2013/petn4-658.pdf> (recommending a minimum three-month waiting period); Yafit Cohn and Karen Hsu Kelley, Simpson Thacher, Discusses Combating Securities Fraud Allegations With 10b5-1 Trading Plans, August 10, 2017, *available at* <https://clsbluesky.law.columbia.edu/2017/08/10/simpson-thatcher-discusses-combatting-securities-fraud-allegations-with10b5-1-trading-plans/> (recommending that “insiders wait 30 to 90 days before selling stock under the trading plan for the first time”); David B.H. Martin, Keir D. Gumbs, David L. Kornblau, Matthew C. Franker, and Stephanie W. Bignon, Rule 10b5-1 Trading Plans: Avoiding the Heat, Bloomberg BNA Securities

To the extent that MNPI may be time-sensitive, we expect such a cooling-off period to effectively discourage officers and directors from adopting new or modified plans on the basis of MNPI.

Some evidence of the extent to which cooling-off periods could prevent insider trading is presented in Larcker et al. (2021). In that study, approximately 14 percent of insider Rule 10b5-1 plans have the first trade within 30 days of plan adoption, 39 percent within the first 60 days, and 82 percent within 6 months.<sup>145</sup> Shorter periods between plan adoption and first trade are associated with worse returns after the sale, which implies that more insider trading occurs in cases of trading commencing closer to plan adoption.<sup>146</sup>

The proposed 120-day cooling-off period for officer and director Rule 10b5-1 trading arrangements would also help deter trades under a newly adopted or modified plan before the release of that quarter's earnings announcement. Trades under Rule 10b5-1(c)(1) prior to an earnings announcement appear to be more likely to involve insider trading behavior. For example, Larcker et al. (2021) find that "38 percent of plans adopted in a given quarter also execute trades before that quarter's earnings announcement (i.e., in the 1 to 90 days prior to earnings [sic]. . . Sales occurring between the adoption date and earnings announcement are about 25 percent larger than sales occurring more than six months after the earnings announcement . . . plans that execute a trade in the window between when the plan is adopted

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Regulation & Law Report, 45 *SRLR* 438, 2013 (referring to the three-month cooling-off period recommended by the Council of Institutional Investors and stating that "[w]aiting periods of this duration, or those which restrict trading until after issuance of the next regular earnings release, may assist insiders in demonstrating good faith and that trades under a Rule 10b5-1 plan were not designed to take advantage of material nonpublic information."). In a February 10, 2021 letter, Senators Warren, Brown and Van Hollen recommended the Commission consider a four to six-month cooling-off period between adoption, or modification of a plan and commencement or recommencement of trading under the plan.

<sup>145</sup> See Larcker et al. (2021), at p. 2.

<sup>146</sup> *Id.*, at p. 2.

and that quarter's earnings announcement anticipate large losses and foreshadow considerable stock price declines."<sup>147</sup>

The proposed cooling-off periods would apply to directors and Rule 16a-1(f) officers but not to other natural persons. Directors and Rule 16a-1(f) officers (1) are generally more likely to be involved in making or overseeing corporate decisions about whether and when to disclose information; and (2) are generally more likely to be aware of MNPI.<sup>148</sup> Given the significant loss of flexibility associated with a cooling-off period, the proposed approach of exempting natural person insiders that are not officers or directors from the proposed cooling-off period would tailor the application of the additional conditions of the affirmative defense in a way that better balances the additional costs to insiders with the investor protection benefits.

## **ii. Restricting Multiple Overlapping and Single-Trade Rule 10b5-1 Trading Arrangements**

The Commission is proposing as a condition to the affirmative defense to disallow the use of multiple overlapping Rule 10b5-1 plans for open market trades in the same class of securities. This means that an insider or company would not be able to use the affirmative defense of Rule 10b5-1(c)(1) to maintain two or more Rule 10b5-1 plans for open market trades in the same security class. In combination with the proposed cooling-off period, this provision is expected to reduce the likelihood that insiders or companies would enter into multiple, overlapping plans and selectively cancel some of the plans at a later time based on MNPI, while availing themselves of Rule 10b5-1(c)(1)'s affirmative defense.<sup>149</sup> The effects of this provision

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<sup>147</sup> *Id.*, at pp. 2-3.

<sup>148</sup> *See, e.g.*, Mavruk and Seyhun (2016), at p. 179.

<sup>149</sup> As a result, the benefit of strategically canceling an existing plan based on MNPI would be significantly reduced for many insiders or issuers, compared to a scenario in which an insider or issuer has multiple plans without cooling off periods, which is permitted today. Under the proposal, an insider or issuer that cancels a

may be modest to the extent that companies already prohibit multiple Rule 10b5-1 plans,<sup>150</sup> or to the extent that companies may allow a trading plan not reliant on Rule 10b5-1(c)(1) to exist in conjunction with a trading plan reliant on Rule 10b5-1(c)(1).<sup>151</sup>

The proposed unavailability of the affirmative defense for multiple overlapping trading arrangements would not apply to transactions in which directors, officers, or employees acquired or sold for themselves securities as participants in ESOPs or DRIPs. This provision is expected to preserve the benefits of flexibility for participants in such plans. The proposed exclusion of multiple overlapping plans would not apply to trades in different classes of securities. For example, a plan for Class A common stock and an overlapping plan for Class B common stock or for preferred stock would still be eligible for the affirmative defense under the proposed amendments, provided that the other conditions are met. Because different classes of shares can have significantly different cash flow and voting rights, this provision is expected to preserve the benefits of flexibility for those plan participants that seek to implement independent purchase or disposition strategies for different share classes through separate, overlapping plans.

The Commission is also proposing to limit the number of single-trade trading arrangements under the Rule 10b5-1(c)(1) affirmative defense to a maximum of one such trading

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plan would be subject to disclosure obligations, as well as a cooling-off period with respect to any new plan, which makes a strategically planned cancellation significantly less attractive for an insider or issuer that plans to continue trading. As proposed, this cooling-off period could not be effectively shortened or eliminated by having multiple plans with similar or staggered adoption dates, because of the proposed restriction on multiple overlapping plans for open-market trades in the same class of securities.

<sup>150</sup> A 2016 industry survey found that 82 percent of respondents do not allow multiple, overlapping Rule 10b5-1 plans. *See* Defining the Fine Line: Mitigating Risk with 10b5-1 Plans, Morgan Stanley/Shearman & Sterling LLP, available at [https://advisor.morganstanley.com/capitol-wealth-management-group/documents/field/c/ca/capitol-wealth-management-group/Defining the Fine Line Locked Version.pdf](https://advisor.morganstanley.com/capitol-wealth-management-group/documents/field/c/ca/capitol-wealth-management-group/Defining%20the%20Fine%20Line%20Locked%20Version.pdf), *supra* note 120. The data is based on the responses of the surveyed public company members of the Society of Corporate Secretaries and Governance Professionals and may not be representative of other companies.

<sup>151</sup> *But see infra* note 157 and accompanying text. Also, trading under a plan not reliant on Rule 10b5-1 could entail additional legal costs and limitations.

arrangement in the prior 12-month period. This is expected to reduce the likelihood that plan participants would be able to repeatedly profit from “one-off,” ad hoc trades based on previously undisclosed MNPI while availing themselves of the protections of the Rule 10b5-1(c)(1) affirmative defense.<sup>152</sup> The incremental benefit of the proposed limitation may be somewhat attenuated if insiders relying on single-trade plans are largely driven by one-time liquidity needs, or if they are effectively deterred from using MNPI by the cooling-off period or certification and good faith provisions also being proposed. The benefit would also be attenuated to the extent that some multi-trade plans may combine a single trade based on MNPI with additional liquidity trades. Nevertheless, there could be some benefit to limiting the frequency of single-trade arrangements to the extent that some MNPI has a longer horizon than the cooling-off period.

### **iii. Director and Officer Certifications**

The Commission is also proposing certification requirements as a condition of the amended Rule 10b5-1(c)(1) affirmative defense for trading arrangements of officers and directors. The proposed certification requirement would reinforce their awareness of their legal obligations under the federal securities law related to the trading in the issuer’s securities. Thus, the proposed certification requirement is expected to act as a deterrent to insider trading based on MNPI by officers and directors through such plans.

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<sup>152</sup> For instance, some suggestive evidence is presented in Larcker et al. (2021) (finding that, for single-trade plans, share prices decreased following insider sales under Rule 10b5-1). As a caveat, the data does not show the dates of all scheduled trades, only the dates of executed trades. Thus, some “single-trade” plans may be multi-trade plans in progress, or multi-trade plans with all but one trade cancelled. *See also* Milian (2016), *supra* note 129 (finding that sales under Rule 10b5-1 plans with few trades are associated with more negative subsequent returns than sales under plans with more trades). As a caveat, the Milian (2016) study does not specifically compare single-trade to multi-trade plans. Further, the number of trades in the plan is highly correlated with the duration of the plan in the study, giving rise to potential confounding.

#### **iv. Requiring that Trading Arrangements be Operated in Good Faith**

The proposed amendments would expand the good faith provision to specify that all Rule 10b5-1 plans must be operated in good faith, as a condition to the availability of the affirmative defense. The amended good faith requirement is expected to further deter potential insider trading as part of operating such plans, and thus alleviate associated incentive distortions. For instance, by making clear that both the initial entry into the plan as well as the operation of the plan, including the circumstances surrounding any trading under the plan, must be conducted in good faith, the proposed amendment might discourage insiders from improperly influencing the timing and content of disclosure motivated by an attempt to profit from MNPI while a plan is ongoing (one of the economic costs of insider incentive distortions due to insider trading discussed in Section IV.A above).<sup>153</sup> The proposed amendments are expected to benefit investor protection by helping deter fraudulent and manipulative conduct throughout the duration of the trading arrangement.

#### **v. Issuer Trading Arrangements under Rule 10b5-1(c)(1)**

Issuers would be subject to the proposed 30-day cooling-off period; restrictions on single-trade and multiple overlapping Rule 10b5-1 trading arrangements; and the proposed requirement that trading arrangements be operated in good faith. These proposed conditions would apply to trading plans adopted by companies, including, for example, those designed to facilitate repurchasing equity to return cash to shareholders.

Companies' attempts to make use of MNPI through Rule 10b5-1 plans may have economic costs, and limiting such trading may benefit investors and markets.<sup>154</sup> Companies'

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<sup>153</sup> See *supra* note 106 and accompanying and following text.

<sup>154</sup> See Jesse M. Fried, Insider Trading via the Corporation, 162(4) *University of Pennsylvania Law Review*, 801-840 (2014).

efforts to use MNPI can incentivize delays and distortions in disclosure, which exacerbate information asymmetries between companies and outside investors. Discovery of a company's insider trading based on MNPI may lead to reputational costs for companies and decreased confidence of investors in purchasing the shares offered by the issuer. The risk of adverse selection due to trading against an informed trader that is the company itself may discourage uninformed traders from secondary trading in the issuer's shares. Thus, reducing the opportunity for insider trading by companies under Rule 10b5-1(c)(1) may result in benefits for investor protection and capital formation and may promote fair, orderly, and efficient markets.

Several factors make it more difficult to predict with certainty the overall extent of the investor protection benefits of the proposed amendments as they apply to issuers. As noted in Section IV.B.1 above, there are only limited data on trading by companies under Rule 10b5-1 plans. Further, some of the economic effects of issuer trades differ from those of natural person insiders. In particular, insider trading by the issuer may benefit existing shareholders, albeit at the expense of other investors.<sup>155</sup>

### **3. Costs**

The proposed amendments will impose additional conditions on the use of the Rule 10b5-1(c)(1) affirmative defense by insiders and companies. All else equal, the proposed conditions on the use of Rule 10b5-1 plans would make it more complicated for insiders and companies to sell or buy shares under such plans. The proposed conditions that would impose additional barriers to

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<sup>155</sup> In addition, it is somewhat less clear if insider trading by the company will result in corporate investment distortions discussed in Section IV.A; the effect would depend, in large part, on whether the interests of insiders that make the actual corporate decisions are aligned with those of the company in conjunction with such trading (*i.e.*, whether the insider has the same MNPI and either trades in the same direction as the company, or abstains from trading in the opposite direction of the trading by the company based on MNPI). For example, a 2014 article argues that insiders indeed profit from companies' MNPI-based trading. *See* Jesse M. Fried, Insider Trading via the Corporation, 162(4) *University of Pennsylvania Law Review*, 801-840 (2014).

sales of company stock under Rule 10b5-1(c)(1) could result in decreased liquidity of the insider's holdings, including reduced ability to meet unanticipated liquidity needs (such as emergency or unplanned expenses), as well as potential constraints on portfolio rebalancing and achieving optimal portfolio diversification and tax treatment. Greater difficulty of selling shares under Rule 10b5-1 plans would impose illiquidity costs on insiders and potentially reduce the value of their compensation.<sup>156</sup>

In general, the economic costs of the proposed amendments to Rule 10b5-1(c)(1) might be partly mitigated by the voluntary nature of the Rule 10b5-1(c)(1) affirmative defense. However, although Rule 10b5-1(c)(1) is voluntary, some companies' insider trading policies may require officers and directors to rely on Rule 10b5-1.<sup>157</sup> Insiders and companies that find the proposed conditions to be too restrictive might elect not to rely on the affirmative defense for their trading. However, insiders and companies that choose not to rely on Rule 10b5-1(c)(1) in conducting their trading may incur other costs (*e.g.*, additional cost of counsel or other experts to evaluate whether trades conducted pursuant to a plan not reliant on Rule 10b5-1(c)(1) or conducted without a trading plan are compliant with the Exchange Act and Commission regulations, and a potential increase in legal liability risk), as well as the loss of the ability to schedule execution of trades during blackout periods (whereas trades under Rule 10b5-1 plans generally can be executed during blackout periods). The effect of the proposed conditions on the

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<sup>156</sup> See Lisa Meulbroek, The Efficiency of Equity-Linked Compensation: Understanding the Full Cost of Awarding Executive Stock Options, 30 (2) *Financial Management*, 5-44 (2001). See also *infra* note 159 and accompanying and following discussion.

<sup>157</sup> A 2016 industry survey found that 17 percent of surveyed companies required the use of Rule 10b5-1 plans for trading. See *Defining the Fine Line: Mitigating Risk with 10b5-1 Plans*, Morgan Stanley/Shearman & Sterling LLP, available at [https://advisor.morganstanley.com/capitol-wealth-management-group/documents/field/c/ca/capitol-wealth-management-group/Defining\\_the\\_Fine\\_Line\\_Locked\\_Version.pdf](https://advisor.morganstanley.com/capitol-wealth-management-group/documents/field/c/ca/capitol-wealth-management-group/Defining_the_Fine_Line_Locked_Version.pdf), *supra* note 120.

Rule 10b5-1(c)(1) affirmative defense for companies may be less significant because companies may be able to rely on the Rule 10b5-1(c)(2) affirmative defense, which is not available to natural persons.<sup>158</sup> To the extent insiders and companies are not aware of MNPI, they may also elect to trade without a plan outside of a blackout window.

Faced with the additional conditions on the use of Rule 10b5-1 plans, some insiders may seek to reduce holdings of company shares in general (through buying fewer shares, selling shares more quickly when eligible, and negotiating for cash pay in lieu of equity pay), to the extent feasible given companies' share ownership guidelines and compensation policies.<sup>159</sup> The proposed amendments also would make it more difficult for insiders to purchase company shares if they wish to do so under a Rule 10b5-1 plan.<sup>160</sup> Reduced insider equity ownership would in turn tend to reduce incentive alignment between insiders and shareholders (to the extent such incentive alignment existed in the first place and was not undermined by existing agency

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<sup>158</sup> See *supra* note 11.

<sup>159</sup> Compensation committees may continue to award incentive pay even if insiders might prefer to reduce exposure to the company's equity. See, e.g., Darren T. Roulstone, The Relation Between Insider-Trading Restrictions and Executive Compensation, 41(3) *Journal of Accounting Research*, 525-551 (2003) (showing that firms restricting insider trading "use more incentive-based compensation and their insiders hold larger equity incentives relative to firms that do not restrict insider trading"). Companies may also impose share ownership guidelines and holding requirements. See, e.g., Bradley W. Benson, Qin Lian, and Qiming Wang, Stock Ownership Guidelines for CEOs: Do They (Not) Meet Expectations?, 69 *Journal of Banking and Finance*, 52-71 (2016); see also, e.g., Equilar, Executive Stock Ownership Guidelines, March 9, 2016, available at <https://www.equilar.com/reports/34-executive-stock-ownership-guidelines.html> (finding that the percentage of Fortune 100 companies that disclose ownership guidelines or holding requirements in any form was 87.6 percent in 2014); John R. Sinkular and Don Kokoskie, Stock Ownership Guideline Administration, *Harvard Law School Forum on Corporate Governance*, June 11, 2020, available at <https://corpgov.law.harvard.edu/2020/06/11/stock-ownership-guideline-administration/>; NASPP, 5 Trends in Stock Ownership Guidelines, December 15, 2020, available at <https://www.naspp.com/Blog/December-2020/5-Trends-in-Stock-Ownership-Guidelines> (finding that "[e]ighty-five percent of respondents to the 2020 survey currently impose ownership guidelines on executives").

<sup>160</sup> However, the likelihood of choosing a Rule 10b5-1 plan for a purchase is much lower than the likelihood of electing to use Rule 10b5-1(c)(1) for a sale (with the caveats about data availability). One study noted that approximately 2.3 percent of purchases versus 22.4 percent of sales were reported to be undertaken using Rule 10b5-1 plans. See Taylan Mavruk and Nejat H. Seyhun, Do SEC's 10B5-1 Safe Harbor Rules Need to Be Rewritten, *Columbia Business Law Review*, 133-183 (2016).

conflicts discussed in greater detail in Section IV.A above), potentially resulting in less efficient corporate decisions. In some cases, insiders facing illiquidity risk may seek higher total pay to compensate for the trading restrictions.<sup>161</sup> The cost to issuers of potential shifts in executive compensation in response to the proposed conditions (whether in the form of additional compensation for insiders, or changes in compensation structure that weaken insider incentives) would be borne by existing shareholders, who are also the primary beneficiaries of the added protections afforded by these changes.

In the subsections below we discuss the individual costs these conditions could impose on affected plan participants. In Section IV.B.3.v below, we discuss the proposed amendments as they would apply to companies' plans.

#### **i. Cooling-off Period for Officers and Directors**

The proposed 120-day cooling-off period condition for officers and directors would restrict their ability to purchase or sell shares pursuant to a Rule 10b5-1 plan for the duration of the cooling-off-period. As a result of that condition, some insiders may choose not to rely on a Rule 10b5-1 plan for future trading.<sup>162</sup> Insiders that sell shares without relying on a Rule 10b5-1 plan are likely to incur additional costs and limitations. The economic costs of decreased liquidity due to Rule 10b5-1 plan restrictions were discussed in detail in Section IV.B.3 above.

Because trading during the four months following adoption of a Rule 10b5-1 plan appears to be common based on available data summarized in Section IV.B.1 above, the

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<sup>161</sup> See Darren T. Roulstone, The Relation Between Insider-Trading Restrictions and Executive Compensation, 41(3) *Journal of Accounting Research*, 525-551 (2003) (finding that “firms that restrict insider trading pay a premium in total compensation relative to firms not restricting insider trading, after controlling for economic determinants of pay.”); see also M. Todd Henderson, Insider Trading and CEO Pay, 64(2) *Vanderbilt Law Review*, 503-556 (2011) (finding that “executives whose trading freedom increased using Rule 10b5-1 trading plans experienced reductions in other forms of pay to offset the potential gains from trading”).

<sup>162</sup> But see *supra* note 157.

proposed amendments are likely to have an adverse impact on insiders, resulting in the economic costs associated with the decreased ability to trade and, especially, divest holdings, which were described in greater detail in Section IV.B.3 above.<sup>163</sup>

## **ii. Restricting Multiple Overlapping and Single-Trade Rule 10b5-1 Trading Arrangements**

The proposed exclusion from the Rule 10b5-1(c)(1) affirmative defense of multiple overlapping plans for open market trades in the same class of securities would limit the flexibility of insiders in using Rule 10b5-1 plans to purchase or sell their shares. The multiple-plan exclusion might be less restrictive to the extent that insiders can anticipate and combine all planned open-market purchases and sales of securities of the same class into a single plan. The focus of the proposed exclusion on multiple plans for open-market trades is expected to reduce the cost of the proposed requirement for insiders with purchases and sales as part of an ESOP or DRIP, in addition to open-market purchases or sales. The incremental costs of the proposed amendment could be limited to the extent that companies already disallow such plans,<sup>164</sup> or may allow the existence of a trading plan under Rule 10b5-1(c)(1) concurrently with a plan not reliant on Rule 10b5-1(c)(1).<sup>165</sup> While insiders may seek to avoid the costs of the prohibition on multiple Rule 10b5-1 plans by terminating an existing plan and adopting a new plan, the proposed cooling off period would be applicable to the modified plan and thus may result in other costs to insiders.

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<sup>163</sup> See Larcker et al. (2021), *supra* note 118 and accompanying text. A 2016 industry survey examining Rule 10b5-1 plan practices at public companies found that 30 days was the most popular cooling-off period among their respondents (41 percent) and that for 77 percent of the respondents, the cooling-off period was 60 days or less. See *supra* note 120.

<sup>164</sup> For example, see *supra* note 150 and accompanying text (discussing company restrictions on multiple overlapping plans).

<sup>165</sup> See *supra* note 151 and accompanying text.

The proposed limitation on single-trade Rule 10b5-1 plans could make it costlier for insiders with repeated sporadic or ad hoc liquidity needs to divest equity holdings.<sup>166</sup> At the same time, the proposed approach of limiting the number of single-trade Rule 10b5-1 plans in a 12-month period, rather than restricting them entirely, would alleviate costs for insiders with occasional unexpected liquidity needs that seek to avail themselves of the affirmative defense for such a single-trade plan.

### **iii. Officer and Director Certifications**

The Commission is proposing to require as a condition to the affirmative defense that directors and officers must personally certify that they were not aware of MNPI about the security or issuer when adopting a Rule 10b5-1 trading arrangement, including a modified trading arrangement.

The proposed certification condition would result in increased costs for insiders and companies, such as the cost of consulting with legal or other experts to help analyze whether they have material nonpublic information.

Because officers and directors, but especially officers, may often be aware of some MNPI, to the extent that officers and directors perceive the certification requirement as increasing the legal cost of, and legal risk associated with, adopting or modifying a Rule 10b5-1 plan, they may reduce their use of Rule 10b5-1 plans (and, as discussed above, potentially seek other compensation terms with less equity exposure in light of the associated illiquidity costs,

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<sup>166</sup> Single-trade plans appear to be common. Based on Washington Service data from January 2016 – May 2020, Larcker et al. (2021) note that 49 percent of the 10b5-1 plans in their sample cover only a single trade. Using Washington Service data for a more recent period (January 2, 2018-October 19, 2021), we estimate that single-trade plans constitute approximately 40 percent of plans during the time period examined. *See supra* note 119. The caveat about classification of plans as “single-trade” plans in the available data applies. *See supra* note 179.

which may result in additional costs to the company and its shareholders<sup>167</sup>). Relatedly, to the extent that companies view the proposed certification condition as increasing the legal costs and risks to the company of adoption or modification of Rule 10b5-1 plans by officers and directors, they may implement additional restrictions on insider trading under such plans, through insider trading policies and procedures. Both potential effects could result in reduced liquidity of insider holdings of company stock, the economic costs of which were discussed in greater detail in Section IV.B.3 above.

#### **iv. Requiring that Trading Arrangements be Operated in Good Faith**

The proposed amendments specify that a trading plan must be operated in good faith as a condition to the continued availability of the affirmative defense may result in costs to obtain legal counsel and potential loss of the affirmative defense if a plan is not operated in good faith. The legal costs of the proposed amendments' requirement that a Rule 10b5-1 plan be operated in good faith would be incremental to the legal costs that plan participants already incur as a result of the existing provision that requires that a Rule 10b5-1 plan be entered into in good faith.

Because insiders, but especially officers, may often be aware of some MNPI, to the extent that they perceive the amended good faith provision as increasing the legal cost of, and legal risk associated with, adopting a new or modified Rule 10b5-1 plan, they may reduce their reliance on Rule 10b5-1 plans.

#### **v. Issuer Trading Arrangements under Rule 10b5-1(c)(1)**

As discussed above, issuers' trading arrangements under Rule 10b5-1(c)(1) would be subject to some of the proposed additional conditions, including to the proposed restrictions on

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<sup>167</sup> See *supra* note 159 and accompanying and following text.

single-trade and multiple overlapping Rule 10b5-1 trading arrangements; the proposed requirement that trading arrangements be operated in good faith; and a 30-day cooling-off period. To the extent companies do not already follow such conditions as part of their existing best practices,<sup>168</sup> these amendments would result in additional costs to companies of conducting purchases and sales under such plans and could decrease some companies' reliance on Rule 10b5-1 plans. For instance, for companies that rely on such plans to implement issuer repurchases, the costs of the proposed amendments could result in an inefficient decrease in repurchases. Costs incurred by companies could be borne by their existing shareholders.<sup>169</sup> In particular, the proposed 30-day cooling-off period could decrease a company's flexibility in implementing and modifying Rule 10b5-1 plans.

The costs of the amendments to companies could be partly mitigated because companies are not required to rely on Rule 10b5-1 plans. Further, companies that value financial flexibility

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<sup>168</sup> We lack data on the length of cooling-off periods and other terms used in companies' own Rule 10b5-1 plans. For a discussion of Rule 10b5-1 practices related to issuer repurchases, *see, e.g.*, these law firm publications providing suggestions and recommendations of best practices to issuers that use Rule 10b5-1 for repurchases and other trading: Capital Market Alert: Share Repurchases, Skadden, Arps, Slate, Meagher & Flom LLP, March 16, 2020, *available at* <https://www.skadden.com/en/insights/publications/2020/03/share-repurchases> (suggesting, among practice tips, that "companies consider a 'cooling-off' period before any transactions under the Rule 10b5-1 plan will occur" and that "[r]egular transactions over an extended period are preferable to a small number of large transactions" and also noting that while a cooling-off period, for instance, 30 days, is recommended, some companies may begin their purchases within days of adopting a Rule 10b5-1 plan); Robert H. Friedman, Jonathan H. Deblinger, and Kenneth S. Mantel, *Navigating Public Company Equity Buybacks*, 25(12) *Insights: The Corporate & Securities Law Advisor* (2011) (discussing, among others, buybacks under Rule 10b5-1 plans and recommending that issuers "[e]stablish a waiting period for some time after a plan's adoption or modification or suspension during which trading under the plan is not permitted. While not cast in stone, a waiting period of 30 days or more is a reasonable timeframe" and that "issuer[s] should not maintain multiple Rule 10b5-1 plans" and cautioning against plans "that will only last a short period of time"); Stuart Gelfond, Arielle L. Katzman, Frank Fried, Shriver Harris, & Jacobson LLP, *A Guide to Rule 10b5-1 Plans*, March 24, 2016, *available at* <https://corpgov.law.harvard.edu/2016/03/24/a-guide-to-rule-10b5-1-plans/> (suggesting, as a "best practice", that issuers "establish only one 10b5-1 plan" and "establish a waiting period" and also noting that "[b]rokers administering plans frequently impose a seasoning period as part of their own trading practices, but companies also adopt these policies. A fourteen day period is often used, but many companies have increased the waiting period to about one month.").

<sup>169</sup> In the case of repurchases under trading plans, costs incurred by companies would be borne by the subset of existing shareholders that are not selling their shares to the company during the repurchase.

in executing their repurchase programs may be minimally affected by changes to the rule because they might already choose not to rely on such plans today.<sup>170</sup> However, companies that would have otherwise relied on a Rule 10b5-1 plan under current rules might see incrementally greater costs from a choice not to rely on such a plan under the proposed rules. The costs of the proposed amendments to companies may be further mitigated by the availability of the Rule 10b5-1(c)(2) affirmative defense.<sup>171</sup>

#### **4. Effects on Efficiency, Competition, and Capital Formation**

We expect the proposed amendments to reduce the improper use of Rule 10b5-1 plans by insiders with MNPI. This decrease in insider trading should also limit insiders' incentives to engage in inefficient corporate decisions associated with insider trading, which were discussed in Section IV.A above. The effects of the proposed rule on the efficiency of corporate investment and other decisions are not fully certain because the proposed rule may induce insiders to adjust their holdings in response to the reduced liquidity and potentially lead companies to adjust incentive and compensation structure or other policies and practices in response to the rule.

Further, limiting insiders' ability to trade on MNPI would decrease the insiders' incentives to influence the timing and content of corporate disclosures. Timelier and higher-quality corporate disclosures would provide more information to investors, resulting in more

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<sup>170</sup> See *supra* note 139 and accompanying text. In particular, one recent study found that “[i]n 2014 [the latest year analyzed in the study], only 12% of repurchase announcements included an ASR [accelerated stock repurchase] whereas 29% included a 10b5-1 plan. These results are consistent with more firms preferring to maintain some level of flexibility in their repurchase programs.” See Alice Bonaimé, Jarrad Harford, and David Moore, Payout Policy Trade-Offs and the Rise of 10b5-1 Preset Repurchase Plans, 66(6) *Management Science*, 2762-2786 (2020). See also *supra* note 140 and accompanying text (estimating that only approximately 220 companies disclosed share repurchase programs executed under a Rule 10b5-1 plan during calendar year 2020, with the caveat that existing disclosure of such plans is voluntary and may therefore be a low bound).

<sup>171</sup> See *supra* note 11.

informationally efficient share prices in the secondary market and more efficient allocation of investor capital across investment opportunities in their portfolio.

A reduction in insider trading may also benefit market efficiency.<sup>172</sup> Further, a lower risk of trading against an informed insider or company is expected to increase investor confidence and the willingness of market participants to buy, and trade in, the company's shares. This would indirectly make it easier for the company to raise capital from investors.

Finally, the proposed amendments may affect competition. Decreasing the ability of insiders and companies to trade on MNPI would weaken their competitive edge in trading, promoting competition among other investors in the market for the company's shares. A lower risk of an insider with a significant private information advantage trading the company's shares may strengthen the incentive of other market participants to trade the company's shares and compete in gathering and processing information about the company.

All of the effects described above would be weaker to the extent that some officers and directors may switch to trading under non-Rule 10b5-1 plans, or may trade in the absence of a plan. Whether the amendments prompt a large-scale shift of insider trading to non-Rule 10b5-1 plans would depend, in part, on how burdensome insiders find the proposed amendments and in part how company policies constrain insider use of MNPI in non-Rule 10b5-1 plans (including in response to the proposed Item 408 disclosure requirements).

It is not clear if the proposed amendments would result in meaningful competitive effects on the labor market for executive talent. We are not exempting any categories of public companies from the amendments. While the proposed Rule 10b5-1(c)(1) amendments could reduce the liquidity of holding company stock and thereby make equity ownership less attractive

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<sup>172</sup> See *supra* note 109.

for insiders of public companies (as discussed in greater detail in Section IV.B.3 above), even with these additional conditions in place, the use of Rule 10b5-1 plans would remain optional, and holdings of private company shares would remain significantly less liquid.

## **5. Reasonable Alternatives**

In the case of Rule 10b5-1 trading arrangements of natural persons, the proposed cooling-off periods and certification requirements would apply to officers and directors, while the proposed amendments to the good faith provisions and the proposed exclusion of multiple overlapping trading arrangements would apply to all natural persons' plans. As an alternative, with respect to natural persons, we could apply all of the proposed Rule 10b5-1(c)(1) amendments only to officers and directors, or only to officers.<sup>173</sup> Compared to the proposal, these alternatives would eliminate the costs of the rule (discussed in greater detail in Section IV.B.3 above) for the exempted plan participants but increase the risk of insider trading by such participants, compared to the proposal. The latter effects may be smaller to the extent the exempted persons are less involved in making and overseeing corporate decisions or are less likely to be aware of MNPI. As another alternative, with respect to natural persons, we could extend all of the proposed Rule 10b5-1(c)(1) amendments to all plan participants. Compared to the proposal, this alternative would subject additional natural persons to the costs of the rule (discussed in greater detail in Section IV.B.3 above) but also decrease the risk of insider trading by such participants. The latter effects may be smaller to the extent that natural persons other than officers and directors are less involved in making and overseeing corporate decisions, may lack control or knowledge about the timing and substance of the company's disclosures, or are

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<sup>173</sup> With the caveat about data availability, where Rule 10b5-1(c)(1) use is reported, officers are far more likely to report trading under Rule 10b5-1 plans than directors.

less likely to be aware of MNPI. The aggregate effects of all of the discussed alternatives, compared to the proposal, may also be smaller to the extent that Rule 10b5-1 plans tend to be most prevalent among officers.

The proposed amendments to Rule 10b5-1(c)(1) would subject Rule 10b5-1 trading arrangements of issuers to a 30-day cooling-off period, amended good faith provisions, and restrictions on single-trade and multiple overlapping Rule 10b5-1 trading arrangements. As an alternative, we could exempt issuer plans from some or all of these proposed conditions, or modify some or all of these conditions for issuers (*e.g.*, subjecting issuers to a shorter or longer cooling-off period). Compared to the proposal, a greater (smaller) number of companies might continue to find Rule 10b5-1 plans attractive for purchases and sales of securities under the alternative of less (more) stringent conditions of the affirmative defense. However, the alternative of imposing less (more) stringent conditions on issuer plans would result in a greater (lower) risk of companies adopting or modifying Rule 10b5-1 plans based on MNPI, compared to the proposal. To the extent that issuers already avail themselves of the affirmative defense under Rule 10b5-1(c)(2), which does not contain such conditions, the incremental effects of such alternatives, compared to the proposal, may be smaller. (For a more detailed discussion of the potential benefits and costs of extending the proposed amendments to issuers, see Sections IV.B.2.v and IV.B.3.v above.)

The Commission is proposing to amend Rule 10b5-1(c)(1) by adding new conditions to the affirmative defense. As an alternative, we could rescind the Rule 10b5-1(c)(1) affirmative defense altogether. Rescinding Rule 10b5-1(c)(1) would increase the costs for existing Rule 10b5-1 plan participants (such as in the form of the additional cost of legal counsel to determine whether trading arrangements, or trades not reliant on a trading arrangement, are compliant with

the Exchange Act in the absence of the Rule 10b5-1(c)(1) affirmative defense). The associated costs of divesting stock in the absence of the affirmative defense would make insiders' holdings of stock less liquid and could further induce insiders to negotiate non-stock-based compensation.<sup>174</sup> Rescinding the Rule 10b5-1(c)(1) affirmative defense would also increase the legal liability risk for insiders that continue to trade due to greater uncertainty about whether they have complied with Rule 10b-5, as well as subject insiders to additional limitations on trading (such as restrictions on trading during blackout periods). Further, while rescinding Rule 10b5-1(c)(1) would eliminate Rule 10b5-1 plans, it would not affect the use of other trading arrangements by officers, directors, and companies. The potential shift of trading from Rule 10b5-1 plans, which contain conditions specifically tailored for investor protection, to other trading arrangements or trading outside of plans might lead to an increase in insider trading, and a negative impact on investor protection, compared to the proposal. From the companies' standpoint, the continued existence of Rule 10b5-1(c)(1) may facilitate companies' efforts to develop and implement corporate governance practices for issuer and insider trading arrangements that comply with securities laws and regulations. We expect the proposed Item 408 disclosure requirements, discussed in detail in Section IV.C below, to partly mitigate incentives to engage in insider trading under all plans, including plans that are not reliant on Rule 10b5-1(c)(1) under this alternative.

As discussed above, the proposed amendments to Rule 10b5-1(c)(1) include several new conditions of the affirmative defense (cooling-off periods, amended good faith requirements, exclusion of multiple overlapping plans for open market trades in the same class of securities, and officer and director certifications). As an alternative, we could propose to impose some, but

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<sup>174</sup> See *supra* note 159 and accompanying and following text.

not all, of these additional conditions. This alternative could possibly lower the aggregate costs of the rule and preserve greater flexibility, compared to the proposal, decreasing the costs discussed in the case of each of the specific provisions. However, this alternative would make the combined set of proposed amendments less effective at curbing insider trading behavior under Rule 10b5-1.

The Commission is proposing a 120-day cooling-off period for officers and directors, and a 30-day cooling-off period for issuers, after the adoption of a new or modified plan. As an alternative to the proposed cooling-off period for officers and directors, the Commission could propose a shorter cooling-off period (*e.g.*, between one and three months), a longer cooling-off period (*e.g.*, five or six months), or a variable time period until the next quarterly or annual report filing or earnings release).<sup>175</sup> As an alternative to the proposed 30-day cooling-off period for issuers, the Commission could propose a shorter or longer cooling-off period. A shorter cooling-off period could reduce some of the costs of a cooling-off period and preserve greater flexibility for insiders and issuers, compared to the proposal, but would increase the risk of trading based on MNPI. Conversely, a longer cooling-off period could increase costs to insiders and issuers and limit flexibility, compared to the proposal, but would decrease the risk of trading based on MNPI. A more detailed discussion of the costs and benefits of a cooling-off period that would be magnified or reduced, respectively, under these alternatives is included in Sections IV.B.2.i, IV.B.2.v, IV.C.2.i, and IV.C.2.v. The discussed effects of the alternatives would also depend on whether they differ from the existing cooling-off period practices.<sup>176</sup>

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<sup>175</sup> See *supra* note 144 (discussing suggestions for three-month and four- to six-month cooling-off periods); see also *supra* note 120 and following text (noting that at over three-quarters of surveyed respondents, the cooling-off period was 60 days or less).

<sup>176</sup> See *supra* notes 118-120 and accompanying and preceding text and *supra* note 168.

The proposed amendments would make the affirmative defense unavailable for multiple overlapping Rule 10b5-1 trading arrangements for open market trades in the same class of securities. As an alternative, we could allow multiple plans but limit their number (*e.g.*, to two or three), limit the provisions to no more than one plan pertaining to purchases and one plan pertaining to sales, or provide other exceptions. These alternatives could preserve greater flexibility, compared to the proposal, and lower costs for plan participants that have multiple accounts through which they trade in the company stock. However, these alternatives would present a greater risk of illegal insider trading, compared to the proposal (to the extent not mitigated by other proposed provisions, including certifications, amended good faith requirement, cooling-off periods, and amended disclosure requirements). In particular, the option to maintain multiple plans concurrently facilitates the ability to selectively cancel one of the plans based on material nonpublic information, without being subject to a waiting period with respect to the remaining plans' trades. This alternative may be less significant to the extent that companies already disallow, or avoid, multiple overlapping plans voluntarily,<sup>177</sup> or to the extent that companies may allow, or have, a trading plan not reliant on Rule 10b5-1(c)(1) to exist in conjunction with a trading plan reliant on Rule 10b5-1(c)(1).<sup>178</sup>

The proposed amendments would also limit the availability of the affirmative defense in the case of single-trade Rule 10b5-1 plans to a maximum of one such plan in a 12-month period. As another alternative, we could restrict the use of single-trade plans under Rule 10b5-1(c)(1) entirely, or conversely, allow a greater number of single-trade plans in a 12-month period. The alternative of more (less) stringent restrictions on single-trade plans could reduce (increase) the

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<sup>177</sup> See *supra* note 150 and accompanying text and *supra* note 168.

<sup>178</sup> See *supra* note 151 and accompanying text.

risk of insider trading, compared to the proposal (to the extent not mitigated by the cooling-off period and other proposed provisions). Unlike in the case of a multi-trade plan, an insider who decides to initiate a single-trade Rule 10b5-1 plan based on MNPI is more likely to be able to execute it with less price impact and not to have to disclose the trade on Form 4 (and, depending on the timing of plan adoption and Form 10-Q/10-K filing, not to have to disclose the plan adoption) until after the plan is fully executed.<sup>179</sup> In turn, the alternatives of more (less) stringent restrictions on single-trade plans could also limit (expand) the flexibility and impose additional costs on insiders with a one-time, ad hoc liquidity need, compared to the proposal.<sup>180</sup>

## **6. Request for Comment**

45. Would the proposed amendments to the conditions of Rule 10b5-1(c)(1) benefit investors? In what specific ways would the proposed amendments help protect investor interests?
46. What would be the costs of the proposed amendments to Rule 10b5-1(c)(1) for insiders, companies, and investors?
47. Would the proposed amendments affect the use of Rule 10b5-1 plans, and if so, how?
48. How often are Rule 10b5-1 plans used today for purchases and sales of securities? How often are Rule 10b5-1 plans used by natural persons other than officers (*e.g.*, directors, beneficial owners, non-executive employees)? How prevalent are concerns about insider trading under Rule 10b5-1 plans? Which traders raise the most significant concerns (*e.g.*, officers, directors, others)?
49. How often do companies impose cooling-off periods on Rule 10b5-1 plans today? What cooling-off period length is most common today? Would the proposed 120-day minimum

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<sup>179</sup> See *supra* note 152.

<sup>180</sup> See *supra* note 166.

- cooling-off period for Rule 10b5-1 plans of officers and directors benefit investors? What would be the costs of the proposed cooling-off periods? Should we consider alternative cooling-off period lengths or definitions, and what would be their costs and benefits?
50. Are there other provisions we should consider instead of cooling-off periods, to more effectively address insider trading through Rule 10b5-1 plans, and what would be the economic effects of such alternative provisions?
51. What other practices and policies are used today to mitigate insider use of material nonpublic information for trading through trading plans?
52. What would be the economic effects of the proposed restriction on multiple overlapping Rule 10b5-1 plans? What would be the costs and benefits of the proposed limit on the number of single-trade Rule 10b5-1 plans in a 12-month period? Would these provisions appropriately balance concerns about the use of multiple overlapping plans and insiders' liquidity needs? Should we consider alternative restrictions, and what would be the benefits and cost of those alternatives?
53. Would the proposed director and officer certification requirements with respect to Rule 10b5-1 plans serve to protect investors and deter insider trading under such plans? What would be the costs of the proposed certification requirements? What challenges might insiders face in complying with the proposed requirements?
54. Would the amended good faith requirement of Rule 10b5-1(c)(1) serve to protect investors from insider trading through Rule 10b5-1 plans? What would be the costs of the amended good faith requirement?
55. How often do companies themselves rely on Rule 10b5-1 plans today to purchase securities and to sell securities, respectively? How often do companies that rely on Rule 10b5-1 plans

disclose such plans? How prevalent are concerns about insider trading under Rule 10b5-1(c)(1) by companies?

56. Would applying the proposed 30-day cooling-off period, the proposed amendments to the good faith provision, and the proposed exclusion of multiple trading plans to companies benefit investors? What would be the costs of the proposed amendments for companies that rely on Rule 10b5-1 plans and their shareholders? What would be the economic effects of exempting companies from some of the proposed conditions, or modifying some of the proposed conditions in cases of companies' Rule 10b5-1 plans? For example, what would be the costs and benefits of exempting companies from the cooling-off period requirement, or applying a shorter or longer cooling-off period to companies' Rule 10b5-1 plans? How would issuer ability to rely on Rule 10b5-1(c)(2) change these economic effects?

#### **C. Disclosure of Trading Arrangements in New Item 408 of Regulation S-K and Mandatory Rule 10b5-1 Checkbox in Amended Forms 4 and 5**

The proposed new Item 408 of Regulation S-K would require quarterly disclosure, on Form 10-Q and Form 10-K (with respect to a company's fourth quarter), of the adoption or termination, and the terms of a Rule 10b5-1 trading arrangement or other preplanned trading arrangement by directors, Rule 16a-1(f) officers, and the company itself. Proposed Item 408 would also require disclosure in Form 10-K and proxy or information statements of policies and procedures governing trading by directors, officers, and employees and the issuer itself (as discussed in greater detail in Section II.B above). A similar requirement with respect to disclosure of policies and procedures would extend to foreign private issuers that file annual

reports on Form 20-F.<sup>181</sup> The proposed disclosures would be tagged using a structured data language (specifically, Inline XBRL). In addition, the proposed amendments would add a Rule 10b5-1 checkbox as a mandatory disclosure requirement on Forms 4 and 5 to indicate that a reported transaction was made pursuant to a Rule 10b5-1 trading arrangement, and disclosure of the date of adoption of the trading plan. We are also proposing to add an optional checkbox to Forms 4 and 5 that would allow a filer to indicate whether a transaction reported on the form was made pursuant to a contract, instruction, or written plan that did not satisfy the conditions of Rule 10b5-1(c).

### **1. Baseline and Affected Parties**

The proposed Item 408(a) disclosure requirements regarding the adoption, modification, termination, and material terms of officer, director, and company trading plans would apply to annual and quarterly reports on Forms 10-K and 10-Q. During calendar year 2020, based on the analysis of EDGAR filings, we estimate that there were approximately 6,400 filers with annual reports on Form 10-K or quarterly reports on Form 10-Q or amendments to it.<sup>182</sup> The proposed Item 408(b) disclosure requirements regarding insider trading policies and procedures would apply to annual reports on Forms 10-K and proxy and information statements on Schedules 14A and 14C. Disclosure requirements similar to proposed Item 408(b) would also apply to foreign private issuers that file Form 20-F. During calendar year 2020, based on the analysis of EDGAR filings, we estimate that there were approximately 5,900 filers of annual reports on Form 10-K

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<sup>181</sup> The discussion in this section referring to Item 408(b) also extends to the economic effects of related amendments to Form 20-F that apply similar requirements to Form 20-F filers.

<sup>182</sup> The estimate excludes registered investment companies and asset-backed securities issuers, which would not be subject to the proposed disclosures.

or proxy or information statements, or amendments to them, and, in addition, approximately 700 filers of annual reports on Form 20-F (or amendments to them).<sup>183</sup>

The proposed requirements regarding the disclosure of trading plans will affect all companies that have their own trading plans or whose officers or directors have trading plans, as well as, indirectly, all officers and directors with trading plans whose plans would now be subject to public disclosure by the company (see Section IV.B.1 above).

The proposed requirements regarding disclosure of insider trading policies and procedures would affect companies subject to the requirements, as well as indirectly, companies and natural persons that engage in trading subject to the disclosed policies and procedures.

The proposed Rule 10b5-1 checkbox requirement would apply to all filers of Forms 4 and 5 (not just officers and directors). During calendar year 2020, we estimate that there were approximately 44,000 such filers.<sup>184</sup>

## **2. Benefits**

The proposed Item 408 of Regulation S-K and related disclosure amendments would benefit investors through greater transparency about officer, director, and issuer trading arrangements, as well as governance practices with respect to insider trading.<sup>185</sup> The timing of trading plan adoption and termination by officers, directors, or the company itself, as well as a description of the terms of the trading arrangement, would enhance the value of existing trade disclosures, potentially conveying valuable information about the insiders' or the company's

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<sup>183</sup> Id.

<sup>184</sup> The estimate is based on filings of Forms 4 and 5 during calendar year 2020 in Thomson Reuters / Refinitiv insiders dataset.

<sup>185</sup> See also Section IV.A.

views on the company's future outlook, aiding investors in obtaining a more accurate valuation of the company's shares and making more informed investment decisions.

The proposed requirement that these data points be tagged in a structured data language (specifically, in Inline XBRL) would facilitate access and analysis of the disclosures by investors, potentially leading to more useful and timely insights. In particular, structuring the disclosures about trading plans that would be required under Item 408(a) of Regulation S-K would enable automated extraction of granular data on such trading plans, which would allow investors to efficiently perform large-scale analyses and comparisons of trading plans across issuers and time periods. Structured data on trading plans could also be efficiently combined with other information that is available in a structured data language in corporate filings (*e.g.*, information on insider sales and purchases of securities) and with market data contained in external machine-readable databases (*e.g.*, information on daily share prices and trading volume). The use of a structured data language could also enable considerably faster analysis of the disclosed data by investors. For the narrative disclosure on policies and procedures that would be required under Item 408(b) of Regulation S-K, structuring the disclosures in Inline XBRL would allow investors to extract information from and search through the disclosures about trading plan policies and procedures (rather than having to manually run searches for these disclosures through entire documents), automatically compare these disclosures against prior periods, and perform targeted artificial intelligence and machine learning assessments (tonality, sentiment, risk words, etc.) of specific narrative disclosures about trading plan policies and procedures rather than the entire unstructured document.

We expect these benefits to result from disclosure of plan terminations and changes in material plan terms, as well as from disclosure of plan adoptions, because a termination, or a

change in material terms, of a prior trading plan may similarly convey information about the views of the officers, directors, or the issuer regarding the company's future outlook and share price. Further, the timing of trading plan adoption or termination, relative to the issuance of other corporate disclosures, would provide investors with valuable insight into potential insider trading under such plans, and thus associated conflicts of interest that erode firm value. We expect such benefits to extend to all trading arrangements, including ones that are not reliant on Rule 10b5-1(c)(1), which also are within the scope of the proposed new Item 408 and related disclosure amendments. This would be particularly beneficial in instances where issuers, officers, or directors forgo reliance on Rule 10b5-1(c)(1) under the proposed amendments or fail to meet one of the proposed amended conditions of the affirmative defense. Moreover, by drawing market scrutiny to the adoption, termination, and changes in the terms of trading plans, enhanced trading plan disclosure is expected to deter insider abuses of trading arrangements based on MNPI. This would benefit investors by reducing insider trading, as well as reducing the economic costs and inefficiencies associated with insider trading, as discussed in Section IV.A above. The described benefits would be lowered or eliminated to the extent that trading plans are initiated due to liquidity needs or other reasons not related to the company's or insider's outlook on future share price.

The proposed additional disclosure of insider trading policies and procedures is expected to provide investors with valuable information about governance practices with respect to insider trading of company stock. This requirement will allow investors to better understand the policies and procedures that guide companies in which they invest and the conduct of officers and directors of those companies, including whether and how issuers adopt standards that are reasonably necessary to promote (i) honest and ethical conduct, including the handling of

conflicts of interest, (ii) full, fair, and accurate disclosure in periodic reports, including the potential mitigation of pricing distortions from insider trading, and (iii) compliance with applicable government rules and regulations, including the prohibition on insider trading.<sup>186</sup> The absence or presence, and the nature of, such policies and practices can inform investors about the likelihood of insider use of MNPI and thus, the likelihood of incurring the economic costs of insider trading discussed in Section IV.A above. It will help investors better understand how issuers protect their confidential information—which “qualifies as property to which the company has a right of exclusive of use”—as well as guard against the misappropriation of that information.<sup>187</sup> The disclosure of insider trading policies and procedures could also aid shareholders’ voting decisions. Requiring the disclosure would also provide greater consistency in disclosures across companies. In addition, the anticipation of market scrutiny following mandatory disclosure may incentivize companies without specific insider trading policies to implement such policies and procedures. Such revisions to insider trading policies are in turn expected to reduce the likelihood of insider trading, and the associated economic costs discussed in Section IV.A above, particularly at companies with weaker governance practices with respect to insider trading.

The proposed amendments adding a Rule 10b5-1 plan checkbox to Forms 4 and 5 would benefit investors by providing transaction-specific disclosure of sales and purchases under Rule 10b5-1 plans. The proposed checkbox disclosure would allow investors easier and timelier access to information about trades under Rule 10b5-1(c)(1). This information would enable investors to more comprehensively identify insider trading pursuant to Rule 10b5-1 plans, as

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<sup>186</sup> See 15 U.S.C. 7264(c).

<sup>187</sup> *O’Hagan*, 521 U.S. at 654 (recognizing that the undisclosed misappropriation of MNPI in breach of a duty of trust and confidence is “akin to embezzlement”).

well as provide greater consistency in the disclosure of Rule 10b5-1 plan trades. Today, the disclosure of a purchase or sale under a Rule 10b5-1 trading arrangement in Forms 4 and 5 is voluntary, resulting in a lack of consistent and comprehensive information about trades. To the extent that trades under Rule 10b5-1(c)(1) are subject to a different regulatory framework and may have different motivations than other insider trades, the checkbox would allow investors to more readily interpret information in Forms 4 and 5.

The proposed mandatory Rule 10b5-1 plan checkbox disclosures, in combination with the proposed quarterly disclosure of adoption, modification, termination, and material terms of trading plans, would provide greater transparency to investors regarding the use of Rule 10b5-1 plans for trading. Such information about insider trading would provide investors with valuable context for interpreting other corporate disclosures in valuing the companies' shares and making informed investment decisions. Because Forms 4 and 5 would continue to use a structured data language, investors would be able to extract and analyze comprehensive information about insider trades under Rule 10b5-1 plans across multiple time periods, individuals, and companies.

### **3. Costs**

First, we consider the direct (compliance-related) costs of the proposed disclosure requirements for insiders and companies. Such costs would include preparing the disclosure and gathering the information required to comply with the new disclosure requirements. Such costs would be lower for companies that already disclose some information about insider and issuer trading plans or insider trading policies today. Insiders are likely to have information about which of their trades were executed pursuant to a Rule 10b5-1 plan readily available, likely resulting only in small direct costs of providing a checkbox disclosure on Forms 4 and 5. The

costs of complying with the new checkbox requirement would be lowest for officers and directors that already voluntarily disclose Rule 10b5-1 plan use in their filings of Forms 4 and 5.

Officers and directors will have information about the adoption, modification, termination, and terms of their trading plans readily available. Similarly, companies will have information about the adoption, modification, termination, and material terms of their own trading plans readily available. However, companies might not currently be collecting such information from officers and directors as part of their existing disclosure obligations, especially with respect to plans that do not rely on Rule 10b5-1(c)(1). In those cases, companies and officers and directors may have to expend additional effort to collect this information about the trading plans of directors and officers and prepare it for disclosure under proposed Item 408(a).

Companies will have information about their insider trading policies and procedures readily available. Identifying and preparing a disclosure of such policies (and for companies without a specific policy, the reasons for not having such a policy) is expected to result in some additional direct costs, however, such costs are likely to be relatively small.

The proposed requirement to tag the proposed disclosures in Inline XBRL will impose incremental compliance costs on issuers. Such costs are expected to be modest, because issuers affected by the proposed Inline XBRL requirements (including small filers) are already required (or, in the case of business development companies, would be required no later than February 2023) to use Inline XBRL to comply with other disclosure obligations.<sup>188</sup> Moreover, the scope of the disclosure proposed to be reported using a structured data language is limited and would thus likely require a relatively narrow in scope taxonomy of additional tags (compared to the

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<sup>188</sup> See *Inline XBRL Filing of Tagged Data*, Release No. 33-10514 (June 28, 2018) [83 FR 40846, 40847 (Aug. 16, 2018)]; *Securities Offering Reform for Closed-End Investment Companies*, Release No. 33-10771 (Apr. 8, 2020) [85 FR 33290 (Jun. 1, 2020) at 33318].

significantly more extensive taxonomies used for financial statement disclosure tagging requirements), thus limiting the initial and ongoing costs of complying with the proposed tagging requirement.

Next, we discuss the indirect costs that the proposed Item 408 and related disclosure amendments could impose on insiders and companies. Indirect costs could include potential reputational and investor relations costs associated with the disclosure. For example, companies that have not implemented specific insider trading policies and procedures, as well as companies at which the adoption, modification, or termination of trading plans appear to correlate to the release of MNPI, may experience reputational and legal costs and a weakening of investor confidence in their corporate governance after public disclosure of this information. To the extent that the proposed amendments to Rule 10b5-1(c)(1) eliminate or deter insider trading based on MNPI under Rule 10b5-1 trading arrangements, these legal and reputational costs of public disclosure should be minimal for such plans. Relatedly, officers and directors that adopt, modify, or terminate trading plans around the release of MNPI may also suffer reputational or legal costs from the public disclosure of this information.

In the case of issuers conducting repurchases, the quarterly disclosure of trading plans could in some circumstances result in another type of indirect cost—the cost of potential partial revelation of the issuer’s future repurchase plans (including potential timing and scale of future trades) to other market participants, which may be further exacerbated if we were to adopt the daily disclosure requirement for share repurchases that we are proposing in a separate release.<sup>189</sup> Issuers that continue to rely on Rule 10b5-1(c)(1) to conduct repurchases might be able to

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<sup>189</sup> See *Share Repurchase Disclosure Modernization*, Release No. 34-93783 (Dec. 15, 2021).

mitigate such costs by structuring their repurchases under a Rule 10b5-1 plan to have a less predictable pattern of trades.<sup>190</sup>

Finally, some companies may implement new insider trading policies, or update existing insider trading policies, in anticipation of the proposed disclosure requirement regarding policies and procedures and the ensuing public scrutiny of disclosed policies and procedures. Additional restrictions on insider trading arrangements adopted in anticipation of the public disclosure could result in economic costs for insiders and in some instances, offsetting changes in insider compensation and insider efforts to reduce their equity exposure in light of the trading restrictions (broadly in line with the discussion of the potential indirect costs of restrictions on insider use of trading arrangements in Section IV.B.3 above). Costs incurred by companies would be borne by their existing shareholders.

#### **4. Effects on Efficiency, Competition, and Capital Formation**

We expect the proposed amendments to reduce the information asymmetry between insiders and outside investors by providing more granular and timelier detail about officers', directors', and companies' trading plans and associated policies. The reduction in information asymmetry as a result of the additional disclosure would result in more informationally efficient stock prices. Because disclosure of insider and issuer trading plans and insider trading policies can inform investors about insider incentives and governance practices, which could affect shareholder value as discussed in Section IV.A above, the proposed additional disclosure about

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<sup>190</sup> This approach of less predictable issuer purchases (such as an algorithm-based plan or another plan other than a series of equally-spaced, similar-sized trades) may emerge organically in cases where the front-running costs are likely to be highest, for example, when an issuer's management is repurchasing shares based on the belief that the company is undervalued. In other cases, for example, when issuer share purchases are intended to incrementally adjust capital structure or pay out excess cash, rather than reflect a belief about significant undervaluation, an issuer may opt for a mechanical rule with equally spaced, similar-sized trades. While such a trade pattern is more predictable to market participants, it may also be more likely to be chosen in instances of repurchases for which concerns about front-running the issuer's information may be relatively less significant.

insider and issuer trading arrangements and insider trading policies could also better inform investment decisions (enabling more efficient allocation of capital in investor portfolios) and shareholder voting decisions.

Importantly, we expect the proposed amendments to draw market scrutiny to officers', directors', and companies' use of Rule 10b5-1(c)(1) or other trading arrangements, decreasing the ability of insiders and companies to trade on MNPI through such trading arrangements. As discussed in Section IV.B.4 above, this should reduce insiders' incentive conflicts associated with insider trading. In particular, it would decrease incentives for inefficient corporate investment decisions and other corporate decisions. Further, it would decrease insiders' incentives to influence corporate disclosures, resulting in timelier and higher-quality disclosures (that enable more informationally efficient share prices and more efficient allocation of capital in investor portfolios).

A lower risk of trading against an informed insider is expected to increase investor confidence and the willingness of market participants to buy, and trade in, the company's shares. This would indirectly make it easier for the company to raise capital from investors. Companies that disclose robust insider trading policies in particular may elicit greater investor confidence, as well as interest from investors seeking companies with stronger corporate governance practices, resulting in capital formation benefits for such companies.

Finally, in line with the discussion in Section IV.B.4 above, the proposed amendments may affect competition. Decreasing the ability of insiders and companies to trade on MNPI would weaken their competitive edge in trading, promoting competition among other investors in the market for the company's shares. As discussed above, a lower risk of an insider with a significant private information advantage trading the company's shares would strengthen the

incentive of other market participants to trade the company's shares and compete in gathering and processing information about the company.

To the extent that the proposed disclosure requirements impose a fixed cost on companies, they would have a negative competitive effect on smaller issuers subject to the amendments, as well as on issuers that do not already disclose insider trading policies and trading arrangements. The proposed Item 408(a) disclosure requirements would not apply to foreign private issuers, potentially placing them at a relative competitive advantage to domestic filers.<sup>191</sup> With that exception, because the proposed disclosure amendments would apply broadly across domestic public companies, generally, we do not anticipate it to result in meaningful competitive disparities in the labor market for executive talent.<sup>192</sup>

All of the effects described above would be smaller to the extent that companies already disclose insider trading policies and trading arrangements today.

## **5. Reasonable Alternatives**

The proposed amendments would require quarterly disclosure of adoption, modification, termination, and a description of the terms of the trading arrangement of directors, Rule 16a-1(f) officers, and companies, as well as disclosure of insider trading policies and procedures in annual reports and proxy and information statements. As an alternative, we could modify the scope and granularity of the proposed disclosure of trading plans and / or of insider trading policies and procedures. The alternatives of expanding or narrowing the scope of the proposed disclosures

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<sup>191</sup> Foreign private issuers that file annual reports on Form 20-F would be subject to requirements similar to Item 408(b), as proposed. Further, foreign private issuers listed on U.S. exchanges would remain subject to insider trading laws and exchange listing standards.

<sup>192</sup> We do not expect significant effects on the labor market competition for executive talent between public and private companies. While the proposed disclosures would increase costs for public companies and, indirectly, their officers and directors, these amendments are likely to have only a marginal effect on the overall tradeoff of being an officer or director at a public company (including the liability risk and costs of public scrutiny of the insider's holdings, trades, and other actions).

could potentially provide greater or lesser detail to investors, enabling better or less informed investment decisions and more or less accurate assessment of the risk of the use of MNPI for informed trading through trading plans, compared to the proposal. However, the alternative of expanding or narrowing the scope of the proposed disclosure could also increase or decrease disclosure costs (discussed in greater detail in Section IV.C.3 above).

As another alternative to the proposed quarterly disclosure of adoption, termination, and the terms of trading arrangements, we could require more or less frequent disclosure. Requiring more or less frequent disclosure under Item 408(a) would provide timelier (or less timely) information to investors about trading arrangements but also impose higher (or lower) costs on companies and insiders. A more detailed discussion of the benefits and costs of the Item 408(a) disclosure is included in Sections IV.C.2 and IV.C.3 above.

As another alternative to the proposed quarterly disclosure, we could narrow its scope to Rule 10b5-1 plans. Under this alternative, issuers and officers and directors with trading arrangements not reliant on Rule 10b5-1(c)(1) would not incur costs of the amendments. However, investors would receive less information about insider trading arrangements, compared to the proposal. This effect on investors would be more pronounced if some issuers or insiders switch from Rule 10b5-1 plans to other trading arrangements.

The proposed amendments would require the quarterly disclosures regarding trading arrangements and the annual disclosures regarding policies and procedures to be tagged using a structured data language (specifically, Inline XBRL). Alternatively, we could change the scope of the tagging requirement, such as by narrowing the requirement to cover only quarterly disclosures required under proposed Item 408(a). This alternative would provide incremental compliance cost savings for filers, who would not be required to select, apply, and review Inline

XBRL tags for the annual report and proxy and information statement disclosures regarding insider trading policies and procedures, although such cost savings would likely be low given the limited number of Inline XBRL tags that are expected to be needed to tag the proposed disclosures. This alternative would also remove the informational benefits to investors that would accrue from facilitating retrieval of issuers' policies and procedures disclosures and comparing such disclosures across issuers and time periods, compared to the proposal.

As proposed, the disclosure requirement regarding trading arrangements would only apply to domestic filers. The disclosure requirement regarding insider trading policies and procedures would apply to domestic filers and to Form 20-F filers. As an alternative, we could exempt Form 20-F filers from the policies and procedures disclosure requirement. As another alternative, we could extend the disclosure requirement regarding trading arrangements to Form 20-F filers. Generally speaking, exempting Form 20-F filers from the scope of the proposed disclosure requirements would prevent such foreign private issuers from incurring the direct and indirect costs of the rule (as described in detail in Section IV.C.3 above). Exempting Form 20-F filers also would decrease the amount of information available to investors about the insider trading incentives and policies at such issuers, potentially limiting investor ability to make informed decisions with respect to such issuers. Exempting Form 20-F filers also could lead to incrementally greater competitive disparities due to the higher compliance burden of domestic issuers with respect to this requirement. Because foreign private issuers that file annual reports on Form 20-F do not have a quarterly reporting obligation equivalent to a Form 10-Q, the incremental benefit of the alternative of extending requirements similar to Item 408(a) to Form 20-F filers could be relatively more modest (due to the less timely disclosure of information on trading arrangements, if it were required to be disclosed in annual reports).

The proposed amendments to Forms 4 and 5 (a mandatory Rule 10b5-1 checkbox and the date of plan adoption) would require disclosure only with respect to Rule 10b5-1 trading arrangements. The date of trading plan adoption and the fact that the trade is conducted under a trading plan would not be required to be disclosed for plans that do not rely on Rule 10b5-1(c)(1) but could be disclosed voluntarily at the option of the filer. As an alternative, we could require disclosure of reliance on a non-Rule 10b5-1 plan and the date of adoption of such a plan. This alternative could provide investors with more comprehensive information about insider trades under trading arrangements. Combined with the proposed Item 408 disclosures about officer and director trading arrangements (including ones not reliant on Rule 10b5-1), it also could enable greater transparency into whether insider trading is occurring under other trading plans, and potentially deter such trading. To the extent that trading arrangements that do not use Rule 10b5-1 can take a wide variety of forms, requiring trades under such trading arrangements to be identified on Forms 4 and 5 separately from other insider trades conducted without a trading arrangement would likely be less meaningful to investors.

## **6. Request for Comment**

57. What are the economic effects of the proposed Item 408 disclosures? Would the proposed disclosures benefit investors, such as by providing additional information to investors or by limiting potential use of MNPI for trading through trading plans?
58. What would be the costs of the proposed Item 408 disclosures?
59. What are the economic effects of applying the proposed Item 408 disclosure requirements regarding plan adoption, modification, termination, and material terms to all trading plans (including both ones that rely and ones that do not rely on Rule 10b-1), as proposed?

60. What are the benefits and costs of the proposed quarterly disclosure regarding plan adoption, modification, termination, and material terms? What are the benefits and costs of alternative reporting requirements or frequencies?
61. What are the economic effects of the proposed Item 408 requirement to disclose the issuer's insider trading policies and procedures governing the purchase, sale, and other dispositions of the registrant's securities on Form 10-K or proxy or information statement? What are the economic effects of extending similar requirements to filers of annual reports on Form 20-F, as proposed?
62. Would the proposed requirement to structure Item 408 disclosures in Inline XBRL benefit investors? What would be the costs of such a requirement for filers? How would the costs and benefits vary if we were to narrow the scope of structured data requirements, for example to include only the quarterly disclosures that would be required under proposed Item 408(a) of Regulation S-K?
63. How often do officers and directors rely on Rule 10b5-1 plans today but elect not to disclose such reliance on beneficial ownership forms (Forms 4 and 5)?
64. Would investors benefit from the proposed requirement to disclose the use of a Rule 10b5-1 plan on Forms 4 and 5?
65. What would be the costs of the proposed requirement to disclose the use of a Rule 10b5-1 plan on Forms 4 and 5?
66. What alternative disclosure requirements related to insider trading arrangements should we consider, and what would be the benefits and costs of such alternatives?

## **D. Additional Disclosure of the Timing of Option Grants and Related Company Policies and Practices (Amendments to Item 402 of Regulation S-K)**

The Commission is proposing to amend Item 402 of Regulation S-K to enhance the transparency regarding companies' grants of stock options, SARs, or similar instruments before or after the filing of a periodic report, or the filing or furnishing of a current report on Form 8-K that contains MNPI.

### **1. Baseline and Affected Parties**

The proposed amendments to Item 402 disclosure requirements would apply to filers of annual reports on Form 10-K and proxy and information statements.<sup>193</sup> During calendar year 2020, we estimate that there were approximately 5,900 affected filers.

Existing Item 402 requires disclosure of option grant dates thus potentially enabling investors today to compare the timing of grant dates and historical filings of a periodic report or another EDGAR filing that contains MNPI. The Commission provided interpretive guidance regarding option grants in the 2006 executive compensation disclosure release.<sup>194</sup> In considering the timing of option grants in coordination with the release of MNPI, the Commission explained in the release that if the company has such a program, plan, or practice, the company should disclose that the board of directors or compensation committee may grant options at times when the board or committee is aware of MNPI.<sup>195</sup> To the extent that the existing disclosures of companies that allow the timing of option grants around MNPI reflect such guidance, the

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<sup>193</sup> Current filing requirements of Form 10-K permit filers to incorporate by reference executive compensation disclosures from a proxy or information statement involving the election of directors. *See supra* note 78. These estimates exclude registered investment companies and asset-backed securities issuers, which would not be subject to the proposed requirements.

<sup>194</sup> *See* Executive Compensation and Related Person Disclosure, *supra* note 65.

<sup>195</sup> *Id.*

incremental effects of a mandate to disclose policies and procedures related to option grants around MNPI would be relatively smaller.

Some studies have noted that the regulatory reforms of the early and mid-2000s have led to the decline, if not disappearance, of questionable option timing practices.<sup>196</sup> However, there is some evidence that option spring-loading and bullet-dodging persists.<sup>197</sup> For example, one study, which examined 4,852 scheduled CEO stock option grants from 2007 through 2011, finds that “managers accelerate bad news before a grant (bullet dodging) and delay good news until after a grant (spring loading) . . . market reactions to SEC Form 8-K filings (which report material corporate events) tend to be negative in the months immediately before a scheduled CEO option grant and positive in the months after the grant. Executives also appear to move earnings from the pre-grant period to the post-grant period, for example, by changing a firm’s accounting choices (*e.g.*, accruals management) and perhaps even by timing investments (*e.g.*, real earnings management).”<sup>198</sup> Another study finds that spring-loading partly replaced the disappearing

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<sup>196</sup> Randall Heron and Erik Lie, What Fraction of Stock Option Grants to Top Executives Have Been Backdated or Manipulated?, 55(4) *Management Science* 513–525 (2009); M. P. Narayanan and H. Nejat Seyhun, The Dating Game: Do Managers Designate Option Grant Dates to Increase Their Compensation? 21(5) *Review of Financial Studies*, 1907–1945 (2008); Lucian Bebchuk, Yaniv Grinstein, and Urs Peyer, Lucky CEOs and Lucky Directors, 65(6) *Journal of Finance*, 2363–2401 (2010); Linxiao Liu, Harrison Liu, and Jennifer Yin, Stock Option Schedules and Managerial Opportunism, 41(5-6) *Journal of Business Finance and Accounting*, 652–684 (2014); Rik Sen, The Returns to Spring-Loading, *New York University* (Working Paper) (2008).

<sup>197</sup> See also “Insider Trading and Stock Option Grants: An Examination of Corporate Integrity in the Covid-19 Pandemic,” Memorandum from FSC Majority Staff to Members, Committee on Financial Services, September 17, 2020, available at <https://financialservices.house.gov/uploadedfiles/hhrg-116-ba16-20200917-sd002.pdf>, at pp. 2-5.

<sup>198</sup> See Robert M. Daines, Grant R. McQueen, and Robert J. Schonlau, Right on Schedule: CEO Option Grants and Opportunism, 53(3) *Journal of Financial and Quantitative Analysis*, 1025-1058 (2018) (finding that: “some CEOs have manipulated stock prices to increase option compensation, documenting negative abnormal returns before scheduled option grants and positive abnormal returns afterward;” “document[s] several mechanisms used to lower stock price, including changing the substance and timing of disclosures;” and further contends that such opportunism “distorts stock prices, leading to capital misallocation, and may dissipate firm value if executives postpone valuable projects.” See also David Aboody and Ron Kasznik, CEO Stock Option Awards and the Timing of Corporate Voluntary Disclosures, 29(1) *Journal of Accounting and Economics*, 73-100 (2000) (focusing on CEO option awards with fixed award schedules and showing that “CEOs make opportunistic voluntary disclosure decisions that maximize their stock option compensation,” based on changes

practice of option backdating.<sup>199</sup> A different study documents spring-loading around stock splits but does not disaggregate the 1992-2012 period into pre- and post-2006 sub-periods.<sup>200</sup>

## 2. Benefits

As discussed in Section II above, certain practices related to the timing of executive compensation option grants raise concerns about the use of MNPI. Improved disclosure would potentially mitigate the economic costs of the associated incentive distortions as these practices would have greater visibility to investors and inform their investment and voting decisions.

Spring-loading and bullet-dodging potentially increase the value of the options granted to the executive, upon MNPI becoming public.<sup>201</sup> Holding the number of the granted options and the policy to grant options with the strike price equal to the current observable market price (“at-the-money”) constant, this leads to the executive effectively receiving a higher compensation award than if the timing of option grants were completely independent of MNPI releases.<sup>202</sup> Regardless of any potential impact of the expected public release of MNPI on compensation cost recognized for the option awards, strategic timing of option awards around MNPI releases

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in share prices, analyst earnings forecasts, and management earnings forecasts); Keith W. Chauvin, and Catherine Shenoy, Stock Price Decreases Prior to Executive Stock Option Grants, 7(1) *Journal of Corporate Finance*, 53-76 (2001) (finding, in a May 1991 to February 1994 sample covering 313 CEOs, “a statistically significant abnormal decrease in stock prices during the 10-day period immediately preceding the grant date” and concluding that “[e]xecutives who expect to be granted stock options have the incentive, opportunity and ability to affect the exercise price with their inside information”).

<sup>199</sup> See Giulian Bianchi, Stock Options: From Backdating to Spring Loading, 59 *Quarterly Review of Economics and Finance*, 215-221 (2016) (examining data through 2011).

<sup>200</sup> See Erik Devos, William Elliott, and Richard Warr, CEO Opportunism? Option Grants and Stock Trades around Stock Splits, 60(1) *Journal of Accounting and Economics*, 18-35 (2015).

<sup>201</sup> Past studies have focused primarily on options. In this context, the same economic effects can be expected in the case of awards of SARs and similar instruments. For purposes of this analysis, the term “option” includes stock options, SARs and similar instruments with option-like features.

<sup>202</sup> See David Yermack, Good Timing: CEO Stock Option Awards and Company News Announcements, 52(2) *Journal of Finance*, 449-476 (1997). See also Iman Anabtawai, Secret Compensation, 82(3) *North Carolina Law Review*, 835-890 (2004).

increases the value of the compensation award.<sup>203</sup> Further, lowering an option's strike price through timing of an option award around MNPI release affects the sensitivity of the awarded options to changes in the company's share price.<sup>204</sup> Some have argued that these practices may be the result of an optimal compensation policy.<sup>205</sup> Whether such practices constitute an optimal compensation policy or not, a lack of transparency about such compensation awards may limit investor ability to fully gauge the key terms of compensation arrangements and their implications for executives' incentives, and thus, firm value.

The Commission is proposing to amend Item 402 of Regulation S-K to require additional disclosure of option granting practices that would provide a more comprehensive picture of whether the company uses MNPI to time option awards. The proposed disclosure would present in a more readily available way information about option grants around MNPI releases, if any, as well as provide new disclosure of policies and procedures related to option grant timing with respect to MNPI. The proposed amendments would reduce information asymmetries between companies and investors with respect to the timing of compensation awards and applicable corporate policies and better inform investors about executives' incentives to maximize

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<sup>204</sup> Spring-loading can cause a call to be in-the-money when it would have otherwise been at-the-money, assuming favorable MNPI is about to be released. Everything else equal, the value of an in-the-money call would have a higher sensitivity to the share price than the value of an at-the-money call. Bullet-dodging can cause a call to be at-the-money when it would have otherwise been out-of-the-money, assuming negative MNPI is about to be released. Generally speaking, the value of an at-the-money call would have a higher sensitivity to the share price than the value of an out-of-the-money call. The effects of such changes would depend on the objectives of the overall compensation package with respect to inducing optimal executive incentives and the role of option and SAR awards in this package.

<sup>205</sup> See, e.g., Erik Devos, William Elliott, and Richard Warr, CEO Opportunism? Option Grants and Stock Trades around Stock Splits, 60(1) *Journal of Accounting and Economics*, 18-35 (2015) (stating that "it is not clear whether shareholders are necessarily harmed by this apparent option grant timing, as it is possible that this is just another way by which the [board of directors] attempts to reward and retain a high performing CEO"). See also Speech by SEC Commissioner: Remarks Before the International Corporate Governance Network 11th Annual Conference by Commissioner Paul S. Atkins, U.S. Securities and Exchange Commission, July 6, 2006, available at <https://www.sec.gov/news/speech/2006/spch070606psa.htm>.

shareholder value and the company's executive compensation policies (the information that can then be compared with the executive's on-the-job performance in assessing the optimality of executive compensation). Besides contributing to better informed investment decisions, the proposed disclosure may inform shareholder say-on-pay votes and votes in director elections.<sup>206</sup>

Another potential benefit of the proposed disclosure is that, to the extent option grants around MNPI releases were not the result of a value-maximizing compensation policy but rather an outcome of agency conflicts (such as executives' attempts to extract additional compensation without drawing investor scrutiny to the full amount of such compensation),<sup>207</sup> and to the extent companies forgo such grants in anticipation of the proposed additional disclosure, the proposed

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<sup>206</sup> See, e.g., 2020 Proxy Paper Guidelines: An Overview of the Glass Lewis Approach to Proxy Advice - United States, available at [https://www.glasslewis.com/wp-content/uploads/2016/11/Guidelines\\_US.pdf](https://www.glasslewis.com/wp-content/uploads/2016/11/Guidelines_US.pdf), at 12-13, 41-42 (stating that "that "[w]hen a company has engaged in spring-loading or bullet-dodging, Glass Lewis will consider recommending voting against the compensation committee members where there has been a pattern of granting options at or near historic lows." Furthermore, "it will also recommend voting against executives serving on the board who benefited from the spring-loading or bullet-dodging." Spring-loading has also been the subject of shareholder suits alleging breach of fiduciary duty. See, e.g., *Howland v. Kumar*, C.A. No.2018-0804, 2019 WL 2479738, at 1 (Del. Ch. June 13, 2019), available at <https://courts.delaware.gov/Opinions/Download.aspx?id=290950>; Verified Stockholder Derivative Complaint 3-5, *Knight v. Miller*, C.A. No.2021-0581, 2021 WL 3018402 (Del. Ch. filed July 9, 2021). See also, e.g., Iman Anabtawai, Secret Compensation, 82(3) *North Carolina Law Review* 835-890 (2004) (stating that "under state law fiduciary duty principles, a manager who receives stock options while in possession of inside information that will raise the stock price when it is later released discharges her fiduciary duty of loyalty through full disclosure to and ratification by a disinterested board. It is then the board's responsibility, pursuant to its fiduciary duty of disclosure, to inform the corporation's shareholders of the favorable timing of the grant, if it disseminates to them information about the company's executive compensation arrangements"); Matthew E. Orso, 'Spring-Loading' Executive Stock Options: An Abuse in Need of a Federal Remedy, 53(2) *Saint Louis University Law Journal* 629-662 (2009); Jonathan Tompkins, Opportunity Knocks, But the SEC Answers: Examining the Manipulation of Stock Options Through the Spring-Loading of Grants and Rule 10b-5, 26 *Washington University Journal of Law and Policy*, 413-458 (2008).

<sup>207</sup> One article notes that "[t]here are, of course, constraints that check the extent to which the level and structure of executive compensation can deviate from what would be optimal for shareholders. . . . To circumvent such pressures, managers will want to enhance their compensation as discreetly as possible. By 'camouflaging' elements of their pay, managers can maximize their compensation while minimizing adverse reaction. Timing option grants is an especially attractive way to enhance executive compensation both because it is difficult to detect and because it has generally eluded attention." See Iman Anabtawai, Secret Compensation, 82(3) *North Carolina Law Review*, 835-890 (2004). See also, e.g., Giuliano Bianchi, Stock Options: From Backdating to Spring Loading, 59 *Quarterly Review of Economics and Finance*, 215-221 (2016) (stating that "[o]ppportunistic option timing is found to be associated with weaker corporate governance. Indeed, practices such as backdating and spring loading raise governance concerns. . . . Eventually, the opportunistic option timing casts doubt on the efficacy of incentives to address the principal agent models.").

disclosure requirement would improve shareholder value. The benefit would be lower if the extra compensation is currently optimally awarded.<sup>208</sup>

Further, to the extent that the practice of option grants around MNPI in some instances contributed to incentives of executives to change the timing and content of MNPI disclosures around option grant dates in an attempt to increase the economic value of compensation awards,<sup>209</sup> the proposed amendments could partly mitigate such incentives if they contribute to a decrease in such option grant practices. In those instances, the indirect effect of the proposed amendments could result in an improvement in the information content, timeliness, and quality of disclosures, and more efficient share prices and better informed investment decisions.

The described benefits of the proposed tabular disclosure would be limited by the fact that investors today can research and assess, based on historical option grant dates required to be disclosed under Item 402, how grant timing relates to EDGAR filings containing MNPI and share price changes around such filings (information that is publicly accessible, albeit not in one location). However, the proposed disclosure would aggregate this information in a more readily available and more salient tabular format in one location, potentially incrementally lowering investor search costs and increasing investor awareness of option grant timing around MNPI.

These benefits could also be modest if investors find the proposed disclosure to be of limited use (for example, if the tabular disclosure is too extensive and /or difficult to parse for companies with multiple MNPI filings and option grants for different executives, or because other factors may affect the share price notwithstanding the disclosure of MNPI).

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<sup>208</sup> See, e.g., Jonathan J. Tompkins, Opportunity Knocks, but the SEC Answers: Examining the Manipulation of Stock Options through the Spring-Loading of Grants and Rule 10b-5, 26 *Washington University Journal of Law and Policy*, 413-458, 444-445, 447 (2008).

<sup>209</sup> See *supra* note 198 and accompanying and following text.

The proposed amendments would require the additional quantitative disclosure to be submitted in Inline XBRL. This proposed requirement is expected to benefit investors by facilitating automated extraction of the disclosure information for purposes of aggregation, analysis, and comparison (across time periods and filers), potentially enabling more informed investment and voting decisions.

The proposed annual disclosure of policies and practices related to option grant timing around MNPI would offer new information that is not presently available to investors. The disclosure of the presence or absence of such policies and practices could inform investment and shareholder voting decisions, with the caveat that such disclosure may be of lower utility if it uses a “boilerplate” format. The anticipation of public disclosure may also lead companies to adopt policies and practices disallowing option grants around MNPI, leading to the benefits discussed above.

In general, the discussed benefits of the proposed amendments would be modest at companies that rely less on stock options and primarily or exclusively grant restricted stock, or do not grant equity-linked compensation.<sup>210</sup> At companies that use stock options extensively as part of executive compensation, the effects of the proposed amendments might be more modest

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<sup>210</sup> The proportion of companies that grant options to executives has declined substantially after the introduction of FAS 123R in 2004 (now codified in Accounting Standards Codification Topic 718). *See, e.g.,* Prevalence of Options Decreases as Companies Tie Awards to Performance, August 23, 2018, Equilar, *available at* <https://www.equilar.com/press-releases/103-prevalence-of-options-decreases-as-companies-tie-awards-to-performance>; Aubrey Bout, Brian Wilby, and Perla Cruz, S&P 500 CEO Compensation Increase Trends, *Harvard Law School Forum on Corporate Governance*, (February 11, 2020), *available at* <https://corpgov.law.harvard.edu/2020/02/11/sp-500-ceo-compensation-increase-trends-3/>. Based on the analysis of Execucomp data for fiscal year 2020 (retrieved on September 14, 2021), approximately 32 percent of companies reported option grants. Execucomp data covers S&P 1500 companies and thus may not be representative of option compensation at smaller companies. Registrants other than small business issuers and small business issuers, respectively, were required to comply with FAS 123R beginning with the first reporting period of the first fiscal year beginning on or after June 15, 2005 and December 15, 2005, respectively. *See Amendment to Rule 4-01(a) of Regulation S-X Regarding the Compliance Date for Statement of Financial Accounting Standards No. 123 (Revised 2004), Share-Based Payment*, Release No. 33-8568 (Apr. 15, 2005) [70 FR 20717 (Apr. 21, 2005)].

if other factors serve to deter spring-loading and bullet-dodging (for example, best practices implemented by the compensation committee or generally robust internal corporate governance mechanisms). The effects of the proposed amendments on executives might be smaller if companies adjust compensation to offset the decline in spring-loading and bullet-dodging under the amendments (*e.g.*, by changing option terms, the allocation of compensation between cash, options, and restricted stock, or the overall amount of compensation).

### **3. Costs**

The proposed amendments to Item 402 requiring additional disclosure of the timing of option awards and related corporate policies would result in direct compliance-related costs for affected filers of compiling the information required in amended Item 402 for inclusion in the annual report or proxy statement. Because companies either already provide such information for other disclosures (option grant information and dates) or can readily obtain the information (daily share prices and dates of EDGAR filings), the direct costs are expected to be modest. Companies also would incur minor costs of aggregating such existing information into the proposed tabular format. Further, companies would incur some compliance-related costs to assess which of the filings from the reporting period contained MNPI and thus would be subject to the scope of the proposed tabular disclosure. Finally, while companies are likely to have information readily available about policies and practices related to option grant timing, they would likely incur some compliance-related costs to prepare that information for public disclosure.

Companies would incur compliance costs of structuring the proposed quantitative tabular disclosure in Inline XBRL. Such costs would be higher for filers with more option grants subject to the new disclosure. However, because the vast majority of filers subject to the proposed

amendments already are subject to other structured disclosure requirements (*e.g.*, Inline XBRL requirements for financial statement information and cover page information in certain filings), the incremental cost of submitting the proposed compensation disclosure in a structured data language would likely be relatively modest.

The proposed amendments are also expected to result in indirect costs for companies and executives. Disclosure of spring-loading or bullet-dodging practices could result in reputational harms for companies or individual executives, including unfavorable say-on-pay votes. Outside scrutiny in response to the proposed disclosure could cause companies to forgo spring-loading and bullet-dodging. For companies at which such practices arose from efforts to implement an economically optimal compensation policy,<sup>211</sup> deviating from such a policy could result in less optimal compensation. However, companies may be able to use other, readily available means to adjust compensation terms to achieve a similar outcome.<sup>212</sup> At companies that forgo spring-loading and bullet-dodging but do not change other compensation terms to offset it, executives could experience effectively smaller, riskier compensation awards.

As discussed in Section IV.D.2 above, the indirect costs of the proposed tabular disclosure are likely to be modest relative to the baseline of existing option disclosures.

The proposed disclosure of policies and practices related to option grant timing around MNPI would offer new public disclosure not presently available to investors. Companies that lack such policies and practices may incur reputational costs of such disclosure. The anticipation of public disclosure may lead such companies to adopt policies and practices disallowing option

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<sup>211</sup> *See supra* note 208.

<sup>212</sup> Companies could lower the strike price, increase the number of options granted, decrease the proportion of options in overall pay, increase overall pay, modify performance-based or other compensation terms, or some combination of those.

grants around MNPI. This may impose costs on executives, to the extent other compensation terms are not adjusted in an offsetting manner, as described above.

As discussed in Section IV.D.2 above, the effects of the proposed amendments would be modest at companies without, or with limited, option compensation.

#### **4. Effects on Efficiency, Competition, and Capital Formation**

We expect the proposed amendments to Item 402 to incrementally decrease the information asymmetry between insiders and investors about the company's option compensation awards and associated policies, resulting in better information about the insiders' incentives related to such option awards. This would result in more informationally efficient prices and more efficient allocation of capital in investor portfolios. Greater availability of information about option compensation awards would also reduce shareholders' information gathering costs and enable them to make more efficient voting decisions in say-on-pay and director election votes.

Importantly, we expect the proposed amendments to draw market scrutiny to companies' use of MNPI in option awards, potentially decreasing the incidence of option award timing around MNPI. This would tend to reduce insiders' incentives to game corporate disclosures, which may result in timelier and higher-quality disclosures (that enable more informationally efficient share prices and more efficient allocation of capital in investor portfolios).

To the extent that the proposed Item 402 requirements impose a fixed cost on companies, they would have a negative competitive effect on smaller issuers subject to the amendments, as well as on issuers that do not already disclose policies and practices related to option award timing. The proposed disclosure requirements would not apply to foreign private issuers, placing them at a relative competitive advantage to domestic filers.

Because the proposed disclosure amendments would apply broadly across public companies, generally, we do not anticipate them to result in meaningful competitive disparities in the labor market for executive talent.<sup>213</sup>

The described effects would be attenuated to the extent investors already can infer whether companies time option awards around MNPI based on existing disclosures of option grant dates and other public information. The described effects would also be attenuated to the extent companies that award options around MNPI already disclose such policies and practices as a result of the 2006 interpretive guidance.

## **5. Reasonable Alternatives**

The proposed amendments to Item 402 involve both a new table with information on individual option grants and the requirement to disclose policies and practices regarding the timing of option awards around the disclosure of MNPI. As an alternative, we could propose only one of those requirements, which could reduce the costs of disclosure for filers discussed in Section IV.D.3 above. However, omitting one of the proposed disclosure requirements would provide investors with less information about option compensation practices, resulting in potentially less informed investment and voting decisions. For example, omitting the tabular disclosure requirement could marginally reduce the salience of information about the actual timing of option grants around MNPI releases and the effects of such timing on the value of granted options in cases where a company discloses that it does not have policies restricting option awards around MNPI releases. In turn, omitting the requirement to disclose the company's practices and policies regarding the timing of option awards would reduce the amount of information about potential future compensation practices, compared to the proposal.

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<sup>213</sup> See *supra* note 192.

Nevertheless, there is likely to be some substitution between the information benefits of the two proposed requirements, particularly in combination with the existing requirements to disclose grant dates.

The proposed amendments to Item 402 would require tabular disclosure of awards made within 14 days before or after the filing of a periodic report, or the filing or furnishing of Form 8-K that discloses MNPI. A typical company issues multiple filings with MNPI in a given year. Thus, it is likely that a typical company would include multiple option and SAR awards in the new tabular disclosure.<sup>214</sup> As an alternative, we could use a shorter or longer time period around filings with MNPI during which option awards would be subject to the additional tabular disclosure (for example, one day, one week, or thirty days). A shorter (longer) time period could result in less (more) disclosure and thus incrementally lower (higher) disclosure costs for filers, compared to the proposal. Because prices may change for reasons other than the release of MNPI when a longer time period is used, pre- and post-filing prices might be more informative for assessing the effects of the MNPI release on the valuation of option awards made during a shorter window around the filing. Shortening (lengthening) the window under these alternatives would reduce (increase) the amount of information aggregated in one location about options granted in proximity to MNPI releases, potentially resulting in marginally less (more) informed investment and voting decisions.

Consistent with other provisions of Item 402, the proposed amendments would apply to option awards to named executive officers. This, would provide for greater consistency with other existing compensation disclosures. It also would provide information about the effects of

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<sup>214</sup> During calendar year 2020, the average (median) filer filed Forms 10-K, 10-Q, 8-K, or amendments to them, on 18 (16) different days, resulting in a potential average (median) disclosure coverage period (14 days before and after such filings) of approximately 207 (221) days.

option award timing on the amount of compensation and structure of compensation incentives for the executives that are likely to have the most influence on the company's business decisions. As an alternative, we could limit the proposed disclosure to the CEO or expand it to all executives. The alternative of narrowing (or expanding) the set of executives whose option awards would be subject to the new disclosure requirement would result in lower (or higher) disclosure costs, compared to the proposal but also would result in less (or more) information about the timing of option awards, and executive incentives, compared to the proposal. These alternatives would also result in less consistency with other existing compensation disclosures compared with the proposal.

The proposed amendments would require the additional disclosure to be submitted using a structured (*i.e.*, machine-readable) data language. As an alternative, we could require the disclosure as proposed, but not require the use of a structured data language. Compared to the proposal, this alternative could make it harder for investors to extract the disclosure information, potentially increasing the costs they incur in making investment and voting decisions. However, this alternative also would decrease costs for affected filers (particularly for filers with more option grants subject to the new disclosure), compared to the proposal.

## **6. Request for Comment**

67. How common is option spring-loading and bullet-dodging? What are the principal costs and benefits of such practices? Would such practices be likely to decline under the proposal? Do companies typically have policies to avoid granting options around releases of material nonpublic information? Why or why not?
68. What would be the main benefits of the proposed amendments? Would the proposed additional Item 402 disclosure requirements related to option granting practices benefit

investors? Would the proposed amendments inform voting decisions? What would be the main costs of the proposed amendments?

69. Would the proposed new compensation table in Item 402 be useful for investors? What are the benefits and costs of the proposed new table?

70. Should we require a different scope of tabular disclosure as part of amended Item 402?

Should we require the proposed tabular disclosure to cover a different time frame around filings containing MNPI (such as one day, one week, or thirty days before and after a filing containing MNPI)? Should we require the proposed tabular disclosure to cover only some filings containing MNPI (such as Form 10-K, or Form 10-K and Form 10-Q)? If so, what would be the benefits and costs of such alternative requirements?

71. What alternative disclosure requirements related to the timing of option compensation grants should we consider, and what would be the benefits and costs of such alternatives?

72. Would the proposed requirement to structure the additional quantitative disclosure in Inline XBRL benefit investors? What would be the costs of such a requirement for filers? How would the costs and benefits vary if we were to expand or narrow the scope of structured data requirements, for example to include the narrative disclosures that would be added under the proposed requirements?

#### **E. Additional Disclosure of Insider Gifts of Stock**

The Commission is proposing amendments that would require the disclosure of insiders' gifts of stock within two business days on Form 4. This would be a change from the existing rules that allow a stock gift to be disclosed on Form 5, which is required to be filed within 45 days of the end of the year during which the gift was made. This proposed amendment would result in timelier disclosure of such transactions across all affected insiders.

## **1. Baseline and Affected Parties**

The proposed amendments would affect insiders that make gifts of stock and report them on Form 5 today. We estimate that approximately 700 insiders reported gifts of stock on Form 5 during calendar year 2020 (including a little over 100 insiders that reported gifts both on Form 4 and Form 5).<sup>215</sup> The majority of insiders already report gifts of stock on Form 4. During calendar year 2020, we estimate that approximately 2,700 insiders reported stock gifts on Form 4 (including a little over 100 insiders that made both Form 4 and Form 5 filings reporting stock gifts).

## **2. Benefits**

The proposed amendments to Form 4 to require disclosure of insider gifts of stock would result in timelier availability of information about beneficial ownership by the company's insiders, to the extent that some insiders are not already reporting such gifts of stock on Form 4. Disposition of an insider's shares through a gift reduces that insider's economic exposure to the company and potentially weakens the alignment of incentives with the shareholder value maximization objective. A scenario in which an insider gifts stock while aware of MNPI and the recipient sells the gifted securities while the information remains nonpublic and material is economically equivalent to a scenario in which the insider trades on the basis of MNPI and shares the trading profits with the recipient.

While non-pecuniary motives may be more important in a gift than in an open market sale, the timing of a gift can reveal the insider's beliefs about the company's future share price. For an insider that has decided to make a gift, finding the time when the shares are priced higher

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<sup>215</sup> The estimate is based on Form 5 data in Thomson Reuters / Refinitiv insiders dataset. Gifts of stock are identified based on transaction code "G" ("bona fide gift").

(e.g., before the release of negative MNPI) would allow the insider to reduce the effective cost of the gift. In light of this, disclosure of timely information about the stock gift could be informative for investors evaluating the company's share price and making investment or sale decisions.<sup>216</sup> However, these information benefits would be lower if the officer or director does not consider the cost of a gift (e.g., because the motive for the gift is solely altruistic or the amount of the gift is inconsequential in the context of the insider's overall net worth).

Finally, the proposed requirement to disclose insiders' stock gifts on Form 4 would facilitate market scrutiny and discourage stock gifts based on MNPI, thereby reducing the associated incentive distortions. While an insider's benefit from using MNPI to time stock gifts is likely smaller than in the case of timing trades, the ability to profit from such stock gift timing is expected to have a similar direction of the effect on insider incentives (such as incentives to pursue inefficient corporate decisions or to distort disclosure, in line with the discussion in Section IV.A above).

These benefits of the proposed Form 4 requirements would be reduced to the extent that many insider gifts of stock already are reported on Form 4, as noted in Section IV.E.1 above.

### **3. Costs**

Amended Form 4 disclosure with regard to gifts of stock would result in additional costs for insiders. Direct costs would include additional compliance-related costs. Indirect costs could

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<sup>216</sup> One recent study finds evidence of informed timing of gifts of stock by the subset of insiders that are beneficial owners. See Sureyya Burcu Avci, Cindy A. Schipani, H. Nejat Seyhun, and Andrew Verstein, *Insider Giving*, *Duke Law Journal*, 71 (2021) (forthcoming). The study also points to gift backdating as a potential consequence of delayed reporting of stock gifts. The accelerated disclosure would likely reduce the potential for backdating of insider gifts. Backdating of reported insider disposition of stock on the beneficial ownership disclosure could provide insufficient information to investors about the changes to an insider's ownership incentives and the incentive alignment with shareholder interests (limiting investors' ability to retrospectively evaluate an insider's corporate decisions in conjunction with the insider's ownership incentives and potentially gauge the extent of agency conflicts).

include reputational and investor relations costs stemming from increased market scrutiny of gifts of stock.

#### **4. Effects on Efficiency, Competition, and Capital Formation**

We expect the proposed amendments to incrementally decrease the information asymmetry between insiders and investors. Recent disposition of shares through gifts of stock informs investors about changes to officers' and directors' incentives derived from holdings of company stock. Timely information about the disposition of shares through stock gifts could in some circumstances inform investors about officers' and directors' outlook on future changes to the company's share prices. Both factors would tend to result in more informationally efficient prices and more efficient allocation of capital in investor portfolios.

Importantly, we expect the proposed amendments to draw market scrutiny to insiders' use of MNPI in the timing of stock gifts, potentially decreasing the incidence of such stock gift timing. This reduces insiders' incentives to manipulate corporate disclosures around stock gifts, which could in turn yield more informationally efficient share prices and more efficient allocation of capital in investor portfolios. The amendments also could marginally reduce insider incentives to pursue inefficient corporate investment decisions driven by personal gain from gifts based on MNPI, in line with the discussion in Section IV.E.2. and IV.A above.

Because the proposed disclosure amendments would apply broadly across all insiders' stock gifts, generally, we do not anticipate them to result in meaningful competitive disparities among insiders.

#### **5. Reasonable Alternatives**

We are proposing to require additional disclosure of insider gifts of stock. As an alternative, we could narrow the scope of the proposed disclosure to apply only to officers and

directors, or only to a certain type of gifts of stock (*e.g.*, charitable gifts to charities affiliated with the insider). Compared to the proposal, narrowing the scope of gifts subject to the disclosure could provide less information to market participants but also result in lower aggregate costs. Further, because the majority of insiders already disclose gifts on Form 4, the economic significance of potential exemptions under this alternative may be modest. The proposed requirement would provide consistency in the timeliness of reporting of stock gifts across insiders.

## **6. Request for Comment**

73. Would the proposed additional Form 4 disclosure requirements related to insider gifts of stock benefit investors? What would be the main benefits of the proposed Form 4 amendments for investors?

74. What would be the costs of the proposed Form 4 amendments for filers?

75. How prevalent is the timing of insider gifts of stock around material nonpublic information?

76. Do companies have policies or practices to prevent insider gifts of stock in connection with material nonpublic information?

77. What alternative disclosure requirements related to insider gifts of stock should we consider, and what would be the benefits and costs of such alternatives?

## **V. Paperwork Reduction Act**

### **A. Summary of the Collections of Information**

Certain provisions of our rules, schedules, and forms that would be affected by the rule amendments contain “collection of information” requirements within the meaning of the Paperwork Reduction Act of 1995 (“PRA”).<sup>217</sup> The Commission is submitting the proposed

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<sup>217</sup> 44 U.S.C. 3501 *et seq.*

amendments to the Office of Management and Budget (“OMB”) for review in accordance with the PRA.<sup>218</sup> The hours and costs associated with preparing, filing, and sending the schedules and forms constitute reporting and cost burdens imposed by each collection of information. An agency may not conduct or sponsor, and a person is not required to comply with, a collection of information unless it displays a currently valid OMB control number. The titles for the collections of information are:

- Form 10-K (OMB Control No. 3235-0063);
- Form 10-Q (OMB Control No. 3235-0070);
- Schedule 14A (OMB Control No. 3235-0059);
- Schedule 14C (OMB Control No. 3235-0057);
- Form 4 (OMB Control Number 3235-0287);
- Form 5 (OMB Control Number 3235-0362)
- Regulation S-K (OMB Control No. 3235-0071);
- Regulation S-T (OMB Control No. 3235-0424);<sup>219</sup> and
- Rule 10b5-1 (a proposed new collection of information).

The forms, schedules, and regulations listed above were adopted under the Securities Act and/or the Exchange Act. These regulations, schedules, and forms set forth the disclosure requirements for registration statements, periodic and current reports, distribution reports, and proxy and information statements filed by registrants to help investors make informed investment and voting decisions. Compliance with these information collections is mandatory.

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<sup>218</sup> 44 U.S.C. 3507(d) and 5 CFR 1320.11.

<sup>219</sup> The paperwork burdens for Regulation S-K and Regulation S-T are imposed through the forms, schedules and reports that are subject to the requirements in these regulations and are reflected in the analysis of those documents. To avoid a PRA inventory reflecting duplicative burdens and for administrative convenience, we assign a one-hour burden to Regulations S-K and S-T.

Responses to these information collections are not kept confidential and there is no mandatory retention period for the information disclosed.

The Commission is also proposing amendments to Rule 10b5-1(c)(1)(ii) that would impose a certification requirement as a condition to the Rule 10b5-1(c)(1) affirmative defense. Under the proposed amendment, if a director or officer (as defined in Rule 16a-1(f) of the issuer of the securities adopts a Rule 10b5-1(c)(1) trading arrangement, as a condition to the availability of the affirmative defense, such director or officer would be required to furnish to the issuer a written certification. The use of the Rule 10b5-1(c)(1) affirmative defense is voluntary, and compliance with this proposed information collection would be mandatory only if a respondent chooses to rely on the affirmative defense. Responses to this information collection would not be confidential and there is no mandatory retention period for the collection of information.

A description of the proposed amendments, including the need for the information and its use, as well as a description of the likely respondents, can be found in Section II above, and a discussion of the economic effects of the proposed amendments can be found in Section IV above.

**B. Estimates of the Proposed Amendments’ Effects on the Collections of Information**

The following table summarizes the estimated effects of the proposed amendments on the paperwork burdens associated with the affected forms.<sup>220</sup>

**PRA Table 1. Estimated Paperwork Burden Effects of the Proposed Amendments**

Proposed Amendments	Affected Forms	Estimated Burden Increase
Item 402(x):		

<sup>220</sup> The OMB PRA filing inventories represent a three-year average. These averages may not align with the actual number of filings in any given year.

Proposed Amendments	Affected Forms	Estimated Burden Increase
<ul style="list-style-type: none"> <li>• Require disclosure of a registrant’s policies and practices on the timing of awards of stock options, SARs or similar instruments in relation to the disclosure of material nonpublic information by the registrant, including how the board determines when to grant options, whether the board or compensation committee takes material nonpublic information into account when determining the timing and terms of an award; and whether the registrant has timed the disclosure of material nonpublic information for the purpose of affecting the value of executive compensation.</li> <li>• Require tabular disclosure of each option award granted within 14 calendar days before or after the filing of a periodic report, an issuer share repurchase, or the filing or furnishing of a current report on Form 8-K that contains material nonpublic information.</li> <li>• Require information to be reported using a structured data language.</li> </ul>	Forms 10–K* and Schedules 14A, and 14C.	9 hour increase in compliance burden per form.
<p><b>Item 408(a):</b></p> <ul style="list-style-type: none"> <li>• Require disclosure of the adoption or termination of any contract, instruction or written plan for the purchase or sale of securities whether or not intended to satisfy the affirmative defense conditions of Rule 10b5-1(c), by the issuer, directors and officers (as defined in Exchange Act Rule 16a-1(f)), including the name and title of the director or officer; and a description of the material terms of the contract, instruction or written plan.</li> </ul>	Forms 10–K and 10–Q.	15 hour increase in compliance burden per form.

Proposed Amendments	Affected Forms	Estimated Burden Increase
<ul style="list-style-type: none"> <li>Require information to be reported using a structured data language.</li> </ul>		
<p><b>Item 408(b):</b></p> <ul style="list-style-type: none"> <li>Require disclosure of whether the registrant has adopted (and if not, why) insider trading policies and procedures governing the purchase, sale, and other dispositions of the registrant’s securities by directors, officers and employees that are reasonably designed to promote compliance with insider trading laws, rules and regulations, and any listing standards applicable to the registrant.</li> <li>Require information to be reported using a structured data language.</li> </ul>	<p>Form 10-K* and Schedules 14A, and 14C.</p>	<p>4 hour increase in compliance burden per form.</p>
<p><b>Form 4:</b></p> <ul style="list-style-type: none"> <li>Require reporting of gifts of securities.</li> <li>Require new checkbox to indicate that a sale or purchase reported on the form was made pursuant to a Rule 10b5-1(c), and disclosure of the date of adoption of the plan.</li> <li>New optional checkbox that would permit a filer to indicate whether a sale or purchase reported on the form was made pursuant to a contract, instruction or written plan to purchase or sell securities not intended to satisfy the affirmative defense conditions of Rule 10b5-1(c).</li> </ul>	<p>Form 4.</p>	<p>0.5 hour increase in compliance burden per form.</p>
<p><b>Form 5:</b></p> <ul style="list-style-type: none"> <li>Require new checkbox to indicate that a sale or purchase</li> </ul>	<p>Form 5.</p>	<p>0.25 hour increase in compliance burden per form.</p>

Proposed Amendments	Affected Forms	Estimated Burden Increase
<p>reported on the form was made pursuant to a Rule 10b5-1(c) plan, and disclosure of the date of adoption of the plan.</p> <ul style="list-style-type: none"> <li>New optional checkbox that would permit a filer to indicate whether a sale or purchase reported on the form was made pursuant to a contract, instruction or written plan to purchase or sell securities not intended to satisfy the affirmative defense conditions of Rule 10b5-1(c).</li> </ul>		
<p><b>Rule 10b5-1(c)(1)(ii):</b></p> <ul style="list-style-type: none"> <li>Require directors and officers (as defined in Exchange Act Rule 16a-1(f)), as a condition to the affirmative defense, to promptly furnish to the issuer a written certification.</li> </ul>		<p>1.5 hour compliance burden per certification.</p>
<p>Notes:  * The burden estimate for Form 10-K assumes that Schedules 14A and 14C would be the primary disclosure documents for the information provided in response to proposed Item 402(w) and Item 408(b) of Regulation S-K and the disclosure requirement under Form 10-K would be satisfied by incorporating the information by reference from the proxy or information statement. Our PRA estimates include an estimated one hour burden for Form 10-K to account for the incorporation of the information.</p>		

**C. Incremental and Aggregate Burden and Cost Estimates**

Below we estimate the incremental and aggregate increase in paperwork burden as a result of the proposed amendments. These estimates represent the average burden for all respondents, both large and small. In deriving our estimates, we recognize that the burdens will likely vary among individual respondents based on a number of factors.

We do not believe that the proposed amendments would change the frequency of responses to the existing collections of information; rather, we estimate that the proposed amendments would change only the burden per response. For the new collection of information, we estimate that there would be 7,200 responses based on the staff’s analysis, discussed in Section IV.B.1, of beneficial ownership filings on Forms 3, 4, and 5 made in the 2020 calendar year.<sup>221</sup> Based on the data from these filings, approximately 4,800 officers and directors reported a transaction pursuant to a Rule 10b5-1 trading arrangement. As noted above, the number of officers and directors using a Rule 10b5-1 trading arrangement is likely larger. Accordingly, we adjusted the estimate upward by 50 percent.

The burden estimates were calculated by multiplying the estimated number of responses by the estimated average amount of time it would take a respondent to prepare and review disclosure required under the proposed amendments. For purposes of the PRA, the burden is to be allocated between internal burden hours and outside professional costs.

The table below sets forth the percentage estimates we typically use for the burden allocation for each form. We also estimate that the average cost of retaining outside professionals is \$400 per hour.<sup>222</sup>

**PRA Table 2. Standard Estimated Burden Allocation for Specified Forms and Schedules.**

<b>Form / Schedule Type</b>	<b>Internal</b>	<b>Outside Professionals</b>
Forms 10-K, 10-Q, and Schedules 14A and 14C	75%	25%
Forms 4 and 5	100%	
Rule 10b5-1	100%	

The table below illustrates the incremental change to the total annual compliance burden of affected forms and schedules, in hours and in costs, as a result of the proposed amendments.

**PRA Table 3. Calculation of the Incremental Change in Burden Estimates of Current Responses Resulting from the Proposed Amendments**

Form / Schedule	Number of Estimated Affected Responses (A) <sup>223</sup>	Estimated Burden Hour Increase /Affected Response (B)	Total Incremental Increase in Burden Hours (C) = (A) x (B)	Estimated Increase in Internal Burden Hours (D) = (C) x (Allocation %)	Estimated Increase in Outside Professional Hours (E) = (C) x (Allocation %)	Total Increase in Outside Professional Costs (F) = (E) x \$400
10-K	8,292	16	132,672	99,504	33,168	\$13,267,200
10-Q	22,925	15	343,875	257,906.25	85,968.75	\$34,387,500
14A	6,369	13	82,797	62,097.75	20,699.25	\$8,279,700
14C	569	13	7,397	5,547.75	1,849.25	\$739,700
4	338,207	0.5	169,103.5	169,103.5	0	0
5	5,939	0.25	1,484.75	1,484.75	0	0
Total			735,844.50	594,159.25	141,685.25	\$56,674,100

The following tables summarizes the requested paperwork burden changes to existing information collections, including the estimated total reporting burdens and costs, under the proposed amendments.

**PRA Table 4. Requested Paperwork Burden under the Proposed Amendments<sup>224</sup>**

Form / Sch.	Current Burden			Program Change			Requested Change in Burden		
	Current Annual Responses (A)	Current Burden Hours (B)	Current Cost Burden (C)	Number of Affected Responses (D)	Increase in Internal Hours (E)	Increase in Outside Professional Costs (F)	Annual Responses (G) = (A)	Burden Hours (H) = (B) + (E)	Cost Burden (I) = (C) + (F)
10-K	8,292	14,188,040	\$1,893,793,119	8,292	99,504	33,168	8,292	14,287,544	\$1,893,826,287
10-Q	22,925	3,182,333	\$421,490,754	22,925	257,906	85,969	22,925	3,440,239	\$421,576,723

<sup>221</sup> See *supra* note 116 and accompanying text.

<sup>222</sup> We recognize that the costs of retaining outside professionals may vary depending on the nature of the professional services, but for purposes of this PRA analysis, we estimate that such costs would be an average of \$400 per hour. This estimate is based on consultations with several registrants, law firms, and other persons who regularly assist registrants in preparing and filing reports with the Commission.

<sup>223</sup> The number of estimated affected responses is based on the number of responses in the Commission’s current OMB PRA filing inventory. The OMB PRA filing inventory represents a three-year average.

<sup>224</sup> Figures in this table have been rounded to the nearest whole number.

14A	6,369	777,590	\$103,678,712	6,369	62,098	20,699	6,369	839,688	\$103,699,411
14C	569	56,356	\$7,514,944	569	5,548	1,849	569	61,904	\$7,516,793
4	338,207	169,104	0	338,207	169,104	0	338,207	338,208	0
5	5,939	5,939	0	5,939	1,485	0	5,939	7,424	0
Total								141,685	\$2,426,619,214

PRA Table 5 summarizes the requested paperwork burden for the proposed new collection of information—namely, the proposed new Rule 10b5-1(c)(1)(ii) certification, including the estimated total reporting burdens and costs. For purposes of the PRA, we estimate that the Rule 10b5-1(c)(1)(ii) certification would entail a one hour compliance burden per response with 7,200 annual responses.

**PRA Table 5. Requested Paperwork Burden for the new Collection of Information**

Collection of Information	Proposed Paperwork Burden	
	Annual Responses (A)	Burden Hours (A) x 1
Rule 10b5-1(c)(1)(ii) Certification	7,200	7,200

**Request for Comment**

Pursuant to 44 U.S.C. 3506(c)(2)(B), we request comment in order to:

- Evaluate whether the proposed collections of information are necessary for the proper performance of the functions of the Commission, including whether the information will have practical utility;
- Evaluate whether the Commission’s estimates of the burden of the proposed collection of information are accurate;

- Determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected;
- Evaluate whether there are ways to minimize the burden of the collection of information on those who respond, including through the use of automated collection techniques or other forms of information technology; and
- Evaluate whether the proposed amendments would have any effects on any other collection of information not previously identified in this section.

Any member of the public may direct to us any comments concerning the accuracy of these burden estimates and any suggestions for reducing these burdens. Persons submitting comments on the collection of information requirements should direct their comments to the Office of Management and Budget, Attention: Desk Officer for the U.S. Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and send a copy to, Vanessa A. Countryman, Secretary, U.S. Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549-1090, with reference to File No. S7-20-21. Requests for materials submitted to OMB by the Commission with regard to the collection of information should be in writing, refer to File No. S7-20-21 and be submitted to the U.S. Securities and Exchange Commission, Office of FOIA Services, 100 F Street NE, Washington DC 20549-2736. OMB is required to make a decision concerning the collection of information between 30 and 60 days after publication of this proposed rule. Consequently, a comment to OMB is best assured of having its full effect if the OMB receives it within 30 days of publication.

## **VI. Initial Regulatory Flexibility Act Analysis**

This Initial Regulatory Flexibility Analysis (“IRFA”) has been prepared in accordance

with the Regulatory Flexibility Act (“RFA”).<sup>225</sup> It relates to proposed amendments to Rule 10b5-1(c)(1); Regulation S-K, Forms 10-K, 10-Q, 4, and 5; and Schedules 14A and 14C.

### **A. Reasons for, and Objectives of, the Proposed Action**

The purpose of the proposed amendments is to address potentially abusive practices associated with Rule 10b5-1 trading arrangements, grants of options and other equity instruments with similar features and the gifting of securities. The proposed amendments are also intended to provide greater transparency to investors about issuer and insider trading arrangements and restrictions, as well as insider compensation and incentives, enabling more informed voting and investment and decisions about an issuer. The proposed amendments are discussed in more detail in Section II above. We discuss the economic impact and potential alternatives to the amendments in Section IV, and the estimated compliance costs and burdens of the amendments under the PRA in Section V above.

### **B. Legal Basis**

We are proposing the amendments under Sections 3(b), 6, 7, 10, 17, 19(a), and 28 of the Securities Act; Sections 3, 9, 10, 12, 13, 14, 15(d), 20A, 21A, 23(a), and 36 of the Exchange Act; and Sections 8, 20(a), 24(a), 30 and 38 of the Investment Company Act; and 15 U.S.C. 7264.

### **C. Small Entities Subject to the Proposed Rules**

The proposed amendments would apply to registrants that are small entities. The Regulatory Flexibility Act defines “small entity” to mean “small business,” “small organization,” or “small governmental jurisdiction.”<sup>226</sup> For purposes of the Regulatory Flexibility Act, under our rules, a registrant, other than an investment company, is a “small business” or “small

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<sup>225</sup> 5 U.S.C. 601 *et seq.*

<sup>226</sup> 5 U.S.C. 601(6).

organization” if it had total assets of \$5 million or less on the last day of its most recent fiscal year and is engaged or proposing to engage in an offering of securities that does not exceed \$5 million.<sup>227</sup> Under 17 CFR 270.0-10, an investment company, including a business development company, is considered to be a small entity if it, together with other investment companies in the same group of related investment companies, has net assets of \$50 million or less as of the end of its most recent fiscal year. An investment company, including a business development company,<sup>228</sup> is considered to be a “small business” if it, together with other investment companies in the same group of related investment companies, has net assets of \$50 million or less as of the end of its most recent fiscal year.<sup>229</sup> Commission staff estimates that, as of June 2021, there were 660 issuers,<sup>230</sup> and 9 business development companies that may be considered small entities that would be subject to the proposed amendments.<sup>231</sup>

#### **D. Reporting, Recordkeeping, and Other Compliance Requirements**

The proposed amendments to Rule 10b5-1(c)(1) would apply to small entities to the same extent as other entities, irrespective of size. The proposed amendments to Rule 10b5-1(c)(1) would not directly impose any recordkeeping or compliance requirements on any small entities. We anticipate that the nature of any benefits and costs associated with the proposed amendments to Rule 10b5-1(c)(1) would be similar for large and small entities. Accordingly, we refer to the

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<sup>227</sup> See Exchange Act Rule 0-10(a) [17 CFR 240.0-10(a)].

<sup>228</sup> Business development companies are a category of closed-end investment company that are not registered under the Investment Company Act [15 U.S.C. 80a-2(a)(48) and 80a-53-64].

<sup>229</sup> 17 CFR 270.0-10(a).

<sup>230</sup> This estimate is based on staff analysis of Form 10-K filings on EDGAR, or amendments thereto, filed during the calendar year of January 1, 2020 to December 31, 2020, or filed by September 1, 2021, and on data from XBRL filings, Compustat, and Ives Group Audit Analytics.

<sup>231</sup> These estimates are based on staff analysis of Morningstar data and data submitted by investment company registrants in forms filed on EDGAR as of June 30, 2021.

discussion of the proposed amendments' economic effects on all affected parties, including small entities, in Section IV.B. above. Consistent with that discussion, we anticipate that the economic benefits and costs likely would vary widely among small entities based on a number of factors, including the nature and conduct of their businesses, which makes it difficult to project the economic impact on small entities with precision. However, we request comment on how the proposed amendments to Rule 10b5-1(c)(1) would affect small entities.

The proposed disclosure amendments to Regulation S-K, Forms 10-K, 10-Q, and Schedules 14A and 14C are designed to provide greater transparency about officer, director, and issuer trading arrangements; policies and procedures with respect to insider trading; and the timing of executive compensation option awards in relation to the release of material nonpublic information. If adopted, these amendments generally would:

- Disclosure regarding the adoption and termination of Rule 10b5-1(c) and non-Rule 10b5-1(c) trading arrangements of directors, officers, and the issuer, as well as the material terms of such trading arrangements;
- Disclosure of whether the issuer has adopted (and if not, why) insider trading policies and procedures governing the purchase, sale, and other dispositions of the issuer's securities by directors, officers and employees that are reasonably designed to promote compliance with insider trading laws, rules and regulations, and any listing standards applicable to the issuer;
- Narrative disclosure of an issuer's policies and practices on the timing of awards of stock options, SARs or similar instruments; and
- Tabular disclosure of each option award granted to a named executive officer within 14 calendar days before or after the filing of a periodic report, an issuer share

repurchase, or the filing or furnishing of a current report on Form 8-K that contains material nonpublic information.

In addition, the proposed amendments to Forms 4 and 5 would:

- Add a Rule 10b5-1 checkbox to these that would require a Form 4 or 5 filer to indicate whether a sale or purchase reported on that form was made pursuant to a Rule 10b5-1 trading arrangement. Filers would also be required to provide the date of adoption of the Rule 10b5-1 trading arrangement;
- Add a second, optional checkbox to both of Forms 4 and 5 that would allow a filer to indicate whether a transaction reported on the form was made pursuant to a contract, instruction, or written plan that is not intended to satisfy the conditions of Rule 10b5-1(c)(1); and
- Require the reporting of dispositions of bona fide gifts of equity securities on Form 4.

We anticipate that the direct costs of preparing disclosure in response to the proposed amendments will likely be relatively small as such information will be readily available to companies. To the extent that the proposed disclosure requirements has a greater effect on small filers relative to large filers, they could result in adverse effects on competition. The fixed component of the legal costs of preparing the disclosure could be one contributing factor. Compliance with the proposed amendments may require the use of professional skills, including legal skills. We request comment on how the proposed disclosure amendments would affect small entities.

#### **E. Duplicative, Overlapping, or Conflicting Federal Rules**

Proposed Item 408(b) may partially duplicate and overlap with an existing disclosure requirement under Item 406 of Regulation S-K, which requires an issuer to disclose whether it

has adopted a code of ethics that applies to its principal executive officer, chief financial officer, and other appropriate executives and, if it has not adopted such a code, to state why it has not done so. An issuer's existing code of ethics may contain insider trading policies. In such instances, an issuer could cross-reference to the particular components of its code of ethics that constitute insider trading policies and procedures in response to proposed Item 408(b)(2). Other than Item 408(b), the proposed amendments would not duplicate, overlap, or conflict with other federal rules.

We additionally note that in a separate release, we are, among other things, proposing rule and form amendments that would require an issuer to provide timely disclosure regarding repurchases of its equity securities, and disclosure of whether the repurchases was pursuant to a Rule 10b5-1 plan. In connection with the potential adoption of these rules, we would plan to coordinate these rulemakings to avoid any duplication, overlap or conflict between the rules.

#### **F. Significant Alternatives**

The RFA directs us to consider alternatives that would accomplish our stated objectives, while minimizing any significant adverse impact on small entities. In connection with the amendments, we considered the following alternatives:

- Establishing different compliance or reporting requirements that take into account the resources available to small entities;
- Clarifying, consolidating, or simplifying compliance and reporting requirements under the rules for small entities;
- Using performance rather than design standards; and
- Exempting small entities from all or part of the requirements.

Insider trading imposes costs on the investors in a company.<sup>232</sup> The proposed disclosure amendments and the amendments to Rule 10b5-1(c)(1) are intended to provide greater transparency to investors and decrease information asymmetries between corporate insiders and outside investors and to deter potentially abusive and problematic practices associated with the use of Rule 10b5-1(c)(1) trading arrangements, grants of option awards, and the gifting of securities. Importantly, we anticipate the proposed amendments will work in tandem to significantly reduce improper insider trading through Rule 10b5-1(c)(1) trading arrangements. As discussed in above in Section IV, deterring insider trading will result in benefits for investor protection, capital formation, and orderly and efficient markets. By deterring insider trading, the amendments would disincentivize insider behavior that undermines investor confidence and harms the securities markets. For these reasons, we do not believe it would be appropriate to provide simplified or consolidated reporting requirements, a differing compliance timetable, or an exemption for small entities from all or part of the proposed amendments.

With respect to using performance rather than design standards, the proposed amendments use a combination of design and performance standards in order to promote uniform compliance requirements for all registrants. We believe the proposed amendments would be more beneficial to investors and small entities if there are uniform requirements that must be satisfied for a trading arrangement to be eligible for the Rule 10b5-1(c)(1) affirmative defense and specific disclosure requirements that apply to all registrants. In addition, the proposed disclosure amendments should result in more comprehensive and clear disclosure.

### **G. Request for Comments**

We encourage the submission of comments with respect to any aspect of this Initial

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<sup>232</sup> See *supra* Section IV.

Regulatory Flexibility Analysis. In particular, we request comments regarding:

- The number of small entity issuers that may be affected by the proposed amendments;
- The existence or nature of the potential impact of the proposed amendments on small entity issuers discussed in the analysis;
- How the proposed amendments could further lower the burden on small entities; and
- How to quantify the impact of the proposed amendments.

Please describe the nature of any impact and provide empirical data supporting the extent of the impact. Such comments will be considered in the preparation of the Final Regulatory Flexibility Analysis, if the proposed amendments are adopted, and will be placed in the same public file as comments on the proposed amendments themselves.

## **VII. Small Business Regulatory Enforcement Fairness Act**

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996 (“SBREFA”),<sup>233</sup> the Commission must advise OMB as to whether the proposed amendments constitute a “major” rule. Under SBREFA, a rule is considered “major” where, if adopted, it results, or is likely to result, in:

- An annual effect on the economy of \$100 million or more (either in the form of an increase or a decrease);
- A major increase in costs or prices for consumers or individual industries; or
- Significant adverse effects on competition, investment or innovation.

We request comment on whether the proposed amendments would be a “major rule” for purposes of SBREFA. We solicit comment and empirical data on: (a) the potential effect on the U.S. economy on an annual basis; (b) any potential increase in costs or prices for consumers or

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<sup>233</sup> Pub. L. No. 104-121, Title II, 110 Stat. 857 (1996).

individual industries; and (c) any potential effect on competition, investment or innovation.

Commenters are requested to provide empirical data and other factual support for their views to the extent possible.

### **VIII. Statutory Authority**

The amendments contained in this release are being proposed under the authority set forth in Sections 3(b), 6, 7, 10, 17, 19(a), and 28 of the Securities Act; Sections 3, 9, 10, 12, 13, 14, 15(d), 20A, 21A, 23(a), and 36 of the Exchange Act; and Sections 8, 20(a), 24(a), 30 and 38 of the Investment Company Act; and 15 U.S.C. 7264.

#### **List of Subjects in 17 CFR Parts 229, 232, 240 and 249**

Reporting and recordkeeping requirements, Securities.

#### **Text of the Amendments**

For the reasons set out in the preamble, the Commission proposes to amend title 17, chapter II of the Code of Federal Regulations as follows:

#### **PART 229—STANDARD INSTRUCTIONS FOR FILING FORMS UNDER SECURITIES ACT OF 1933, SECURITIES EXCHANGE ACT OF 1934 AND ENERGY POLICY AND CONSERVATION ACT OF 1975 – REGULATION S-K**

1. The authority citation for part 229 is revised to read as follows:

*Authority:* 15 U.S.C. 77e, 77f, 77g, 77h, 77j, 77k, 77s, 77z-2, 77z-3, 77aa(25), 77aa(26), 77ddd, 77eee, 77ggg, 77hhh, 77iii, 77jjj, 77nnn, 77sss, 78c, 78i, 78j, 78j-3, 78l, 78m, 78n, 78n-1, 78o, 78u-5, 78w, 78ll, 78 mm, 80a-8, 80a-9, 80a-20, 80a-29, 80a-30, 80a-31(c), 80a-37, 80a-38(a), 80a-39, 80b-11 and 7201 et seq.; 18 U.S.C. 1350; sec. 953(b), Pub. L. 111-203, 124 Stat. 1904 (2010); and sec. 102(c), Pub. L. 112-106, 126 Stat. 310 (2012).

2. Amend §229.402 by adding new paragraph (x) to read as follows:

**§229.402 (Item 402) Executive compensation.**

\* \* \* \* \*

(x) *Narrative disclosure of the registrant's policies and practices related to the grant of equity awards in coordination with the release of material nonpublic information.*

(1) Discuss the registrant's policies and practices on the timing of awards of stock options, SARs or similar instruments in relation to the disclosure of material nonpublic information by the registrant, including how the board determines when to grant options (for example, whether awards are granted on a predetermined schedule); whether the board or compensation committee takes material nonpublic information into account when determining the timing and terms of an award, and if so, how, the board or compensation committee takes material nonpublic information into account when determining the timing and terms of an award; and whether the registrant has timed the disclosure of material nonpublic information for the purpose of affecting the value of executive compensation.

(2) *Options awarded shortly before or after the filing of documents containing material nonpublic information.*

(i) If during the last completed fiscal year, a grant of stock options, SARs or similar instruments was awarded to a named executive officer within a 14-day period before or after the filing of a periodic report on Form 10-Q or Form 10-K, an issuer share repurchase, or the filing or furnishing of a current report Form 8-K that discloses material nonpublic information (including earnings information), provide the information specified in paragraph (2)(ii) of this Item, concerning each such award for each of the named executive officers on an aggregated basis in the following tabular format:

Name (a)	Grant Date (b)	Number of securities underlying the option award (c)	Exercise Or Strike Price of Option Award (\$/Sh) (d)	Grant date fair value of stock and option award (e)	Market value of the securities underlying award one trading day before disclosure of material nonpublic information (f)	Market value of the securities underlying award one trading day after disclosure of material nonpublic information (g)
PEO						
PFO						
A						
B						
C						

(ii) The Table shall include:

(A) The name of the executive officer (column (a));

(B) On an award-by-award basis, the grant date for option awards reported in the table (column (b));

(C) On an award-by-award basis, the number of securities underlying the options (column (c));

(D) The per-share exercise or strike price of the option award (column (d)).

(E) On an award-by-award basis, the grant date fair value of each equity award computed in accordance with FASB ASC Topic 718 (column (e)).

(F) If the award was made within 14 calendar days before the filing of a periodic report on Form 10-Q or Form 10-K, an issuer share repurchase, or the filing or furnishing of a current report on Form 8-K that discloses material nonpublic information (including earnings information), disclose for each instrument reported in column (c), the market value of the securities underlying the award the trading day before disclosure of material nonpublic information (column (f)); and

(G) If the award was made within 14 calendar days after the filing of a periodic report on Form 10-Q or Form 10-K, an issuer share repurchase, or the filing or furnishing of a current Form 8-K that discloses material nonpublic information, disclose for each instrument reported in column (c), the market value securities underlying the award the trading day after disclosure of material nonpublic information (column (g)).

*Instructions to paragraph (2).*

(1) A registrant that is a smaller reporting company may limit the disclosures in the table to its PEO, the two most highly compensated executive officers other than the PEO who were serving as executive officers at the end of the last completed fiscal year, and up to two additional individuals who would have been the most highly compensated but for the fact that the individual was not serving as executive officers at the end of the last completed fiscal year.

(2) Compute the market value of stock reported in column (f) by multiplying the closing market price of the registrant's stock at the end of the trading day before the disclosure of material nonpublic information by the number of shares or units of stock or the amount of equity incentive plan awards, respectively. Compute the market value of stock reported in column (g) by multiplying the closing market price of the registrant's stock at the end of the trading day after the disclosure of material nonpublic information by the number of shares or units of stock or the amount of equity incentive plan awards, respectively.

(c) Provide the disclosure required by this Item in an Interactive Data File as required by Rule 405 of Regulation S-T (17 CFR 232.405) in accordance with the EDGAR Filer Manual.

3. Add §229.408 to read as follows:

**§229.408 (Item 408) Insider trading arrangements and policies.**

(a)(1) Disclose whether, during the registrant's last fiscal quarter (the registrant's fourth

fiscal quarter in the case of an annual report), the registrant has adopted or terminated any contract, instruction or written plan for the purchase or sale of securities of the registrant whether or not intended to satisfy the affirmative defense conditions of Rule 10b5-1(c) (§ 240.10b5-1(c) of this chapter), and provide a description of the material terms of the contract, instruction or written plan, including (i) the date of adoption or termination; (ii) the duration of the contract, instruction or written plan; and (iii) the aggregate amount of securities to be sold or purchased pursuant to the contract, instruction or written plan.

(2) Disclose whether, during the registrant's last fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report), any director or officer (as defined in § 240.16a-1(f) of this chapter) has adopted or terminated any contract, instruction or written plan for the purchase or sale of securities of the registrant whether or not intended to satisfy the affirmative defense conditions of Rule 10b5-1(c) (§ 240.10b5-1(c) of this chapter) and provide a description of the material terms the contract, instruction or written plan including: (i) the name and title of the director or officer; (ii) the date on which the director or officer adopted or terminated the contract, instruction or written plan; (iii) the duration of the contract, instruction or written plan; and (iv) the aggregate number of securities to be sold or purchased pursuant to the contract, instruction or written plan.

(3) Provide the disclosure required by this paragraph (a) in an Interactive Data File as required by Rule 405 of Regulation S-T (17 CFR 232.405) in accordance with the EDGAR Filer Manual.

Note to paragraph (a): Any modification or amendment to a prior contract, instruction, or written plan is deemed to be the termination of such prior contract, instruction, or written plan, and the adoption of a new contract, instruction, or written plan.

(b)(1) Disclose whether the registrant has adopted insider trading policies and procedures governing the purchase, sale, and other dispositions of the registrant’s securities by directors, officers and employees that are reasonably designed to promote compliance with insider trading laws, rules and regulations, and any listing standards applicable to the registrant. If the registrant has not adopted such policies and procedures explain why it has not done so.

(2) If the registrant has adopted insider trading policies and procedures, disclose such policies and procedures.

(3) Provide the disclosure required by this paragraph (b) in an Interactive Data File as required by Rule 405 of Regulation S-T (17 CFR 232.405) in accordance with the EDGAR Filer Manual.

**PART 232 — REGULATION S-T — GENERAL RULES AND REGULATIONS FOR  
ELECTRONIC FILINGS**

4. The general authority citation for part 232 continues to read in part as follows:

Authority: 15 U.S.C. 77c, 77f, 77g, 77h, 77j, 77s(a), 77z-3, 77sss(a), 78c(b), 78l, 78m, 78n, 78o(d), 78w(a), 78ll, 80a-6(c), 80a-8, 80a-29, 80a-30, 80a-37, 7201 *et seq.*; and 18 U.S.C. 1350, unless otherwise noted.

\* \* \* \* \*

5. Amend §232.405 by:

- a. Adding paragraph (b)(1)(iii);
- b. Adding paragraph (b)(3)(i)(C); and
- c. Adding paragraph (b)(4).

**§232.405 Interactive Data File Submissions.**

\* \* \* \* \*

(b) *Content - categories of information presented.* (1) If the electronic filer is neither a management investment company registered under the Investment Company Act of 1940 (15 U.S.C. 80a et seq.), nor a separate account (as defined in Section 2(a)(14) of the Securities Act (15 U.S.C. 77b(a)(14)) registered under the Investment Company Act of 1940, nor a business development company as defined in Section 2(a)(48) of the Investment Company Act of 1940 (15 U.S.C. 80a-2(a)(48)) an Interactive Data File must consist of only a complete set of information for all periods required to be presented in the corresponding data in the Related Official Filing, no more and no less, from all of the following categories:

\* \* \* \* \*

(iii) The disclosure set forth in paragraph (4) of this section.

\* \* \* \* \*

(3) If the electronic filer is either a closed-end management investment company registered under the Investment Company Act of 1940 (15 U.S.C. 80a et seq.) or a business development company as defined in Section 2(a)(48) of the Investment Company Act of 1940 (15 U.S.C. 80a-2(a)(48)), an Interactive Data File must consist only of a complete set of information for all corresponding data in the Related Official Filing, no more and no less, as follows:

(i) For a business development company, for all periods required to be presented:

\* \* \* \* \*

(C) The disclosure set forth in paragraph (4) of this section.

\* \* \* \* \*

(4) An Interactive Data File must consist of the disclosures provided under Regulation S-K (17 CFR 229) and related provisions that are required to be tagged, including, as applicable:

- (a) Item 402(x)(b) of Regulation S-K (§229.402(x)(b) of this chapter);
- (b) Item 408(a)(3) of Regulation S-K (§229.408(a)(3) of this chapter); and
- (c) Item 408(b)(3) of Regulation S-K (§229.408(b)(3) of this chapter).

\* \* \* \* \*

**PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE  
ACT OF 1934**

6. The authority citation for part 240 is revised to read as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78c-3, 78c-5, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78n-1, 78o, 78o-4, 78o-10, 78p, 78q, 78q-1, 78s, 78u-5, 78w, 78x, 78dd, 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, and 7201 et seq., and 8302; 7 U.S.C. 2(c)(2)(E); 12 U.S.C. 5221(e)(3); 18 U.S.C. 1350; Pub. L. 111-203, 939A, 124 Stat. 1376 (2010); and Pub. L. 112-106, sec. 503 and 602, 126 Stat. 326 (2012), unless otherwise noted.

\* \* \* \* \*

7. Amend § 240.10b5-1 to read as follows:

- a. Removing the Preliminary Note;
- b. Revising paragraph (a);
- c. Revising paragraph (b); and
- d. Revising paragraph (c)(1).

The revisions to read as follows:

**§ 240.10b5-1 Trading “on the basis of” material nonpublic information in insider trading cases.**

(a) *Manipulative or Deceptive Devices.* The “manipulative or deceptive device[s] or

contrivance[s]” prohibited by Section 10(b) of the Act (15 U.S.C. 78j) and § 240.10b-5 thereunder include, among other things, the purchase or sale of a security of any issuer, on the basis of material nonpublic information about that security or issuer, in breach of a duty of trust or confidence that is owed directly, indirectly, or derivatively, to the issuer of that security or the shareholders of that issuer, or to any other person who is the source of the material nonpublic information.

(b) *Awareness of material nonpublic information.* Subject to the affirmative defenses in paragraph (c) of this section, a purchase or sale of a security of an issuer is 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. The law of insider trading is otherwise defined by judicial opinions construing Rule 10b-5, and Rule 10b5-1 does not modify the scope of insider trading law in any other respect.

(c) *Affirmative Defenses.*

(1)

(i) Subject to paragraph (c)(1)(ii) of this section, a person’s purchase or sale is not “on the basis of” material nonpublic information if the person making the purchase or sale demonstrates that:

(A) Before becoming aware of the information, the person had:

(1) Entered into a binding contract to purchase or sell the security,

(2) Instructed another person to purchase or sell the security for the instructing person's account, or

(3) Adopted a written plan for trading securities;

(B) The contract, instruction, or plan described in paragraph (c)(1)(i)(A) of this Section:

(1) 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;

(2) Included a written formula or algorithm, or computer program, for determining 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; or

(3) Did not permit the person to exercise any subsequent influence over how, when, or whether to effect purchases or sales; provided, in addition, that any other person who, pursuant to the contract, instruction, or plan, did exercise such influence must not have been aware of the material nonpublic information when doing so; and

(C) The purchase or sale that occurred was pursuant to the contract, instruction, or plan. A purchase or sale is not “pursuant to a contract, instruction, or plan” if, among other things, the person who entered into the contract, instruction, or plan altered or deviated from the contract, instruction, or plan to purchase or sell securities (whether by changing the amount, price, or timing of the purchase or sale) or entered into or altered a corresponding or hedging transaction or position with respect to those securities.

(ii) Paragraph (c)(1)(i) of this section is applicable only when:

(A) The contract, instruction, or plan to purchase or sell securities was given or entered into and operated in good faith and not as part of a plan or scheme to evade the prohibitions of this section;

(B) If the person who entered into the contract, instruction, or plan is a director or officer (as defined in Rule 16a-1(f) (§ 240.16a-1(f)) of the issuer, no purchases or sales occur until expiration of a cooling-off period of at least 120 days after the date of the adoption of the

contract, instruction, or plan; if the person who entered into the contract, instruction, or plan is the issuer of the securities, no purchases or sales occur until expiration of a cooling-off period of at least 30 days after the date of the adoption of the contract, instruction, or plan;

(C) If the person who entered into the contract, instruction, or plan is a director or officer (as defined in Rule 16a-1(f) (§ 240.16a-1(f)) of the issuer (or a subsidiary of such issuer ) of the securities, such director or officer on the date of adoption of the contract, instruction, or plan has promptly furnished to the issuer a written certification that they are not aware of any material nonpublic information about the security or issuer or any subsidiary of the issuer; and that they are adopting the contract, instruction, or plan in good faith and not as part of a plan or scheme to evade the prohibitions of this section;

*Instruction to paragraph (c)(1)(ii)(C):* Officers and directors seeking to rely on the affirmative defense should retain a copy of the certification provided to the issuer for a period of ten years after providing such certification.

(D) The person who entered into the contract, instruction, or plan, has no outstanding (and does not subsequently enter into an additional) contract, instruction, or plan for open market purchases or sales of the same class of securities; and

(E) If the contract, instruction, or plan is designed to effect the purchase or sale of the total amount of securities as a single transaction, the person who entered into the contract, instruction, or plan has not during the prior 12-month period executed a contract, instruction, or plan that effected the purchase or sale of the total amount of securities in a single transaction.

Note to paragraph (c): Any modification or amendment to a prior contract, instruction, or written plan is deemed to be the termination of such prior contract, instruction, or written plan, and the adoption of a new contract, instruction, or written plan.

\* \* \* \* \*

8. Amend § 240.14a-101 by revising paragraph (b) of Item 7 to read as follows:

**§240.14a-101 Schedule 14A. Information required in proxy statement.**

\* \* \* \* \*

*Item 7. Directors and executive officers.*

\* \* \* \* \*

(b) The information required by Items 401, 404(a) and (b), 405, 407 and 408(b) of Regulation S-K (§§ 229.401, 229.404(a) and (b), 229.405, 229.407, and 229.408(b) of this chapter), other than the information required by:

\* \* \* \* \*

9. Amend § 240.16a-3 by:

- a. Revising paragraph (f)(1)(i)(A); and
- b. Revising paragraph (g)(1).

The revisions to read as follows:

**§ 240.16a-3 Reporting transactions and holdings.**

\* \* \* \* \*

(f) \* \* \*

(A) Exercises and conversions of derivative securities exempt under either § 240.16b-3 or § 240.16b-6(b), dispositions by bona fide gifts exempt under § 240.16b-5, and any transaction exempt under § 240.16b-3(d), § 240.16b-3(e), or § 240.16b-3(f), (these are required to be reported on Form 4);

\* \* \* \* \*

(g)(1) A Form 4 must be filed to report: All transactions not exempt from section 16(b) of

the Act; All transactions exempt from section 16(b) of the Act pursuant to § 240.16b-3(d), § 240.16b-3(e), or § 240.16b-3(f); and dispositions by bona fide gifts and all exercises and conversions of derivative securities, regardless of whether exempt from section 16(b) of the Act. Form 4 must be filed before the end of the second business day following the day on which the subject transaction has been executed.

\* \* \* \* \*

#### **PART 249 — FORMS, SECURITIES EXCHANGE ACT OF 1934**

10. The general authority citation for part 249 continues to read as follows:

*Authority:* 15 U.S.C. 78a *et seq.* and 7201 *et seq.*; 12 U.S.C. 5461 *et seq.*; 18 U.S.C. 1350; Sec. 953(b) Pub. L. 111-203, 124 Stat. 1904; Sec. 102(a)(3) Pub. L. 112-106, 126 Stat. 309 (2012), Sec. 107, Pub. L. 112-106, 126 Stat. 313 (2012), and Sec. 72001 Pub. L. 114-94, 129 Stat. 1312 (2015), unless otherwise noted.

\* \* \* \* \*

11. Amend Form 4 (referenced in §249.104) by:

- a. Adding new General Instruction 10; and
- b. Adding text and two check boxes at the top of the first page immediately below the text “Check this box if no longer subject to Section 16. Form 4 or Form 5 obligations may continue. *See* Instruction 1(b).”

The additions to read as follows:

**Note: The text of Form 4 does not, and this amendment will not, appear in the Code of Federal Regulations.**

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 4**

\* \* \* \* \*

## General Instructions

\* \* \* \* \*

### **Rule 10b5-1(c) and Non-Rule 10b5-1(c) Transaction Indication**

Indicate by check mark whether a transaction was made pursuant to a contract, instruction or written plan for the purchase or sale of equity securities of the issuer that satisfies the conditions of Rule 10b5-1(c) under the Exchange Act [§240.10b5-1(c) of this chapter]. Provide the date of adoption of the Rule 10b5-1(c) plan in the “Explanation of Responses” portion of the Form.

If a transaction was made pursuant to a contract, instruction or written plan for the purchase or sale of equity securities of the issuer that did not satisfy the conditions of Rule 10b5-1(c), a reporting person may elect to check the optional non-Rule 10b5-1(c) box appearing on this Form.

\* \* \* \* \*

Check this box to indicate that a transaction was made pursuant to Rule 10b5-1(c). *See* Instruction 10.

A reporting person may elect to check this box to indicate that a transaction was made pursuant to a contract, instruction or written plan for the purchase or sale of equity securities of the issuer that did not satisfy the conditions of Rule 10b5-1(c) under the Exchange Act. *See* Instruction 10.

\* \* \* \* \*

12. Amend Form 5 (referenced in §249.105) by:
  - a. Adding new General Instruction 10; and

b. Adding text and two check boxes at the top of the first page immediately below the text “Form 4 Transactions Reported”.

The additions to read as follows:

**Note: The text of Form 5 does not, and this amendment will not, appear in the Code of Federal Regulations.**

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 5**

\* \* \* \* \*

General Instructions

\* \* \* \* \*

**Rule 10b5-1(c) and Non-Rule 10b5-1(c) Transaction Indication**

Indicate by check mark whether a transaction was made pursuant to a contract, instruction or written plan for the purchase or sale of equity securities of the issuer that satisfies the conditions of Rule 10b5-1(c) under the Exchange Act [§240.10b5-1(c) of this chapter]. Provide the date of adoption of the Rule 10b5-1(c) plan in the “Explanation of Responses” portion of the Form.

If a transaction was made pursuant to a contract, instruction or written plan for the purchase or sale of equity securities of the issuer that does not satisfy the conditions of Rule 10b5-1(c), a reporting person may elect to check the optional non-Rule 10b5-1(c) box appearing on this Form.

\* \* \* \* \*

Check this box to indicate that a transaction was made pursuant to Rule 10b5-1(c). *See*

Instruction 10.

A reporting person may elect to check this box to indicate that a transaction was made pursuant to a contract, instruction or written plan for the purchase or sale of equity securities of the issuer that did not satisfy the conditions of Rule 10b5-1(c) under the Exchange Act. *See*

Instruction 10.

\* \* \* \* \*

13. Amend Form 20-F (referenced in § 249.220f) by adding new Item 16J to read as follows:

**Note: The text of Form 20-F does not, and this amendment will not, appear in the Code of Federal Regulations.**

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**FORM 20-F**

\* \* \* \* \*

**Item 16J. Insider trading policies**

(a) Disclose whether the registrant has adopted insider trading policies and procedures governing the purchase, sale, and other dispositions of the registrant's securities by directors, senior management, and employees that are reasonably designed to promote compliance with applicable insider trading laws, rules and regulations, and listing standards. If the registrant has not adopted such policies and procedures, explain why it has not done so.

(b) If the registrant has adopted insider trading policies and procedures, disclose such policies and procedures.

(c) Provide the disclosure required by Item 16J in an Interactive Data File as required by Rule 405 of Regulation S-T (17 CFR 232.405) in accordance with the EDGAR Filer Manual.

Instruction to Item 16J: Item 16J applies only to annual reports, and does not apply to

registration statements, on Form 20-F.

\* \* \* \* \*

14. Amend Form 10-Q (referenced in § 249.308a) by adding paragraph (c) to Item 5 in Part II to read as follows:

**Note: The text of Form 10-Q does not, and this amendment will not, appear in the Code of Federal Regulations.**

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**  
**FORM 10-Q**

\* \* \* \* \*

**Part II—Other Information**

\* \* \* \* \*

**Item 5. Other Information.**

\* \* \* \* \*

(c) Furnish the information required by Item 408(a) of Regulation S-K (17 CFR 229.408(a)).

\* \* \* \* \*

15. Amend Form 10-K (referenced in § 249.310) by revising Item 10 in Part III to read as follows:

**Note: The text of Form 10-K does not, and this amendment will not, appear in the Code of Federal Regulations.**

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**Form 10-K**

\* \* \* \* \*

**PART III**

\* \* \* \* \*

**Item 10. Directors, Executive Officers and Corporate Governance.**

Furnish the information required by Items 401, 405, 406, 407(c)(3), (d)(4), (d)(5), and 408 of Regulation S-K (§ 229.401, § 229.405, § 229.406, § 229.407(c)(3), (d)(4), (d)(5), and § 229.408 of this chapter).

\* \* \* \* \*

By the Commission.

Dated: December 15, 2021

Vanessa A. Countryman  
Secretary