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Skadden

The Informed Board Alert

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What the SEC's New Insider Trading Rules Mean for Directors

Takeaways

- New SEC rules on Rule 10b5-1 preset trading plans for insiders add lengthy "cooling-off periods" for directors and officers between the time they establish a plan and the date a first trade can be made.
- Most multiple overlapping plans and single-trade plans are now prohibited.
- The good faith requirement has been expanded and directors and executives will now have to certify when they create or modify a plan that they are acting in good faith and have no material nonpublic information.
- Companies will be required to disclose individuals' 10b5-1 plans in detail every quarter, and itemize annually all options awarded to top executives around the time of significant SEC filings.

In December 2022, the U.S. Securities and Exchange Commission (SEC) modified the rules governing preset stock trading programs for corporate insiders, known as 10b5-1 plans, which begin taking effect this year. The new rules will require directors, executives and other insiders to rethink their own preplanned trading programs, and companies will need to revisit their policies, and disclosure controls and procedures.

Below are answers to questions you may have. These are simplified and omit some conditions, exceptions and other details, so consider this just an overview and introduction.

What's behind the changes?

The SEC's Rule 10b5-1 allows insiders to establish preset plans to trade their companies' securities in the future. If a plan complies with the requirements, it can be used as an affirmative defense to any claim that the insider's trades were based on material nonpublic information.

The new rules reflect concerns that some insiders have gamed the rules, arranging advantageous trades based on inside information.

How will this affect my 10b5-1 plans?

Existing plans are not affected, but the rules will apply to any modifications as well as new plans starting February 27, 2023, so directors and officers may confront the new rules soon.

Cooling-off period. In the past, unless restricted by a company's own insider trading policy, an insider could adopt a plan that called for trades to commence almost immediately. Under the amended rules, trades under a director's or officer's plan cannot begin until at least:

> (a) 90 days after the adoption or modification of their trading plan, or
>
> (b) two business days after the company files a quarterly or annual financial report with the SEC covering the quarter in which the plan was adopted or modified,

whichever is later, but no later than 120 days after the plan is established.

Limits on multiple overlapping plans. Individuals generally will be prohibited from having more than one 10b5-1 plan covering the same time period for open market purchases or sales. An individual will be allowed to have two separate 10b5-1 plans for open market transactions only if trading under one does not commence until all trades under the other have been completed. (There is an exception for plans covering sales needed to satisfy tax withholding obligations triggered by the vesting of equity compensation.)

Limits on single-trade arrangements. At present, many 10b5-1 plans are set up for a single trade. Under the revised rules, a person will be limited to one single-trade plan in any 12-month period (with the same exception for tax withholding obligations).

What does "an expanded good faith duty" mean?

There are two significant changes here.

Under the old rules, to qualify as a 10b5-1 plan, it only had to be entered into in good faith. The new rules require *a written certification* from directors and officers when adopting or modifying a 10b5-1 plan that he or she (a) is not aware of material nonpublic information about the company or its securities and (b) is adopting or modifying the plan in good faith and not as part of a plan or scheme to evade the prohibitions of Rule 10b-5.

In addition, good faith will be tested not just at inception of the plan. For a plan to qualify as an affirmative defense under the new rules, the person must have "acted in good faith with respect to" the plan, thus extending the good faith requirement throughout the duration of the plan.

Of particular note, the SEC said that influencing the timing of a company's disclosure so that trades under a plan are more profitable would run afoul of this ongoing good faith requirement.

What kind of disclosures will be required?

Companies will be required to disclose annually whether they have insider trading policies and procedures governing the trading by directors, officers and employees, and those policies must be included as an exhibit to the company's annual financial report filed with the SEC.

Of particular relevance to directors and officers, companies will be required to (a) disclose quarterly whether any director or officer has adopted, modified or terminated a Rule 10b5-1 plan or other trading arrangement and (b) describe the material terms of each plan adopted, modified or terminated, including the name and title of the director or officer; the date the plan was adopted, modified or terminated; the plan's duration; and the total amount of securities to be purchased or sold under the plan. Pricing terms need not be disclosed.

So my trading plans will be made public?

Yes, the details of the plans will be public, but without pricing information.

What are the new rules on option awards?

Under the amended rules, each year companies will need to state (a) how the timing of option awards is decided, (b) if and how material nonpublic information is considered when determining the timing and terms of awards, and (c) whether disclosure of that information is timed to affect the value of executive compensation.

Companies also will be required to disclose each year any options awarded to named executive officers within four business days before or one business day after quarterly financial filings or "current reports" that disclose material nonpublic information. Companies need to disclose:

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

Do any of the changes affect corporate share repurchases?

Not at present, but the SEC said it is considering whether rule changes are necessary for open-market share repurchases by companies.

What will boards need to think about now that the new rules are taking effect?

Different parts of the amendments take effect on different dates over the next year. Your company's legal and compliance departments will handle the details of complying with the new rules. But, as a director, you may be involved in broader issues the changes raise:

- Insider trading policies and guidelines may need to be revised.
- Companies should consider what controls and procedures they will need to comply with the new disclosure requirements.
- Boards may need to revisit the schedule for compensation committee meetings in light of the new disclosure rules regarding option grant practices generally, and specifically for options granted to named executive officers close in time to a quarterly financial filing or other release of material nonpublic information.

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