MAYNARD
COOPER GALE

SEC Takes Aim at 10b5-1 Plans and Issuer Share Repurchases with Proposed Rules

On December 15, 2021, the Securities and Exchange Commission (the "SEC") announced proposed amendments to Rule 10b5-1 under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and related insider trading laws (the "Proposed Insider Trading Amendments"), as well as proposed amendments to rules concerning issuer repurchases of equity securities (the "Proposed Share Repurchase Amendments"). This alert summarizes the proposed rules and suggests actions you can take now to prepare for any final rules that the SEC may adopt on these topics.

Proposed Insider Trading Amendments

Rule 10b5-1 under the Exchange Act provides an affirmative defense to insider trading liability if:

- A trading plan or arrangement is adopted in good faith and at a time when the person or issuer was not aware of material nonpublic information;
- The plan specifies a non-discretionary trading method;
- The person adopting the plan has no ability to influence how, when or whether to make purchases or sales once the plan is adopted; and
- The purchase or sale was made in accordance with the plan's terms.

There has been a growing perception that Rule 10b5-1 plans have led to abuses of insider trading laws by issuers and insiders opportunistically trading in company securities while in possession of material nonpublic information. We have been anticipating proposed amendments to Rule 10b5-1 since SEC Chairman Gensler's remarks on June 7, 2021, calling for the SEC Staff to review Rule 10b5-1 and make recommendations on potential reforms to the rule to help resolve the "cracks in our insider trading regime" caused by Rule 10b5-1 plans. This focus on Rule 10b5-1 plan abuses built on the informal proposal by former SEC Chairman Clayton in September 2020 to amend Rule 10b5-1 to impose a cooling off period prior to the first transaction after a Rule 10b5-1 plan is adopted or modified.[1]

The Proposed Insider Trading Amendments would amend Rule 10b5-1 to require compliance with the following conditions in order to rely on the affirmative defense to insider trading liability:

- 10b5-1 plans entered into by officers and directors must include a 120-day cooling off period between the time of adoption or modification of the plan and the first transaction under the plan.
- 10b5-1 repurchase plans entered into by issuers must include a 30-day cooling off period between the time of adoption or modification of the plan and the first repurchase transaction under the plan.
- Officers and directors must personally certify to the issuer that they are not aware of material nonpublic information about the issuer or the security when adopting a new or modified 10b5-1 plan.
- Insiders and issuers may have in place only one 10b5-1 plan at a time for open market transactions in the same class of securities.
- 10b5-1 trading arrangements designed to cover a single trade are limited to one plan per 12-month period.
- 10b5-1 plans must be entered into and operated in good faith.

[1] See Jay Clayton, "Letter to Rep. Brad Sherman (Sept. 14, 2020), available at https://www.sec.gov/files/clayton-letter-to-chairman-sherman-20200914.pdf.

In addition, the Proposed Insider Trading Amendments would add the following enhanced disclosure requirements regarding 10b5-1 plans, option grants, issuer insider trading policies, and gifts of securities:

- Issuers' annual reports would be required to disclose all policies and practices relating to equity compensation grants, and to include a table showing option grants made within 14 days following the release of material nonpublic information and the market price of the underlying securities on the trading day before and after the release of such information.
- Issuers' quarterly reports would be required to disclose the adoption and termination of Rule 10b5-1 plans and other trading arrangements by directors, officers, and issuers and the material terms of such trading arrangements, including the date of adoption or termination, the duration of the plan, contract or instruction, and the aggregate amount of securities to be sold or purchased under such plan, contract or instruction.
- Issuers' annual reports would be required to disclose whether the issuer has adopted insider trading policies and procedures and, if not, why not, and to disclose the issuer's insider trading policies and procedures if they have adopted such policies and procedures.
- Officers and directors would be required to check a new box on Forms 4 and 5 to report that a transaction was made pursuant to a Rule 10b5-1 plan and would be required to disclose the date of adoption of the Rule 10b5-1 plan.
- Insiders would be required to report bona fide gifts of securities within two business days of the date of the gift on a Form 4. Under current rules, bona fide gifts of securities are reportable on a Form 5 due within 45 days after the end of the issuer's fiscal year, with early reporting on Form 4 permitted. In practice, many insiders choose to report gifts early so that they do not forget to file the Form 5 after the end of the fiscal year. The proposed rule, if adopted, would require gifts to be reported on a Form 4 within two business days just like many other transactions reportable under Section 16(a).

Given the SEC's focus on Rule 10b5-1 plan abuses, we expect the SEC to adopt final rules in some form, likely in substantially the form proposed. Accordingly, we recommend that companies take the following actions in anticipation of any final rules:

- A lot of the proposed new requirements concerning 10b5-1 plans are considered "best practice" and are already widely adopted in company insider trading policies. Companies should review their insider trading policy and other applicable policies and identify which of the proposed amendments the company already has in place and whether the company would need to amend its policies.
- Update the board of directors and employees on possible changes to the company's policies in response to any final SEC rules.
- Prepare potential updates to your disclosure controls to capture the potential disclosure requirements related to the timing of equity compensation awards and Section 16 filing requirements for transactions made under a Rule 10b5-1 plan and gifts of securities, as well as determine whether there will be any impact on equity grant practices in connection with the disclosure requirements associated with equity compensation awards.

Proposed Share Repurchase Amendments

The Proposed Share Repurchase Amendments are intended to improve the quality, relevance, and timeliness of information related to issuer share repurchases. The volume of share repurchases has grown dramatically in recent years, with a study by S&P Dow Jones Indices reporting that S&P 500 companies completed $145 billion in share repurchases in just the third quarter of 2021. The SEC has expressed concern regarding the availability of adequate information on share repurchases.

The SEC currently has rules requiring certain disclosures in issuers' annual and quarterly reports on Forms 10-K and 10-Q regarding both open market and private transactions. These disclosures are covered in Item 703 of Regulation S-K and include information about the volume, timing, and pricing of the issuer's share repurchases and information about the issuer's share repurchase plans. This information is available only on a delayed basis after the end of the quarter of the repurchases. Because of the delay, it is hard for market participants to understand the effects on market pricing on a current basis. In addition, commentators have expressed concerns about the stated purposes, and potential misuses, of share repurchase programs.

The Proposed Share Repurchase Amendments would create a new Form SR to be filed by issuers before the end of the first business day following the day on which the issuer or an affiliate executes a share repurchase. The proposed Form SR would require the following disclosure:

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

The Proposed Share Repurchase Amendments also would amend Item 703 of Regulation S-K to require additional information regarding repurchases in annual and quarterly reports on Forms 10-K and 10-Q. This additional information would include:

- The objective or rationale for the share repurchases and the process or criteria used to determine the amount of repurchases;
- Any policies and procedures relating to purchases and sales of the issuer's securities by its officers and directors during a repurchase program, including any restrictions on such transactions;
- Whether repurchases were made pursuant to a plan that is intended to satisfy the affirmative defense conditions of Exchange Act Rule 10b5-1(c) and, if so, the date that the plan was adopted or terminated; and
- Whether repurchases were made in reliance on the nonexclusive safe harbor set forth in Exchange Act Rule 10b-18.

In addition, the Proposed Share Repurchase Amendments would require issuers to indicate via a checkbox if any officers or directors reporting pursuant to Section 16(a) of the Exchange Act purchased or sold the issuer's equity securities that are the subject of an issuer share repurchase plan or program within 10 business days before or after any announcement of an issuer purchase plan or program. The checkbox would appear above the Item 703 share repurchase table in the issuer's annual and quarterly reports on Forms 10-K and 10-Q.

The Proposed Share Repurchase Amendments would apply to issuers that repurchase securities registered under Section 12 of the Exchange Act, including foreign private issuers and certain registered closed-end funds. The comment period for the Proposed Insider Trading Amendments and Proposed Share Repurchase Amendments will remain open for 45 days after publication in the Federal Register.

For additional information about these amendments, or to discuss any questions that you may have, please contact a member of Maynard Cooper's Public Company Advisory Group.