ESG Collaborative Update

December 15, 2022

SEC Issues Final Rules on Rule 10b5-1 Insider Stock Trading Plans and Insider Trading Policies and Procedures

On December 14, 2022, the SEC adopted final rules relating to Rule 10b5-1 insider stock trading plans, company insider trading policies and procedures, and certain equity grants. While the final rules are similar in many respects to the initial proposals announced in December 2021, the SEC made several meaningful changes from the proposals.

What to Do Now?

- ***Insider Trading Policies and Procedures***. Companies should review their controls and procedures and insider trading plans and policies to ensure compliance with the new rules, as well as gather information that will be required for the new disclosures. Many insider trading policies will have to be amended.
- ***D&O Questionnaires***. With the proxy season around the corner, consider also if any changes are needed to D&O questionnaires and representations included in those questionnaires.
- ***Reporting of "Gifts" on Forms 4***. In particular, companies should be aware of the new timing for disclosures of dispositions by gift, which will be required to be disclosed on Form 4 within two business days of the transaction. Companies should coordinate with insiders, as this requirement may be particularly cumbersome in connection with some transfers to family trusts and other complex estate planning transactions.
- ***Option Grant Practices***. Companies should also reassess their option and stock appreciation right (SAR) grant practices, revisiting existing grant schedules, in light of the new disclosure requirements.

When Do These Changes Take Effect?

The final rules will be effective 60 days after publication in the Federal Register. In addition, the SEC adopted the following transition periods for the new SEC disclosures and Section 16 reporting changes:

- ***New SEC disclosures***: The new disclosures and related iXBRL tags in periodic reports on Form 10-Q, 10-K and 20-F and proxy statements will be required in the first filing that covers the first full fiscal period beginning on or after:
    - *Non-smaller reporting companies*: April 1, 2023.
    - *Smaller reporting companies*: October 1, 2023.
- ***Section 16 reporting changes***: The changes to Section 16 reports will be effective for reports filed on or after April 1, 2023. This includes gift transactions by directors and officers, which will now be required to be reported on a Form 4 no later than two business days following the gift (rather than a Form 5 following the year-end).

Rule 10b5-1 Plan Conditions

Rule 10b5-1 is a safe harbor established to allow company insiders to trade shares during trading blackouts pursuant to a written plan, binding contract or instruction to another person (generally referred to collectively as a "plan"), where such plan was adopted while the insider was not in possession of material nonpublic information.

The final rules resulted in a number of amendments to Rule 10b5-1, including additional conditions to the availability of the defense, as described further below. In a change from the initial proposal, at this time, the amendments to Rule 10b5-1 stock trading plans described below do **not** apply to the company stock repurchase programs structured under Rule 10b5-1, with the exception of the good faith condition. These amendments also will not affect the affirmative defense available under an existing plan entered into by an insider prior to the effective date of the new rules (except, in certain cases, to the extent the plan is modified after the effective date).

- ***Cooling-off period***: Trading under a newly adopted or, in certain cases, modified Rule 10b5-1 plan cannot begin until the "cooling-off" period expires:
  - *Officers and directors*: on the later of (i) 90 days after plan adoption or modification or (ii) two business days following disclosure of the company's financial results in a Form 10-K or 10-Q for the fiscal quarter in which the plan was adopted or modified, or, for foreign private issuers, in a Form 20-F or Form 6-K (in each case, subject to a 120-day maximum). (This is a shorter cooling-off period than the 120-day period that was initially proposed.)
  - *Other persons*: 30 days after plan adoption or modification.
- ***D&O certifications included in the Rule 10b5-1 stock trading plan***: Directors and officers adopting or modifying a Rule 10b5-1 plan are also required to include a representation in the plan (as opposed to a standalone certification) certifying that: (i) they are not aware of material non-public information about the company or the security; and (ii) they are adopting the plan in good faith and not as part of a plan or scheme to evade the prohibitions of Rule 10b-5.
- ***Prohibition on overlapping plans***: Multiple, overlapping Rule 10b5-1 stock trading plans covering open market trades are not permitted, subject to certain exceptions, which include the following:
  - A person can have a second Rule 10b5-1 plan, so long as trading under such plan is not authorized to begin until after (i) the earlier plan is completed or expires and (ii) the applicable cooling-off period has expired, as determined using the termination date of the earlier plan as the adoption date of the later plan.
  - Rule 10b5-1 plans providing for an "eligible sell-to-cover transaction," where an insider authorizes a third party to sell only such securities as are necessary to satisfy tax withholding obligations arising from the vesting of a compensatory award (such as restricted stock or SARs), and the insider does not otherwise control the timing of such sales.
- ***Limitations on single-trade plans***: Persons can rely on the Rule 10b5-1 affirmative defense for a plan "designed to effect" a single trade for only one such plan during any consecutive 12-month period. This is intended to provide for unexpected liquidity needs. Plans providing for an "eligible sell-to-cover transaction," as described above, are excluded from this limitation.
- ***Good faith requirement***: Persons who enter into a 10b5-1 plan are required to have acted in good faith with respect to the plan.

New SEC Disclosures

The amendments also impose new disclosure requirements regarding Rule 10b5-1 and other trading arrangements by directors and officers, insider trading policies and procedures, and option grants. Many of these new disclosures will need to be tagged in iXBRL.

Director and Officer Trading Arrangements

Companies will be required to provide quarterly disclosures regarding the adoption, termination or modification (which counts as both a termination and an adoption), and certain material terms of, any Rule 10b5-1 or certain other trading arrangements by directors and officers, pursuant to new Item 408(a) of Regulation S-K. Material terms include (i) the name and title of the director or officer, (ii) date of adoption, modification or termination, and the duration, of the trading arrangement, and (iii) the aggregate number of securities to be sold or purchased. (Unlike in the initial proposal, pricing information is not required.)

In addition, companies will be required to indicate whether the trading arrangement is pursuant to Rule 10b5-1 or is a non-Rule 10b5-1 trading arrangement. Non-Rule 10b5-1 trading arrangements are other pre-planned trading contracts, instructions, or plans, as defined in the rule.

Disclosures will need to be provided in quarterly reports on Form 10-Q (under Item 5. Other Information) and annual reports on Form 10-K (under Item 9B. Other Information). Foreign private issuers will not be required to provide these disclosures.

Insider Trading Policies and Procedures

- ***Description of insider trading policies and procedures***: Companies will be required to disclose whether (and if not, why not) they have adopted insider trading policies and procedures with respect to transactions in their securities by directors, officers and employees and the company itself. This would include any policies or procedures with respect to the company's share repurchase plans. These disclosures will be required in annual reports on Form 10-K (which can be incorporated by reference from the proxy statement) and proxy statements, pursuant to new Item 408(b) of Regulation S-K.
- ***New exhibit***: Companies will also be required to file a copy of their insider trading policies and procedures as Exhibit 19 to their Form 10-K.
- ***Foreign private issuers***: Foreign private issuers will be required to disclose similar information in, and to file such policies and procedures as an exhibit to, their annual report on Form 20-F.

Option Grant Policies and Practices

As a result of concerns regarding "spring-loaded" options (i.e., option grants timed to occur immediately before the release of positive material nonpublic information), companies will be required to provide the following information with respect to grants of options, SARs and other option-like instruments (collectively referred to as "options" in this section):

- ***Narrative description*** describing policies and practices with respect to the timing of option grants in relation to the disclosure of material nonpublic information by the company, including (i) how the board determines when to grant such awards (i.e., is there a set schedule?); (ii) whether and how the board or compensation committee takes material nonpublic information into account when determining the timing and terms of such awards; and (iii) whether the company has timed the disclosure of material nonpublic information for the purpose of affecting the value of executive compensation.
- ***New table***, in the format below, disclosing any options granted to named executive officers during the period beginning four business days before the filing of a Form 10-K or 10-Q or the filing or furnishing of a Form 8-K disclosing material nonpublic information (including earnings information, but excluding Form 8-Ks solely disclosing a material new option grant) and ending one business day after the triggering event. (This time period is substantially more limited than the initial proposal, which would have required disclosure of such grants during the 14 days before or after the filing of a periodic report, a share repurchase by the company or the filing or furnishing of a Form 8-K disclosing material nonpublic information.)

Name[1]	Grant date	Number of securities underlying the award	Exercise price of the award ($/Sh)	Grant date fair value of the award	Percentage change in the closing market price of the securities underlying the award between the trading day ending immediately prior to the disclosure of material nonpublic information and the trading day beginning immediately following the disclosure of material nonpublic information
PEO					
PFO					
A					
B					
C					

[1] Smaller reporting companies and emerging growth companies are only required to include the named executive officers as provided under Item 402(l).

These disclosures will be required in annual reports on Form 10-K (which can be incorporated by reference from the proxy statement) and proxy statements, pursuant to new section (x) of Item 402 of Regulation S-K.

Section 16 Reporting Changes

Beneficial ownership reports on Forms 4 and Forms 5 will include a mandatory check box that a reported transaction was intended to satisfy the affirmative defense conditions of Rule 10b5-1(c); if checked, the date of adoption of the plan will need to be disclosed under "Explanation of Responses."

In addition, dispositions by gift will be required to be reported on Form 4 within two business days (rather than being permitted to be included on a Form 5 following the year-end). Acquisitions by gift may still be reported on Form 5. The Rule 10b5-1 affirmative defense is available for gifts; in the release, the SEC noted that insiders may enter into a binding arrangement instructing their attorney or tax advisor to gift shares to a charitable organization, with the amount of shares gifted determined according to a traditional algorithm or formula, or instead according to some tax objective, such as the amount of shares that would maximize the individual's annual charitable contribution deduction.

FOR MORE INFORMATION

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