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SEC Approves New Insider Trading Rules

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On December 14, 2022, the Securities and Exchange Commission ("SEC" or "Commission"), in a rare unanimous vote, adopted final rules on the affirmative defense to insider trading liability and new disclosures related to insider trading. The final rules: (i) add new conditions to the affirmative defense to insider trading pursuant to a contract, instruction, or plan intended to satisfy the conditions of Exchange Act Rule 10b5-1(c) (a "Rule 10b5-1 plan"), (ii) introduce new periodic disclosure requirements related to insider trading, including with respect to company insider trading policies and procedures and the adoption and termination of Rule 10b5-1 plans by directors and officers, and director and officer equity compensation awards made close in time to the company's disclosure of material nonpublic information ("MNPI"), and (iii) require identification of transactions made pursuant to a Rule 10b5-1 plan on Forms 4 and 5, and require that *bona fide* gifts be reported on Form 4 within two business days rather than after year-end on Form 5. The final rules are thematically aligned with the rule proposal issued by the Commission in December of last year[i] – also in a unanimous vote – but with meaningful changes and the addition of several carve outs, particularly for companies.

The adopting release is available here and a Fact Sheet is available here. The final rules will become effective 60 days after publication in the Federal Register (the "Effective Date"), at which point any Rule 10b5-1 plan thereafter adopted or modified should comply with the new requirements. Companies will be required to comply with the new periodic disclosure requirements in the first filing that covers the first full fiscal period that begins on or after April 1, 2023 (i.e., the second-quarter Form 10-Q for a company with a December 31 fiscal year-end). Smaller reporting companies have until the first filing covering a period that begins on or after October 1, 2023 to comply (i.e., the fiscal 2023 Form 10-K for a company with a December 31 fiscal year-end). Section 16 insiders will be required to comply with the amendments to Form 4 beginning with reports filed on or after April 1, 2023. Set forth below is a summary of the final rules and some considerations for companies and insiders.

Summary of Final Rules

New Conditions for Rule 10b5-1 Plans. The rules introduce new conditions on the availability of the affirmative defense to Rule 10b-5 liability pursuant to a Rule 10b5-1 plan. Any plans adopted after the Effective Date must comply with the new conditions or the person adopting the plan will not be able to rely on the affirmative defense. Note that these changes do not affect the affirmative defense available under an existing Rule 10b5-1 plan that was entered into prior to the Effective Date, unless it is modified in a manner that is treated as an adoption of a new plan (described below) after the Effective Date.[ii] The new conditions for Rule 10b5-1 plans consist of the following:

1. *Cooling-Off Period*. In a significant change from the rule proposal, the final rules do not require any cooling-off period for companies. Rule 10b5-1 plans adopted by directors and officers[iii] must provide that trading under the plan cannot begin until the later of: (a) 90 days after the adoption of the Rule 10b5-1 plan; or (b) two business days following the disclosure of the company's financial results in a Form 10-Q or 10-K for the fiscal quarter in which the plan was adopted, or, for foreign private issuers, in a Form 20-F or 6-K that discloses the company's financial results. The required cooling-off period for directors and officers is capped at a maximum of 120 days after the Rule 10b5-1 plan's adoption. Persons other than

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directors and officers are subject to a 30 day cooling-off period following a Rule 10b5-1 plan's adoption. Notably, certain changes to Rule 10b5-1 plans are treated as the adoption of a new plan. The final rules codify that any change to the amount, price, or timing of the purchase or sale of the securities (including a change to a written formula or algorithm, or computer program affecting these terms, the "Essential Terms") underlying a Rule 10b5-1 plan constitutes a termination of such plan and the adoption of a new plan, triggering the same cooling-off period described above. Other changes that do not alter the Essential Terms, such as an adjustment for stock splits or a change in account information, will not trigger a new cooling-off period.[iv]The cooling-off period requirements of the final rules appear less burdensome on directors and officers as compared to the proposed rules, but they are more complex and introduce uncertainty as to when the first purchase or sale under the plan can occur. The proposed rules contemplated an inflexible 120 day cooling-off period for the Rule 10b5-1 plans of directors and officers.[v] Under the final rules, the cooling-off period for directors and officers will vary between 90 and 120 days, depending on when/whether a Form 10-K or Form 10-Q is filed during this period.

2. *Director and Officer Certifications*. When adopting a Rule 10b5-1 plan, directors and officers must include a representation in the Rule 10b5-1 plan certifying, at the time of the adoption of a new or modified plan, that: (a) they are not aware of MNPI about the company or its securities; and (b) 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. Because the plan is typically a form document prepared by the broker-dealer, counsel for directors and officers should review the plan to ensure that this new representation is included in any new or modified Rule 10b5-1 plan entered into after the Effective Date.

3. *Prohibition on Overlapping Plans*. A person (other than the company) may not have another outstanding (and may not subsequently enter into any additional) Rule 10b5-1 plan for purchases or sales of any class of securities of the company on the open market during the same period. Unlike the proposed rules, the final rules permit several exceptions. A person may have two separate Rule 10b5-1 plans so long as (a) the later-commencing plan does not begin trading during the cooling-off period that would have applied if the later-commencing plan was adopted on the date the earlier-commencing plan terminates, and (b) the plans meet all other conditions applicable to Rule 10b5-1 plans.In addition, the final rules provide an exception to allow for separate Rule 10b5-1 plans for "sell-to-cover" transactions in which an insider instructs their agent to sell securities in order to satisfy tax withholding obligations at the time an equity award vests. An insider may maintain additional eligible Rule 10b5-1 plans so long as the additional plans only authorize qualified sell-to-cover transactions, where the plan authorizes an agent to sell only such securities as are necessary to satisfy tax withholding obligations in connection with the vesting of a compensatory award, such as restricted stock or restricted stock units, and the insider does not otherwise exercise control over the timing of such sales. It is important to note that this exception does not extend to sales incident to the exercise of option awards, as the SEC posits that option exercises create a risk of opportunistic trading.[vi]The final rules clarify that a series of separate contracts with different broker-dealers or other agents acting on behalf of the person (other than the company) may be treated as a single Rule 10b5-1 plan, provided that the contracts with each broker-dealer or other agent, when taken together as a whole, meet all of the applicable conditions of, and remain collectively subject to, Rule 10b5-1(c)(1). In such a scenario, the modification of any of the individual contracts will be considered a modification of the other contracts constituting the Rule 10b5-1 plan. Substituting a broker-dealer or other agent with another broker-dealer or other agent would not be considered a modification so long as the Essential Terms are not changed. Although the final rules introduced these exceptions, it also expanded the scope of the prohibition relative to the proposed rules. Under the proposed rules, the

prohibition would have only applied to the *same class* of the company's securities,[vii] whereas the final rules prohibit overlapping plans for *any class* of the company's securities. In the adopting release, the SEC recognized that, given the likelihood that the values of different classes of a given company's securities are highly correlated, allowing the use of multiple plans for trading in the securities of a company would allow for opportunistic behavior.[viii]

4. *Restrictions on Single-Trade Plans*. A person (other than the company) may not have more than one single-trade Rule 10b5-1 plan during any 12-month period. The defense will only be available for a single-trade plan if such a person had not, during the preceding 12-month period, adopted another single-trade plan that qualified for the affirmative defense, meaning that an ineligible plan does not preclude the availability of the affirmative defense for another plan.[ix] As with the prohibition on overlapping plans, the final rules introduce an exception to this restriction for "sell-to-cover" plans. A single-trade plan is one "designed to effect" (e.g., has the practical effect of requiring) the purchase or sale of securities as a single transaction. A plan is not designed to effect a single transaction where the plan (a) leaves the person's agent discretion over whether to execute the plan as a single transaction, or (b) provides that the agent's future acts will depend on events or data not known at the time the plan is entered into (such as a plan to execute specified sales or purchases at each of several given future stock prices) and it is reasonably foreseeable at the time the plan is entered into that it may result in multiple transactions.[x]

5. *Act in Good Faith*. The person entering into a Rule 10b5-1 plan must act in good faith with respect to the Rule 10b5-1 plan. This requirement extends the existing requirement – i.e., to enter into the Rule 10b5-1 plan in good faith – from the time of adoption through the duration of the Rule 10b5-1 plan. This departs from the proposed rules, which would have required the Rule 10b5-1 plan to be "operated" in good faith,[xi] a term that many commentators found ambiguous.

New Periodic Reporting Requirements. The final rules introduce the following new periodic reporting requirements:

1. *Quarterly Disclosure of Trading Arrangements*. In Forms 10-Q and 10-K, companies will be required to disclose whether, during the company's last fiscal quarter, any director or officer adopted or terminated (i) any contract, instruction or written plan for the purchase or sale of securities of the company that is intended to satisfy the affirmative defense conditions of Rule 10b5-1(c) (e.g., a Rule 10b5-1 plan), or (ii) a "non-Rule 10b5-1 trading arrangement." A non-Rule 10b5-1 trading arrangement is a written trading arrangement that complies with the old Rule 10b5-1 affirmative defense (circa 2000 to 2022) but does not comply with the new affirmative defense conditions of Rule 10b5-1(c). The SEC requires disclosure for these arrangements to make clear that one cannot avoid disclosure of trading plans that are structured to comply with alternative liability defenses other than the Rule 10b5-1 affirmative defense.[xii]Companies will also be required to indicate whether the arrangement is a Rule 10b5-1 plan or non-Rule 10b5-1 trading arrangement and provide a description of the material terms, other than with respect to price, such as:
    - The name and title of the director or officer;
    - The date of adoption or termination of the trading arrangement;
    - The duration of the trading arrangement; and
    - The aggregate number of securities to be sold or purchased under the trading arrangement.

   Unlike the proposed rules, the final rules do not require disclosure of whether the company adopted a Rule 10b5-1 plan or non-Rule 10b5-1 trading

arrangement.[xiii] The proposed rules also did not specifically carve out price from the material terms of Rule 10b5-1 plans or non-Rule 10b5-1 trading arrangements that are required to be disclosed.[xiv]

2. *Annual Disclosure of Insider Trading Policies and Procedures*. Companies will be required to disclose in Forms 10-K or 20-F and proxy and information statements whether they have adopted insider trading policies and procedures governing the purchase, sale, and other dispositions of their securities by directors, officers, and employees, or the company itself that are reasonably designed to promote compliance with insider trading laws, rules, and regulations, and any listing standards applicable to the company. If a company has not adopted such insider trading policies and procedures, it must explain why it has not done so. The disclosure may be incorporated by reference from the proxy statement into the Form 10-K if the proxy statement is filed within 120 days of the fiscal year-end. A copy of the insider trading policies and procedures must be filed as an exhibit to Form 10-K and 20-F.
3. *Disclosure of Certain Equity Awards Close in Time to Release of MNPI*. In their discussions of executive compensation (i.e., in Part III of Form 10-K or a proxy statement), companies will be required to discuss their policies and practices on the timing of awards of stock options, stock appreciation rights ("SARs") or similar option-like instruments in relation to the disclosure of MNPI by the company, including how the board determines when to grant such awards (e.g., whether the awards are granted according to a predetermined schedule). Companies must also discuss whether, and if so, how, the board or compensation committee takes MNPI into account when determining the timing and terms of an award, and whether the company has timed the disclosure of MNPI for the purpose of affecting the value of executive compensation.In addition, if, during the last completed fiscal year, stock options, SARs or similar option-like instruments were awarded to a named executive officer ("NEO") within a period beginning four business days before the filing of a periodic report, or the filing or furnishing of a current report on Form 8-K that discloses MNPI (including earnings information), and ending one business day after the filing of such report, the company must provide information concerning each such award for the NEO on an aggregated basis in the following tabular format:

Name	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					

The window in which awards will trigger disclosure is significantly reduced from the proposed rules, which would have covered 14 days both before and after the relevant filing.[xv] The final rules also clarify that a Form 8-K reporting a material new option award grant under Item 5.02(e) would not trigger the disclosure requirement, and removes company share repurchases as events that would trigger disclosure.

This new disclosure requirement will not affect foreign private issuers.

4. *Inline XBRL Tagging*. The periodic disclosure requirements outlined above will be required to be tagged in Inline XBRL.

New Beneficial Ownership Reporting Requirements. The amendments add a checkbox to Forms 4 and 5 for insiders to indicate whether the reported transaction is pursuant to a plan that is "intended to satisfy the affirmative defense conditions" of Rule 10b5-1(c). In addition, insiders will be required to report dispositions of *bona fide* gifts of equity securities on Form 4 (rather than Form 5), thereby shortening the deadline to report gifts from 45 days after fiscal year-end to two business days following the date of execution. The final rules do not adopt the proposed second checkbox for indicating a transaction was made pursuant to a plan that did not qualify for Rule 10b5-1(c).[xvi]

Importantly, the adopting release builds on the note from the proposing release that opined that gifts are subject to Section 10(b) liability, and the SEC reiterated that the affirmative defense of Rule 10b5-1(c)(1) is available for any *bona fide* gift of securities.[xvii]

Observations and Considerations for Companies and Insiders

Insider trading policies should be updated as of the Effective Date, but existing Rule 10b5-1 plans do not need to be amended unless any Essential Terms are modified after the Effective Date. Companies should update their current insider trading policies and procedures (including any separate Rule 10b5-1 plan guidelines), to amend any provisions that conflict with the final rules. For example, many companies already require their employees' Rule 10b5-1 plans to have cooling-off periods. If the cooling-off periods permissible under a company's policy are shorter than those under the final rules, the policy should be updated to reflect the required cooling-off periods, subject to the grandfathering accommodations for Rule 10b5-1 plans existing prior to the Effective Date. Companies may consider removing policy provisions requiring insiders to trade only through Rule 10b5-1 plans in light of the final rules, which will require disclosure of the number of shares insiders intend to sell under such plans. This disclosure could cause an unfavorable market price reaction and become a topic of discussion in shareholder engagement or a point of contention for shareholder activists, causing a chilling effect on the use of Rule 10b5-1 plans by insiders. Some companies may determine to instead encourage insiders to trade during ordinary open window periods after pre-clearance from the company's general counsel, at least with respect to transactions other than sell-to-cover trades. In addition, with the new requirement to file insider trading policies and procedures as an exhibit to the Form 10-K, companies may want to revisit their policies to make sure they are sufficiently robust.

Companies should consider waiting at least two business days following the release of MNPI to make equity compensation awards. The new disclosure requirement regarding equity awards made close in time to the release of MNPI is meant to combat the practice of "spring-loading," in which equity grants are made immediately before positive MNPI is released so that executives benefit from the increased share price when the MNPI is made public. Companies should be aware of the optics of making awards close to the public release of MNPI, and can mitigate potential concerns by waiting at least two business days following the release of MNPI before making equity awards. This will entail coordinating board and board committee meeting and/or schedules with the reporting calendar for periodic reports and any planned Form 8-K filings.

Corporate insiders should be cautious when gifting while aware of MNPI. The SEC has historically been silent with respect to the liability of gifts under Section 10(b). With the Commission's reaffirmations in the adopting release, corporate insiders who are aware of MNPI should proceed with caution when gifting company securities, as they could be liable if they gift securities when they are aware of MNPI and while knowing (or being reckless in not knowing) that the donee would sell the securities prior to the disclosure of the MNPI. Many, if not most, non-profit organizations have a policy of immediately selling any securities received as a gift, as they are not in the business of holding securities.

Companies also may want to revisit how their insider trading policies apply to gifts.

There are no new share repurchase requirements for companies, but this is likely to change. The single new condition on Rule 10b5-1 plans applicable to companies is the requirement to act in good faith, as companies are carved out from the other new conditions, allowing them to implement overlapping and multiple single-trade plans, all without cooling-off periods. Although the proposed rules contemplated periodic disclosure requirements with respect to a company's adoption and termination of Rule 10b5-1 plans, these provisions were removed in the final rules. However, the Commission noted in the adopting release that it is continuing to consider whether regulatory action is needed to mitigate the risk of misuse of Rule 10b5-1 plans by companies, such as in the share repurchase context.[xviii] The SEC is still working on final rules for share repurchase disclosure, which were originally proposed alongside the insider trading rules last year. The SEC recently reopened the comment period for the share repurchase rule proposal so that commenters could consider a SEC Staff memorandum analyzing the impact of the new excise tax on share repurchases on the potential economic effects of the SEC's rule proposal.[xix]

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[i] For our discussion of the proposed rules, *see* Gibson Dunn Client Alert, SEC Proposes Rules on Insider Trading, Rule 10b5-1 and Share Repurchases (Dec. 23, 2021).

[ii] Insider Trading Arrangements and Related Disclosures, Exchange Act Release No. 96492 (Dec. 14, 2022) (the "Adopting Release") at III, available at https://www.sec.gov/rules/final/2022/33-11138.pdf.

[iii] The term "officer" refers to how that term is defined in Exchange Act Rule 16a-1(f).

[iv] Adopting Release at II.A.1.c.

[v] *See* Rule 10b5-1 and Insider Trading, Exchange Act Release No. 93782 (Dec. 15, 2021) (the "Proposing Release"), at II.A.1, available at https://www.sec.gov/rules/proposed/2022/33-11013.pdf

[vi] Adopting Release at II.A.3.c.

[vii] Proposing Release at II.A.3.

[viii] *See* Adopting Release at II.A.3.c.

[ix] *Id*.

[x] *Id*.

[xi] Proposing Release at II.A.4.

[xii] *See* Adopting Release at II.B.1.c.

[xiii] *See Id*.

[xiv] *See* Proposing Release at II.B.1.

[xv] Proposing Release at II.C.

[xvi] *See* Proposing Release at II.B.4.

[xvii] *See* Proposing Release at II.B.2.; Adopting Release at II.E.3.

[xviii] Adopting Release at II.A.1.c.

[xix] Reopening of Comment Period for Share Repurchase Disclosure Modernization, Exchange Act Release No. 96458 (Dec. 7, 2022), available at https://www.sec.gov/rules/proposed/2022/34-96458.pdf.

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Gibson, Dunn & Crutcher's lawyers are available to assist in addressing any questions you may have about these developments. To learn more about these issues, please contact the Gibson Dunn lawyer with whom you usually work, the authors, or any of the following leaders and members of the firm's Securities Enforcement or Securities Regulation and Corporate Governance practice groups:

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