The Asset Management Industry
SERVING INDIVIDUAL INVESTORS
INVESTMENT COMPANY INSTITUTE

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SEC Proposes Amendments to Insider Trading Plans; Member Call Scheduled for January 6 at 1:00 pm (Eastern)

[33964]

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TO: ICI Members SUBJECTS: Closed-End Funds
Compliance
Disclosure RE: SEC Proposes Amendments to Insider Trading Plans; Member Call Scheduled for January 6 at 1:00 pm (Eastern)

The Securities and Exchange Commission recently proposed amendments that would change certain insider trading plans under Rule 10b5-1 under the Securities Exchange Act of 1934 and related disclosure.[1] The proposed amendments would (i) add new conditions to the availability of one of the two affirmative defenses under Rule 10b5-1; (ii) create new disclosure requirements for operating companies and business development companies regarding insider trading arrangements and insider trading policies; (iii) require corporate insiders to identify transactions made pursuant to a Rule 10b5-1 trading arrangement and disclose all gifts of equity securities; and (iv) create new disclosure requirements for executive and director compensation regarding the timing of certain equity compensation awards.

Comments on the proposed amendments are due 45 days after they are published in the *Federal Register*. ICI will have a call to discuss the proposal and potential comments on **Thursday, January 6 at 1:00 pm (Eastern Time)**. If you would like to participate in the call, please contact Nadia Ishmael at nadia.ishmael@ici.org to receive dial-in information. In the meantime, if you have any questions or comments about the proposal, please contact Ken Fang at kenneth.fang@ici.org.

Below we provide the Commission's rationale for the proposal, then summarize the proposed amendments.

I. Background and Rationale

The Commission proposes the amendments to address concerns that corporate insiders and issuers have taken advantage of the liability protections of Rule 10b5-1 to opportunistically trade securities on the basis of material non-public information. It provides

examples in which corporate insiders have used multiple overlapping trading plans to selectively cancel trades on the basis of material non-public information or that have commenced trades soon after the adoption or modification of a trading plan. In addition, it cites concerns about using Rule 10b5-1 trading plans to conduct share repurchases to boost the price of the issuer's stock before corporate insider sales.[2] The Commission notes that these practices can undermine the public's confidence and expectations of honest and fair capital markets by creating the appearance that some insiders do not play by the same rules as everybody else.

II. Proposed Amendments to the Rule 10b5-1(c)(1) Affirmative Defense

The Commission proposes amending Rule 10b5-1(c)(1) under the Exchange Act to add several new conditions before a person could use the provision as an affirmative defense.[3] These new conditions would:

- Require a "cooling off "period of 120 days after the adoption or modification of a Rule 10b5-1(c)(1) trading arrangement for directors or officers, and a "cooling off" period of 30 days for issuers, before any trading can commence;[4]
- Require a certification from directors and officers that they are not aware of any material non-public information about the issuer or the security when they adopt a Rule 10b5-1 trading arrangement and that they are adopting the contract, instruction, or plan in good faith and not to evade insider trading prohibitions;[5]
- Provide that the Rule 10b5-1(c)(1) affirmative defense does not apply to multiple overlapping Rule 10b5-1 trading arrangements for open market trades in the same class of securities;[6]
- 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;[7] and
- Require that a person asserting the affirmative defense under Rule 10b5-1(c)(1) enter the trading arrangement in good faith and not as a plan to evade insider trading prohibitions.[8]

III. Proposed Disclosure Amendments

The Commission also proposes to require operating companies and BDCs to provide: (1) new quarterly disclosure regarding the use of any trading arrangements by the issuer, and its directors and officers for the trading of the issuer's securities (whether pursuant to Rule 10b5-1 or not); and (2) new annual disclosure of the issuer's insider trading policies and procedures.[9] This information would be tagged in Inline eXtensible Business Reporting Language ("XBRL"). In addition, the Commission proposes amendments to Forms 4 and 5 to require corporate insiders to identify whether a reported transaction was executed pursuant to a Rule 10b5-1 trading arrangement and whether an insider has made any gift of equity securities.[10] We further describe each of these proposed requirements below:

Quarterly Disclosure of Trading Arrangements. The proposed amendments would require operating companies and BDCs to disclose:

- Whether, during the last fiscal quarter, the issuer has adopted or terminated any contract, instruction, or written plan to purchase or sell securities of the issuer and to provide a description of the material terms of the contract, instruction, or written plan.

- Whether, during the 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 issuer and a description of the materials terms of the contract, instruction, or written plan.

Annual Disclosure of Insider Trading Policies and Procedures. The proposed amendments would require operating companies and BDCs to disclose annually whether the issuer has adopted insider trading policies and procedures governing the purchase, sale, and other disposition of the issuer's securities by directors, officers, and employees or the issuer itself that are reasonably designed to promote compliance with insider trading laws, rules, and regulations, and any applicable listing standards. If it has not, the issuer must explain why it has not. If it has, it must disclose such policies and procedures with sufficient detail so investors can assess the sufficiency of the insider trading policies and procedures.[11]

Changes in Beneficial Ownership. The proposed amendments would require corporate insiders subject to Section 16 reporting to identify whether a reported sale or purchase reported on either Form 4 or 5 was made pursuant to a Rule 10b5-1 trading arrangement.[12] In addition, the proposed amendments would require any such insider making a gift of equity securities to report the gift on Form 4 before the end of the second business day following the date of execution of the transaction.

IV. Proposed Disclosure Regarding the Timing of Certain Equity Compensation

The Commission also proposes to require new tabular disclosure of: (i) 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 non-public information; (ii) the market price of the underlying securities the trading day before disclosure of the material non-public information; and (iii) the market price of the underlying securities the trading day after disclosure of the material non-public information.[13] Issuers would need to tag such information in XBRL.

Kenneth Fang
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endnotes

[1] *See* Rule 10b5-1 and Insider Trading, Securities Exchange Act Rel. No. 93782 (Dec. 15, 2021), *available at* www.sec.gov/rules/proposed/2021/33-11013.pdf. Rule 10b5-1 provides that a purchase or sale of an issuer's securities is on the basis of material non-public information and potentially subject to insider trading liability, if the person making the purchase or sale was aware of material non-public information when the person made the purchase or sale. Rule 10b5-1(c)(1) provides an affirmative defense for insider trading liability where it is apparent that the trading was not made on the basis of material non-public 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 (each, a "trading arrangement"). Rule 10b5-1(c)(2) provides a separate affirmative defense for entities that demonstrate that the individual making the investment decision on behalf of the entity was not aware of material non-public information, and the entity had implemented reasonable policies and procedures to prevent insider trading.

[2] The Commission also notes that some issuers have granted stock options and other equity awards with option-like features to directors and executive officers in connection with the release of material non-public information. In addition, it notes that some corporate insiders have been timing the gifting of securities while aware of material non-public information relating to such securities.

[3] Currently, a person asserting a Rule 10b5-1(c)(1) affirmative defense must: (1) demonstrate that, before becoming aware of material non-public information, it had entered into a binding contract to purchase or sell that security, provided instructions to another person to execute the trade for the instructing person's account, or adopted a written plan for trading the securities; (2) demonstrate that the applicable contract, instructions, or plan: a) specified the amount of securities purchased or sold, price, and date; b) provided a written formula, algorithm, or computer program for determining amounts, prices, and dates; or c) did not permit the person to exercise any subsequent influence over how, when or whether to effect the transaction, provided that any other person who exercised such influence was not aware of the material non-public information when doing so; and (3) demonstrate that the purchase or sale was pursuant to the prior contract, instruction, or plan. The defense only is available if the trading arrangement was entered in "good faith" and not to evade insider trading prohibitions.

[4] The Commission proposes the "cooling off" periods to address concerns that traders are able to misuse the affirmative defense to set up trading arrangements that use material non-public information about an issuer prior to the disclosure of such information.

[5] The Commission proposes the certification to reinforce directors' and officers' cognizance of their obligation not to trade or adopt a trading plan while aware of material non-public information, that it is their responsibility to determine whether they are aware of material non-public information when adopting a Rule 10b5-1 trading plan, and that the affirmative defense under Rule 10b5-1 requires them to act in good faith and not adopt such plans to evade insider trading prohibitions.

[6] The Commission proposes the restriction on multiple overlapping trading arrangements to prevent persons from exploiting insider information by setting up trades to occur around dates on which they expect the issuer to release material non-public information and to prevent circumvention of the proposed "cooling off" period by setting up multiple overlapping Rule 10b5-1(c)(1) trading arrangements and deciding later which to execute and which to cancel. The proposed amendment would not apply to transactions where a person acquires (or sells) securities directly from the issuer (*e.g.*, employee stock ownership plans or dividend reinvestment plans).

[7] The Commission proposes the once-per-12-month single-trade plan limitation to prevent the potential for abuse through the establishment of multiple single-trade plans throughout a one-year period.

[8] The Commission proposes the good-faith requirement to make clear that the affirmative defense would not be available to a trader that cancels or modifies its plan in an effort to evade insider trading prohibitions or that uses its influence to affect the timing of a corporate disclosure to occur before or after a planned trade under a trading arrangement to benefit the trader.

[9] Currently, there are no disclosure requirements concerning the use of Rule 10b5-1trading arrangements or other trading arrangements by companies or insiders. An

issuer, however, must disclose whether it has adopted a code of ethics. Those codes of ethics may have insider trading policies and restrictions. In addition, issuers may have other policies and procedures governing insider trading. The Commission proposes the amendments to reduce potential abuse of the insider trading provisions and to inform investors and the Commission regarding potential violations.

[10] Currently, there are no requirements to disclose whether a transaction was part of an insider trading policy. Gifts of equity securities must be disclosed but may be reported more than one year after the gift. The proposed amendments would increase the timeliness of the filing to occur before the end of the second business day following the date of execution of the transaction. The Commission proposes the amendments to help investors, other market participants, and the Commission better evaluate the actions of insiders and the context in which equity securities gifts are being made.

[11] The Commission also would require this information in proxy statements.

[12] Section 16(a) of the Exchange Act requires certain beneficial owners (i.e., those holding greater than 10 percent of any class of such equity security or who is a director or officer of the issuer of such security) to file with the Commission reports disclosing the amount of all equity securities of such issuer of which the insider is the beneficial owner, and any subsequent changes in beneficial ownership.

[13] The Commission proposes these amendments to provide investors with a clearer picture of the effect of an option award that is made close in time to the release of material non-public information on the executives' or directors' compensation and on the company's financial statements.
