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SEC Adopts Amendments to Insider Trading Plans and Related Disclosure

[34823]

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TO: ICI Members SUBJECTS: Closed-End Funds
Compliance
Disclosure RE: SEC Adopts Amendments to Insider Trading Plans and Related Disclosure

Last month, the Securities and Exchange Commission adopted amendments that will impact certain insider trading plans under Rule 10b5-1 under the Securities Exchange Act of 1934 and related disclosure.[1] The amendments will (i) add new conditions to the availability of one of the two affirmative defenses to insider trading under Rule 10b5-1; (ii) create new disclosure requirements for operating companies and business development companies regarding insider trading arrangements, insider trading policies, and executive compensation; and (iii) require corporate insiders to disclose transactions made pursuant to Rule 10b5-1 trading arrangements and gifts of equity securities on their beneficial ownership reports. Importantly, as ICI recommended, many of the amendments will not apply to closed-end fund issuers at this time.[2]

The effective date for the Rule 10b5-1 amendments is February 27, 2023, and all trading arrangements entered into in reliance on the rule following that date must comply with the amended rule.[3] The compliance date for the new issuer disclosures begins for filings covering the first full fiscal period on or after April 1, 2023, and begins for beneficial ownership reports filed on or after April 1, 2023.[4] Below we provide background for the rulemaking, then summarize the amendments.

I. **Background**

The Commission proposed 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.[5] In proposing the amendments, the Commission provided examples in which corporate insiders adopted multiple overlapping trading plans and selectively cancelled trades while possessing material non-public information or commenced trades soon after the adoption or modification of a trading plan (suggesting that those trades may be on the basis of material non-public information). The Commission noted concerns that these practices, which may technically satisfy the requirements of Rule 10b5-1, permit an insider's

awareness of material non-public information to still factor into trading decisions, undermining the integrity of the securities markets. The adopted rules aim to address these potentially abusive practices.

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

To address these concerns, the Commission amended Rule 10b5-1(c)(1) under the Exchange Act to add several new conditions before a person can use the provision as an affirmative defense.[6] These new conditions will:

- Require a "cooling-off "period between the date a trading arrangement is adopted and the date of the first transaction under the trading arrangement for all persons other than the issuer. For directors and officers, the cooling-off period will be the later of: (1) 90 days following the trading arrangement adoption or modification; or (2) two business days following the filing of the issuer's financial results for the fiscal quarter in which the trading arrangement was adopted or modified (but not to exceed 120 days following adoption or modification). For all other persons except for issuers, it set a cooling-off period of 30 days before any trading can commence. As ICI recommended, the Commission determined not to apply a cooling-off period to issuers, including closed-end funds, at this time.[7]
- Require a representation from directors and officers. Directors and officers must include a representation in the plan certifying that at the time of the adoption of a new or modified Rule 10b5-1 trading arrangement, the directors and officers are not aware of any material non-public information about the issuer or its securities, and that they are adopting the contract, instruction, or plan in good faith and not to evade insider trading prohibitions.
- Limit the availability of the affirmative defense under Rule 10b5-1(c)(1) for persons other than issuers when there are multiple overlapping trading arrangements or single-trade plans. The amendments provide that, for persons other than issuers, the Rule 10b5-1(c)(1) affirmative defense generally does not apply to multiple overlapping Rule 10b5-1 trading arrangements for open market trades in any class of securities. They also limit the availability of the affirmative defense for a single-trade plan, for persons other than issuers, to one single-trade plan during any consecutive 12-month period.[8]
- Impose a good faith requirement. The amendments add a condition requiring that any 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.

III. Amendments to Insider Trading Arrangements and Policies and Executive Compensation Disclosure

The Commission also adopted amendments to require operating companies and BDCs to provide: (1) new quarterly disclosure regarding a director's or officer's use of trading arrangements for the trading of the issuer's securities (whether pursuant to Rule 10b5-1 or not); (2) new annual disclosure on whether the issuer has adopted insider trading policies and procedures;[9] and (3) new annual disclosure about the timing of option grants.[10] This information must be tagged in Inline eXtensible Business Reporting Language.

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

- Whether, during the last fiscal quarter, any director or officer has adopted or terminated any trading arrangement for the purchase or sale of equity securities of the issuer (whether pursuant to Rule 10b5-1 or not).[11]
- A description of the material terms of the trading arrangement, other than terms with respect to the price at which the individual executing the respective trading arrangement is authorized to trade (e.g., the name and title of the director or officer, the date of adoption or termination of the trading arrangement; and the aggregate number of securities to be transacted under the trading arrangement).

Annual Disclosure of Insider Trading Policies and Procedures. The amendments will 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 file a copy of its insider trading policies and procedures as an exhibit to its annual report.

Annual Disclosure of Executive Compensation. The amendments will require narrative disclosure about the issuer's policies and practices on the timing of awards of stock options, stock appreciation rights, and/or similar option-like instruments in relation to the issuer's disclosure of material non-public information.[12] The amendments also will require tabular disclosure describing each option award granted in the 4 business days before and the 1 business day after the filing of a periodic report or the filing or furnishing of a current report on Form 8-K that discloses material non-public information.[13]

IV. **Amendments to Beneficial Ownership Reporting**

The amendments will require corporate insiders subject to Section 16 reporting to identify whether a sale or purchase reported on either Form 4 or 5 was made pursuant to a plan intended to satisfy the conditions of a Rule 10b5-1 trading arrangement.[14] In addition, the amendments will require any such insider gifting 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.[15]

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Notes

[1] See Insider Trading Arrangements and Related Disclosures, Securities Exchange Act Rel. No. 96492 (Dec. 14, 2022), available at https://www.sec.gov/rules/final/2022/33-11138.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 when it is apparent that the trading was not made on the basis of material non-public information. The defense applies if a person can demonstrate, among other things, that the trade was made pursuant to a binding contract, an instruction to

another person to execute the trade for the instructing person's account, or a written plan for the trading of securities (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] See Letter from Dorothy Donohue, Deputy General Counsel, Investment Company Institute, to Vanessa A. Countryman, Secretary, Securities and Exchange Commission, dated April 1, 2022 (strongly recommending that the Commission exclude exchange-traded closed-end investment companies registered under the Investment Company Act of 1940 from the amendments), available at https://www.sec.gov/comments/s7-21-21/s72121-20122898-279268.pdf. For a brief summary of the letter, see ICI Memorandum No. 34092, available at https://www.ici.org/memo34092.

[3] The amendments to Rule 10b5-1 would not affect the affirmative defense under existing Rule 10b5-1 trading arrangements, except to the extent that the amount, price, or timing of the purchase or sale of securities underlying a trading arrangement is modified or changed after the effective date of the final rules. In those cases, the modification or change would be equivalent to adopting a new trading arrangement and the amendment would need to comply with the amended Rule 10b5-1.

[4] Issuers that are smaller reporting companies must begin complying with the disclosure requirements in the first filing that covers the first full fiscal period on or after October 1, 2023.

[5] See Rule 10b5-1 and Insider Trading, Securities Exchange Act Rel. No. 93782 (Jan. 13, 2022) ("proposing release"), available at https://www.sec.gov/rules/proposed/2022/33-11013.pdf. For a summary of the proposing release, see ICI Memorandum No. 33963, available at https://www.ici.org/memo33963.

[6] 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.

[7] In determining to exclude issuers, the Commission noted its belief that further consideration of the potential application of a cooling-off period to issuers is warranted. It added that, in general, a corporation is considered an insider with regard to its duty to either disclose or abstain when transacting in its own shares on the basis of material non-public information.

[8] In adopting the requirements limiting multiple overlapping trading arrangements and single-trade plans, the Commission specifically excluded issuers, noting that, as with the cooling-off period, further consideration of the potential application to issuers is warranted.

[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.

[10] The annual report information would appear in annual reports and certain proxy statements.

[11] In a change from the proposal, the adopted rules do not require corresponding disclosure regarding an issuer's use of trading arrangements. The Commission noted that, in light of the various comments received, further consideration of the potential application of the disclosure requirements on an issuer's transactions in equity securities is warranted.

[12] The narrative disclosure would include how the board determines when to grant such awards; whether, and if so, how, the board or compensation committee takes material non-public information into account when determining the timing and terms of the award; and whether the issuer has timed the disclosure of material non-public information for the purpose of affecting the value of executive compensation.

[13] For these option awards, the issuer must provide: (i) the name of the executive officer receiving the award; (ii) the grant date of the award; (iii) the number of securities underlying the award; (iv) the per-share exercise price; (v) the grant date fair value of each award (computed using the same methodology as used for the registrant's financial statements under generally accepted accounting principles); and (vi) the percentage change in the closing market price of the securities underlying the award between the one trading day before and the one trading day after the material non-public information is disclosed.

[14] 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.

[15] 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 amendments increase the timeliness of the filing.
