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SEC Approves New Restrictions On Insider Trading By Execs

By **Sarah Jarvis**

Law360 (December 14, 2022, 1:13 PM EST) -- The U.S. Securities and Exchange Commission on Wednesday unanimously adopted new disclosures and trading restrictions to crack down on potential abuses of insider trading by executives, with Chair Gary Gensler calling the matter one "of fair competition and trust in our capital markets."

Gensler and the commissioners adopted amendments to Rule 10b5-1 of the Securities Exchange Act of 1934 addressing decades-old insider trading concerns and bolstering disclosures around company insider trading policies.

"We've heard from courts, commenters, and members of Congress that insiders have sought to benefit from the rule's liability protections while trading securities opportunistically on the basis of material nonpublic information," Gensler said in a statement. "I believe today's amendments will help fill those potential gaps."

Republican Commissioners Hester M. Peirce and Mark T. Uyeda took issue with parts of the final amendments, but ultimately supported the measures. Commissioner Jaime Lizárraga, a Democrat, said closing some of the rule's loopholes "will provide investors with the confidence that there's a level playing field."

"The confidential information of issuers belongs to the company and its shareholders, not to insiders," Lizárraga said. "Investors have a right to understand how issuers protect material nonpublic information from being misused."

The amendments — which were proposed about a year ago, and have since been revised — aim to curb potential stock transaction abuses by corporations and company insiders.

One change addresses bipartisan concerns that the two-decade-old "affirmative defense" within Rule 10b5-1 is not strict enough to prevent insider trading. The affirmative defense provides a so-called safe harbor for companies and their insiders to buy and sell stock as long as they adopt trading plans in good faith and before becoming aware of material nonpublic information.

Gensler expressed concern when the amendments were proposed last year that there were gaps in the rule.

Under the final amendment, corporate officers or directors who enter into Rule 10b5-1 trading arrangements would be held to a cooling-off period of up to 120 days before any trading could commence following the adoption of that arrangement. The period will be either 90 days after a plan is adopted or modified, or two business days after certain periodic financial reports are disclosed, whichever is later.

Howard Berkenblit, head of the capital markets team at Sullivan & Worcester LLP, noted that a cooling-off period is currently voluntary and that the new periods are much longer than many current plans use.

The new amendments also mandate a cooling-off period of 30 days for trading arrangements for people other than issuers, directors or officers.

Among other things, the final amendments also prohibit overlapping trading plans, addressing concerns over the practice of corporate insiders using multiple plans to selectively cancel individual trades because of material, nonpublic information.

Issuers also have to report annually if they have adopted insider trading policies and procedures — or explain why they haven't — while officers and directors would need to disclose whether a reported transaction was made under an affirmative defense arrangement.

The final rules will be sent to the Federal Register and will go into effect 60 days after publication there. Issuers will be required to comply with the new disclosure requirements in financial reports and information statements that cover the first full fiscal period on or after April 1, 2023.

Under the new rules, directors and managers adopting a new plan or modifying an existing one must certify that they aren't aware of any material nonpublic information about a company or its securities and that they are adopting the plan in good faith.

Commissioner Uyeda said in prepared remarks at Wednesday's meeting that "good faith is an inherently subjective determination."

"The potential uncertainty of whether a person's actions after his or her adoption of a plan will be deemed — in hindsight — to not constitute good faith, may similarly render amended rule 10b5-1 to be difficult to implement," the commissioner noted.

Among Uyeda's other concerns, the commissioner said the final amendments don't adequately detail which disclosures should be reported with so-called structured data. He also said the final rule may unnecessarily restrict the use of certain trading plans that were established for legitimate reasons.

Uyeda said he hopes market participants will "provide the commission with feedback on whether the right balance was struck."

Commissioner Peirce offered her own criticisms of the final rule, including that it imposes what she described as an unnecessarily long cooling-off period, unreasonably short deadlines for reporting bona fide gifts and a lack of a financial hardship exemption. But she said the final rule is better than the initially proposed rule because it includes fewer costly disclosure requirements, among other things.

The Council of Institutional Investors said it has pressed the SEC to reform Rule 10b5-1 trading plans for 10 years. The organization — which represents pension funds, endowments and other entities — applauded the SEC's approval of the rules Wednesday.

Executive Director Amy Borrus said in a statement that the new rules close gaps in the SEC's enforcement regime that allow executives to use 10b5-1 plans as cover for insider trading.

"The SEC amendments will better protect public investors from misuse of these plans and strengthen confidence in corporate management teams and the capital markets generally," Borrus said.

Mayer Brown LLP partner John Ablan said that creating more requirements for the use of Rule 10b5-1 plans could have an adverse effect: causing some insiders to value it less, possibly resulting in public companies needing to issue larger awards to attract and retain top talent.

Ablan noted that the SEC walked back a requirement from its initial proposal that mandated a 30-day cooling-off period for issuers, saying that move shows the importance of a robust notice-and-comment process.

While the final rule's cooling-off periods for corporate officers and directors are shorter than initially proposed, he said "90 to 120 days is a long time, and ironically, requiring them may result in some insiders deciding to sell outside of a 10b5-1 program when they are otherwise not in possession of [material nonpublic information.]" The initial proposal included a 120-day mandatory cooling-off period for officers and directors.

Ablan said that public companies may want to consider requiring internal approval of officer and director 10b5-1 plans prior to entering into an agreement with a broker-dealer, in order to prepare for the new disclosure requirements.

Morrison Foerster LLP partner Jina Choi, a former regional director of the SEC's San Francisco office, told Law360 the final rule is a positive development in an area that has needed updates.

She said it's not good to have cynicism surrounding the 10b5-1 plans, and it's important that people have faith in the system and don't view it as rigged. She highlighted the rule's disclosure requirements as particularly impactful, saying such requirements can shape behavior.

The SEC is strongest when it acts unanimously in passing rules, Choi said, and Wednesday's vote reflects that the rules were a bit outdated.

Choi added that the new rule is "a sign that our government is working, our commission is working."

--Additional reporting by Tom Zanki. Editing by Alyssa Miller.

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