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# SEC Adopts Amendments to Insider Trading Rules and Reporting Requirements

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In late 2022, the U.S. Securities and Exchange Commission (SEC) adopted final amendments to certain rules and reporting requirements concerning insider trading arrangements, including Rule 10b5-1(c) under the *Securities Exchange Act of 1934* (Exchange Act).

Rule 10b5-1(c) provides affirmative defences for issuers and insiders against insider trading liability under section 10(b) of the Exchange Act and Rule 10b-5 thereunder. It permits issuers and insiders to adopt a written plan (known as a “10b5-1 plan”) that would carry out pre-planned trades on the basis of pre-established criteria, even if they later become aware of material non-public information (MNPI). The rule amendments impose additional conditions that must be met in order to have the affirmative defences under Rule 10b5-1(c) available. These rule amendments apply to all securities that are listed on a U.S. national securities exchange or are otherwise registered under section 12 of the Exchange Act, whether issued by domestic issuers or foreign private issuers, including Canadian issuers that rely on the multijurisdictional disclosure system (MJDS).

The rule amendments also impose new disclosure requirements concerning trading arrangements by directors and officers, insider trading policies and procedures of issuers, and director and executive compensation regarding equity compensation awards made close in time to the issuer’s disclosure of MNPI. Certain of these disclosure requirements apply only to domestic issuers whereas others apply to both domestic issuers and non-MJDS foreign private issuers, as discussed below. None of these disclosure requirements apply to MJDS issuers.

The rule amendments are designed to address concerns about abuse of Rule 10b5-1 to trade securities opportunistically on the basis of MNPI, including in situations in which an insider’s awareness of MNPI may still factor into the trading decision even if the insider’s plans appear to satisfy the requirements of Rule 10b5-1.

## Amendments to 10b5-1 Plans

**Expansion of “Good Faith” Requirement.** Prior to the rule amendments, Rule 10b5-1(c) required only that a 10b5-1 plan be entered into in good faith. The rule amendments expand the good faith requirement by requiring the person entering into the plan (whether an issuer or an insider) to act in good faith with respect to that plan even after the plan is adopted. This amendment relates to activities that are within the insider’s control. Cancellations directed by the issuer that are outside the insider’s control or influence (e.g., due to a possible merger) may not, by themselves, implicate the good faith condition. The rule amendment is designed to discourage issuers and insiders from attempting to evade the prohibitions of Rule 10b5-1(c) – for example, by using their influence to affect corporate disclosure being made before or after a planned trade under a trading arrangement.

**Cooling-off Period.** The rule amendments provide for a “cooling-off period” whereby no trade may occur for a specified period after a plan is adopted by any person other than the issuer.<sup>1</sup> The cooling-off period for directors and officers of the issuer<sup>2</sup> expires on the later of (i) 90 days after the adoption of the plan and (ii) two business days after the disclosure of the issuer’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, 40-F or 6-K that discloses the issuer’s financial results, but in any event not more than 120 days after the adoption of the plan. For persons other than directors and officers, the cooling-off period expires 30 days after the adoption of the plan.

**Modification of 10b5-1 Plans.** The rule amendments codify an existing SEC staff guidance that any modification or change to the amount, price or timing of the purchase or sale of the securities underlying a contract, instruction or plan is deemed to be a termination of such contract, instruction or plan and the adoption of a new contract, instruction or plan for purposes of Rule 10b5-1(c), which will trigger a new cooling-off period.<sup>3</sup>

**Multiple Overlapping 10b5-1 Plans.** The rule amendments add a new condition to the affirmative defences under Rule 10b5-1(c) that prohibits a person, other than an issuer, from having another outstanding (or subsequently entering into an additional) contract, instruction or plan that would qualify for the affirmative defence under Rule 10b5-1(c) for purchases or sales of any class of securities of the issuer on the open market during the same period. This prohibition has three limited exceptions:

- A series of separate contracts with different broker-dealers or other agents acting on behalf of the person to execute trades thereunder may be treated as a single plan, provided that the contracts with each broker-dealer or other agent, when taken together as a whole, meet all the applicable conditions of, and remain collectively subject to, the provisions of Rule 10b5-1(c). In addition, the substitution of a broker-dealer or other agent acting on behalf of the person for another broker-dealer that is executing trades under a contract, instruction or plan will not be deemed to be a modification of the contract, instruction or plan provided that the purchase or sales instructions applicable to the substitute and substituted broker-dealer are identical to the prices and amount of securities to be purchased or sold, and the dates of the purchases or sales to be executed.
- A person may have one later-commencing contract, instruction or plan for trading securities of the issuer on the open market under which trading is not authorized to begin until after all trades under the earlier-commencing contract, instruction or plan are completed or expired without execution and the applicable cooling-off period is expired.
- A contract, instruction or plan providing for an eligible sell-to-cover transaction will not be considered an outstanding or additional contract, instruction or plan provided that it authorizes an agent to sell only the securities necessary to satisfy tax withholding obligations arising exclusively from the vesting of a compensatory award, such as restricted stock or stock appreciation rights, and the insider does not otherwise exercise control over the timing of such sales.

**Single-Trade Plans.** Amended Rule 10b5-1(c) limits the availability of the affirmative defence in respect of a “single-trade plan” (i.e., a contract, instruction or plan that is designed to effect the open-market purchase or sale of the total amount of securities as a single transaction); such a plan cannot be adopted if another single-trade plan was adopted during the prior 12-month period. This limitation does not apply to plans that provide for a sell-to-cover transaction that meets the criteria described above.

**Required Representation in Plans.** Amended Rule 10b5-1(c) requires directors and officers (but not issuers) adopting a 10b5-1 plan to include in the plan a representation that, on the date of adoption of the plan, they (i) were not aware of MNPI about the issuer or its securities and (ii) are adopting the contract, instruction or plan in good faith and not as part of a plan or scheme to evade the prohibitions of Rule 10b-5(c).

### Required Disclosure by Issuers

Prior to the rule amendments, no mandatory disclosure concerning the use of trading arrangements by issuers was required.<sup>4</sup> The rule amendments impose the following new disclosure requirements, all of which must be tagged using Inline eXtensible Business Reporting Language (XBRL):

**Disclosure of Insider Trading Arrangements.** New Item 408(a) of Regulation S-K requires domestic issuers (not foreign private issuers) to provide the following disclosure in their quarterly and annual reports on Forms 10-Q and 10-K, respectively:

- Disclose whether, during the issuer’s last fiscal quarter, any director or officer has adopted or terminated (a) any contract, instruction or written plan for the purchase or sale of securities of the issuer that is intended to satisfy the affirmative defence conditions of Rule 10b5-1(c) (referred to as a “Rule 10b5-1 trading arrangement”); or (b) any written trading arrangement (referred to as a “non-Rule 10b5-1 trading arrangement”) of which (i) the director or officer was not aware of MNPI about the security or the issuer when it had adopted such arrangement and (ii) such arrangement either provides for trades based on pre-established criteria or does not permit

the director or officer to exercise any subsequent influence over purchases or sales (provided that any other person who did exercise such influence must not have been aware of MNPI when doing so). The issuer must indicate whether such trading arrangement is a Rule 10b5-1 trading arrangement or a non-Rule 10b5-1 trading arrangement.

- Provide a description of the material terms of the Rule 10b5-1 trading arrangement or non-Rule 10b5-1 trading arrangement other than terms regarding the price at which the individual executing the respective trading arrangement is authorized to trade, such as (i) the name and title of the director or officer, (ii) the date of adoption or termination of the trading arrangement, (iii) the duration of the trading arrangement and (iv) the aggregate number of securities to be sold or purchased under the trading arrangement.

Any modification or change to a 10b5-1 plan by a director or officer that falls within the meaning of new Rule 10b5-1(c) must also be disclosed under Item 408(a) as it constitutes the termination of an existing plan and the adoption of a new contract, instruction or written plan.

**Disclosure of Insider Trading Policies and Procedures.** The following disclosure must be made by (i) all domestic issuers in their annual reports on Form 10-K and proxy and information statements on Schedules 14A and 14C, under new Item 408(b) of Regulation S-K, and (ii) all non-MJDS foreign private issuers in their annual reports on Form 20-F under new Item 16J of Form 20-F:

- State whether the issuer has adopted insider trading policies and procedures governing the purchase, sale and other dispositions of its 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 listing standards applicable to the issuer.
- If the issuer has not adopted such insider trading policies and procedures, it must explain why it has not done so.
- If the issuer has adopted insider trading policies and procedures, it must file a copy of such policies and procedures as an exhibit to the applicable forms.<sup>5</sup>

**Disclosure of Option Grants and Similar Equity Instruments.** New Item 402(x) of Regulation S-K, requires domestic issuers (not foreign private issuers) to provide the following disclosure in their annual reports on Form 10-K and proxy and information statements on Schedules 14A and 14C:

- a discussion about the issuer's policies and practices on the timing of awards of stock options and similar option-like instruments in relation to the disclosure of MNPI by the issuers, including how the board determines when to grant such awards (e.g., whether such awards are granted on a predetermined schedule); whether and how the board or compensation committee takes MNPI into account when determining the timing and terms of an award; and whether the issuer has timed the disclosure of MNPI for the purpose of affecting the value of executive compensation.
- tabular disclosure of any options granted by the issuer to a named executive officer in the period beginning four business days before the filing of a periodic report on Form 10-Q or Form 10-K or the filing or furnishing of a current report on Form 8-K that discloses MNPI and ending one business day after the filing or furnishing of such report; the required tabular disclosure must contain basic information about the applicable award such as the grant date, number of securities underlying the award, exercise price, fair value of the award and percentage change in the market value of the securities underlying the award between the trading day before and the trading day after the release of the MNPI.

### Required Disclosure by Insiders

The rule amendments amend Forms 4 and 5, which are used by insiders of domestic issuers to report eligible transactions under section 16(a) of the Exchange Act, by adding a new checkbox that insiders must check if the transaction reported on the form was made under a contract, instruction or written plan that is intended to satisfy the affirmative defence conditions of Rule 10b5-1(c). If the checkbox is checked, the insider must also provide the date of adoption of the 10b5-1 plan in the appropriate place on the form.

The rule amendments also amend Rule 16a-3 under the Exchange Act to require section 16 reporting persons to report dispositions of bona fide gifts of equity securities on Form 4 (which is due before the end of the second business day following the date of execution of the transaction), rather than permitting such reporting persons to report these dispositions on Form 5 (which is due within 45 days of the end of the year in which the gift was made).

## Effective Date

The rule amendments will become effective on February 27, 2023. However, the amendments to Rule 10b5-1(c) would not affect the affirmative defence available under an existing 10b5-1 plan that was entered into before February 27, 2023, unless that plan is modified or changed in the manner described under the heading Modification of 10b5-1 Plans above after February 27, 2023. In that case, the modification or change would be equivalent to adopting a new trading arrangement and, therefore, amended

Rule 10b5-1(c) would be the applicable affirmative defence available for that modified arrangement.

Issuers must comply with the new disclosure requirements beginning with the first filing that covers the first full fiscal period beginning on or after April 1, 2023, other than smaller reporting companies, which will be afforded an additional six-month transition period.

Section 16 reporting persons must comply with the amendments to Forms 4 and 5 for beneficial ownership reports filed on or after April 1, 2023.

<sup>1</sup> In contrast to the amendments initially proposed by the SEC, the final rule amendments do not include a cooling-off period for issuers. However, the adopting release provides that the SEC is continuing to consider whether regulatory action is needed to mitigate any risk of investor harm from the misuse of 10b5-1 plans by the issuer, such as in the share repurchase context.

<sup>2</sup> The term "officer" is consistent with the definition of that term in Rule 16a-1(f) under the Exchange Act and includes the issuer's president, principal financial officer, principal accounting officer (or, if there is no such accounting officer, the controller), any vice-president of the issuer in charge of a principal business unit, division or function, any other officer who performs a policy-making function, or any other person who performs similar policy-making functions for the issuer.

<sup>3</sup> Modifications that do not change the sales or purchase prices or price ranges, the amount of securities to be sold or purchased or the timing of transactions under a plan (such as an adjustment for stock splits or a change in account information) will not trigger a new cooling-off period.

<sup>4</sup> Issuers are required to disclose their codes of ethics under Item 406 of Regulation S-K (in the case of domestic issuers), Item 16B of Form 20-F (in the case of non-MJDS foreign private issuers) or Paragraph 9 of General Instruction B of Form 40-F (in the case of MJDS issuers), which may address certain insider trading issues. However, the SEC notes in the adopting release that the codes of ethics may lack the detail necessary for investors to assess actual practices regarding potential insider trading.

<sup>5</sup> If all of the issuer's insider trading policies and procedures are included in its code of ethics and the code of ethics is filed as an exhibit, a hyperlink to that exhibit accompanying the issuer's disclosure as to whether it has insider trading policies and procedures would satisfy this component of the disclosure requirement.

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