

Why Wait for Congress (and the SEC) Before Reviewing Your 10b5-1 Plan?

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With overwhelming bipartisan support, on January 28, 2019 the U.S. House of Representatives approved the “Promoting Transparent Standards for Corporate Insiders Act” which is aimed at curbing potential abuse of Securities and Exchange Commission (SEC) Rule 10b5-1 trading plans by corporate insiders.

The bill includes six procedural restrictions for the SEC to study for consideration as potential amendments to Rule 10b5-1. The proposed restrictions prescribe a reasonable approach for administering plans based on sound governance practices. One might wonder why companies would wait for Congress (and the SEC) when they could consider these changes now.

The SEC adopted Rule 10b5-1 in 2000 to allow insiders to transact in their company's securities by providing an affirmative defense to insider trading allegations if prearranged plans are established and meet certain criteria. Specifically, Rule 10b5-1 trading plans must be entered into in good faith and while unaware of any material non-public information. In addition, the plans must specify the date, price and number of securities of future transactions or be based on a pre-set formula for making future trades, and the insider must not have subsequent influence over any person executing the plan.

Properly established Rule 10b5-1 trading plans provide several benefits to insiders and companies including protection from undue criticism over insider stock sales and a reduction in the risk of litigation over insider trading allegations. In addition, Rule 10b5-1 plans decrease the administrative burden of determining whether insiders hold material nonpublic information upon each transaction, as well as allow executives to diversify their assets without sending unintended signals to the market.

In recent years, Rule 10b5-1 plans have received increased scrutiny based on academic studies and media reports indicating insiders generated above-average returns on transactions of their company's stock despite trading through such plans. The majority of criticism focuses on an insider's ability to adopt plans shortly before executing the first trade under the plan, establish multiple overlapping plans, and/or cancel plans at any time without disclosing such action, including once an insider has learned of material non-public information.

The House bill seeks to address the shortfalls of Rule 10b5-1 trading plans. If enacted, the bill would require that within one year the SEC conduct a study on whether the rules governing Rule 10b5-1 should be amended to:

- Limit the ability of insiders to adopt plans only during open trading windows
- Limit the ability to adopt multiple overlapping plans
- Establish mandatory delays between adoption of a plan and the first trade
- Limit the frequency of plan modifications or cancellations
- Require plan adoptions, amendments, terminations and transactions to be filed with the SEC

- Require boards of companies that have adopted plans to (i) adopt policies covering trading plan practices (ii) periodically monitor trading plan transactions, and (iii) ensure company policies discuss trading plan use in the context of guidelines or requirements on equity hedging, holding and ownership.

Following the completion of the study, the SEC must issue a report to Congress and then adopt amended final rules following a comment period consistent with the results of the study.

The SEC adoption of final rules will not occur anytime soon, if ever, considering that the Senate has yet to take up the bill. Even if enactment of the House bill should occur this year, the SEC would not be obligated to issue its study to Congress until well into 2020. Afterwards, the SEC would be required to adopt final rules but under no specific timetable. Given the speed at which the SEC has issued proposed and final rules under Dodd-Frank, the SEC adoption of final rules amending Rule 10b5-1 could be years away.

However, good governance need not wait for Congress and the SEC to act. Boards should proactively review their company's Rule 10b5-1 plans now to ensure they include most of the procedural restrictions prescribed in the bill. Limiting the number of overlapping plans an insider can adopt and terminations to specific unanticipated circumstances (e.g., personal financial hardship), requiring plans be adopted only during open trading windows with reasonable delays between adoption and the first trades under such plans and periodic monitoring by Boards each would address areas of potential abuse and enhance good governance practices. Furthermore, the outcome of such efforts should benefit companies and executives by making them less vulnerable to undue criticism and allow for appropriate levels of stock sales by senior executives who seek to diversify their personal holdings.