HAS THE SEC KILLED OFF RULE 10B5-1 TRADING PLANS?

By Donald Kalfen

FORTUNATELY, THE SHORT ANSWER IS NO. Clearly, the Commission believes there is a need to review current guidance on Rule 10b5-1 trading plans and that action is required to mitigate or avoid potential abusive trading activity through these plans. Accordingly, on December 15, 2021, the Commission proposed rules to place further restrictions on these plans. We anticipate that any adopted final rule will closely mirror the proposed rule. However, we do not anticipate that the final rule will undermine the use or effectiveness of trading plans.

Big Picture Role of 10b5-1 Plans

It is commonplace to view trading plans as simply a mechanism for insiders (i.e., officers and directors) to sell company stock (although the rules apply to purchases as well). However, trading plans serve two important purposes:

1. Ability for insiders to diversify holdings of company stock while mitigating the risk of violating securities laws, and

2. Orderly buying/selling that helps minimize the potential for "surprises" or disruption in the pricing of company stock.

When properly implemented, trading plans provide an affirmative defense to claims of insider trading even when an insider is trading while in possession of material non-public information (MNPI). The Commission's proposed rule does not undermine the use of the affirmative defense.

AREA OF RESTRICTION	PROPOSED RULE	MARKET PRACTICE
Cooling off period	▪ Insiders prohibited from trading for 120 days after adopting a new trading plan or modifying/terminating an existing trading plan	▪ Nearly 80 percent of companies require trading plans to include cooling off periods ▪ Cooling off periods typically range from 14- to 90-days or until the beginning of the next open window period/fiscal quarter (72 percent of companies)
Multiple overlapping trading plans	▪ Insiders prohibited from implementing multiple overlapping plans for open market trades in the same class of securities	▪ 67 percent of companies do not allow insiders to maintain overlapping trading plans
Single trade plans	▪ Insiders allowed to use single-trade plans only once during any consecutive 12-month period	▪ Generally, companies do not restrict the use of single-trade plans
Certification that insider is not aware of MNPI when adopting a trading plan	▪ Insiders required to certify: · They were not aware of MNPI when adopting trading plans, · The adoption was in good faith, and · The trading plan is not part of a scheme to evade anti-fraud provisions of Securities Exchange Act of 1934	▪ Generally, companies do not require such certification ▪ The first two items subject to certification are requirements under existing rules

The proposed rule also includes new disclosure rules on trading plans, which are beyond the scope of this article.

Proposed Rule and Current Market Practice

The proposed rule would place four new restrictions on trading plans (in addition to existing restrictions). The table below discusses these restrictions and the extent to which current market practice has evolved to mirror the proposed rule to some degree.

As the table shows, market practice is generally aligned with three of the four restrictions that would be placed on trading plans under the proposed rule.

- Currently, a majority of companies include cooling off periods in their trading plans and prohibit the use of multiple overlapping plans. However, most companies would need to lengthen their cooling off periods to meet the requirements of the proposed rule.

- Generally, the new certification requirement does not impose any new substantive requirements but covers items already required under existing rules, except for certification that the adoption of a trading plan is not part of a scheme to evade anti-fraud provisions.

- The restriction on single transaction plans is not a current market practice. Notably, however, the proposed rule would still allow for such plans but limit them to once during any consecutive 12-month period.

Given current market practice and the relative ease of compliance with the proposed rule, we do not anticipate the proposed rule dampening the creation of new trading plans or, if applied retroactively, causing a cutback in existing trading plans.

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