

VOLUME 13, ISSUE 20
DECEMBER 29, 2022

Meridian Client Update

SEC Adopts Final Rules on 10b5-1 Trading Plans

On December 14, 2022, the Securities and Exchange Commission (SEC) adopted Final Rules that will impose new conditions and disclosure requirements on Rule 10b5-1 trading plans.

The SEC voted unanimously to adopt amendments to Rule 10b5-1 under the Securities Exchange Act of 1934 and new disclosure requirements. The Final Rules:

- Add new conditions to the availability of the affirmative defense under Rule 10b5-1(c)(1), including cooling-off periods for directors, officers, and other persons (other than registrants);
- Create new disclosure requirements regarding registrants' insider trading policies and procedures and the adoption and termination (including modification) of Rule 10b5-1 trading plans and certain other similar trading arrangements by directors and officers;
- Create new disclosure requirements for executive and director compensation regarding certain equity compensation awards made close in time to the registrant's disclosure of material nonpublic information; and
- Update Forms 4 and 5 to require filers to (i) identify transactions made pursuant to a plan that is intended to satisfy the affirmative defense conditions of Rule 10b5-1(c) and (ii) disclose all bona fide gifts of securities on Form 4.

According to the SEC, these amendments were adopted to:

- Improve investor confidence in the securities markets,
- Continue to provide appropriate flexibility to traders who would like to plan securities transactions in advance, when they are not aware of material nonpublic information,
- Reduce opportunities for corporate insiders to misuse Rule 10b5-1 to trade on material nonpublic information, and
- Increase transparency regarding the use of Rule 10b5-1 trading plans, registrants' insider trading policies and procedures, and their policies and practices with respect to awards of options, stock appreciation rights ("SARs"), and/or similar option-like instruments close in time to the release of material nonpublic information.

Comparison of Final Rule and Current Rule Applicable to 10b5-1 Trading Plans

The table below compares the Final Rule and Current Rule applicable to 10b5-1 trading plans.

Final Rule	Current Rule
<ul style="list-style-type: none"> ▪ Impose the following new conditions on Rule 10b5-1 trading plans: 	
<ul style="list-style-type: none"> — Cooling-off Period – mandatory delay between trading plan adoption, modification or termination and initial trades 	No Cooling-off Period
<ul style="list-style-type: none"> — Prohibit multiple overlapping trading plans (with exception for additional plan(s) for sale of shares to cover tax withholding obligations and certain other narrow exceptions) 	No prohibition on overlapping trading plans, except in certain narrow circumstances related to hedging transactions
<ul style="list-style-type: none"> — Restriction on single trading plans to one per every 12 month period (with exception for additional plan(s) for sale of shares to cover tax withholding obligations) 	No restrictions on single trading plans, except in certain narrow circumstances related to hedging transactions
<ul style="list-style-type: none"> — Require trading plan to be operated in good faith 	No requirement that trading plans be operated in good faith; only includes requirement that trading plans be entered in good faith
<ul style="list-style-type: none"> — Require officers and directors to certify that (i) they are not aware of material nonpublic information when they adopt a trading plan and (ii) the adoption of the plan is in good faith and not as part of a plan or scheme to evade the prohibition of Rule 10b5-1 	No certification requirement
<ul style="list-style-type: none"> ▪ Require companies to meet new disclosure rules covering the following matters: 	
<ul style="list-style-type: none"> — Rule 10b5-1 trading plans and other trading arrangements (disclose adoption/termination of trading arrangement, whether arrangement is a Rule 10b5-1 plan and description of material terms) 	No requirement to disclose insider adoption, modification or termination of trading plan
<ul style="list-style-type: none"> — Insider trading policies and procedures (disclose whether registrant maintains an insider trading policy and terms of such policy) 	No requirement to disclose insider trading policies or procedures
<ul style="list-style-type: none"> — Timing of stock option grants (disclose policies and practices on the timing of stock options, SARs and/or similar option-like instruments in relation to disclosure of material nonpublic information by registrant) 	May require a company to disclose in its Compensation Discussion and Analysis information about the timing of option grants in close proximity to the release of material nonpublic information by the company
<ul style="list-style-type: none"> — Reporting of trading plan transactions on Forms 4 and 5 (disclose whether reported trades made under a Rule 10b5-1 trading plan) 	No requirement to disclose stock transactions were made under a trading plan

Background on Rule 10b5-1 Trading Plans

Rule 10b5

This rule prohibits securities fraud, including insider trading through the purchase or sale of securities on the basis of material nonpublic information.

Rule 10b5-1

This rule was adopted in 2000 to allow insiders (e.g., officers¹ as defined under Rule 16a-1(f) and board members) to transact in their company's securities by establishing prearranged trading plans. Rule 10b5-1 **trading plans** provide an **affirmative defense to insider trading allegations** if the plan is entered into:

- In good faith;
- While the individual or public company is unaware of any material nonpublic information;
- With specifications regarding the number of securities, price and date of future transactions or a formula for making such determinations; and
- With prohibitions on exercising any subsequent influence over any person executing the plan.

Rule 10b5-1 provides an affirmative defense designed to demonstrate that a purchase or sale was not made "on the basis of" material nonpublic information. The rule provides a safe harbor for "insiders" who are buying or selling registrant stock, as well as public companies that repurchase shares through buyback programs, to make trades during periods where they are aware of material nonpublic information or during "black-out" periods during which trading is otherwise prohibited. As a result, many executives have adopted Rule 10b5-1 trading plans that govern the sale of their holdings of registrant securities.

When properly administered, Rule 10b5-1 trading plans benefit both executives and companies by reducing the risk of litigation alleging insider trading, making it easier for companies to administer their stock programs, and, perhaps most importantly, allowing executives to diversify their assets while not sending unintended signals to the market.

Imposition of New Conditions on Rule 10b5-1 Trading Plans

The SEC's amendments to Rule 10b5-1 will impose the following new conditions on trading plans that are intended to provide an affirmative defense to claims of insider trading:

- Mandatory delay between trading plan adoption, modification or termination and initial trades.
- Prohibition on multiple overlapping trading plans, subject to narrow exceptions.
- Restriction on single-trade plans, subject to narrow exceptions.
- Operation of trading plan in good faith.

¹ Under Rule 16a-1(f), the term officer means an registrant's president, principal financial officer, or principal accounting officer (or, if there is no such accounting officer, the controller), any vice-president of the registrant in charge of a principal business unit, division or function (such as sales, administration or finance), any other officer who performs a policy-making function, or any other person who performs similar policy-making functions for the registrant. Officers of the registrant's parent(s) or subsidiaries shall be deemed officers of the registrant if they perform such policy-making functions for the registrant.

- Certification by officers and directors, individually, that they are not aware of material nonpublic information about the registrant when they adopt a trading plan.

These new trading plan requirements are effective as of 60 days following publication of the Final Rules in the Federal Register, likely resulting in an effective date that falls in the first quarter of 2023. The new requirements will apply to trading plans entered into on or after the effective date and existing trading plans modified on or after the effective date. The SEC's amendments to Rule 10b5-1 **will not** affect an insider's reliance on the affirmative defense with regard to trades under an **existing** Rule 10b5-1 plan that was entered into prior to the effective date, unless the plan is modified in the manner set forth in amended rules (i.e., a change to the amount, price or timing of the purchase or sale of securities) after the effective date.

Each of these new conditions on Rule 10b5-1 trading plans are described below.

Mandatory Cooling-off Period

The amendments to Rule 10b5-1 will impose the following mandatory delay between a plan adoption or modification and initial trades:

- Directors and officers will be prohibited from trading under a trading plan until **later of**:
 - 90 days following plan adoption or modification; or
 - Two business days following the disclosure of the registrant's financial results in a Form 10-Q or Form 10-K (or a foreign private registrant's financial results in a Form 20-F or Form 6-K) for the fiscal quarter in which the plan was adopted (but in any event, the required cooling-off period is subject to a maximum of 120 days after adoption of the plan).
- Persons other than registrants, directors or officers will be prohibited from trading for a 30-day period after adopting a new trading plan or modifying an existing trading plan.

Only certain modifications would trigger a Cooling-off Period under the Final Rules. A change to the amount, price or timing of the purchase or sale of securities would trigger a Cooling-off Period. However, modifications that **do not change** the sales or purchase prices or ranges, the amount of securities to be sold or purchased, or the timing of transactions under a Rule 10b5-1 trading plan **would not trigger** the required Cooling-off Period.

The SEC chose not to extend the Cooling-off Period to registrants but believes that further consideration of the potential application to registrants is warranted.

Prohibition on Multiple Overlapping Trading Plans

The amendments to Rule 10b5-1 will generally prohibit officers, directors and other persons (other than a registrant) from implementing multiple overlapping plans for open market trades for **any** class of securities. This prohibition is subject to the following exceptions:

- **Use of multiple broker-dealers.** A series of separate contracts with different broker-dealers or other agents acting on behalf of an officer, director or person (other than the registrant) to execute trades thereunder will 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 of the applicable conditions of and remain collectively subject to the provisions of Rule 10b5-1(c)(1). A modification of any such contract will be a modification of each other contract or instruction of such single plan.

A broker-dealer or other agent executing trades on behalf of the insider pursuant to the Rule 10b5-1 plan may be substituted by a different broker-dealer or other agent as long as the purchase or sales instructions applicable to the substituted broker and the substitute are identical, including with respect to the prices of securities to be purchased or sold, dates of the purchases or sales to be executed, and amount of securities to be purchased or sold.

- **Establishment of multiple plans to run consecutively.** An officer, director or other person (other than the registrant) **may** maintain two separate Rule 10b5-1 plans at the same time so long as trading under the later-commencing plan is not authorized to begin until after all trades under the earlier-commencing plan are completed or expire without execution, subject to certain timing restrictions.
- **Establishment of a separate plan for sell-to-cover transaction.** An insider **may** establish and maintain multiple trading plans where the additional plan (or plans) is used to execute transactions to cover an insider's tax withholding obligations incident to the vesting of equity awards ("sell-to-cover plans"). However, an insider may not establish a sell-to-cover plan to cover sales incident to the exercise of a stock option award since option exercises occur at the discretion of the insider.

Restriction on Single-Trade Plans

The amendments to Rule 10b5-1 will prohibit officers, directors and other persons (other than the registrant) from entering into more than one trading plan that is "designed to effect" the open-market purchase or sale of the total amount of securities as a single transaction during any consecutive 12-month period. A trading plan is "designed to effect" the purchase or sale of securities as a single transaction when the contract, instruction, or plan has the practical effect of requiring such a result.

A trading plan will not be treated as a single-trade plan under the following circumstances:

- The plan leaves the person's agent discretion over whether to execute the contract, instruction, or plan as a single transaction, or
- The plan does not leave discretion to the agent, but instead provides that the agent's future acts will depend on events or data not known at the time the plan is entered into, such as a plan providing for the agent to conduct a certain volume of sales or purchases at each of several given future stock prices; and (2) it is reasonably foreseeable at the time the plan is entered into that the plan might result in multiple transactions.

An insider who establishes a single trade plan may also concurrently establish and execute a sell-to-cover plan.

Requirement to Act in Good Faith

Currently, the Rule 10b5-1(c)(1) affirmative defense is only available if a trading arrangement was entered into in good faith and not as part of a plan or scheme to evade the prohibitions of the rule. The amendment to Rule 10b5-1 further requires that the person who entered into trading plan has acted in good faith with respect to the operation of the trading plan (thereby extending the good faith requirement throughout the duration of the plan, including in relation to an individual's decision to modify or terminate a plan).

Officer and Director Certification

The amendment to Rule 10b5-1 will require an officer or director to certify the following at the time that the officer or director adopts a trading plan:

- The person is not aware of material nonpublic information about the registrant or its securities.
- The person is adopting the plan in good faith and not as part of a plan or scheme to evade the prohibitions of Rule 10b-5.

The Final Rule requires this certification to be included as a representation in the adopted trading plan, rather than to be included in a separate document to be presented by an insider to the registrant (as would have been required under the Proposed Rule).

The certification will not provide an independent basis of liability for directors or officers under Section 10(b) or Rule 10b-5².

New Disclosure Requirements

Currently, there are no mandatory disclosure requirements concerning the use of Rule 10b5-1 trading arrangements or other trading arrangements by registrants or corporate insiders. To address this lack of transparency, the Final Rules require companies to disclose certain information about the following items:

- Rule 10b5-1 trading plans and other trading arrangements.
- Insider trading policies and procedure.
- Timing of stock option grants.
- Reporting of trading plan transactions on Forms 4 and 5.

New Disclosure Requirements on Rule 10b5-1 Trading Plans

Companies³ will be required to make the following quarterly disclosures on Form 10-Q and Form 10-K, as applicable:

- Disclose whether, during the registrant's last fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report), any director or officer has adopted or terminated:
 - Any written trading arrangement for the purchase or sale of securities of the registrant that is intended to satisfy the affirmative defense conditions of Rule 10b5-1(c) (a "Rule 10b5-1(c) trading arrangement"), and/or
 - Any written trading arrangement for the purchase or sale of securities of the registrant that is **not** intended to satisfy the affirmative defense conditions of Rule 10b5-1 (a "non-Rule 10b5-1 trading arrangement"); and
- Disclose whether any trading arrangement subject to disclosure is a Rule 10b5-1 trading arrangement or a non-Rule 10b5-1 trading arrangement.

² To prevail in a securities fraud claim under Section 10(b) of the Exchange Act, a plaintiff must allege and prove that the defendant acted with knowledge of wrongdoing. A false certification would be evidence that an officer or director acted with such intent.

³ The new disclosure requirements applicable to trading plans will not apply to foreign private registrants.

- Provide a description of the material terms of the Rule 10b5-1 trading arrangement or non-Rule 10b5-1 trading arrangement, except for terms related to the price at which the individual executing the arrangement is authorized to trade, such as:
 - The name and title of the director or officer,
 - The date of adoption or termination of the trading arrangement,
 - The duration of the trading arrangement, and
 - The aggregate number of securities to be sold or purchased under the trading arrangement.

In addition, a registrant will be required to disclose a modification or change to a Rule 10b5-1 trading plan by a director or officer if such modification or change constitutes the termination of an existing plan and the adoption of a new plan.

Disclosure Requirement Related to Insider Trading Policies and Procedures

Under the Final Rules, a registrant⁴ will be required to disclose the following information on their insider trading policies and procedures in annual reports filed on Form 10-K and proxy and information statements⁵:

- Whether the registrant has adopted insider trading policies and, if so, the procedures governing the purchase, sale, and other dispositions of their securities by directors, officers, and employees, or the registrant itself that are reasonably designed to promote compliance with insider trading laws, rules, and regulations, and any listing standards applicable to the registrant, and
- If a registrant has not adopted insider-trading policies, it must explain why it has not done so.

The Final Rules do not require disclosure of the registrant's insider trading policies and procedures within the body of the annual report or proxy/information statement. Instead, registrants will be required to file a copy of their insider trading policies and procedures as an exhibit to Form 10-K or Form 20-F (for foreign private registrants).

Disclosure Requirement Related to the Timing of Stock Option Grants, SARs and other Similar Option-Like Instruments

The Final Rules require registrants, including smaller reporting companies and emerging growth companies, to include narrative disclosures on the registrant's policies and practices on the timing of awards of stock options, SARs and/or similar option-like instruments in relation to the disclosure of material nonpublic information by the registrant.

A registrant will be required to annually disclose the following information in Form 10-Ks and proxy statements related to the election of directors, shareholder approval of new compensation plans, and Say on Pay proposals:

- How the board determines when to grant such awards (for example, whether such awards are granted on a predetermined schedule);

⁴ Includes foreign private issuers.

⁵ Registrants may incorporate by reference in the Form 10-K their insider trading policy disclosed in their proxy.

- Whether, and if so, how, the board or compensation committee takes material nonpublic information into account when determining the timing and terms of an award, and
- Whether the registrant has timed the disclosure of material nonpublic information for the purpose of affecting the value of executive compensation.

A registrant will also be required to disclose in such filings information concerning each subject award for each named executive officer (NEO) in a tabular format when an award is made close in time to the release of material nonpublic information (such as an earnings release). Specifically, such disclosure will be required for awards that were granted to an NEO during the last completed fiscal year within a period starting four business days prior to the filing of a periodic report on Form 10-Q or Form 10-K, or the filing of a current report on Form 8-K that discloses material non-public information (with limited exceptions) and ending one business day after the triggering event. In the event such disclosure is required, the following information must be provided in tabular format:

- The name of the NEO;
- The grant date of the award;
- The number of securities underlying the award;
- The per-share exercise price;
- 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
- The percentage change in the market price of the underlying securities between the closing market price of the security one trading day prior to and one trading day following the disclosure of material nonpublic information.

Reporting of Trading Plan Transactions on Forms 4 and 5

The Final Rules modify Forms 4 and 5 to require Section 16 reporting persons to disclose in a checkbox whether a reported transaction was made pursuant to a plan that is intended to satisfy the affirmative defense conditions of Rule 10b5-1(c). Such individuals would also have to disclose the date of adoption of the trading plan on the form.

In addition, Section 16 reporting persons will be required to report dispositions of bona fide gifts of equity securities on Form 4 (rather than Form 5) in accordance with Form 4's filing deadline (that is, before the end of the second business day following the date of execution of the transaction).

Compliance Dates for New Disclosure Requirements

Registrants and Section 16 reporting persons will be required to comply with the new disclosure requirements in accordance with the following dates:

- Section 16 reporting persons will be required to comply with the amendments to Forms 4 and 5 for beneficial ownership reports filed on or after April 1, 2023.
- Registrants (other than smaller reporting companies) will be required to comply with the new disclosure requirements in periodic reports on Forms 10-Q, 10-K and 20-F (for foreign private issuers) and in any

proxy or information statements in the first filing that covers the first full fiscal period that begins on or after April 1, 2023.

- Smaller reporting companies will be required to comply with the new disclosure requirements beginning in their first full fiscal period that begins on or after October 1, 2023.

Thus, calendar year companies (other than smaller reporting companies) will need to provide such disclosure beginning with Form 10-Q filed for the second quarter of 2023 and their annual reports filed in the first half of 2024. Companies with a fiscal year-end between June 30 and November 30 will be subject to the new disclosure requirements in their annual reports earlier than calendar-year companies.

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The **Client Update** is prepared by Meridian Compensation Partners' Governance and Regulatory Team led by Donald Kalfen. Questions regarding this Client Update or executive compensation technical issues may be directed to Donald Kalfen at 847-235-3605 or dkalfen@meridiancp.com.

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