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Public Company Updates: SEC Adopts 10b5-1 Trading Plan Rules; Stock Buyback Proposal Comment Period Reopened; New Non-GAAP CDIs

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Key Takeaways:

- New rules regarding Rule 10b5-1 plans were adopted by the SEC, but the SEC reopened the comment period for the related proposal regarding stock buybacks.
- SEC rules now contain new requirements in order for insiders to rely on the affirmative defense to insider trading provided by Rule 10b5-1(c)(1), including mandatory minimum cooling-off periods for individuals (between 30 and 120 days) between entry into or modification of a Rule 10b5-1 trading plan and execution of the first trade.
- The SEC did not adopt rules requiring a cooling-off period for issuers.
- Forms 4 and 5 have been amended to require Section 16 filers to identify trades made pursuant to a Rule 10b5-1 plan.
- Bona fide gifts of securities by insiders are now reportable within 2 days on Form 4, rather than at the end of the year on Form 5.
- The Division of Corporation Finance published new and revised Compliance & Disclosure Interpretations to expand the universe of what the staff believes to be "misleading" non-GAAP disclosures and provide examples of when non-GAAP measures may be considered to be more "prominent" than comparable GAAP measures.

SEC Adopts Amendments to Rule 10b5-1 and Related Rules and Forms

Overview

Rule 10b5-1(c)(1) under the Securities Exchange Act of 1934, as amended (the "Exchange Act") provides an affirmative defense to allegations of insider trading for persons who trade in a company's securities if the person can demonstrate, among other conditions, that before becoming aware of material nonpublic information ("MNPI"), the person had: (i) entered into a binding contract to buy or sell the securities; (ii) provided instructions to another person to execute the trade for the instructing person's account; or (iii) adopted a written plan for trading securities. These arrangements are often referred to as "Rule 10b5-1 plans," and must meet certain requirements with respect to trading and be entered into in good faith. Rule 10b5-1 plans are commonplace both for companies that buy their own securities in the open market as well as directors, officers and certain other employees who are frequently in possession of MNPI.

On December 14, 2022, the SEC adopted rules related to the use of Rule 10b5-1 trading plans (the "SEC 10b5-1 Plan Rules") that add new conditions to the availability of the affirmative defense to insider trading under the Exchange Act; and create new disclosure requirements for issuers, Section 16 officers, employees and directors regarding such 10b5-1 trading plans.

Below is a summary of and certain implications and recommendations regarding the SEC 10b5-1 Plan Rules.

Effective Dates

The SEC 10b5-1 Plan Rules will become effective 60 days following publication of the SEC adopting release in the Federal Register. Section 16 reporting persons will have to comply with changes to Forms 4 and 5 beginning on April 1, 2023. Companies must comply with the new disclosure requirements in Forms 10-Q, 10-K, 20-F and in proxy and information statements in the first filing that covers the first full fiscal period that begins on or after April 1, 2023. Smaller reporting companies must provide the new

disclosures in the first filing that covers the first full fiscal period that begins on or after October 1, 2023.

New Requirements

1. Cooling-Off Periods

Under the SEC 10b5-1 Plan Rules, individual insiders—not the issuer itself—are now subject to a "cooling-off period" after the adoption or modification of a Rule 10b5-1 plan before trades may commence pursuant to such plan. Specifically, directors and officers are subject to a cooling-off period of the later of: (1) 90 days following plan adoption or modification; or (2) two business days following the disclosure in certain periodic reports (Form 10-Q or Form 10-K for domestic filers and Form 20-F or Form 6-K for foreign private issuers) of the issuer's financial results for the fiscal quarter in which the plan was adopted or modified (but not to exceed 120 days following plan adoption or modification). Persons other than directors or officers must comply with a 30-day cooling-off period. In a change from the proposal, the SEC did not adopt a cooling-off period for issuers.

Implications and Recommendations with Respect to Cooling-Off Periods
Although there was no statutorily required cooling-off period prior to the adoption of the SEC 10b5-1 Plan Rules, it was common practice for insiders to adhere to a cooling-off period in connection with their adoption of Rule 10b5-1 plans — either because the issuer and/or plan administrator required it or as a matter of good practice.[1] Issuers themselves often have no cooling-off period at all between entry into a Rule 10b5-1 Plan and execution of the first trade. Issuers and/or plan administrators who required shorter cooling-off periods for individuals — or no cooling-off period at all — should upwardly adjust or implement cooling-off periods as required for Rule 10b5-1 plans by the time the SEC 10b5-1 Plan Rules become effective.

Amended Rule 10b5-1(c)(1) specifies that the following types of modifications to a Rule 10b5-1 plan are considered a termination of such plan and adoption of a new plan and therefore trigger the cooling-off period requirement:

> …a modification or change to the amount, price, or timing of the purchase or sale of the securities (or a modification or change to a written formula or algorithm, or computer program that affects the amount, price, or timing of the purchase or sale of the securities) underlying a contract, instruction, or written plan…

The SEC adopting release explains on page 36 that:

> 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 Rule 10b5-1 plan (such as an adjustment for stock splits or a change in account information) will not trigger a new cooling-off period.

2. Limitations on Multiple Plans and Single Trade Plans

The SEC 10b5-1 Plan Rules limit overlapping Rule 10b5-1 plans by individuals—but not issuers. Specifically, the SEC 10b5-1 Plan Rules contain the general rule that overlapping plans are prohibited with the following limited exceptions:

a. An individual may enter into more than one plan with different broker-dealers or other agents and treat the plans as a single Rule 10b5-1 plan so long as, when taken as a whole, the "plan" complies with all of the rule's requirements;
b. An individual may adopt one later-commencing Rule 10b5-1 plan 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. If the earlier-commencing plan is terminated earlier, the later-commencing plan must have a cooling-off period that starts when the first plan terminates; and
c. An individual may have an additional plan set up solely to sell securities as necessary to satisfy tax withholding obligations arising exclusively from the vesting of a compensatory award, otherwise known as "sell-to-cover" transactions.

In addition, an individual will be able to rely on the Rule 10b5-1(c)(1) affirmative defense for only one single-trade plan during any 12-month period, and only if the person did not adopt another single-trade plan that qualified for the affirmative defense during the preceding 12-month period. The limitation on single-trade Rule 10b5-1 plans will not apply to sell-to-cover transactions.

Implications and Recommendations with Respect to Overlapping Plans and Single-Trade Plans

The exceptions provided to the general rule that an insider cannot have multiple 10b5-1 plans will be meaningful to insiders who sell-to-cover when stock awards vest as well as for those who hold their securities in multiple brokerage accounts. Issuers should revise insider trading plans carefully to ensure that insiders understand when they are allowed to enter into multiple plans at the same time and to limit the usage of single-trade plans.

3. Certifications by Directors and Officers

The SEC 10b5-1 Plan Rules require directors and officers to make a certification in order to rely on Rule 10b5-1 for an affirmative defense. At the time of the adoption of a 10b5-1 plan, directors and officers must personally certify in writing in plan documents that (1) they are not aware of MNPI about the issuer or its securities; and (2) they are adopting the plan in good faith and not as part of a plan or scheme to evade the prohibitions of Rule 10b-5.

In addition, there is a new condition that requires any person who has a Rule 10b5-1 plan in place to act in good faith with respect to the plan. The SEC adopting release on page 67 provides an example of how an insider might violate this new requirement:

> [A] corporate insider would not be operating a Rule 10b5-1 plan in good faith if the corporate insider, while aware of material nonpublic information, directly or indirectly induces the issuer to publicly disclose that information in a manner that makes their trades under a Rule 10b5-1 plan more profitable (or less unprofitable). In such a scenario, notwithstanding that the Rule 10b5-1 plan may have been adopted or entered into in good faith, the corporate insider would not be entitled to the affirmative defense.

Implications and Recommendations with Respect to Certifications
Most issuers have insider trading policies and procedures that require insiders to confirm that they do not have any MNPI when requesting the ability to trade in the company's securities or enter into a Rule 10b5-1 plan. In addition, this certification is already standard in brokers' Rule 10b5-1 plan agreements. Issuers should nonetheless review their plans and policies, as well as plans provided by broker-dealers, to ensure they conform to these new requirements. Further, for directors and officers, this confirmation should be reviewed by senior legal or compliance personnel to police insider trading given the negative publicity of enforcement.

4. New Reporting Requirements for Issuers and Section 16 Reporting Persons

Issuers will now be required to disclose quarterly on Forms 10-K and 10-Q the use of Rule 10b5-1 plans and certain other written trading arrangements by the issuer's directors or officers in the quarterly period preceding the filing of such report, including descriptions of certain material terms of such plans or arrangements.

Public reporting companies, including foreign private issuers, must annually report on their insider trading policies and procedures and file those policies and procedures as

exhibits to the annual report on Form 10-K or Form 20-F. If an issuer does not have insider trading policies or procedures, it must explain why.

In addition, Item 402 of Regulation S-K was amended to require new narrative and tabular disclosure regarding awards and options granted close in time to the release of MNPI as well as related company policies and procedures. Issuers will now have to disclose and discuss awards granted in the period beginning four business days preceding a triggering event and ending one business day after a triggering event.

With respect to reporting by individuals, the SEC 10b5-1 Plan Rules amend Form 4 to add a "check box" requirement for sales under Rule 10b5-1 plans. Finally, the SEC 10b5-1 Plan Rules require insiders subject to the reporting requirements of Exchange Act to disclose promptly dispositions of bona fide gifts of securities on Form 4.

Implications and Recommendations with Respect to Reporting of Activity
Issuers should evaluate existing disclosure controls and procedures and implement changes, as necessary, to ensure readiness for the new quarterly reporting obligation. Issuers should also review insider trading policies to ensure conformity with the SEC 10b5-1 Plan Rules and consider whether to make any other changes before publicly disclosing the contents of the policy.

For Section 16 reporting persons, the current convention of some issuers is to include a voluntary footnote on Form 4 explaining that the transactions were made through a Rule 10b5-1 plan adopted by the reporting person on a certain date. Therefore, for those issuers the requirement to make such disclosure mandatory through a box check rather than a footnote is relatively minor. Issuers should alert their directors and Section 16 officers about the new requirement to report bona fide gifts on Form 4 to prevent late Section 16 filings.

Conclusion

The rules adopted by the SEC are far more reasonable than what the SEC initially proposed. Many of the proposed restrictions on issuers were not ultimately adopted and certain exceptions were made to the proposed rules that will allow individual insiders to rely on the affirmative defense while still trading in an efficient manner. That said, the SEC 10b5-1 Plan Rules do create many new obligations for public companies, their directors, officers and employees, as well as brokerage firms that execute Rule 10b5-1 plans. Issuers and insiders should review their existing policies and procedures with respect to Rule 10b5-1 plans and discuss whether any changes to existing

arrangements should be made. Issuers should also begin preparing for the new disclosure requirements in SEC filings. We expect that brokerage firms will review their standard Rule 10b5-1 plan agreements and make revisions as necessary to comply with the SEC 10b5-1 Plan Rules.

Comment Period Reopened for SEC Share Repurchase Disclosure Modernization Rules

The SEC announced on December 7, 2022 that it is reopening the comment period on its proposed amendments to the stock buyback disclosure rules (the "SEC Share Repurchase Disclosure Modernization Rules"). If adopted as proposed, the SEC Share Repurchase Disclosure Modernization Rules would require daily reporting of an issuer's share repurchases, which could impose significant burdens on issuers and also impact the price, volatility and liquidity of an issuer's stock.

The SEC Share Repurchase Disclosure Modernization Rules were initially proposed at the same time as the SEC 10b5-1 Plan Rules, and they are intended to modernize and improve disclosure of an issuer's stock buybacks. However, the SEC reopened the comment period for the SEC Share Repurchase Disclosure Modernization Rules because after they were proposed, Congress passed the Inflation Reduction Act of 2022 (the "IRA"), which contains an excise tax on stock buybacks. The SEC has also prepared a memorandum that details potential economic effects of the excise tax contained in the IRA and its impact on the SEC Share Repurchase Disclosure Modernization Rules.

Division of Corporation Finance Publishes New and Amended Non-GAAP Compliance & Disclosure Interpretations

On December 13, 2022, the Division of Corporation Finance staff (the "Staff") expanded its published guidance regarding non-GAAP financial measures. The new Compliance & Disclosure Interpretations ("CDIs") focus on examples of when the Staff may find non-GAAP measures to be misleading. For instance, in new CDI 100.06, the Staff provides its view that "a non-GAAP measure could mislead investors to such a degree that even extensive, detailed disclosure about the nature and effect of each

adjustment would not prevent the non-GAAP measure from being materially misleading."

In addition to discussing the Staff's view on misleading non-GAAP measures, the CDIs address non-GAAP prominence issues. For instance, in Question 102.10(b), the Staff provides a list of examples of disclosure of non-GAAP measures that the Staff believes would make the non-GAAP measures more prominent than the comparable GAAP measures:

- Starting the reconciliation with a non-GAAP measure.
- Presenting a non-GAAP income statement when reconciling non-GAAP measures to the most directly comparable GAAP measures. See Question 102.10(c).
- When presenting a forward-looking non-GAAP measure, a registrant may exclude the quantitative reconciliation if it is relying on the exception provided by Item 10(e)(1)(i)(B) of Regulation S-K. A measure would be considered more prominent than the comparable GAAP measure if it is presented without disclosing reliance upon the exception, identifying the information that is unavailable, and its probable significance in a location of equal or greater prominence.

This new guidance may not be consistent with issuers' current understanding of how they can present non-GAAP measures in compliance with SEC rules; fulsome disclosure may not, in the Staff's view, provide investors with the information they need to understand and evaluate management's use of non-GAAP measures. To avoid comments or potential enforcement actions, all issuers that provide investors with non-GAAP measures should read the amended and additional CDIs and refer back to them when drafting earnings statements as well as SEC periodic filings. The Division of Corporation Finance non-GAAP CDIs can be found here.

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1. The comment letter submitted by the Society for Corporate Governance in response to the rule proposal provided the following data: "The proposed 120-day cooling-off period for individual 10b5-1 plans would far exceed the periods currently used by most public companies. In an October 2021 survey of Society members, just 12 percent reported that their companies had cooling-off periods of 60 days or longer for individuals. The majority (51 percent) of respondents said their companies had 30-day periods." Letter from Society for Corporate Governance, *available at* https://www.sec.gov/comments/s7-20-21/s72021-20122264-278309.pdf ↩

Authors

Ann Becchina

Partner / New York

Philippa Bond, P.C.

Partner / Los Angeles – Century City

Sharon Freiman

Partner / New York

Robert M. Hayward, P.C.

Partner / Chicago

Sophia Hudson, P.C.

Partner / New York

Joshua N. Korff, P.C.

Partner / New York

Matthew R. Pacey, P.C.

Partner / Houston

Henry C. Pruitt

Partner / Bay Area – San Francisco

Christina M. Thomas

Partner / New York / Washington, D.C.

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- Transactional
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Suggested Reading

- 26 June 2023 - 30 June 2023 Speaking Engagement Oxford Private Equity Programme
- 19 December 2022 Press Release Kirkland Advises Canada Pension Plan Investment Board on its $200 Million Investment in Redaptive, a Leading Energy-As-A-Service Provider
- 19 December 2022 Award Thriving in Their 40s 2022