

SEC and U.S. Congress Consider Changes to Insider Trading Rules

The chair of the U.S. Securities and Exchange Commission recently asked his staff to recommend ways to “freshen up” Rule 10b5-1 in order to address “real cracks” in the insider trading regime.

Rule 10b5-1 of the Securities Exchange Act of 1934, as amended, was adopted in 2000 to provide an affirmative defense for directors, executive officers and employees to transact in their company’s securities while in possession of material nonpublic information. The rule allows individuals to create plans to purchase and sell their company stock when they have material nonpublic information. These plans have become relatively more commonplace, particularly for executives as well as for other employees wanting to sell company securities when taxable events occur during blackout windows.

From time to time, Rule 10b5-1 plans have been criticized when there are large sales of stock by executives at a time when the company is otherwise in the news. Some perceived abuses include making excessive modifications to plans or not having a meaningful cooling off period between the adoption of a plan and the first trade. As part of this criticism, three Democratic senators called for the SEC to tighten restrictions around Rule 10b5-1 plans earlier this year.

Meanwhile, the SEC is also looking into changes. On June 7, 2021, in prepared remarks at the CFO Network Summit, SEC Chair Gary Gensler told the audience that he had asked the SEC staff to consider revisions to Rule 10b5-1 in an effort to address “cracks” in the current insider trading regime and “freshen up” the rule. His remarks called out four areas for consideration as follows:

1. There is currently no mandated cooling off period required following the adoption of a Rule 10b5-1 plan and the first trade thereunder.
2. There currently are no limitations on when Rule 10b5-1 plans can be canceled. The SEC’s initial position was that not doing a trade is not itself a violation of any rule. Critics, however, believe that the SEC should consider specific rules around when and how Rule 10b5-1 plans can be canceled.

3. There are no mandatory public disclosure requirements regarding the adoption of Rule 10b5-1 plans. More disclosure regarding the adoption, modification and terms of Rule 10b5-1 plans by individuals and companies could enhance confidence in the markets.
4. There are no limits on the number of Rule 10b5-1 plans that insiders can adopt, and the SEC staff should consider whether there should be a limit on the number of Rule 10b5-1 plans that an individual could adopt at any one time.

Although there is no timeline when any changes to Rule 10b5-1 will be proposed, it is on the SEC's short-term agenda.

As mentioned, the U.S. Congress is also weighing in on the subject. Following criticism from some senators, the House of Representatives passed the Insider Trading Prohibition Act by a wide bipartisan margin on May 18, 2021. The bill is now awaiting Senate action, but it is uncertain whether it will move forward. The legislation is intended to more specifically define insider trading. A version of the bill passed the House in 2019 by an even stronger vote, but never made it through the Republican-led Senate.

For decades, insider trading has been enforced under the anti-fraud provisions of Section 10(b) of the Exchange Act and Rule 10b-5. There has been a longstanding debate over whether insider trading liability should arise only when someone trades on the basis of such information or when someone trades while in possession of such information. The SEC attempted to resolve that dispute by promulgating Rule 10b5-1, which adopts a "possession" standard while creating certain affirmative defenses for situations where such trading seems unproblematic, but questions have remained. This current piece of legislation, however, has been criticized as not being able to clarify concerns around insider trading and that it would create more ambiguity.

Next Steps

Many companies require certain employees to enter into Rule 10b5-1 plans based on many of the suggested changes by the SEC to further protect them and their employees from the appearance of any impropriety. Although we do not know whether the SEC will adopt changes to Rule 10b5-1, the SEC continues to focus on insider trading and reviewing Rule 10b5-1 plans in connection with such cases to determine whether these plans have been appropriately implemented.

If changes to Rule 10b5-1 are implemented, companies may be required to revisit their equity plan designs, including vesting timing, mandated sales restriction periods (or post-vest holding periods), and equity ownership guidelines in order to offer alternatives that allow for vesting or taxation outside of a blackout window.

If you have questions about this topic or other related matters, please contact one of the authors or write to rewards-solutions@aon.com.

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