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SEC Chair Seeks New Restrictions and Tougher Enforcement on Rule 10b5-1 Trading Plans

Insights
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Earlier this week, Securities and Exchange Commission (SEC) Chair Gary Gensler was interviewed about his policy-making priorities at *The Wall Street Journal*'s CFO Network Summit, where he identified Rule 10b5-1 trading plans and practices as a rulemaking and enforcement imperative. [1] His prepared remarks sketch a detailed regulatory roadmap and offer valuable insight into the SEC's thinking regarding potential 10b5-1 plan reforms. Specifically, Gensler:

- called for new restrictions on 10b5-1 plans and greater transparency into trading by company insiders;
- outlined five specific areas of reform intended to curb the potential for opportunistic abuse that "ha[s] led to real cracks in our insider trading regime";
- signaled more-aggressive enforcement efforts under the current rule designed to root out perceived abuses;
- urged companies and their insiders to exercise care and revisit best practices when adopting, amending or terminating 10b5-1 plans; and
- issued a forceful reminder, when using 10b5-1 plans, to act in good faith and avoid the kinds of concerns (or even the appearance of such concerns) his proposed reforms are meant to address.

Potential 10b5-1 Plan Reforms

Gensler announced he has directed Division of Corporation Finance staff to study and make recommendations on how the SEC might "freshen up" Rule 10b5-1 to try to reduce the risk of improper trading. In particular, he highlighted five potential areas of reform:

1. ***Require insiders to wait 4-6 months after a plan's adoption before trading***. Currently, there is no mandatory "cooling-off," or waiting, period between when insiders or companies adopt 10b5-1 plans and when they make their first trade. Citing research showing that approximately 14 percent of plans begin trading within 30 days of plan inception, and almost 40 percent within the first 60 days, Gensler expressed concern "that some bad actors could perceive this as a loophole to participate in insider trading."

2. ***Impose limitations on when and how plans can be canceled***. Currently, there are no limitations on when 10b5-1 plans can be canceled. Gensler said the fact that, under the current rule, insiders can cancel a plan when they have material nonpublic information (MNPI) "seems kind of upside-down to me. It may also undermine investor confidence. In my view, canceling a plan may be as economically significant as carrying out an actual transaction. That's because MNPI might influence an insider's decision to cancel an order to sell."

3. ***Require public disclosure regarding the adoption, modification and terms of plans by individuals and companies***. Currently, there are no mandatory disclosure requirements applicable to 10b5-1 plans. Gensler suggested that clearer and more-robust disclosure could enhance investor confidence in the public markets and ensure a level playing field.

4. ***Restrict the number of plans insiders can adopt***. Currently, there are no limits on the number of plans insiders may establish. Gensler noted that "[w]ith the ability to enter into multiple plans, and potentially to cancel them, insiders might mistakenly think they have a 'free option' to pick amongst favorable plans as they please."

5. ***Examine the intersection of Rule 10b5-1 with share buyback programs***. Without further elaboration, Gensler indicated he has instructed the staff to review the interplay between company share repurchases and trading under (or changes to) 10b5-1 plans, among other potential revisions to the rule.

Gensler observed that many public companies may currently have practices in place consistent with the above proposals, but opined that our capital markets would be better served if these practices were consistently required. This is an area, he

emphasized, where public companies and boards should focus more of their time and attention.

Tougher Enforcement Posture

In addition to possible rule amendments, Gensler signaled more-aggressive enforcement efforts under the current rule, warning that the SEC "will use all of the tools in our toolbox to ensure we are identifying and punishing abuses of 10b5-1 plans."

He also urged companies and their insiders—in advance of any future rulemaking—to exercise care, revisit best practices and act in good faith when adopting, amending or terminating 10b5-1 plans:

> "Make no mistake: As the rule stands today, canceling or amending any 10b5-1 plans calls into question whether they were entered into in good faith. If insiders don't act in good faith when using 10b5-1 plans, those plans will not offer them an affirmative defense."

Next Steps

Any formal rule changes would first be issued as proposals and be subject to a months-long notice-and-comment rulemaking process informed by perspectives obtained through public input. Although Gensler did not specify when the SEC would publish a rulemaking proposal and related request for public comment, we expect the agency to move swiftly.

In the meantime, separate and apart from any SEC actions, public companies and boards should carefully consider their controls and procedures around the design and administration of their 10b5-1 plans to ensure such plans are being created, modified, suspended or terminated only while not in possession of MNPI.

We will continue to monitor developments closely.

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[1] Rule 10b5-1 under the Securities Exchange Act of 1934 provides an affirmative defense against allegations of illegal insider trading for entities and individuals, such as directors, executive officers and other corporate insiders, transacting in their own companies' securities, as long as a written trading plan meeting certain requirements is adopted in good faith and while not in possession of material nonpublic information. The rule was enacted in 2000 and, despite repeated calls for reform in the past, has not been revised since. More recently, the plans began to receive renewed scrutiny at the onset of the COVID-19 pandemic.

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