Governance & Securities Alert

Weil

From the Public Company Advisory Group of Weil, Gotshal & Manges LLP

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Upcoming Form 10-Q or Form 10-K –

New Disclosures for Rule 10b5-1 and Non-Rule 10b5-1 Trading Arrangements of Directors and Section 16 Officers

Updating of Disclosure Controls and Procedures Required

Beginning with the first periodic filing that covers the first full fiscal quarter beginning on or after April 1, 2023 (for many domestic calendar year companies, that is the Form 10-Q for the fiscal quarter ending June 30, 2023), companies are required to disclose, whether, in the last fiscal quarter, a director or Section 16 officer[1] adopted or terminated any "Rule 10b5-1 trading arrangement" or "non-Rule 10b5-1 trading arrangement." [2] If so, Item 408(a) of Regulation S-K requires companies to identify whether the arrangement is a "Rule 10b5-1 trading arrangement" or "non-Rule 10b5-1 trading arrangement" and to describe its material terms (other than execution price), including the:

- name and title of the director or Section 16 officer;
- date of adoption or termination;
- duration of the arrangement; and
- aggregate number of securities to be bought or sold pursuant to the arrangement.

In addition, a modification or change (e.g., change to the amount, price, or timing of the purchase or sale) also would be required to be disclosed as it constitutes the termination of an existing plan and the adoption of a new contract, instruction, or written plan. Furthermore, Rule 10b5-1 and non-Rule 10b5-1 trading arrangements also could relate to gifts of securities.

These new disclosures are required in Part II-Item 5 of Form 10-Q and Part II-Item 9B of Form 10-K and must be tagged in EDGAR using Inline XBRL.

What is a "Rule 10b5-1 trading arrangement"?

Under most circumstances a company should be able to determine readily what is intended to be a Rule 10b5-1 trading arrangement. Item 408 defines it to mean any contract, instruction or written plan for the purchase or sale of securities of the company intended to satisfy the affirmative defense conditions of SEC Rule 10b5-1(c). These conditions became more stringent beginning on February 27, 2023, when amendments by the SEC to Rule 10b5-1(c) became effective.[3]

What is a "non-Rule 10b5-1 trading arrangement"?

Less clear is what types of arrangements fall within the definition of a non-Rule 10b5-1 trading arrangement. Item 408 states that a non-Rule 10b5-1 trading arrangement is one where a director or Section 16 officer asserts that, at a time when such person was not aware of material non-public information, such person had adopted a written arrangement for trading the securities and the arrangement either:

- specified the amount of securities to be purchased or sold and the price at which and the date on which the securities were to be purchased or sold;
- included a written formula or algorithm, or computer program, for determining the amount of securities to be purchased or sold and the price at which and the date on which the securities were to be purchased or sold; or
- did not permit such person to exercise any subsequent influence over how, when, or whether to effect purchases or sales; provided, in addition, that any other person who, pursuant to the trading arrangement, did exercise such influence must not have been aware of material non-public information when doing so.

This definition, according to the SEC in the Adopting Release, is consistent with the requirements of the Rule 10b5-1 affirmative defense that the SEC originally adopted in 2000[4] (prior to the changes that were effective in 2023).[5] Some principal differences between "old" Rule 10b5-1 (2000) and "new" Rule 10b5-1 (2023) are that new Rule 10b5-1 has a required cooling-off period, certifications by directors and Section 16 officers, and limitations on the use of multiple overlapping or single-trade plans. Hopefully the SEC staff will provide some interpretive guidance.

WHAT TO DO NOW:

- Companies should ensure that they have updated their disclosure controls and procedures to support timely disclosure of the information required by new Item 408(a). For example, some companies have chosen to inquire now and quarterly thereafter of directors and Section 16 officers on whether they have entered into, modified, or terminated any Rule 10b5-1 or non-Rule 10b5-1 trading arrangements. This likely should be combined with a reminder of the company's disclosure requirements and of their compliance with the company's insider trading policy (including preclearance requirements and the upcoming trading window). Companies also should be proactively identifying the existence and terms of Rule 10b5-1 and non-Rule 10b5-1 arrangements.
- Companies should be preparing Item 408(a) compliant disclosures to be included in either Part II-Item 5 of Form 10-Q or Part II-Item 9B of Form 10-K, as the case may be, and tagged in Inline XBRL. Companies have some flexibility; the rule does not specifically prescribe narrative or tabular disclosure.

OTHER NEW RULE 10b5-1 DISCLOSURES

- Beginning April 1, 2023, there was a new "check box" on Forms 4 and 5 that Section 16 filers are required to check if a reported transaction occurred pursuant to a Rule 10b5-1 trading arrangement. Filers are also required to provide the date of adoption of the Rule 10b5-1 trading arrangement in the "Explanation of Responses" portion of the forms. According to the SEC staff, the box is to be checked only if the transaction occurred pursuant to an arrangement intended to comply with "new" Rule 10b5-1(c).
- Beginning with the first periodic filing that covers the first full fiscal quarter beginning on or after October 1, 2023 (which for calendar year domestic companies would be the Form 10-K for the year ending December 31, 2023):
  - New Item 408(d) of Regulation S-K will require domestic companies to disclose on a quarterly basis (in Part II-Item 9B of Form 10-K and Part II-Item 5 of Form 10-Q) whether they adopted, modified or terminated any Rule 10b5-1 trading arrangement (with respect to their own securities) during the quarter, including a description of the material terms of the arrangement (other than the price at which trades are authorized to be executed), tagged using Inline XBRL.
  - New Exhibit 26 to Forms 10-K and 10-Q will require companies to provide daily repurchase disclosure in tabular format (on a quarterly basis) and must include, for each day, among other things, the total number of shares purchased pursuant to a plan that is intended to satisfy the affirmative defense conditions of Rule 10b5-1(c), tagged using Inline XBRL. Foreign private issuers who file on Form 20-F will be required to provide the same information quarterly on new Form F-SR beginning with the Form F-SR that covers the first full fiscal quarter that begins on or after April 1, 2024.

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[1] As defined in SEC Exchange Act Rule 16a-1(f).

[2] See SEC Release No. 33-11138 (Dec. 14, 2022), available here (the "Adopting Release"). For smaller reporting companies, compliance is required in the first periodic filing that covers the first full fiscal quarter beginning on or after October 1, 2023. Additionally, foreign private issuers will not be required to provide disclosure regarding the adoption, modification, or termination of Rule 10b5-1 and non-Rule 10b5-1 trading arrangements by directors and officers.

[3] See Adopting Release.

[4] See SEC Release No. 33-7881 (Aug. 24, 2000), available here.

[5] You might be wondering what the SEC's rationale was for this disclosure. In the Adopting Release, the SEC stated "In adopting this requirement, we recognize that Rule 10b5-1 provides affirmative defenses, but that corporate insiders may assert other defenses to liability under Section 10(b). Absent this disclosure requirement, directors and officers may be more likely to choose to trade in reliance on alternative defenses to liability other than [the Rule 10b5-1] affirmative defense in order to avoid the disclosure requirements for Rule 10b5-1 plans, as well as avoiding the other requirements of the affirmative defense. Further, we believe these disclosures would be useful to investors for largely the same reasons that disclosure of plans that fully satisfy Rule 10b5-1 is useful: they provide important context about how insiders use their trading plans, such as in the case where an insider cancels a plan close in time to the release of material nonpublic information." Adopting Release, pp. 79-80.

If you have questions concerning the contents of this Alert, or would like more information, please speak to your regular contact at Weil or to any of the following authors:

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