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SEC Proposes Amendments to Rule 144

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At the end of 2020, the Securities and Exchange Commission (SEC) proposed amendments to Rule 144 of the Securities Act of 1933 (Securities Act) to revise the holding period for securities acquired upon conversion or exchange of certain "market-adjustable" securities that are subsequently sold in reliance on Rule 144. In addition, the SEC proposed related changes to improve investor access to Form 144 filings and to streamline the filing process, which include (i) mandating that all Form 144s be filed electronically; (ii) revising Form 4 and Form 5 to permit filers to satisfy their Section 16 and Form 144 filing obligations on a single form; and (iii) extending the Form 144 filing deadline to coincide with the Form 4 filing deadline. Finally, the SEC is proposing to eliminate the Form 144 filing requirement entirely for resales by affiliates of issuers not subject to the reporting requirements of the Securities Exchange Act of 1934 (Exchange Act). The full text of the proposed amendments can be found here. Given that the SEC proposed these amendments prior to a change in administration, there is a possibility that any final rules may differ significantly from the proposal.

Background of Rule 144

Rule 144 of the Securities Act is a nonexclusive safe harbor that allows public resales of unregistered securities that were acquired from the issuer and other securities held by affiliates of the issuer (such as directors and officers), provided that certain conditions are met. These proposed rules impact two of these Rule 144 conditions. One is the holding period condition, which requires the seller to hold the securities for a certain period of time prior to the resale to ensure that the seller is not acting as an underwriter of the issuer's securities. Second, any affiliate of the issuer who intends to sell more than a minimal amount of that issuer's securities within a three-month period is required to file a Form 144.

Proposed Changes to Rule 144

The significant substantive proposal in this rulemaking would change how the holding period is calculated for securities acquired upon the conversion or exchange of market-adjustable securities. Currently, Rule 144 allows the acquirer of certain securities that were received in exchange for, or upon conversion of, other securities of the same issuer to calculate its holding period from the date the convertible security was issued rather than the date the conversion or exchange occurred (commonly referred to as “tacking”). This means that, generally speaking, if the holder of a convertible security satisfies the Rule 144 holding period prior to conversion, it would be eligible to sell the new security in reliance on Rule 144 as soon as the conversion or exchange occurs.

As the SEC points out in its release, the purpose of the Rule 144 holding period is to ensure the seller bears the full economic risk of the investment. The most common convertible securities are exchangeable based on a conversion formula or price that is fixed and certain at the time the convertible securities are sold, subject only to anti-dilution adjustments. In these circumstances, the acquirer becomes subject to the economic risks associated with the underlying securities upon acquisition of the convertible security itself, making tacking as permitted by Rule 144 appropriate. However, certain market-adjustable securities contain additional terms and conditions designed specifically to offset economic risk, such as a conversion rate that is not fixed but rather represents a discount to the market price of the underlying securities at the time of conversion.

The proposed amendment creates an exception to these tacking rules for market-adjustable securities that are issued by issuers without securities listed on a national exchange. If these rules are adopted as proposed, a holder of market-adjustable securities issued by an unlisted issuer would not be able to include the period of time between issuance and exercise of the convertible security when calculating its Rule 144 holding period for the underlying securities. In other words, the acquirer would have to hold the converted securities for the full holding period, measured from the date of conversion, before reselling those securities under Rule 144.

The SEC is not proposing to extend this tacking limitation to securities issued by issuers with a class of securities listed on a national securities exchange, observing that such transactions are uncommon for listed companies and positing that exchange rules requiring shareholder approval of significant issuances of securities serve as an adequate check on potentially abusive transactions.

Mandatory Electronic Filing and Voluntary Combined Reporting

As noted above, for those securityholders who are affiliates of an issuer and intend to sell an amount of the issuer’s securities above a certain threshold (specifically, more than 5,000 shares or shares valued at more than $50,000) within a three-month period, compliance with Rule 144 requires, among other things, the filing of a Form 144. The Form 144 must be filed concurrently with either the placing of an order with a broker to execute the sale or the execution of a sale directly with a market maker. Although filers are permitted to file Form 144 electronically if the issuer is subject to Exchange Act reporting requirements, the SEC has indicated that, practically speaking, the vast majority of Form 144 filings are still done on paper.

Separately, Section 16(a) of the Exchange Act requires certain “insiders” (directors, certain officers, and greater than 10% beneficial owners) to report changes in their beneficial ownership of the issuer’s securities. Most of these transactions are reported on a Form 4, due within two business days of the transaction, but some transactions are eligible for deferred reporting on an annual Form 5, due within 45 days after the end of the issuer’s fiscal year. Since 2003, the SEC requires all Section 16 filings to be submitted electronically.

As a result of these two regulatory frameworks, Section 16 insiders who resell securities under Rule 144 are often required to make two separate filings — a Form 144, due the same day, and a Form 4, due two business days later. The SEC proposes to simplify reporting compliance by allowing a Section 16 insider to satisfy both his or her Section 16 and any Rule 144 obligations in a single filing, by amending Form 4 and Form 5 to include Form 144 reporting. Under the proposed rules, filing on a single form would be voluntary but, in all cases, Form 144 would need to be filed electronically. The SEC is also proposing to extend the Form 144 filing deadline to coincide with the deadline for filing of Form 4 (*i.e.*, by the end of the second business day following the date on which the sale of securities has been executed or the deemed date of execution), regardless of whether separate or combined filing is used. However, to further alleviate the burden of reporting, the SEC proposes eliminating the Form 144 filing requirement entirely for affiliates of issuers that are not subject to Exchange Act reporting.

Addition of Rule 10b5-1 Plan Check Box

Among other things, Form 144 requires selling securityholders to represent that they do not have nonpublic knowledge of any material adverse information in regard to the current and prospective operations of the issuer of securities to be sold. One way to provide this representation on Form 144 is to note that the transaction was made pursuant to a Rule 10b5-1 plan, providing the date on which the plan was adopted. Rule 10b5-1(c) establishes an affirmative defense to allegations of insider trading for certain persons trading in the issuer's securities. If an insider adopts a written Rule 10b5-1 trading plan at a time when he or she was not in possession of any material nonpublic information, transactions pursuant to that plan may be executed in the future at times when the insider would otherwise be unable to trade (for example, during a closed trading window or when in possession of material nonpublic information). Currently, neither Form 4 nor Form 5 requests any information regarding whether the transaction was pursuant to a Rule 10b5-1 plan (although some insiders elect to add an explanatory note to that effect). Therefore, the SEC is proposing to add an additional check box to Form 4 and Form 5 to elicit that information, disclosure of which would be voluntary if the filer was not relying on it for his or her Form 144 representation.

As noted previously, these rules were proposed during an outgoing administration's final month in office, creating additional uncertainty as to what the final rules may be. While many of the proposed changes are relatively uncontroversial, it remains to be seen to what extent the final rules, if any, will be revised to reflect the priorities of a new administration.

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