Published on *The National Law Review* https://natlawreview.com

Changes in the Wind for Rule 10b5-1 Trading Plans?

Article By:

Gregory C. Schick

On December 28, 2012, the Council of Institutional Investors (CII) submitted a letter to the **Securities and Exchange Commission (SEC)** requesting that the SEC implement rulemaking to impose new requirements with respect to Rule 10b5-1 trading plans.

Under rules adopted by the SEC back in 2000, public company insider executives can adopt a trading plan (commonly referred to as a Rule 10b5-1 trading plan) which permits them to effect subsequent trades of their employer's securities on the open market even if the insider is in possession of material non-public information (MNPI) at the time that the trade is consummated. An effective 10b5-1 plan can provide the insider with an affirmative defense to allegations of unlawful insider trading. Typically, a Rule 10b5-1 plan involves an agreement (containing enumerated trading instructions) between the insider and his/her broker. The insider's employer will often have limited direct involvement with the specifications of such trading plan other than to ensure that it complies with the employer's insider trading policy.

Because an insider is not permitted to be aware of MNPI when adopting a 10b5-1 trading plan, it has been presumed that trades executed under a 10b5-1 plan should not be able to outperform the market. However, there have been prior studies, and more recently a November 27, 2012 Wall Street Journal (WSJ) article titled "Executives' Good Luck in Trading Own Stock", that have cast doubts on this premise. In light of the WSJ article, which the CII letter liberally references, the CII is expressing its concern that the rules governing 10b5-1 plans are too lax and that insiders may be abusing the use of these plans. The CII letter calls for greater involvement by company boards of directors and stricter regulatory rules including:

- Adoption of 10b5-1 plans may occur only during a company open trading window
- Prohibition of an insider having multiple, overlapping 10b5-1 plans
- Mandatory delay of at least three months between 10b5-1 plan adoption and the first trade under the plan
- Prohibition on frequent modifications/cancellations of 10b5-1 plan

The CII also advocates pre-announced disclosure of 10b5-1 plans and immediate disclosure of plan amendments and plan transactions. Moreover, the employer's board of directors would need to adopt policies covering 10b5-1 plan practices, monitor plan transactions, and ensure that such company policies discuss plan use in the context of equity hedging and ownership.

Some of the above concepts are considered by practitioners to constitute best practices but the CII letter's recommendations, if adopted, would make them mandatory and place more accountability on companies. Indeed, if the CII proposals were implemented, it would likely materially alter the processes and practices for future 10b5-1 trading plans.

What Next?

Rule 10b5-1 trading plans can be a valuable tool for insiders with respect to managing their company securities. Noncompliance with the SEC's 10b5-1 regulations could cause the loss of the affirmative defense and thereby undermine the *raison d'etre* for trading under a 10b5-1 plan. Companies and their executives will want to monitor the SEC's response to the CII letter and whether the SEC takes regulatory or enforcement actions regarding 10b5-1 plans. Whether or not the SEC does implement any changes to the rules governing 10b5-1 trading plans, companies may want to review their insider trading policies and procedures regarding 10b5-1 trading plans to ensure that such plans are operating within the regulatory framework of Rule 10b5-1.

National Law Review, Volume III, Number 18