

Gifts of Securities by Public Company Insiders: SEC Reporting Changes and Potential Insider Trading Liability

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Earlier this year, the Securities and Exchange Commission (SEC) adopted final rules amending Rule 10b5-1 under the Securities Exchange Act of 1934 (Exchange Act) and adding new disclosure requirements to Regulation S-K (the Release), previously reported here. These rules are intended to enhance investor protections against insider trading by giving shareholders more visibility into the trading practices of company insiders and the policies and procedures implemented by issuers to address insider trading concerns. The Release included an accelerated reporting requirement for gifts of securities made by public company insiders under Section 16 of the Exchange Act and also contained some cautionary language from the SEC regarding insider trading implications of gift-giving.

While these changes have been effective since April 1, 2023, the practice of traditional year-end gift-giving warrants a reminder to both public companies and insiders.

Accelerated Reporting of Gifts Under Section 16

Section 16 of the Exchange Act requires insiders of public companies to file reports with the SEC regarding their transactions and holdings in the company's equity securities.^[1] Prior to the adoption of the final rules, bona fide gifts of equity securities by insiders were permitted to be reported on a Form 5 within 45 days following the end of the company's fiscal year rather than within two business days on a Form 4.

In the Release, the SEC signaled its increased focus on and scrutiny of potential

improprieties surrounding gifts of securities by insiders, noting that the delayed reporting requirement “may allow Section 16 reporting persons to engage in problematic practices involving gifts of equity securities, such as making stock gifts while in possession of material nonpublic information or backdating stock gifts in order to maximize the tax benefits associated with such gifts.”

In response to this concern, effective April 1, 2023, the SEC began requiring *dispositions* of company securities via a bona fide gift to be reported on a Form 4 within two business days following the transaction. This change does not apply to *acquisitions* of stock via a bona fide gift or inheritance, which are still subject to delayed reporting on a Form 5.

The SEC noted that this accelerated Section 16 reporting will be informative to investors, will facilitate market scrutiny, and may reduce an insider’s incentive to donate stock based on material nonpublic information.

Potential Insider Trading Violations When Making Gifts

With respect to Section 16, the SEC’s rule changes related to gifts were limited to the *timing* of reporting, and *bona fide gifts remain exempt from the Section 16(b) short-swing trading liability provisions*. However, in the Release, the SEC indicated that gift transactions can implicate insider trading prohibitions. The SEC cautioned that a gift of public company stock followed closely by the donee’s sale of such stock, “under conditions where the value at the time of donation and sale affects the tax or other benefits obtained by the donor, may raise the same policy concerns as more common forms of insider trading” and noted that “a gift made with the knowledge that the donee will soon sell can be seen as in effect a sale for cash followed by gift of the cash.” We note that it is common practice among nonprofit organizations to immediately sell public company securities received as gifts.

In addition, the SEC clarified that the affirmative defense of Rule 10b5-1(c)(1) is available for any bona fide gift of securities, “including a gift that might otherwise cause the donor to be subject to liability under Section 10(b), because when making the gift the donor was aware of material nonpublic information about the security or issuer and knew or was reckless in not knowing that the donee would sell the securities prior to the disclosure of such information.”

We believe the SEC’s comments in the Release indicate the SEC’s heightened scrutiny of, and potential increased regulatory action in the future against, insiders that the SEC suspects are gifting securities while in possession of material nonpublic information or acting in a way to maximize the tax benefits associated with the gifts in a manner that breaches a duty to the company. Thus, public company insiders should

proceed with caution when gifting securities and should consider the SEC's commentary when structuring such transactions.

Next Steps

For Insiders:

- Report gifts on a Form 4 within two business days of making a gift of the public company's equity securities, as now required by the Section 16 rules.
- Consider making gifts only when not in possession of material nonpublic information, especially if the securities may be sold by the donee. This will likely require that gift transactions be consummated during an open window period, which may require changes to the timing of the insider's historic year-end tax planning.
- Consider adopting a Rule 10b5-1 trading plan if donations may occur when the insider is in possession of material nonpublic information.

For Public Companies:

- Confirm company insiders are aware of the Section 16 reporting changes and the SEC's commentary regarding the insider trading implications of gifts.
- Revisit the company's insider trading policy to confirm whether gifts are appropriately addressed.

[1] Under Section 16, "insiders" include each person who is a director or an officer (as defined under Section 16) of a public company or who is directly or indirectly the beneficial owner of more than 10% a public company's equity securities, and a "public company" is any company with a class of equity security (other than an exempted security) registered pursuant to Section 12 of the Exchange Act.

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