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# SEC Proposed Rulemaking Regarding Share Repurchase Programs and 10b5-1 Insider Trading Plans in the US

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On December 15, 2021, the Securities and Exchange Commission ("SEC") adopted two proposals setting forth proposed amendments to its rules regarding share repurchase programs and 10b5-1 insider trading plans.[1]

These much anticipated proposals have been described as an effort by the SEC to enhance transparency with regard to issuer and insider transactions in issuer securities. Although the SEC recognizes in the proposals that issuers may have legitimate business reasons for repurchasing their equity securities, it believes that such enhanced transparency is necessary because issuers and their affiliated purchasers often have inside information about the issuer and its prospects and may have incentives to engage in opportunistic repurchases or cancellation of trades.

While each proposal is subject to a 45-day comment period, companies should begin to evaluate existing internal reporting and compliance frameworks with regard to insider trading and share repurchase programs.

## Proposed Share Repurchase Disclosure Modernization

Currently, the SEC's disclosure requirements with regard to share repurchase activity are limited to periodic disclosure of certain transaction-related details during the relevant period with regard to open market purchases and private transactions in an issuer's equity securities. The SEC proposes amendments to Item 703 of Regulation S-K that will apply to periodic reports filed by issuers whose equity securities are registered under Section 12 of the Securities Exchange Act of 1934 and corresponding changes that will apply to Form 20-Fs filed by foreign private issuers and Form N-CSRs filed by certain closed-end investment companies. The proposed rules would require more detailed and frequent disclosure about issuer share repurchases and require issuers to present the disclosure using a structured data language (e.g., InlineeXtensible Business Reporting Language or XBRL).

The proposed rules would require a new daily reporting requirement on a new form, Form SR, furnished to the SEC one business day after executing a repurchase order[2]. The Form SR as proposed would require disclosure regarding the date of purchase, class of securities purchased, total shares purchased (including all repurchases whether pursuant to publicly announced plans or programs), average price paid per share and aggregate total number of shares purchased in the open market, the aggregate total number of shares purchased in reliance on the safe harbor in Exchange Act Rule 10b-18 and the aggregate number of shares purchased pursuant to a plan intended to satisfy the affirmative defense conditions of Exchange Act Rule 10b5-1(c).

In addition to daily reporting on Form SR, the rules propose enhanced periodic disclosures by amending Item 703 of Regulation S-K, Form 20-F and Form N-CSR to require an issuer to disclose:

- The objective or rationale for share repurchases
- The process and criteria used to determine share repurchase amounts
- Procedures relating to purchases and sales by insiders during a repurchase program, including restrictions on such transactions
- Whether repurchases were made pursuant to a plan intended to satisfy the affirmative defense conditions of Exchange Act Rule 10b5-1(c) and, if so, the date the plan was adopted or terminated
- Whether repurchases were made in reliance on the Exchange Act Rule 10b-18 nonexclusive safe harbor; and
- Whether any directors or executive officers subject to the reporting requirements of Exchange Act Section 16(a) purchased or sold shares or other units of the class of the issuer's equity securities that is the subject of an issuer's repurchase program within 10 business days before or after the issuer's announcement of such repurchase program

## Proposed Rule 10b5-1 Updates

SEC Rule 10b5-1 provides an affirmative defense to insider trading liability in circumstances where, subject to certain conditions, the trade was made pursuant to a binding contract, an instruction to another person to execute the trade for the instructing person's account, or a written plan adopted when the trader was not aware of material nonpublic information.

The proposed amendments would add new conditions to the availability of the Rule 10b5-1(c)(1) affirmative defense to insider trading liability, including a 120-day cooling-off period by corporate officers or directors, and a 30-day cooling-off period by issuers, before any trading can commence under a 10b5-1 trading arrangement after its adoption (including adoption of a modified trading arrangement). As further described in the proposed release and the SEC's fact sheet, the SEC proposes amendments to Rule 10b5-1 that would:

- Add new conditions to the availability of the affirmative defense under Exchange Act Rule 10b5-1(c)(1)
- Create new disclosure requirements regarding issuers' insider trading policies and regarding the adopting and termination (including modification) of Rule 10b5-1 and certain other trading arrangements by directors, officers and issuers

1 Share Repurchase Disclosure Modernization, SEC Release No. 34-93783 (https://www.sec.gov/rules/proposed/2021/34-93783.pdf); and Rule 10b5-1 and Insider Trading, SEC Release No. 33-11013; 34-93782 (https://www.sec.gov/rules/proposed/2021/33-11013.pdf). The SEC has published fact sheets summarizing each proposal (https://www.sec.gov/rules/proposed/2021/33-11013-fact-sheet.pdf; https://www.sec.gov/rules/proposed/2021/34-93783-fact-sheet.pdf)

2 It should be noted that "execution" takes place on the trade date, rather than on the settlement date which may occur up to two business days later.

- Create new disclosure requirements for executive and director compensation regarding the timing of certain equity compensation awards; and
- Update Forms 4 and 5 to require corporate insiders subject to the reporting requirements of Exchange Act Section 16 to identify transactions made pursuant to a Rule 10b5- 1(c)(1) trading arrangement and to disclose all gifts of securities on Form 4

The proposed amendments would also add new conditions to the availability of the Rule 10b5-1(c)(1) affirmative defense to insider trading liability, including:

- Requiring officer and director certification that they are not aware of material nonpublic information about the issuer or the security when adopting a new or modified trading arrangement
- Providing that the affirmative defense under Rule 10b5-1(c)(1) does not apply to multiple overlapping Rule 10b5-1 trading arrangements for open market trades in the same class of securities
- Limiting 10b5-1 trading arrangements to execute a single trade are limited to one plan per 12-month period
- Requiring that 10b5-1 trading arrangements must be entered into and operated in good faith; and
- Requiring issuers to disclose in their annual reports whether or not (and if not, why not) that the issuer has adopted insider trading policies and procedures, and also disclose their insider trading policies and procedures if they have so adopted such policies and procedures

The SEC is also proposing new enhanced disclosure in periodic reports regarding 10b5-1 plan and the timing of option grants and other equity compensation awards, which would:

- Require issuers to disclose in its annual reports its option grant policies and practices, and to provide tabular disclosure showing grants made within 14 days of the release of material nonpublic information and the market price of the underlying securities on the trading day before and after the release of such information; and
- Require an issuer to disclose in its quarterly reports the adoption and termination of Rule 10b5 1 trading arrangements and other trading arrangements by directors, officers and issuers, and the terms of such trading arrangements

## Next Steps

While the above-described rules remain subject to public comment and final approval by the SEC, issuers should begin to review existing insider trading compliance programs and evaluate internal processes for trading by insiders, to ensure their compliance framework is adequate, realizing that the SEC will likely require some form of disclosure and enhanced compliance on these topics depending on final rules. In particular, issuers should could consider taking the following steps in anticipation of the adoption of the new rules:

- Since the rationale for repurchases may soon have to be disclosed, issuers should carefully consider and document their rationale for repurchasing shares. The SEC has indicated in the proposed rule release that share repurchases by issuers are generally not problematic when used to maximize shareholder value or to offset dilution or because issuers believe that their shares are undervalued. However, repurchases should not be used to try to meet earnings targets or to maximize executive compensation.
- Since repurchases may have to be disclosed, issuers should review their insider trading policies and procedures to determine whether to restrict repurchases within a set number of business days before and after the announcement of a repurchase program.
- Consider whether to adopt option grant policies that take into account the timing of grants in close proximity to repurchase announcements and whether there should be any restrictions on making grants a set number of business days before or after the announcement of a repurchase program.
- If the new rules are adopted, the SEC may closely monitor and scrutinize executive compensation programs that use EPS targets. When adopting compensation programs, issuers should consider whether to use EPS targets or at least consider the impact of repurchases when earnings targets are met or in setting targets.
- If adopted, Form SR will require a one-day filing deadline. Issuers who are not already closely monitoring daily trading with their brokers should consider doing so and/or discussing with them what logistics they will be developing to handle Form SR filings, or any similar filing requirement that may be approved in the final rules.

## Contacts

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