

Client Alert: SEC Adopts Amendments Regarding Rule 10b5-1 Insider Trading Plans and Disclosures for Equity Awards and Gifts

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On December 14, 2022, the US Securities and Exchange Commission (the SEC) unanimously adopted amendments to Rule 10b5-1 under the Securities Exchange Act of 1934 (the Exchange Act) and created new disclosure requirements to address insider trading concerns.^[1] The Rule 10b5-1 amendments are the first revision of Rule 10b5-1 since its original promulgation in 2000, and they follow years of public discourse regarding whether Rule 10b5-1 (in its current form) and related regulations sufficiently curb opportunistic trading by public companies and their corporate insiders when they are in possession of material nonpublic information (MNPI).

The final amendments will become effective 60 days after publication in the Federal Register. Information about key compliance dates is provided in the section below entitled “Effective Date and Compliance Dates.”

Rule Amendments At-a-Glance	
<p>Newly Adopted Conditions for the Availability of the Rule 10b5-1(c)(1) Affirmative Defense for New Rule 10b5-1 Plans</p>	<ul style="list-style-type: none"> • New Rule 10b5-1 plans of persons and entities other than the issuer must include a “cooling-off” period before trades under their plan can commence. • New Rule 10b5-1 plans of directors and certain officers of the issuer must include certain certifications at the time of adoption or modification. • New restrictions on the use of multiple overlapping Rule 10b5-1 plans and single-trade Rule 10b5-1 plans. • New requirement that persons entering into Rule 10b5-1 plans must act in good faith with respect to the plans.
<p>Newly Adopted Disclosure and Reporting Obligations</p>	<ul style="list-style-type: none"> • New Item 408 of Regulation S-K will require registrants to disclose: <ul style="list-style-type: none"> ○ information on the use of Rule 10b5-1 plans and certain non-Rule 10b5-1 trading arrangements by directors and certain officers of the registrant; and ○ whether the registrant has adopted insider trading policies and procedures and, if not, why the registrant has not done so. • New Item 402(x) of Regulation S-K will require disclosure about the registrant’s policies and procedures related to the grant of options and similar equity awards in close proximity to the release of MNPI and, under certain circumstances, additional disclosure about grants of options and similar equity awards made by the registrant in close proximity to certain of its SEC filings. • New Section 16 reporting obligations will apply with respect to transactions made pursuant to Rule 10b5-1 plans and gifts of equity securities.

Background

Rule 10b5-1, which was adopted in August 2000, codified the SEC’s position that (1) the manipulative or deceptive devices prohibited by Section 10(b) of the Exchange Act and Rule 10b-5 thereunder include the purchase or sale of a security of any issuer, on the basis of MNPI about that security or issuer, in breach of a duty of trust or confidence owed to the issuer of that security or the shareholders of that issuer, or to any other person who is the source of the MNPI; and (2) a purchase or sale of a security of an issuer is on the basis of MNPI if the person making the purchase or sale was aware of the MNPI when the person made the purchase or sale.^[2]

Rule 10b5-1 created an affirmative defense against allegations of insider trading when a Rule 10b5-1 plan (defined below) is used in compliance with the rule. In particular, Rule 10b5-1(c)(1) provides that a purchase or sale is not on the basis of MNPI if:

- The person making the purchase or sale demonstrates that:
 - the purchase or sale was pursuant to a contract, instruction, or written plan (a Rule 10b5-1 plan) entered into or adopted before the person became aware of the MNPI, and
 - The Rule 10b5-1 plan:
 - specified the amount of securities to be purchased or sold and the price at which and 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 date on which the securities were to be purchased or sold, or
 - did not permit the 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 Rule 10b5-1 plan, did exercise such influence must not have been aware of the MNPI when doing so); and
- The Rule 10b5-1 plan was entered into in good faith.^[3]

Citing the need to “address critical gaps in the SEC’s insider trading regime,” on January 13, 2022, the SEC proposed several rule and form amendments to address potentially abusive practices associated with Rule 10b5-1 plans, grants of options and other equity instruments with similar features, and the gifting of securities.^[4] On December 14, 2022, the SEC adopted various rule and form amendments, which, among other things, added additional conditions to the availability of the affirmative defense for Rule 10b5-1 plans. A summary of those key changes is set forth below.

Key Changes

1. Cooling-Off Period.

As a new condition to the availability of the affirmative defense for Rule 10b5-1 plans, amended Rule 10b5-1 will require that, for Rule 10b5-1 plans adopted by a director or “officer”^[5] of the issuer, no purchases or sales under the Rule 10b5-1 plan may occur until the end of a cooling-off period that extends until the later of: (1) 90 days following adoption of the Rule 10b5-1 plan; or (2) two business days following the disclosure of the issuer’s financial results in a Form 10-Q or 10-K for the completed fiscal quarter in which the plan was adopted or, for foreign private issuers, in a Form 20-K or 6-K that discloses the issuer’s financial results (provided that the cooling-off period is subject to a maximum of 120 days following adoption of the Rule 10b5-1 plan). For Rule 10b5-1 plans adopted by persons and entities who are not the issuer and not a director or “officer” of the issuer, amended Rule 10b5-1 will require, as a condition to the availability of the affirmative defense for Rule 10b5-1 plans, a cooling-off period of 30 days following adoption of the Rule 10b5-

1 plan before any trading can commence under the plan. The amendments do not mandate any cooling-off period for Rule 10b5-1 plans adopted by the issuer of the securities.

Notably, new Rule 10b5-1(c)(1)(iv) also specifically provides that any modification or change to the amount, price, or timing of the purchase or sale of the securities underlying a Rule 10b5-1 plan will be deemed to be a termination of such Rule 10b5-1 plan and the adoption of a new Rule 10b5-1 plan. Such a modification or change would trigger a new cooling-off period, as noted above, if the Rule 10b5-1 plan was adopted by any person or entity other than the issuer of the securities. The SEC noted in the Adopting Release that modifications that do not change the sales or purchase prices or price ranges, the amount of securities to be sold or purchased, or the timing of transactions under a Rule 10b5-1 plan (such as an adjustment for stock splits or a change in account information) will not trigger a new cooling-off period.^[6]

The SEC also emphasized in the Adopting Release that the amendments to Rule 10b5-1 would not affect the affirmative defense available under an existing Rule 10b5-1 plan that was entered into prior to the revised rule's effective date unless there is a modification or change to the amount, price, or timing of the purchase or sale of the securities underlying such pre-existing Rule 10b5-1 plan after the effective date of the final rules. The SEC noted that, in that case, the modification or change would be equivalent to the adoption of a new trading arrangement, and thus all the requirements under amended Rule 10b5-1 would then need to be satisfied for the affirmative defense for Rule 10b5-1 plans to be available for that modified arrangement.^[7]

2. Director and Officer Certifications.

As a new condition to the availability of the affirmative defense for Rule 10b5-1 plans, amended Rule 10b5-1 will also require that if the person adopting a Rule 10b5-1 plan is a director or "officer"^[8] of the issuer of the securities, such director or officer must include in the Rule 10b5-1 plan a representation certifying that, on the date of adoption of the plan, they:

- Are not aware of any MNPI about the issuer or its securities, and
- Are adopting the plan in good faith and not as part of a plan or scheme to evade the prohibitions of Rule 10b-5.

3. Multiple Overlapping and Single-Trade Rule 10b5-1 Plans.

Amended Rule 10b5-1 will also limit the ability of anyone (other than the issuer of the subject securities) to use multiple overlapping Rule 10b5-1 plans. As a new condition to the availability of the affirmative defense for Rule 10b5-1 plans, amended Rule 10b5-1 will provide that persons may not have another outstanding (and may not enter into any additional) Rule 10b5-1 plan that would qualify for the affirmative defense for Rule 10b5-1 plans for purchases or sales of any class of the

issuer's securities on the open market during the same period, subject to a number of limited exceptions.

The limited exceptions to the general prohibition on overlapping plans include:

- A series of separate contracts with different broker-dealers or other agents acting on behalf of the person (other than the issuer) to execute trades may be treated as a single Rule 10b5-1 plan; provided that all of the individual contracts, when taken together as a whole, meet all of the applicable conditions of and remain collectively subject to Rule 10b5-1 (including that a modification of any individual contract acts as a modification of the whole plan).
- The substitution of a broker-dealer or other agent acting on behalf of a person (other than the issuer) for another broker-dealer that is executing trades pursuant to a Rule 10b5-1 plan shall not be deemed a modification of the Rule 10b5-1 plan as long as the purchase or sales instructions applicable to the old and new broker are identical with respect to the prices of the securities, dates of trades to be executed, and amount of securities to be purchased or sold.
- A person (other than the issuer) may have one later-commencing Rule 10b5-1 plan for purchases or sales of any securities of the issuer on the open market under which trading is not authorized to begin until after all trades under the earlier-commencing plan are completed or expired without execution; provided that the first trade under the later-commencing plan must not be prior to the end of the cooling-off period that would be applicable (as discussed above) to the later-commencing plan if the later-commencing plan had been adopted on the date of termination of the earlier-commencing plan.
- A contract, instruction, or plan providing for an eligible sell-to-cover transaction shall not be considered an outstanding or additional Rule 10b5-1 plan or be subject to the restrictions on multiple overlapping plans. An eligible sell-to-cover transaction is provided for where:
 - The contract, instruction or plan authorizes an agent to sell only such securities as are necessary to satisfy tax withholding obligations arising exclusively from the vesting of a compensatory award, and
 - The insider does not otherwise exercise control over the timing of such sales.

Amended Rule 10b5-1 will also limit the usage of single-trade Rule 10b5-1 plans. As a new condition to the availability of the affirmative defense for Rule 10b5-1 plans, amended Rule 10b5-1 will provide that if the Rule 10b5-1 plan is designed to effect the open-market purchase or sale of the total amount of securities as a single transaction (and does not provide for an eligible sell-to-cover transaction (as discussed above)), the person who entered into the Rule 10b5-1 plan must not have, during the prior 12-month period, entered into a separate Rule 10b5-1 plan that:

- Was designed to effect the open-market purchase or sale of all of the securities covered by the plan in a single transaction, and
- Would otherwise qualify for the affirmative defense for Rule 10b5-1 plans.

4. Acting in Good Faith.

While the affirmative defense for Rule 10b5-1 plans already requires as a condition to its availability that the trading arrangement be entered into in good faith, amended Rule 10b5-1 adds an additional condition that the person entering into the Rule 10b5-1 plan must act in good faith with respect to that plan. This additional requirement is intended to help ensure that traders do not engage in opportunistic trading in connection with Rule 10b5-1 plans, and to deter corporate insiders from improperly influencing the timing of corporate disclosures to benefit their trades under their plan. The SEC noted as an example in the Adopting Release that an insider would not be operating a Rule 10b5-1 plan in good faith if the insider, while aware of MNPI, directly or indirectly induces the issuer to publicly disclose that information in a manner that makes their trades under a Rule 10b5-1 plan more profitable (or less unprofitable).^[9]

5. Company Disclosure about Rule 10b5-1 and Non-Rule 10b5-1 Trading Arrangements.

In order to improve transparency around the use of Rule 10b5-1 plans, the SEC adopted new Item 408(a) of Regulation S-K and corresponding amendments to Forms 10-Q and 10-K to require quarterly disclosure by registrants of:

- Whether, during the registrant’s last fiscal quarter, a director or “officer”^[10] of the registrant adopted or terminated:
 - any contract, instruction or written plan for the purchase or sale of securities of the registrant intended to satisfy the affirmative defense conditions of Rule 10b5-1(c) (a “Rule 10b5-1 trading arrangement”); and/or
 - any “non-Rule 10b5-1 trading arrangement” (as defined below);
- Whether the trading arrangement is intended to satisfy the Rule 10b5-1(c) affirmative defense; and
- A description of the material terms of the trading arrangement (other than terms with respect to price), such as:
 - the name and title of the director or officer,
 - the date of adoption or termination of trading arrangement,
 - the duration of the trading arrangement, and

- the aggregate number of securities to be sold or purchased under the trading arrangement.

The definition of “non-Rule 10b5-1 trading arrangement” accords with the requirements of the affirmative defense for Rule 10b5-1 plans that the SEC originally adopted in August 2000. In particular, for purposes of this disclosure requirement, a “non-Rule 10b5-1 trading arrangement” will exist where:

- The covered person asserts that, at a time when they were not aware of MNPI about the security or the issuer of the security, they had adopted a written arrangement for trading the securities; and
- The trading arrangement:
 - Specified the amount of securities to be purchased or sold and the price at which and 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 date on which the securities were to be purchased or sold; or
 - Did not permit the covered 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 MNPI when doing so.

In adopting the rule to require disclosures about non-Rule 10b5-1 trading arrangements (in addition to Rule 10b5-1 trading arrangements), the SEC noted in the Adopting Release that while Rule 10b5-1 provides affirmative defenses, corporate insiders may assert other defenses to Section 10(b) liability and that, absent a requirement to disclose such non-Rule 10b5-1 trading arrangements, directors and officers may be more likely to choose to trade in reliance on alternative defenses to liability other than the affirmative defense for Rule 10b5-1 plans in order to avoid the disclosure requirements for Rule 10b5-1 plans, as well as to avoid the other requirements of the affirmative defense.^[11]

The SEC also noted that any modification or change to a Rule 10b5-1 plan by a director or officer that modifies or changes the amount, price, or timing of the purchase or sale of the securities underlying a Rule 10b5-1 plan would also be required to be disclosed under Item 408(a), as it constitutes the termination of an existing plan and the adoption of a new contract, instruction, or written plan.^[12]

The SEC did not at this time adopt its earlier proposal to require corresponding disclosure regarding the use of trading arrangements by the issuer of the securities, and noted that the SEC believes that

further consideration of the potential application of the disclosure requirement for purchases of equity securities by an issuer is warranted.^[13]

6. Company Disclosure about Insider Trading Policies and Procedures.

New Item 408(b) of Regulation S-K will require (1) annual disclosure of whether the registrant has adopted insider trading policies and procedures governing the purchase, sale and/or other dispositions of the registrant's securities by directors, officers and employees, or the registrant itself, that are reasonably designed to promote compliance with insider trading laws, and (2) if the registrant has not adopted such policies and procedures, annual disclosure about why it has not done so. These disclosures will need to be contained in annual reports on Form 10-K, and proxy and information statements on Schedules 14A and 14C.^[14] Foreign private issuers will also be required to provide analogous disclosure in their annual reports under new Item 16J in Form 20-F.

Further, registrants that have adopted insider trading policies and procedures will now be required to file the adopted policies and procedures as exhibits to their Form 10-K or Form 20-F filings. However, if all of the registrant's insider trading policies and procedures are included in its code of ethics, and the code of ethics has been filed under Item 406(c)(1) as an exhibit to its annual report, this would satisfy the new Item 408(b) filing requirement.

7. Company Disclosure about Certain Equity Award Grants in Close Proximity to the Release of MNPI.

To increase transparency concerning stock option award grants to executives in close proximity to the release of MNPI (referred to as "spring-loaded" when awarded shortly before the release of positive news and "bullet dodging" when shortly after bad news), the SEC adopted Item 402(x) of Regulation S-K.

Item 402(x)(1) will require narrative disclosure about the registrant's policies and practices on the timing of awards of "options"^[15] in relation to the disclosure of MNPI by the registrant, including:

- How the board determines when to grant such awards,
- Whether and how the board or compensation committee takes MNPI into account when determining the timing and terms of such an award, and
- Whether the registrant has timed the disclosure of MNPI for the purpose of affecting the value of executive compensation.

Further, if during the last completed fiscal year, the registrant awarded options to any of its "named executive officers" in the period (1) beginning four business days before the filing of a periodic report on Form 10-Q or Form 10-K, or the filing or furnishing of a current report on Form 8-K that discloses MNPI (except for a Form 8-K solely disclosing a material new option award grant under

Item 5.02(e) of Form 8-K), and (2) ending one business day after the filing or furnishing of such report, Item 402(x)(2) will require tabular disclosure concerning each such award for each named executive officer. The required disclosure will include:

- The name of the named executive officer;
- On an award-by-award basis: (i) the grant date of the option award, (ii) the number of securities underlying the option, (iii) the per-share exercise price of the option, and (iv) the grant date fair value of each award computed using the same methodology as used for the issuer's financial statements under generally accepted accounting principles; and
- For each reported instrument, the percentage change in the closing market price of the underlying securities between one trading day before and one trading day after the disclosure of the MNPI.

Generally speaking, any disclosure covered by this new Item 402(x) will need to be included in any filing that must include executive compensation disclosure under Item 402 of Regulation S-K, such as certain proxy and information statements on Schedule 14A or 14C and annual reports on Form 10-K (which may incorporate by reference the disclosure from a proxy or information statement under the circumstances permitted by General Instruction G to Form 10-K).

8. Section 16 Insider Reporting.

The SEC also adopted amendments to the reporting obligations of Section 16 insiders, including:

- Amending Form 4 and Form 5 to require Section 16 insiders to check a box indicating whether a reported transaction was made pursuant to a trading plan intended to satisfy the Rule 10b5-1(c) affirmative defense, and
- Amending Rule 16a-3 to require Section 16 insiders who make a gift of the issuer's equity securities to report the gift on Form 4 within two business days (which is a change from the current rules that allow certain gifts to instead be reported on a delayed basis on Form 5 within 45 days after the issuer's fiscal year end).

Effective Date and Compliance Dates

The final rule amendments will become effective 60 days after publication in the Federal Register.

Section 16 reporting persons will be required to comply with the amendments to Forms 4 and 5 for beneficial ownership reports filed on or after April 1, 2023.

Registrants that are smaller reporting companies will be required to comply with the new disclosure requirements in periodic reports on Forms 10-Q, 10-K, and 20-F and in any proxy or information statements that are required to include the Item 408, Item 402(x), or Item 16J disclosures in the first filing that covers the first full fiscal period that begins on or after October 1, 2023.

All other registrants will be required to comply with the new disclosure requirements in periodic reports on Forms 10-Q, 10-K, and 20-F and in any proxy or information statements that are required to include the Item 408, Item 402(x), or Item 16J disclosures in the first filing that covers the first full fiscal period that begins on or after April 1, 2023.

Footnotes

[1] Insider Trading Arrangements and Related Disclosures, SEC Release Nos. 33-11138; 34-96492 (Dec. 14, 2022), available at <https://www.sec.gov/rules/final/2022/33-11138.pdf>. We refer to this SEC release as the “Adopting Release.”

[2] See 17 CFR § 240.10b5-1.

[3] Rule 10b5-1 also contains a second, separate affirmative defense against allegations of insider trading that is set forth in Rule 10b5-1(c)(2), which provides that a person other than a natural person (i.e., a corporation, limited liability company, partnership or other entity) also may demonstrate that a purchase or sale of securities is not on the basis of MNPI if the entity demonstrates that (1) the individual making the investment decision on behalf of the entity to purchase or sell the securities was not aware of the information and (2) the entity had implemented reasonable policies and procedures, taking into consideration the nature of the person’s business, to ensure that individuals making investment decisions would not violate the laws prohibiting trading on the basis of MNPI. The amendments to Rule 10b5-1 discussed in this client alert apply only to the affirmative defense for Rule 10b5-1 plans under Rule 10b5-1(c)(1) and do not affect this separate affirmative defense available only to entities under Rule 10b5-1(c)(2), which remains in effect and unchanged.

[4] See U.S. Sec. & Exch. Comm’n, SEC Proposes Amendments Regarding Rule 10b5-1 Insider Trading Plans and Related Disclosures (Dec. 15, 2021), available at <https://www.sec.gov/news/press-release/2021-256>; Rule 10b5-1 and Insider Trading, Release No. 33–11013 (Jan. 13, 2022), available at <https://www.sec.gov/rules/proposed/2022/33-11013.pdf>.

[5] For purposes of the cooling-off period provisions, “officer” is defined to be the persons who are Section 16 officers of the issuer under Rule 16a-1(f).

[6] Adopting Release at 36.

[7] *Id.* at 116.

[8] For purposes of the certification provisions, “officer” is defined to be the persons who are Section 16 officers of the issuer under Rule 16a-1(f).

[9] Adopting Release at 67.

[10] For purposes of the Item 408(a) disclosure requirement, “officer” is defined to be the persons who are Section 16 officers of the issuer under Rule 16a-1(f).

[11] Adopting Release at 79.

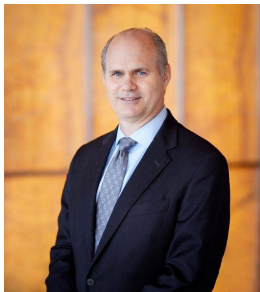
[12] *Id.* at 76-77.

[13] *Id.* at 80.

[14] Under General Instruction G to Form 10-K, a registrant can incorporate by reference into its Form 10-K the information required by Item 408(b) from a definitive proxy statement or information statement involving the election of directors if the proxy or information statement is filed within 120 days of the end of the fiscal year.

[15] Existing Item 402(a)(6)(i) of Regulation S-K defines the term “option” to mean “instruments such as stock options, stock appreciation rights and similar instruments with option-like features.”

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