SEC Chairman Gensler Announces Review of Rules Governing Trading Plans by Insiders

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In an interview with *The Wall Street Journal* on June 7, the Chairman of the SEC advised the investment community that the agency is planning to undertake a rulemaking process relating to Rule 10b5-1 trading plans. In his comments, Gary Gensler cited perceived abuses by insiders in these plans, and therefore it seems likely that a rulemaking process would impose additional compliance burdens and limitations on their use. Mr. Gensler's comments follow a letter sent to the SEC from three U.S. Senators in February which also cited abuses in these plans and called for similar reform. (That letter may be found here.)

Rule 10b5-1 of the Securities Exchange Act of 1934 provides an affirmative defense to claims of insider trading (*i.e.*, trading by officers and directors of public companies on the basis of material nonpublic information, or MNPI). Rule 10b5-1 contemplates the use of written trading plans (so-called "Rule 10b5-1 plans") that provide for securities transactions occurring pursuant to formulaic instructions set in advance, e.g., on fixed dates and/or in fixed amounts and/or at fixed prices. The theory of the rule is that, as long as the Rule 10b5-1 plan is put in place by an insider at a time when the insider lacks MNPI and the insider has no discretion over the transactions under the plan, those transactions, even if occurring at a time when the insider has MNPI, are afforded the protection of the rule's affirmative defense. Rule 10b5-1 plans are a popular and practical solution for executives of public companies to comply with insider trading policies and the constant flow of MNPI, which often can result in a near-permanent bar to trading.

While the nature of Mr. Gensler's comments renders it difficult to determine the precise scope of any intended rule proposal, it should be expected that the following may be on the menu:

- *A "cooling-off" period between the entry into the Rule 10b5-1 plan and the first trade under the plan*. Currently, trades may begin under a Rule 10b5-1 plan immediately after it is adopted (again, as long as the insider does not have MNPI when the plan is adopted). Many insider trading policies already impose a cooling-off period, although, if the SEC were to follow the recommendation of the Senators in their letter, the required period would be much longer (four to six months) than is normal.

- *Restrictions on the use of sequential Rule 10b5-1 plans*. Under current law, terminating a Rule 10b5-1 plan has no direct legal consequence because the termination of the plan does not result in a sale or purchase of a security. However, the SEC has for years observed that sequential adoption and termination of plans call into question the bona fide nature of the plan(s) and thus the availability of the affirmative defense, and it is possible that this observation will now be codified into the rule itself.

- *Advance disclosure, including potential Form 4 "reform"*. There is currently no obligation to report the adoption of a Rule 10b5-1 plan. In our experience, advance disclosure of Rule 10b5-1 plans is relatively rare and is typically motivated by a concern that investors will be confused when they see the required Form 4 reporting of a transaction under Section 16 of the Exchange Act. (A Form 4 is due only two days after a trade takes place, and this post-transaction disclosure is a particular target of the Senators' letter, which also suggests that insiders occasionally deliberately delay Form 4s due to the SEC's lack of enforcement of late filings.) If advance disclosure is required, it will be important to understand the scope of the required disclosure, as detailed disclosure (e.g., of share amounts or target transaction prices) could have a significant chilling effect on the use of these plans.

In light of the popularity of Rule 10b5-1 plans, we expect that the rulemaking process will generate significant attention. Our hope would be that, in chasing after abuses (whether perceived or real), the SEC process does not swallow the many situations in which this helpful and important planning tool is used fairly and in good faith by insiders and their employers. A key open question will be the effective date of any rule changes, and the extent of any available grandfathering of pre-effective date plans.

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