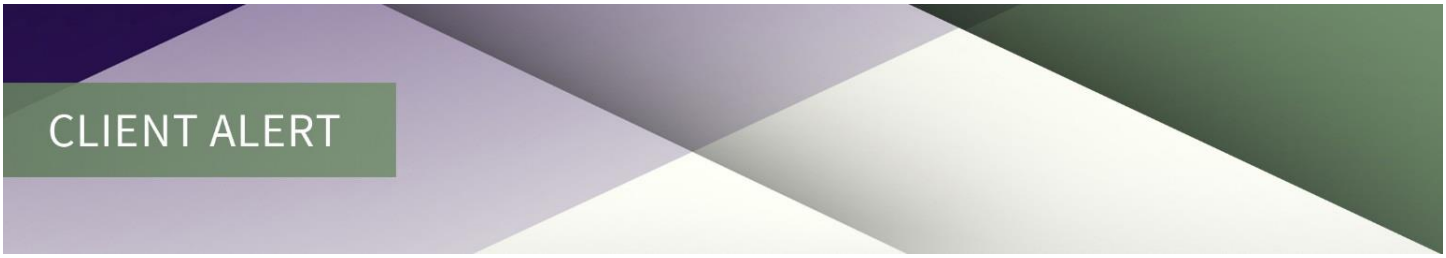

SEC Proposes Amendments to Rules Governing Share Repurchases and Rule 10b5-1 Plans

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Amendments to Rules Governing Share Repurchases

On December 15, 2021, the Securities and Exchange Commission (the "SEC" or the "Commission") voted 3-2 to propose changes to the requirements for disclosure of purchases of equity securities made by or on behalf of an issuer or an affiliated purchaser.[1]

Currently, issuers typically disclose repurchase programs following authorization of the program by the board of directors and most share repurchases are executed over time through open market transactions.[2] Issuers typically do not disclose the specific dates on which they executed trades pursuant to an announced repurchase program.[3] However, pursuant to Rule 703 of Regulation S-K, each issuer is currently required to disclose in its periodic reports on a quarterly basis (i) information as to any share repurchases by the issuer or an affiliated purchaser during such quarter, and (ii) the principal terms of all publicly announced repurchase programs.[4]

1 *See* Share Repurchase Disclosure Modernization, Securities Exchange Act of 1934 (the "Exchange Act") Release No. 93783 (Dec.15, 2021) (the "Share Repurchases Proposing Release").

2 *Id.* at p. 4.

3 *Id.* at p. 4.

4 *Id.* at p. 5-7. Registered closed-end investment companies are required to disclose share repurchase programs, including information regarding purchases of their equity securities registered pursuant to Section 12 of the Exchange Act, in their reports on Form N-CSR.

Form SR. The proposed amendments would require an issuer[5] to report any repurchase made by or on behalf of the issuer or any affiliated purchaser of shares or other units of any class of the issuer's equity securities registered pursuant to Section 12 of the Exchange Act before the end of the first business day following execution by the issuer of a share repurchase.[6] The issuer would report such repurchases on new Form SR.

Form SR would require the following disclosures:

- identification of the class of securities purchased;
- the total number of shares purchased, whether or not made pursuant to a publicly announced program;
- the average price paid;
- the aggregate total number of shares purchased on the open market;
- the aggregate total number of shares purchased in reliance on the safe harbor of Rule 10b-18; and
- the aggregate total number of shares purchased pursuant to a Rule 10b5-1 plan.[7]

Form SR would be furnished, rather than filed, and the information would not be deemed incorporated by reference into filings under the Securities Act; thus, issuers would not be subject to liability under Section 11 of the Securities Act for such disclosures unless the issuer expressly incorporated such information.[8]

Additional Periodic Disclosure. The Share Repurchases Proposing Release also provides for amendments to Item 703 of Regulation S-K that would require an issuer to make the following additional disclosures in its periodic reports:

- the objective or rationale for its share repurchases and the process or criteria used to determine the amount of repurchases;
- any policies relating to purchases and sales of the issuer's securities by its officers and directors during an issuer repurchase program;

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5 "Issuer" would include any foreign private issuer, business development company or registered closed-end investment company. *Id.* at p.11.

6 *Id.* at p. 11-12. The Share Repurchases Proposing Release provides that the "date of execution" (i.e., the trade date) is the point of a securities transaction at which the parties have agreed to terms and are contractually obligated to settle the trade. *Id.* at note 23.

7 *Id.* at p. 12.

8 *Id.* at p. 17. In addition, by requiring Form SR to be furnished, a late submission of the form would not affect eligibility to use Form S-3 or to file a short-form registration statement under General Instruction A.2 of Form N-2.

- whether repurchases were made pursuant to a Rule 10b5-1 plan;
- whether repurchases were made in reliance on the safe harbor of Rule 10b-18; and
- whether any of the issuer's officers or directors subject to the reporting requirements under Section 16(a) of the Exchange Act purchased or sold any shares that are the subject of an issuer repurchase program within 10 business days before or after the announcement of an issuer repurchase program.[9]

In discussing the rationale for the proposed amendments, the Share Repurchases Proposing Release notes research finding (i) repurchases can serve as a form of earnings management, and (ii) compensation arrangements tied to share price or earnings per share could incentivize management to undertake repurchases in a manner to maximize their compensation.[10] The Share Repurchases Proposing Release also notes that certain commentators (x) view share repurchases as a tool to raise the stock price in a manner that allows insiders to extract value from the issuer rather than using the funds to invest in the issuer and its employees and (y) noted the potential for repurchases to be made by issuers in a non-transparent manner when the stock has been undervalued by investors.[11]

Commissioner Roisman issued a statement in dissent, noting that share repurchases have become a politically charged issue and that the SEC staff conducted a study last year of the 50 firms that repurchased the most stock in 2018 and 2019 and concluded that it was unlikely that most buybacks were motivated by a desire to inflate share prices to benefit insiders compensated in stock, which study was sent to Congress on December 23, 2020.[12] Commissioner Roisman also noted a concern that the proposed daily reporting of share repurchases will be overly burdensome to companies and a concern that the daily reports could be used by traders to trade ahead of the issuer and artificially raise the stock price and reduce market efficiency.[13]

Comments on the proposed share repurchase amendments must be received within 45 days after the Share Repurchases Proposing Release is published in the Federal Register.

Amendments to Rules Governing Rule 10b5-1 Plans

On December 15, 2021, the Commission voted unanimously to propose: (i) amendments to Exchange Act Rule 10b5-1, (ii) new disclosure requirements regarding insider trading policies and the adoption, modification and termination of trading arrangements by issuers, officers and directors, (iii) new disclosure requirements as to equity awards made in

9 *Id.* at p. 22.

10 *Id.* at p. 7-8.

11 *Id.* at p. 8-9.

12 *See* Dissenting Statement on Proposed Rules Regarding Share Repurchases, Commissioner Elad L. Roisman (Dec. 15, 2021).

13 *Id.*

close proximity to an issuer's disclosure of material nonpublic information, (iv) amendments to Forms 4 and 5 to identify transactions made pursuant to a Rule 10b5-1 plan and (v) new disclosure requirements as to dispositions by gift of securities by insiders.[14]

Exchange Act Rule 10b5-1(c) provides an affirmative defense to Rule 10b-5 liability for insider trading in circumstances where the trade was pursuant to a binding contract, an instruction to another person to execute the trade for the instructing person's account, or a written plan meeting the requirements of the rule (collectively or individually, a "Rule 10b5-1 plan") adopted when the trader was not aware of material nonpublic information.[15]

A Rule 10b5-1 plan is required to (i) specify the amount of securities to be purchased or sold and the price and date thereof; (ii) provide a written formula or algorithm, or computer program, for determining amounts of securities to be purchased or sold and the price at which and the date on which the securities were to be purchased or sold; and (iii) not permit the trader to exercise any later influence over how, when, or whether to effect purchases or sales. Also the Rule 105-1 plan must be entered into in good faith and not as a part of a scheme to evade the prohibitions of Rule 10b5-1.[16]

The Rule 10b5-1 Plan Proposing Release noted concerns expressed by courts, commentators and members of Congress that this affirmative defense has allowed traders to take advantage of the liability protections provided by the rule to opportunistically trade securities on the basis of material nonpublic information.[17] The use of multiple overlapping trading plans to selectively cancel individual trades, the termination of trading plans soon after adoption, and the commencement of trades soon after the adoption of a new trading plan or the modification of an existing trading plan are among the practices cited negatively in the Rule 10b5-1 Plan Proposing Release.[18] The Rule 10b5-1 Plan Proposing Release also noted that some academic studies have shown that corporate insiders trading pursuant to a Rule 10b5-1 plan consistently outperform trading of insiders not conducted under a Rule 10b5-1 plan.[19]

Earlier this year, the Commission's Investor Advisory Committee recommended that the SEC amend Rule 10b5-1 to address loopholes in the rule that could allow insiders to unfairly exploit informational asymmetries.[20]

Finally, the Rule 10b5-1 Plan Proposing Release noted that (i) some issuers have engaged in the practice of granting equity awards with option-like features to insiders in coordination with the release of material nonpublic information and (ii)

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14 *See* Rule 10b5-1 and Insider Trading, Exchange Act Release No. 93782 (Dec.15, 2021) (the "Rule 10b5-1 Plan Proposing Release").

15 *Id.* at p. 8.

16 *Id.* at p. 13-14.

17 *Id.* at p. 9.

18 *Id.* at p. 9-10, 15.

19 *Id.* at p. 9.

20 *Id.* at p. 10.

some insiders may be opportunistically timing gifts of securities while aware of material nonpublic information relating to such securities.[21]

Rule 105-1 Plan Proposals. The proposals relating to Rule 10b5-1 plans would:

- require a Rule 10b5-1 plan entered into by officers and directors to include a 120-day cooling-off period before trading can commence after its adoption or modification;
- require a Rule 10b5-1 plan entered into by issuers to include a 30-day cooling-off period before trading can commence after its adoption or modification;
- require each officer (as "officer" is defined in Exchange Act Rule 16a-1(f)) and director to certify in writing to the issuer when the officer or director adopts or modifies a Rule 10b5-1 plan that (i) they are not aware of any material nonpublic information about the issuer or the security and (ii) they are adopting or modifying the Rule 10b5-1 plan in good faith. The certification would not need to be filed with the Commission and would not be an independent basis of liability for directors or officers under Rule 10b-5;[22]
- provide that the affirmative defense under Rule 10b5-1(c)(1) does not apply to multiple overlapping Rule 10b5-1 plans for open market trades in the same class of securities. The proposed amendments would not apply to transactions where a person acquires or sells securities directly from or to the issuer; [23]
- limit the availability of the affirmative defense under Rule 10b5-1(c)(1) for a single-trade Rule 10b5-1 plan to one such plan during any 12-month period;
- provide that the affirmative defense under Rule 10b5-1(c)(1) only is available if a Rule 10b5-1 plan was operated in good faith (in addition to the existing requirement that the plan be entered into in good faith);
- require insiders to identify on Forms 4 and 5 whether a reported transaction was executed pursuant to a Rule 10b5-1(c) plan; and
- require new quarterly disclosure in Forms 10-K and 10-Q regarding the adoption, modification and termination of Rule 10b5-1 plans and other trading arrangements[24] of Section 16 officers, directors and issuers and the material terms of such trading arrangements (including the duration of the trading

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[21] *Id.* at p. 10.

[22] *Id.* at p. 20-22.

[23] *Id.* at p. 24-25.

[24] Disclosure would also be required for all "non-Rule 10b5-1 plan trading arrangements." *Id.* at p. 30--32.

arrangement and the aggregate number of securities to be sold thereunder). Currently there are no mandatory disclosure requirements concerning the use of Rule 10b5-1 plans or other trading arrangements by issuers or insiders, or terminations or modifications thereof. The proposed disclosures that would be required to be included in a Form 10-Q or Form 10-K (including the insider trading policy disclosures as discussed below) would be subject to the certifications required by Section 302 of the Sarbanes-Oxley Act of 2002.[25]

Insider Trading Policies. The Rule 10b5-1 Plan Proposing Release would also require an issuer to disclose in its Form 10-K whether or not (and if not, why not) the issuer has adopted insider trading policies that govern the purchase or sale of the issuer's securities by employees and directors that are reasonably designed to promote compliance with insider trading laws. Currently, issuers are not required to disclose their insider trading policies, though the Rule 10b5-1 Plan Proposing Release notes that a registrant's existing code of ethics may contain insider trading policies and, in that case, the registrant could cross-reference to the particular components of its code of ethics that constitute insider trading policies.[26]

The Rule 10b5-1 Plan Proposing Release provides that registrants should endeavor to make disclosures about their insider trading policies from which investors can assess the sufficiency of such policies. The Rule 10b5-1 Plan Proposing Release notes that investors may find useful:

- information on the issuer's process for analyzing whether the issuer or insiders have material nonpublic information when the issuer is conducting an open-market share repurchase;
- the issuer's process for documenting such analyses and approving requests to purchase or sell its securities;
- how the issuer enforces compliance with its policies; and

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[25] *Id.* at p. 28-30. Section 302 requires an issuer's CEO and CFO to certify, among other things, that the Form 10-Q or Form 10-K, as applicable, does not contain untrue statements of material facts or omit to state material facts necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the periods covered by the reports. The Rule 10b5-1 Plan Proposing Release notes that in effectuating this responsibility, the CEO and the CFO may be aided by a sub-certification from the issuer's principal legal or compliance officer that, based on a reasonable review, such legal or compliance officer has determined the issuer's insider trading practices and procedures comport with what the issuer is disclosing about them in such reports, unless the CEO or CFO, as applicable, is aware of information that is inconsistent with, or raises doubts about the reliability of, the representations in the sub-certification. *Id.* at note 49.

[26] *Id.* at p. 35.

- a description of any policies that apply to other dispositions of the issuer's securities where material nonpublic information could be misused, such as through gifts of securities.[27]

Equity Grants Within 14 Days of Disclosure of MNPI. The Rule 10b5-1 Plan Proposing Release would also require disclosure of grants of equity compensation awards within 14 days before or after an issuer's disclosure of material nonpublic information, in order to provide shareholders information as to any "spring-loaded" or "bullet-dodging" option grants during the fiscal year.[28] This disclosure would be required in Form 10-Ks, as well as in proxy statements and information statements related to the election of directors, shareholder approval of new compensation plans, and solicitations of advisory votes to approve executive compensation.[29]

Information required to be provided would include the number of securities underlying the award, the date of grant, the grant date fair value, the option exercise price, the market price of the underlying securities the trading day before disclosure of the material nonpublic information; and the market price of the underlying securities the trading day after disclosure of the material nonpublic information.[30]

The new requirements would also require narrative disclosure about an issuer's option grant policies regarding the timing of option grants and the release of material nonpublic information, including how the board determines when to grant options and whether, and if so, how, the board or compensation committee takes material nonpublic information into account when determining the timing and terms of an award. For companies that are required to include Compensation Discussion and Analysis ("CD&A") in their proxy statement, the proposed narrative disclosure could be included in the CD&A.[31]

Gifts. Finally, the Rule 10b5-1 Plan Proposing Release would require disclosure of dispositions by gift of securities by insiders on Form 4 within two business days after such a gift is made. The Rule 10b5-1 Plan Proposing Release notes that under the current rules insiders at times are not required to report such gifts for more than one year after the date of the gift.[32]

Comments on the proposed Rule 10b5-1 plan amendments must be received within 45 days after the Rule 10b5-1 Plan Proposing Release is published in the Federal Register.

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27 *Id.* at p. 36.

28 *Id.* at p. 46.

29 *Id.* at p. 46-47.

30 *Id.* at p. 45.

31 *Id.* at p. 46.

32 *Id.* at p. 49-50.

If you have any questions regarding this client alert, please contact the following attorneys or the Willkie attorney with whom you regularly work.

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