House Bill Would Require SEC to Study and Potentially Restrict Rule 10b5-1 Insider Trading Plans

On January 28, 2019, in a bipartisan vote, the House of Representatives passed the Promoting Transparent Standards for Corporate Insiders Act (the "Act"),[1] a bill that would require the Securities and Exchange Commission (the "SEC") to carry out a study of Rule 10b5-1 trading plans and revise Rule 10b5-1 consistent with the study's results. The Act seeks to close perceived gaps in Rule 10b5-1 and curb abuses of Rule 10b5-1 trading plans by corporate insiders.

I. Rule 10b5-1 Trading Plans

Rule 10b5-1 provides a safe harbor from insider trading liability under Rule 10b-5. The safe harbor establishes an affirmative defense for corporate insiders who are able to demonstrate that they had entered into a "Rule 10b5-1 trading plan" with respect to a security before becoming aware of material non-public information with respect to that security. Such trading plans may take the form of a binding contract, instructions to another person, or a written plan to trade in the security.[2]

Rule 10b5-1 trading plans must meet one of three conditions: they must (i) specify the amount, price, and date of the securities to be traded; (ii) include a written formula that determines the trading amount, price, and date; or (iii) not allow the person or any other person who has been aware of the material nonpublic information to exercise any subsequent influence over the manner of trading.[3] The person also must prove that the transaction was executed pursuant to and did not deviate from the contract, instruction, or plan.[4] Insiders must enter into Rule 10b5-1 trading plans in good faith and not to evade the insider trading prohibitions.[5]

Since the implementation of the safe harbor, trading plans have been used widely by corporate officers and directors to purchase and sell their company's stock. The potential for abuse has drawn scrutiny from certain legislators and regulators. Some commentators have called attention to "loopholes" that may allow executives to profit from their possession of material nonpublic information while avoiding insider trading liability, specifically, the flexibility that executives have to cancel or change an existing trading plan, and the fact that there is no obligation to file plans with any federal agency. [6]

---

[1] H.R.624, 116th Cong. (2019).

[2] 17 C.F.R. § 240.10b5-1(c)(1)(i)(A).

[3] 17 C.F.R. § 240.10b5-1(c)(1)(i)(B).

[4] 17 C.F.R. § 240.10b5-1(c)(1)(i)(C).

[5] 17 C.F.R. § 240.10b5-1(c)(1)(ii).

[6] *See* Susan Pulliam & Rob Barry, *Executives' Good Luck in Trading Own Stock*, WALL ST. J. (Nov. 27, 2012), https://www.wsj.com/articles/SB10000872396390444100404577641463717344178; Susan Pulliam, Jean Eaglesham & Rob Barry, *Insider-Trading Probe Widens*, WALL ST. J. (Dec. 10, 2012), https://www.wsj.com/articles/SB10001424127887323339704578171703191880378; Jean Eaglesham & Rob Barry, *Trading Plans Under Fire*, WALL ST. J. (Dec. 13, 2012), https://www.wsj.com/articles/SB10001424127887324296604578177734024394950.

II. Promoting Transparent Standards for Corporate Insiders Act

If passed by the Senate and signed by the President, the Act would require the SEC to conduct a study and consider whether Rule 10b5-1 should be amended to (i) limit the availability of trading plans to issuer-adopted trading windows; (ii) limit the adoption of multiple trading plans; (iii) establish a mandatory delay between trading plan adoption and first trade execution; (iv) limit the frequency of trading plan modifications and cancellations, (v) require SEC filings upon trading plan adoptions, amendments, terminations and transactions; and (vi) require the corporate boards of issuers that have adopted a trading plan to adopt relevant policies and periodically monitor trading plan transactions.[7] The Act also would direct the SEC to consider the effects of any such amendments on existing prohibitions on insider trading, recruitment of managerial talent, capital formation, the willingness of issuers to go public or remain public, and investor protection.[8]

The Act would require the SEC to report its to Congress one year post-enactment and to proceed with rulemaking in accordance with its recommendations.[9]

This Act passed the House by a vote of 413-3 on January 28, 2019 and has been received in the Senate and referred to the Committee on Banking, Housing, and Urban Affairs.[10] All public companies whose insiders use 10b5-1 trading plans will want to monitor this important legislation.

* * *

If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Helene R. Banks at 212.701.3439 or hbanks@cahill.com; Bradley J. Bondi at 202.862.8910 or bbondi@cahill.com; Charles A. Gilman at 212.701.3403 or cgilman@cahill.com; Elai Katz at 212.701.3039 or ekatz@cahill.com; Geoffrey E. Liebmann at 212.701.3313 or gliebmann@cahill.com; Ross Sturman at 212.701.3831 or rsturman@cahill.com; or Yilin Zhu at 212.701.3384 or yzhu@cahill.com.

[7] H.R.624, 116th Cong. (2019).

[8] *Id.*

[9] *Id.*

[10] H.R.624 – Promoting Transparent Standards for Corporate Insiders Act, CONGRESS.GOV, https://www.congress.gov/bill/116th-congress/house-bill/624.