April 1, 2022

Ms. Vanessa Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street NE
Washington, DC 20549

Re: Rule 10b5-1 and Insider Trading (Release Nos. 33-11013, 34-93782; File No. S7-20-21)

Dear Ms. Countryman:

The Center On Executive Compensation ("Center") welcomes this opportunity to provide comments to the Securities and Exchange Commission ("Commission") regarding its recent proposal on Rule 10b5-1 and insider trading ("Proposal").

The Center and its members support initiatives by policymakers to ensure that rules intended to prevent illicit insider trading are effective in practice. Investors must have confidence in the Commission's ability to combat unlawful activity. At the same time, regulations must not be so restrictive and cost-prohibitive that they disincentivize individuals from using legitimate vehicles – such as 10b5-1 plans – that were created to strengthen insider trading law and boost transparency. It is with this perspective in mind that the Center offers our observations and recommendations on the Proposal.

The Center is a research and advocacy organization that seeks to provide a principles-based approach to executive compensation policy from the perspective of Chief Human Resource Officers at over 150 large companies, representing a broad cross-section of industries. These comments reflect the input of the top human resources and executive compensation professionals at our member companies, who have extensive experience in crafting compensation disclosures and in engaging with institutional investors on executive compensation matters.

Background

In 2000, the Commission adopted Rule 10b5-1 to provide an affirmative defense from insider trading liability for individuals who enter into a binding contract to buy or sell an underlying company's securities according to a predetermined date and at a specified amount and price. Individuals who trade according to a 10b5-1 plan are not permitted to "exercise any subsequent influence over how, when, or whether to effect purchases or sales" under the plan.[1]

[1] 17 CFR 240.10b5-1

The Commission determined there were two significant benefits contained in Rule 10b5-1. As the Commission explained in the adopting release:

> …the rule should increase investor confidence in the integrity and fairness of the market because it clarifies and strengthens existing insider trading law. Second, the rule will benefit corporate insiders by providing greater clarity and certainty on how they can plan and structure securities transactions. The rule provides specific guidance on how a person can plan future transactions at a time when he or she is not aware of material nonpublic information without fear of incurring liability. We believe that this guidance will make it easier for corporate insiders to conduct themselves in accordance with the laws against insider trading.[2]

Because of these benefits, 10b5-1 plans have become an increasingly used vehicle for corporate insiders to trade their company's securities without risk of running afoul of insider trading law. According to a 2018 survey conducted by the National Association of Stock Plan Professionals (NASPP Survey), by 2017, 54% of S&P 500 companies used 10b5-1 compared to 26% in 2003.[3] A recent Wall Street Journal article also noted that 10b5-1 plans accounted for 61% of all insider trades in 2020.[4] 10b5-1 plans remain a valuable tool to guard against inappropriate trading behavior by corporate insiders and any public perception of such behavior.

Like any other area of securities regulation, the Commission should regularly review and assess how Rule 10b5-1 is working in practice and whether any amendments to the rule are necessary. The Center shares the Commission's view that "insider trading and the fraudulent use of material nonpublic information (MNPI) by corporate insiders not only harm individual investors but also undermine the foundations of our markets by eroding investor confidence."[5] However, the Center is concerned that as currently drafted and without significant revisions, the Proposal would disincentivize the use of 10b5-1 plans and undermine their longstanding status as an important tool for the SEC to enforce rules regarding insider trading.

Accordingly, the Center wishes to provide the following observations and recommendations regarding the Proposal:

I. Much of the behavior the Commission is seeking to prevent is already prohibited under existing insider trading law. The Commission should carefully consider whether the costs of proposed restrictions to 10b5-1 plans will outweigh their benefits.

II. The proposed 120 day "cooling off period" for individuals is unnecessarily long. The Commission should consider current market practices and whether a shorter timeframe would achieve the same goals outlined in the Proposal.

---

[2] Selective Disclosure and Insider Trading. Release Nos. 33-7881; 34-43154; IC 24599 (August 15, 2000). Available at https://www.sec.gov/rules/final/33-7881.htm

[3] National Association of Stock Plan Professionals – Insights and Trends: Evolving Practices for 10b5-1 Plans. Available at https://advisor.morganstanley.com/chesapeake-group/documents/field/c/ch/chesapeake-group/10b5-1%20Evolving%20Practices.pdf

[4] Shifflett, Shane. "Executive Stock Sales Are Under Scrutiny. Here's What Regulators Are Interested In." *Wall Street Journal*, August 11, 2021. Available at https://www.wsj.com/articles/executive-stock-sales-are-under-scrutiny-heres-what-regulators-are-interested-in-11628682985

[5] 87 Fed. Reg. at 8,687

III. A broad prohibition on overlapping plans is misguided and will negatively impact legitimate trading practices of 10b5-1 plan users.

IV. The proposed limitation on single-trade plans would similarly have the effect of prohibiting legitimate trades and likely push more trading activity outside of 10b5-1 plans.

V. While well-intentioned, the requirement that 10b5-1 plans be "operated" in good faith will present users with difficult compliance questions and allow regulators to second guess decisions made with the best interests of shareholders in mind.

VI. The proposed requirement to report gift transactions within two business days is unnecessarily short and will increase compliance burdens while offering little benefit to the public. The Commission should consider removing this requirement or permitting a longer period (e.g., 45 days) for filing.

Each of these observations and recommendations are discussed in greater detail below.

I. Much of the behavior the Commission is seeking to prevent is already prohibited under existing insider trading law. The Commission should carefully consider whether the costs of proposed restrictions to 10b5-1 plans will outweigh their benefits.

The Proposal includes examples and hypotheticals of how corporate insiders could abuse or exploit Rule 10b5-1 for their own benefit. These examples include:

- An individual influencing a company's timing of the release of MNPI in order to benefit the individual's own trading schedules;
- Corporate insiders using multiple overlapping plans to selectively cancel trades on the basis of MNPI;
- Individuals commencing trades on the basis of MNPI soon after adopting a 10b5-1 plan; and
- Individuals opportunistically timing the gift of securities on the basis of MNPI.

The Center agrees that this type of behavior falls outside both the text and spirit of Rule 10b5-1 and should be a concern for the Commission and the investing public. However, we also note that such activities – which each involve an individual possessing and using MNPI for their own personal benefit – are already clearly prohibited by existing insider trading laws and regulations.[6]

As described in more detail below, the Center is concerned that as currently drafted, certain provisions of the Proposal would do more to discourage legitimate trading practices under 10b5-1 plans than they would to mitigate illegal insider trading. Individuals and companies already go to considerable lengths to comply with Rule 10b5-1 and ensure that trading plans are compliant with all SEC regulations. Additional mandates that could make these plans unusable or cost-prohibitive to users would weaken insider trading law and the SEC's ability to identify and mitigate illegal activity.

II. The proposed 120-day "cooling off period" for individuals is unnecessarily long. The Commission should consider current market practices and whether a shorter timeframe would achieve the same goals outlined in the Proposal.

The Proposal would apply a 120-day "cooling off" period for officers and directors to prohibit trading between the time a 10b5-1 plan is adopted and when the first trade takes place. The purpose of the cooling off period is to avoid situations where an individual adopts a 10b5-1 plan while in possession of MNPI, then begins trading shortly thereafter.

The Proposal notes:

> Under the current rule, a trader can adopt a Rule 10b5-1(c)(1) trading arrangement and execute a trade under the arrangement on the same day. Investors and other commentators have suggested that requiring a minimum waiting period of several months between the adoption of a trading arrangement and the date on which trading can commence would reduce the risk that an insider could benefit from any material nonpublic information of which they may have been aware at the time of adopting the trading arrangement.[7]

The Center believes that a cooling off period can help prevent abuses and the perception that an executive may seek to trade quickly based off their knowledge of MNPI. However, we believe 120 days is unnecessarily long and would create unintended consequences for users of 10b5-1 plans. A 120-day period would in many instances expire well after a company's upcoming quarterly reporting period. By definition, corporate insiders are permitted to trade within a window once quarterly financial results have been released so it makes little sense to maintain a trading prohibition after the release of those earnings.

A 2019 survey conducted by the Center found that a large majority of respondents (75%) already require some type of cooling off period. The most common period was 30 days (40% of respondents) but responses ranged from 14 to 60 days, or the next open trading window. The

---

[6] The prohibition of "manipulative and deceptive" practices under Section 10(b) of the Securities Exchange Act includes trading a security "on the basis of" material nonpublic information about that security. Per 17 CFR 240.10b5-1, trading on the "on the basis of" material nonpublic information is defined as *"a purchase or sale of a security of an issuer is "on the basis of" material nonpublic information about that security or issuer if the person making the purchase or sale was aware of the material nonpublic information when the person made the purchase or sale."* Further, per Rule 10b5-1, individuals can only establish a 10b5-1 plan prior to becoming aware of MNPI.

[7] 87 Fed. Reg. at 8,689-90

survey results indicate that most companies already acknowledge that cooling off periods can guard against any perception that executives are regularly able to trade "quickly" once they come in possession of MNPI.

Additionally, the Center survey found that 88% of companies do not allow executives to establish a 10b5-1 plan during blackout periods. This further underlines the fact that a 120-day waiting period would extend well beyond the company's next quarterly earnings release and could create significant challenges for users of 10b5-1 plans in certain situations particularly as it relates to the exercise of stock options.

For example, take an individual that has a tranche of options that are set to expire on April 1st of a given year, and the company is scheduled to release earnings on March 1st of the same year. Assume the company's stock has been underwater for years but has performed well recently to the point that the options are in the money and the individual wants to exercise them through a 10b5-1 plan. If the open window for the individual to establish the 10b5-1 plan runs the day after the March 1st earnings release until the first day of the following month, the options would have long expired once the 120-day cooling off period is over.

If the Commission ultimately determines that a mandated cooling off period is necessary, the Center suggests that a much shorter period (e.g., 30 days) or a requirement to wait until after the next earnings release (as some companies do now) would be more appropriate and meet the same goals the Commission is trying to achieve with the currently proposed 120-day cooling off period. In the example above, either approach would have protected against the potential for insider trading, while still allowing an employee to effectively use a 10b5-1 plan.

III. A broad prohibition on overlapping plans is misguided and will negatively impact legitimate trading practices of 10b5-1 plan users.

When the Commission adopted Rule 10b5-1, it recognized the possibility that 10b5-1 plans could be engineered in a way that allowed executives to hedge their position by cancelling certain trades that were not in their favor. An individual is therefore ineligible for the affirmative defense under Rule 10b5-1 if they enter into or alter a "corresponding or hedging transaction" designed for their personal benefit. The Commission now proposes prohibiting individuals from having multiple 10b5-1 plans in effect at the same time.

The Proposal states that an individual could "adopt and employ multiple overlapping trading arrangements and exploit inside information by setting up trades to occur around other dates on which they expect the issuer will likely release MNPI,"[8] although the Proposal does not cite evidence pointing to this being a common practice among 10b5-1 plan users.

The Center discourages an outright ban on overlapping plans. Instead, we urge the Commission to consider some of the legitimate, benign reasons for why an individual may wish to establish more than one 10b5-1 plan.

---

[8] 87 Fed. Reg. at 8,692

Some real-life examples provided by our members include:

- An individual who establishes a plan specifically designed to pre-plan the exercise of cashless options;

- An individual who holds their ‘long’ shares at an external brokerage firm but wishes to sell their net shares from options through the company’s brokerage firm due to lower fees; or

- An individual who has an unexpected need for liquidity and whose only alternatives are to amend a current plan (which many companies do not allow) or have multiple plans in place.

None of these examples involve an individual seeking to skirt the letter or intent of Rule 10b5-1, yet all would be banned under the Proposal as currently drafted. Furthermore, the NASPP Survey found that while over two-thirds of companies already prohibit corporate insiders from having multiple concurrent 10b5-1 plans, companies that allow for multiple plans typically do so under limited circumstances. For example, most companies that allow for multiple plans only do so if each plan represents unique tranches of options or shares, while other companies impose different restrictions. We urge the Commission to take these current market practices into account and avoid an arbitrary ban on overlapping plans that would prohibit legitimate trading in many circumstances.

IV. The proposed limitation on single-trade plans would similarly have the effect of prohibiting legitimate trades and likely push more trading activity outside of 10b5-1 plans.

The Proposal would limit the availability of the affirmative defense for single-trade arrangements to one single-trade plan during any 12-month period. While the Proposal acknowledges the importance of single-trade plans to address one-time liquidity needs, the Commission states that the limitation is intended to balance this proper use of 10b5-1 plans with the potential for single-trade plan abuses.

Similar to the proposed outright ban on overlapping plans, the Center is concerned that the Proposal fails to consider certain scenarios that could arise which could cause an individual to establish more than one single-trade plan.

Several member companies noted that an individual could encounter a greater liquidity need than they originally envisioned when adopting a single-trade plan. Under the Proposal, they would be prohibited from establishing another plan for 12 months even though they are addressing a matter – the need for liquidity – that the Proposal acknowledges is a “legitimate use” for single-trade plans. Individuals may also seek to adopt an additional single-trade plan for a tranche of stock that previously vested and which they wish to liquidate pursuant to a 10b5-1 plan.

It should be noted that under this provision in the Proposal, an individual could liquidate positions *outside* of their plan, but not *within* a single-trade 10b5-1 plan. We do not believe this is an outcome or incentive that the Commission intends to create, but it would be an unintended consequence if the Proposal goes into effect as currently drafted.

Further, a limitation on single-trade plans is unnecessary if the Commission adopts a mandatory cooling off period for any 10b5-1 plan. A cooling off period is intended to address near-term trading by individuals while in possession of MNPI and would obviate any need to limit the use of single-trade 10b5-1 plans.

V. While well-intentioned, the requirement that 10b5-1 plans be "operated" in good faith will present users with difficult compliance questions and allow regulators to second guess decisions made with the best interests of shareholders in mind.

The 2000 regulation that governs Rule 10b5-1 included a requirement that plans be entered into in "good faith." In practical terms, this means that individuals cannot adopt a plan with the intention of using MNPI to engage in trading that is favorable to them.

The current Proposal would expand the good faith standard and require that plans also be *operated* in good faith. This means that every decision made by an individual or issuer as to whether to cancel or modify an existing plan will be subject to review and scrutiny by the Commission. This creates the potential for the Commission to make inaccurate or inappropriate inferences about an individual's trading activity.

Unexpected events may occur while an individual has a 10b5-1 plan in effect, and decisions may be made to cancel or modify certain trades due to those events. For example, a stock offering by a large shareholder could lead a company to cancel an executive's planned trades if those trades were set to occur around the time of the offering and there is a concern over how they may be perceived by the public. Similarly, companies could also utilize current rules and cancel an existing plan when an individual comes into possession of MNPI if they believe trading activity would be viewed skeptically.

Both scenarios involve individuals seeking to do right by their shareholders in response to unexpected events. An ambiguous "good faith" standard would allow the Commission to second guess these decisions based on developments or circumstances outside the control of a 10b5-1 plan user. This would lead to misleading narratives about corporate insiders taking advantage of current rules, when in reality decisions to cancel or modify a plan were made with the best interests of the company and its shareholders in mind.

As Commissioner Peirce stated when the Proposal was released:

> the proposed condition that the plan be "operated" in good faith may raise an unintended incentive for directors or officers to consider their Rule 10b5-1 plans in connection with corporate actions long after establishing their plans. The general idea behind a Rule 10b5-1 plan is for the director or officer to "set it and forget it" to ensure that she is not trading on the basis of material nonpublic

> information. Are we inadvertently rendering the safe harbor a "sort-of safe harbor" by making its availability contingent on ongoing good faith to be judged in hindsight?[9]

The Center echoes these sentiments and urges the Commission to rethink the implications of this ongoing good faith requirement. The Commission is right to be concerned about certain activity that the proposed good faith requirement is intended to prevent, such as when an individual "improperly influence[s] the timing of corporate disclosures to benefit their trades under the trading arrangement, for example, by delaying or accelerating the release of material nonpublic information."[10]

However, the proposed requirement would not be limited to this type of clearly improper activity and would have applications far beyond the type of behavior that should concern regulators. Accordingly, the Center believes that the Commission should maintain the existing requirement that 10b5-1 plans be *entered into* in good faith while focusing its oversight efforts on behavior conducted in clear violation of Rule 10b5-1.

VII. The proposed requirement to report gift transactions within two business days is unnecessarily short and will increase compliance burdens while offering little benefit to the public. The Commission should consider removing this requirement or permitting a longer period (e.g., 45 days) for filing.

The Proposal would require the disclosure of insiders' gifts of stock within two business days on Form 4. Existing rules allow a stock gift to be disclosed on Form 5, which is required to be filed within 45 days of the end of the year during which the gift was made.

The Center understands the Commission's concerns regarding gifts made while in possession of MNPI, but the proposed two business day reporting requirement is excessively short. Moreover, the requirement is overly broad, and would encompass transactions with little possibility of abuse. For example, the requirement would capture activities related to estate planning and gifts to an insider's own family members that are not deemed to constitute continued beneficial ownership or may that be deemed a change from direct to indirect beneficial ownership. The Commission is correct to recognize in the Proposal that "non-pecuniary motives may be more important in a gift than in an open market sale." Indeed, non-pecuniary motives are typically the dominant or sole reason for gifts. Many gifts entail no tax advantage, and, notwithstanding the tax benefits of certain charitable gifts, it is difficult to imagine realistic scenarios in which an insider would gain a net economic benefit by giving away stock. It is therefore inappropriate to treat gifts as if they are market transactions motivated by pecuniary concerns and conducted at arms-length.

Earlier reporting will impose substantial burdens on insiders and companies for little gain. While many gifts are currently reported on Form 4, such reporting includes voluntary reporting that is often not conducted within two business days. Existing compliance structures and policies at companies are typically not designed or intended to report non-market gift

---

[9] Statement on Rule 10b5-1 and Insider Trading Release. Commissioner Hester Peirce (December 15, 2021) Available at https://www.sec.gov/news/statement/peirce-10b5-20211215
[10] 87 Fed. Reg. at 8,693

transactions within this time period. Also, reporting complex gift transactions, such as those sometimes present in estate planning, could pose a substantial burden on insiders because reporting implications would need to be fully determined in advance to ensure compliance with a two business day deadline. In addition, by forcing insiders and companies to choose between sending an immediate but ambiguous information signal to the markets and making a charitable gift, requiring earlier reporting may decrease charitable giving. Similarly, a two business day filing requirement could unnecessarily complicate estate planning activities that have a very low likelihood of abuse.

The Commission should consider dropping the additional disclosure requirement for insider gifts of stock. If it is retained, the Commission should consider limiting the requirement to charitable gifts to charities affiliated with the insider and retaining a longer reporting time period (e.g., 45 days).

Conclusion

The Center appreciates this opportunity comment on the Proposal and the SEC's focus on increasing transparency and accountability surrounding 10b5-1 plans. However, as noted above, we believe that meaningful revisions to the current draft Proposal are necessary to achieve its intended goal. We are concerned that the Proposal as drafted could serve as a disincentive for individuals to establish and maintain 10b5-1 plans. The Center looks forward to continuing to engage with the Commission on this important issue.

Sincerely,

Ani Huang

President and CEO
Center On Executive Compensation