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Via Electronic Submission

April 29, 2022

Ms. Vanessa A. Countryman
Secretary
United States Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

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

Dear Ms. Countryman:

This letter is submitted on behalf of the Federal Regulation of Securities Committee (the "Committee" or "we") of the Business Law Section of the American Bar Association (the "ABA"), on the above-referenced proposing release issued by the Securities and Exchange Commission (the "Commission") regarding the proposed amendments to Rule 10b5-1 under the Securities Exchange Act of 1934 and related disclosure requirements (the "Proposing Release"). We appreciate the opportunity to comment on the proposals.

The comments expressed in this letter represent the views of the Committee only and have not been approved by the ABA's House of Delegates or Board of Governors and, therefore, do not represent the official position of the ABA. In addition, this letter does not represent the official position of the Business Law Section of the ABA nor does it necessarily reflect the views of all members of the Committee.

Recommendations

Historical Underpinnings of Rule 10b5-1

We believe it is important to understand the basis and effect of Rule 10b5-1 in order to properly consider the Commission's proposed amendments. Rule 10b5-1 was adopted in 1999 at the same time that the Commission adopted Regulation FD (Fair Disclosure). It was part of the Commission's effort to address concerns about selective disclosure of material nonpublic information and to clarify and enhance prohibitions against insider trading in violation of Rule 10b-5. Rather than address all the elements of a violation of Rule 10b-5, Rule 10b5-1 only addresses one: a person trades "on the basis of" material non-

public information when the person purchases or sells securities while in “knowing possession” (or being “aware”) of the information when the person made the purchase or sale. Thus, Rule 10b5-1 sought to negate a need to show actual “use” of the information, thereby resolving a then unsettled issue of insider trading law. Rule 10b5-1 then provides several affirmative defenses to cover trades “where it is clear that the information was not a factor in the decision to trade.”

Rule 10b5-1 states explicitly in its Preliminary Note that it “does not address or modify the scope of insider trading law in any other respect” and the Adopting Release (*Selective Disclosure and Insider Trading*, Release No. 33–7881, Dec. 20, 1999) at III.A.1. explains that the rule “is designed to address only the use/possession issue” and “does not modify or address any other aspect of insider trading law,” giving as an example the need for scienter in order to violate Rule 10b-5. For a discussion of the elements required for a violation of Rule 10b-5, see *United States v. O’Hagan*, 521 U.S. 642 (1997).

Against this background, we are concerned that, if adopted as proposed, the proposal could, as discussed below, increase the burdens on persons using Rule 10b5-1 and place limits on the availability of its specified affirmative defenses, causing persons who would otherwise use the rule not to use it. Instead of using the rule, they could attempt to avoid violating Rule 10b-5 in other ways, thus increasing the uncertainty Rule 10b5-1 was intended to alleviate and increase transactional costs. In addition, we believe that adding conditions to the rule’s affirmative defenses that do not relate directly to the purpose of permitting persons to trade “where it is clear that the information was not a factor in the decision to trade” may undermine the purpose of the rule and interfere with legitimate trading activity. Moreover, we are concerned that adding the proposed conditions to the affirmative defenses in Rule 10b5-1 as it is now constructed would be inconsistent with insider trading law. In our letter dated May 8, 2000 commenting on the proposal to adopt Rule 10b5-1, we expressed our concern about whether the enumerated affirmative defenses fully reflected insider trading law and suggested that they be designated as non-exclusive safe harbors or that a catch-all affirmative defense be added. The Commission chose not to take our suggestions in adopting Rule 10b5-1. However, that was not particularly problematic because the affirmative defenses in the rule as adopted were closely aligned with insider trading law. That would not be the case though if the Commission were to adopt the proposed amendments because of the substantial limitations that would be imposed on the affirmative defenses. Accordingly, we are concerned that the proposal, if adopted, would depart from established insider trading law. To illustrate: under current Rule 10b5-1 a person who does not have material non-public information could grant discretionary authority to sell shares to a third party; that third party can then sell at a time it does not have material nonpublic

information even if the person granting the authority, who may not even know about the sale at the time it is made, then has material nonpublic information. If the Rule 10b5-1 affirmative defenses are unavailable because one or more of the conditions that would be added by the proposal (such as a cooling-off period) have not been met, the person who granted the discretionary authority in the foregoing circumstances still may not be violating Rule 10b-5 even though it is not relying directly on Rule 10b5-1 as amended.

We therefore recommend that the Commission reconsider its approach in light of these concerns and either:

- (i) If there are demonstrable abuses in how Rule 10b5-1 is currently being used, the Commission should address them directly. For example, if terminating a plan in order to take advantage of material nonpublic information is considered an abuse, the Commission could make clear that such a termination would violate the good faith requirement of Rule 10b5-1 and the plan would not be a defense to liability as provided in Rule 10b5-1(c)(1)(ii). This targeted approach would address an abuse but not interfere with other terminations for good reason that are not abusive; or
- (ii) If additional requirements to the availability of the affirmative defenses along the lines of those proposed are adopted, the rule should expressly recognize that it provides non-exclusive safe harbors so that Rule 10b5-1 as amended is consistent with insider trading law. Recognition of safe harbors would encourage adoption of practices consistent with the safe harbors, but to be effective the safe harbors should reflect prevailing practices, such as those we describe below, adopted by companies designed to ensure compliance and prevent abuses.

Cooling-Off Periods

In the event the Commission chooses to implement a cooling-off period for 10b5-1 plans entered into by directors and officers as well as material modifications to such plans requiring an additional cooling-off period, we believe the limited available data supports a shorter period than that proposed by the Commission, particularly considering the costs and potential consequences to individuals of an excessive cooling-off period. In addition, we do not support a cooling-off period for issuer 10b5-1 plans given the meaningful challenges issuers would face as a result and the actual costs that would be borne by shareholders.

Cooling-Off Period for Section 16 Directors and Officers. With respect to a 10b5-1 plan that is entered into by a director or officer (as defined in Exchange Act Rule 16a-1(f)), we believe a shorter cooling-off period than what is proposed is appropriate, such as a cooling-off period of the lesser of 60 days or one business day after the date the issuer discloses its earnings results for the quarter during which the 10b5-1 plan is adopted.

We appreciate that the recent academic study cited by the Proposing Release and the Investor Advisory Committee,¹ which examined trading activity for over 20,000 10b5-1 plans, found that plans with short cooling-off periods avoided significant losses and were associated with meaningful share price declines in excess of industry peers. However, the authors of the study explained that when the number of days between plan adoption and initial trade was greater than 60 days, evidence of loss avoidance disappeared.² The study also found that plans that executed an initial trade in the window between when the plan was adopted and that quarter's earnings announcement anticipated large losses. However, the authors explained that loss avoidance was not evident for plans where the initial trade occurred after the applicable quarter's earnings announcement.³ If loss avoidance was not evident for plans where the initial trade occurred more than 60 days after plan adoption and for initial trades occurring after the earnings announcement for the quarter in which the plan was adopted, then a cooling-off period that satisfies either criteria should prevent most opportunistic trading and provide appropriate guardrails.

While a cooling-off period of 60 days would be a simpler condition to apply, the alternative cooling-off period we are proposing, one business day after the applicable earnings announcement, is warranted given it should provide the desired benefit (i.e. an appropriate safeguard against trading on the basis of material non-public information (“**MNPI**”)) while reducing anticipated costs (i.e., providing directors and officers with additional flexibility to legitimately trade). Note that two weeks before the end of the quarter is a fairly common time frame for issuers to commence their blackout period, and many issuers announce earnings 30 days or less after the quarter ends (i.e., a total period of approximately 44 days or less). Under our proposed alternative cooling-off period, many directors and officers would gain the added flexibility to adopt a 10b5-1 plan shortly before the blackout period commenced (when

¹ See Proposing Release at pg. 60; Recommendations of the Investor Advisory Committee Regarding Rule 10b5-1 Plans (Sept. 9, 2021) at <https://www.sec.gov/spotlight/investor-advisory-committee-2012/20210916-10b5-1-recommendation.pdf>; David F. Larcker et al., Gaming the System: Three “Red Flags” of Potential 10b5-1 Abuse, Stanford Closer Look Series (Jan. 19, 2021) at <https://www.gsb.stanford.edu/sites/default/files/publication-pdf/cgri-closer-look-88-gaming-the-system.pdf> (“**Gaming the System**”).

² Gaming the System at pg. 2.

³ Gaming the System at pg. 3.

they could validly represent they are not in possession of MNPI) and commence trading under the plan 45 or fewer days later, but after the market has the benefit of a regular quarterly update from the issuer.

We urge the Commission to further consider the potential costs of a cooling-off period that is excessively long. The longer the required cooling-off period, the more those with legitimate trading needs, such as unforeseen liquidity requirements, will use alternative means to transact, resulting in a chilling effect on the use of Rule 10b5-1. As noted in the Proposing Release, a 2021 study found that “the overall level of opportunistic behavior is smaller for sales within 10b5-1 plans than for sales outside of such plans. . .”⁴ Further, 10b5-1 plans cover a significant number of individuals and amount of trading activity.⁵ Accordingly, the conditions placed on 10b5-1 plans should be limited where reasonable to encourage the use of such plans.

Cooling-Off Period for Issuers. We do not support imposing a 30-day cooling-off period for issuer 10b5-1 plans. Issuers are fundamentally different than directors and officers because limitations placed on their activities are directly detrimental to shareholders. Imposing a cooling-off period on issuers would reduce the effectiveness and efficiency of their share repurchase activity. As the Commission has noted, “firms that favor share repurchases tend to have more volatile cash flows than dividend-paying firms.”⁶ Indeed, issuers with volatile cash flows often opt for share repurchase programs because of the challenges that result from the inflexibility of regular dividends. In that context, issuers with share repurchase programs dynamically manage those programs multiple times a year during “open windows,” taking into account cash balances, leverage levels, market conditions and share price. Issuers faced with volatile cash flows and other unpredictable factors that are forced to forecast at least 30 days ahead will risk exceeding long-term repurchase goals or being significantly too conservative. This will necessarily cause issuers to either be less efficient with cash or return less cash to shareholders.

In addition, as noted in the Proposing Release, there is generally an absence of data related to issuer 10b5-1 plans⁷ and therefore a lack of studies demonstrating the type of opportunistic behavior evident in 10b5-1 plans of some directors and officers. As a result of the proposed enhanced disclosure regarding issuer 10b5-1 plans, such data would become available for analysis.

⁴ Proposing Release at pg. 63.

⁵ See Proposing Release at pg. 58 (noting that 4,900 individuals reported trades under 10b5-1 plans during 2020) and *Gaming the System* at pg. 2 (examining 20,595 10b5-1 plans, covering trading activity of 10,123 people, related to sales transactions totaling \$105.3 billion between January 2016 and May 2020).

⁶ *Share Repurchase Disclosure Modernization*, Release No. 34-93783 (Dec. 15, 2021) at pg. 41.

⁷ Proposing Release at pg. 64.

The Commission should not preemptively adopt a cooling-off period for issuer 10b5-1 plans that would result in actual costs for shareholders before there is evidence of the benefits from such measures.

Modifications to Prior 10b5-1 Plan. With respect to the “[n]ote to paragraph (c)” in proposed amended Rule 10b5-1, it is important to recognize that not all changes to a plan should be deemed a termination of a prior plan and adoption of a new plan requiring a new cooling-off period. However, the Commission cannot anticipate all of the changes that could be made to 10b5-1 plans, and so it should not attempt to define the parameters for a *de minimis* exception. Instead, deemed termination of a prior plan and adoption of a new plan should be limited to “material” modifications or amendments. Accordingly, “[n]ote to paragraph (c)” could be amended to refer to “[a]ny material modification or amendment. . .” Similarly, the “[n]ote to paragraph (a)” in proposed amended Item 408 of Regulation S-K should refer to “[a]ny material modification or amendment. . .”

At the same time, it would be helpful if the Commission provided guidance on significant modifications that would not be considered material. For example, a modification to a 10b5-1 plan that would impact trading activity more the 60 days in the future (i.e. beyond our proposed cooling-off period) could result in a significant modification, but it should not be viewed as a material modification triggering a new cooling-off period. Because such a modification would be further in time than our proposed cooling-off period, it is inherently less likely to result in opportunistic trading. There is no reason to prohibit directors and officers not in possession of MNPI from trading for the immediate 60 day period because they have made a change to their 10b5-1 plan that will take effect more than 60 days in the future.

Proposed New Item 408 Disclosure in Form 10-K

If the Commission decides to adopt enhanced disclosures of 10b5-1 plans, we recommend the Commission further clarify in the rule that pricing is not a required “material term” of a 10b5-1 plan that is required to be disclosed. If pricing information were required to be disclosed, we believe registrants, directors and officers would be at a disadvantage to the market in that they would be disclosing in advance their specific trading price. Such disclosure requirement would further increase the burdens on persons using Rule 10b5-1, causing persons who would otherwise use the rule not to use it.

We also suggest some technical modifications related to the placement of the disclosures. Since Item 408(a) disclosure is specific to the last fiscal quarter, and the Commission proposes requiring it in Item 5 of Form 10-Q, it would be more appropriate for that disclosure to appear in Form 10-K rather

than Schedule 14A, as proposed. We suggest that Form 10-K be amended to require (i) Item 408(a) disclosure in Part II, Item 9(B) of Form 10-K and (ii) Item 408(b) disclosure in Part III, Item 10 of Form 10-K. Requiring Item 408(a) disclosure in Item 9(B) rather than Item 10 of Form 10-K would align with the Commission's proposal to require Item 408(a) disclosure in Item 5 of Form 10-Q, since both Items cover similar types of information. Further, this approach would ensure that Item 408(a) disclosure, which as mentioned relates to the last fiscal quarter, appears in each periodic report. Additionally, requiring only Item 408(b) disclosure in Part III, Item 10 of Form 10-K would align with the Commission's proposed requirement to include Item 408(b) disclosure (but not Item 408(a) disclosure) in Schedule 14A.

Proposed New Item 402 Disclosure in Form 10-K

Under proposed Item 402(b), the Commission would require registrants to disclose in a new compensation table any option awards to named executive officers or directors that are made within 14 calendar days before or after the filing of a periodic report, an issuer share repurchase, or the filing or furnishing of a current report on Form 8-K that contains material nonpublic information. Aside from the difficulty in determining exactly which 8-Ks might contain MNPI, we believe this disclosure is redundant with information already in the market, such as the extensive award reporting under the existing Item 402 compensation tables as well as the Section 16 reporting regime. Contrary to "decision useful" disclosure, it appears the disclosure would actually leave investors with the false impression that any grants made with 14 days before or after the release of MNPI is "spring-loaded" or "bullet-dodging" as the Proposing Release mentions. For these reasons, we recommend removing this additional table.

* * *

We appreciate the opportunity to participate in this process and respectfully request that the Commission consider our recommendations and suggestions. We are available to meet and discuss these comments or any questions the Commission and its staff may have, which may be directed to the individuals listed below.

Very truly yours,



Jay H. Knight
Chair of the Federal Regulation of
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