Protect Against Insider Trading Charges
With a 10b5-1 Plan

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The laws against insider trading are designed to ensure that insiders — such as officers, directors and major shareholders — don’t gain an unfair advantage over other investors by trading on material nonpublic information (MNPI). Defending allegations of insider trading can be challenging. Under Rule 10b5-1, a securities purchase or sale is deemed to be made “on the basis of” MNPI if the insider is aware of MNPI at the time of the transaction. One way for insiders to protect themselves against insider trading charges is to establish a 10b5-1 trading plan.

Using the affirmative defense

A 10b5-1 plan is typically a contract between an insider and his or her broker, entered into at a time when the insider possesses no MNPI about the company or its securities. It instructs the broker to purchase or sell the corporation’s securities according to a schedule that specifies the dates, amounts and prices of future trades or according to a formula for determining them.

Once insiders adopt the plan, they have no authority over the amount or timing of trades. This provides protection against insider trading liability even if they become aware of MNPI before the trades are executed.

However, a 10b5-1 plan is an affirmative defense against insider trading charges, not a safe harbor. The SEC can overcome this defense by showing that the plan’s timing or plan modification patterns reflect insider trading.

Designing a plan

Designing a 10b5-1 plan to avoid SEC scrutiny can be tricky. Make sure you:

Restrict the timing. Require insiders to adopt, modify or terminate the plan only during your company’s open trading windows — typically, brief periods following your company’s quarterly earnings announcements. This minimizes the risk that an insider will use the plan to take advantage of insider information.

Consider preapproval. Have your company’s legal or compliance department preapprove the 10b5-1 plan. Some companies limit preapproval to an insider’s execution of a plan, while others require preapproval of the plan’s terms.

Impose a waiting period. Rule 10b5-1 doesn’t require a waiting period before trading can begin. But you can help avoid SEC scrutiny by imposing a waiting period long enough to ensure that any MNPI is stale or has been publicly announced by the time trading commences.

Avoid changes. The SEC may view plan amendments, suspensions or terminations as red flags signaling that an insider is attempting to take advantage of MNPI — especially when there’s a pattern to such modifications. Prohibit these actions and establish plan terms that are long enough to provide benefits, but short enough that insiders can adopt new plans from time to time to meet their changing needs.

Announce the plan publicly. You don’t have to publicly disclose the adoption, amendment or termination of a 10b5-1 plan. However, it’s a good idea to disclose these events to avoid public or investor relations issues.

Managing the risk

A 10b5-1 plan protects companies from insider trading charges by establishing the timing, amount and price of securities trades at a time when an insider has no MNPI. Incorporate the features described above, and your company will make your plan transparent to investors and the public and reduce any suspicions of abuse.