

DETERMINING THE RIGHT 10B5-1 PLAN FOR YOU

Understanding how SEC Rule 10b5-1 provides flexibility to corporate executives seeking methods of managing their ownership in company stock.

Corporate trading policies limit the number of days when company insiders are allowed to transact in their stock, in some cases reducing open trading windows to fewer than 60 days per year. Insiders who utilize a 10b5-1 plan, however, can establish a trading strategy that allows for transactions in their stock during blackout periods that surround important corporate events, announcements and quarterly earnings releases, while also establishing a defense against accusations of insider trading violations.

HOW DOES A 10B5-1 PLAN WORK?

During an open trading window, a corporate executive can institute an automated trading program that executes transactions in company stock over a predefined period of time, even if the insider becomes aware of material, nonpublic information during the transaction period.



KEY TAKEAWAYS

Implementing a 10b5-1 plan allows corporate insiders to transact in company stock during blackout periods or periods of time when they may become aware of material, nonpublic information.

This automated tool is especially useful for executives who face limited windows of opportunity to transact in company stock due to strict corporate trading policies.

Utilizing Rule 10b5-1 correctly can provide executives with an affirmative defense against accusations of insider trading violations.

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10B5-1 DEFINED

A rule established by the Securities and Exchange Commission (SEC) that allows publicly traded corporations and their employees to transact in company stock through a written plan that defines a number of shares, price points and timing for trades. Such a plan allows for companies to transact through blackouts while providing an affirmative defense against accusations of insider trading.

REQUIREMENTS OF RULE 10B5-1

In order to be effective and provide the insider with an affirmative defense against allegations of insider trading, a 10b5-1 plan must meet the following requirements:

- The plan must be in writing and established in good faith at a time when the executive is not in possession of material, nonpublic information.
- The plan must specify the number of securities to be traded, the price at which transactions should take place, and the dates on which transactions should occur. These inputs can be static or formula-driven.
- The plan prohibits the executive from exercising any further influence over how, when or whether to effect trades under the plan specifications.

In addition to the requirements of Rule 10b5-1, the plan also must adhere to the company's internal trading policies regarding open trading windows for corporate executives. Additionally, corporate counsel is often required to provide a statement approving the plan before it can be enacted.

MAKING CHANGES TO PLANS

- Changes to an existing 10b5-1 plan are allowed as long as they are made when the executive is not in possession of material, nonpublic information and in an open trading window.
- Typically, the company must approve the changes before they can be enacted.
- Cancellations can occur at any time, even if the executive is in possession of material, nonpublic information.
- Insiders may lose the affirmative defense afforded by Rule 10b5-1 if changes or cancellations are deemed to have been made as part of a plan to evade insider trading laws. The "good faith" requirement cannot be overemphasized.

BEST PRACTICES

In order to maximize the flexibility and effectiveness of a 10b5-1 plan, our team recommends the following strategies:

- **Implement the plan on a portion of your holdings:** Some executives have the perception that a 10b5-1 plan to sell stock must involve all of their company shares. This is not the case. Implementing the plan on a portion of your shares offers you continued flexibility on the shares not in the plan, and may present a better signal to the market of your belief in the long-term prospects for the company.
- **Choose a short duration:** 10b5-1 plans can be implemented for any duration. However, we recommend setting them up for no longer than one year. This way, as market conditions change over time, the trading strategy can be adjusted without changing the plan while it is in effect.
- **Use the plan to exercise discipline:** Building specific price limits into a 10b5-1 plan allows you to create a disciplined strategy for transacting in company stock, which can help you avoid emotional bias that may lead to compromised financial decisions.
- **Set it and forget it:** The SEC has clearly identified situations involving 10b5-1 plans that are modified or canceled repeatedly as a sign of potential violations of the “good faith” requirement within the rule. Prior to implementation, corporate executives should think through the variables of a plan thoroughly, then allow the plan to proceed without change or cancellation, barring extreme circumstances. Even if the executive is not in possession of material, nonpublic information, changing or canceling a plan could give the appearance of insider trading in certain situations.
- **Use a seasoning period:** A common element of 10b5-1 plans is a built-in delay between when the plan is adopted and when the first transaction can occur. This “seasoning period” can strengthen the argument that the trades were not reliant upon any material, nonpublic information. The most common seasoning period is 30 days, although it can be shorter or longer depending on the executive’s circumstances and the company’s trading policies.

COMMUNICATION OF THE PLAN

Corporate executives often feel concerned about the impact their stock sales have on market perceptions. To minimize the risk of adverse publicity resulting from transactions executed by insiders under their 10b5-1 plans, we recommend the following techniques:

- Consider publicly disclosing new 10b5-1 plans through a press release, 8-K filing or reference in the next 10-Q filing. While there is no need to disclose the specific terms of the plan, an announcement should indicate that a plan was adopted.
- Include a time delay between the plan’s creation/ disclosure date and effective date for when transactions can occur.
- Footnote Form 4 and Form 144 filings with a statement identifying that the transactions occurred pursuant to an existing 10b5-1 plan.

ADDITIONAL APPLICATIONS

Supplementary strategies that can be built into a 10b5-1 plan worth noting include:

- **Purchasing stock:** Company insiders can establish a plan to purchase stock if the market price hits a desired entry point; plans can also be used to facilitate corporate share repurchases.
- **Stock vesting events:** Executives with restricted stock, restricted stock units, performance shares and other award types that have a future vesting date typically need to pay a tax withholding at the time of vest; sales required to fund the withholding can be built into a 10b5-1 plan.
- **Exercising options:** 10b5-1 plans can be used to exercise both non-qualified and incentive stock options if the executive is concerned about being in a corporate trading blackout when the option contracts are set to expire; the plans can accommodate any type of exercise method as well.
- **Personal milestone events:** Individuals with a specific future event that requires a significant cash outlay, such as a child's college education or a vacation home purchase, may use a 10b5-1 plan to generate the necessary liquidity.

TALK TO OUR TEAM

A Rule 10b5-1 plan is an effective tool available to public company executives. Navigating the complexities of insider trading regulations requires the assistance of a team with expertise in Rule 144, Section 16 and Rule 10b5-1. The Raymond James CES team has designed and executed 10b5-1 plans for thousands of clients over the years and is available to provide advice for developing a 10b5-1 strategy, drafting the necessary contracts and executing transactions according to the plan's instructions. Learn more at RJCES.com.

Meet our team, and learn how the experts at Raymond James can provide customized solutions for your business at RJCES.com.

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