

March 28, 2022

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

Ms. Vanessa Countryman
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington D.C. 20549-1090

Dear Ms. Countryman:

We are submitting this letter in response to the Commission's request for comments on its Rule 10b5-1 and Insider Trading proposal.

The Commission adopted Rule 10b5-1 in 2000 in order to provide companies, their directors and employees and other corporate insiders with a potential affirmative defense to insider trading liability under Section 10(b) of the Securities Exchange Act of 1934. The rule's benefits are available when, among other requirements, a trading plan is adopted at a time when the company or insider is not in possession of material nonpublic information, or MNPI.

Although companies and insiders are not required to employ Rule 10b5-1 plans, their use has become widespread and as practitioners giving advice on the rule for more than two decades, we have seen the rule's enormous utility in navigating the complex informational considerations that arise when a company or insider wants to trade in the company's securities. In particular, for many employees of the overwhelming number of companies who view equity compensation as an important component of their pay packages,¹ Rule 10b5-1 plans have become a widely used tool to ensure that they are able to realize the rewards of their work in a manner consistent with their legal responsibilities. That said, we are certainly familiar with the press and academic commentary that these plans have attracted from time to time, which may have had the unwarranted effect of raising public doubt about the purpose and operation of Rule 10b5-1 plans. For this reason, we welcome the Commission's efforts to improve public confidence in the use of Rule 10b5-1 plans, and the proposal incorporates important concepts we have long recommended as best practice.² We believe that some aspects of the proposal, however, run contrary to the purpose of the rule by introducing uncertainty over its availability and operation, or by making the rule's conditions unnecessarily difficult to meet. We hope the Commission will find our observations useful as it moves forward with this timely project.

¹ Morgan Stanley at Work (2022) "The State of Equity Plan Management 2022 Report: Equity Compensation and Talent Retention." According to the report, nearly all business leaders indicated that equity is an important component of compensation strategy, and approximately 80% expect the importance of equity compensation programs to increase over the next five years.

² E.g., Davis Polk & Wardwell LLP, "Rule 10b5-1 Plans: What You Need to Know" (Jan. 18, 2013), available at https://www.davispolk.com/sites/default/files/files/Publication/c0b412f9-d08e-4abf-a327-3f215728160e/Preview/PublicationAttachment/5dbd1bac-15b1-4b37-ae75-4388773478c4/011813_10b5_1.pdf.

Our comments in response to certain of the specific questions raised in the proposal follow.

Amendments to Rule 10b5-1

Cooling-Off Periods

1. *Is the proposed cooling-off period an appropriate condition to the Rule 10b5-1(c)(1) affirmative defense for contracts, instructions and written plans? Would a cooling-off period effectively reduce the potential to abuse the rule, such as from selective termination of trades?*

The proposal would require a mandatory cooling-off period of 120 days for officers and directors, and 30 days for companies, between the date of adoption or modification of a plan and the start of trading under the plan.

Officers and Directors

We support, in principle, a mandatory cooling-off period for officers and directors, because we believe that the benefit of promoting public confidence in the use of Rule 10b5-1 plans by insiders outweighs the potential inconvenience for officers and directors, many of whom are already subject to company policies that impose cooling-off periods. However, we think a more narrowly tailored approach would achieve the same benefit. As we see it, since the rule already includes a requirement that the insider not be in possession of MNPI at the time of plan adoption, and could therefore freely trade on that date, the purpose of a cooling-off period is to separate the act of plan adoption from the first trade under the plan as a concrete demonstration that trading under the plan does not benefit from any material discrepancy between what the insider and the public may know about the company's current results and prospects. Because this discrepancy, if any exists, is typically neutralized when the company makes its next earnings announcement, we believe the cooling-off period should be allowed to expire one trading day after the company's next earnings announcement covering at least one fiscal quarter and filed with or furnished to the Commission on Form 8-K, Form 6-K, Form 10-K, Form 10-Q or Form 20-F. Each such report would of course be subject to Rule 12b-20 and therefore contain, in addition to the information expressly required, any further material information as may be necessary to make the required statements, in the light of the circumstances under which they are made, not misleading.

We do not think immaterial modifications to a Rule 10b5-1 plan should trigger a new cooling-off period. An immaterial modification, in our view, would include any modification that does not change the pricing or volume terms of sales or purchases under the plan, including modifications needed to change the broker, to reflect changes resulting from stock splits or reclassifications or to update contact information. We would also treat suspensions of plans imposed by the company, rather than individual officer or directors, as exempt from triggering a new cooling-off period. For prudential reasons, companies sometimes suspend transactions under their officers' and directors' plans (for example, when the company is aware of the potential for a significant earnings miss, it may want to suspend insider selling activity), but would be reluctant to do so if this automatically meant a new cooling-off period would be triggered.

We believe that allowing the officer and director cooling-off period to be shorter than 120 days, depending on when in a company's earnings cycle the individual establishes their trading plan, and allowing immaterial modifications without triggering a new cooling-off period, would result in more widespread usage of Rule 10b5-1 plans and in fact would make it more likely that companies would require their officers and directors to use these plans for their personal trading. On the other hand, requiring an inflexible 120-day cooling-off period and denying the flexibility to make immaterial modifications is likely to discourage companies from maintaining policies that require their officers and directors use Rule 10b5-1 plans. This is moreover the

case because there are often times when directors and officers are subject to additional blackout periods outside of the normal earnings cycle and are therefore unable to enter into Rule 10b5-1 plans, which when coupled with the prohibition on overlapping trading arrangements, will make companies reluctant to encourage or require Rule 10b5-1 plan use.

Companies

We do not support a mandatory cooling-off period for companies, and believe that if one is required, companies will be discouraged from using Rule 10b5-1 plans for their share repurchase activities, which is the only significant use of the rule by companies. We note that companies do not use Rule 10b5-1 plans for selling securities, because generally speaking an issuer may only sell securities into the public market via a registration statement and prospectus that contain all material information about the company and the securities, and Rule 10b5-1 provides no exemption from this fundamental disclosure obligation enforced through Sections 11 and 12 of the Securities Act of 1933. (In view of this, we believe that if the Commission nevertheless adopts a cooling-off period for companies, it should revise proposed Rule 10b5-1(c)(1)(ii)(B) to remove the implication that sales of securities by an issuer can occur under a Rule 10b5-1 plan.)

We recommend that the Commission not mandate a cooling-off period for company share repurchases for several reasons. First, the proposing release does not cite any studies or other evidence to suggest a widespread practice of companies withholding favorable material information in order to buy back stock at artificially depressed prices. As a result there would appear to be no need to introduce company cooling-off periods into the rule. Second, even if a company were inclined to withhold materially favorable developments from the market, there is no reason to think a cooling off period would provide the incentive to change that. Indeed, in a rare enforcement case recently brought by the Commission involving a share repurchase program, the company apparently engaged in buyback activity while in possession of materially favorable MNPI for more than two months before announcing the favorable development.³ Third, as discussed below, a cooling-off period for companies would interfere with ordinary and legitimate practices in connection with accelerated share repurchase programs, or ASRs. Finally, effectively discouraging companies from using Rule 10b5-1 plans for their repurchase activity should not be expected to bolster public confidence in the integrity of the securities markets.

Any mandatory cooling-off period for company share repurchases would be especially problematic for ASRs, which are widely considered to be advantageous for companies and their shareholders because, among other things, they often allow companies to purchase their stock from a financial institution at a discount to the then-current trading price.⁴ Since the adoption of Rule 10b5-1, substantially all ASRs have been executed as Rule 10b5-1 plans. In a typical ASR, a company enters into an agreement with a financial institution to purchase a fixed dollar amount of its stock.⁵ The aggregate number of shares to be purchased is determined by the average price per share over the term of the ASR, often less a discount. At inception of the ASR, the company makes a cash payment to the financial institution, which, in turn, makes an initial delivery to the company of stock that it has borrowed. During the term of the ASR, the financial institution buys the stock in the open market in order to close out its open borrow position. The final average price per share over the term of the ASR is then determined at the end of the ASR, and the financial institution makes an additional delivery of stock to the company, or the company makes a payment or delivery of stock to the financial institution, as the case may be, based on such average price. A required 30-day cooling-off period would prohibit the use of a typically structured ASR and make companies use a “forward

³ *In the Matter of Andeavor LLC*, Rel. No. 34-90208 (Oct. 15, 2020).

⁴ Olivier Guéant, Iuliia Manziuk, Jiang Pu; “Accelerated Share Repurchase and other buyback programs: what neural networks can bring”; arXiv:1907.09753 (November 3, 2019). Tammy Whitehouse; “The pros and cons of using stock buybacks”; *Compliance Week* (August 9, 2016). Olivier Guéant; “Optimal execution of ASR contracts with fixed notional”; arXiv:1410.1481 (May 4, 2016).

⁵ While some companies do execute *fixed share* ASRs, these are relatively rare, as the discount, if any, provided to the company through a fixed share ASR as described below is smaller than for a fixed dollar ASR.

starting” ASR mechanism, in which there is a delay in the commencement of the stock repurchases. This delay would make the dealer’s costs more uncertain and undoubtedly increase the price paid by companies to repurchase their stock. As a result, the implementation of ASRs would become more challenging and the cost of buying stock through ASRs more expensive.

In addition, we note that requiring a mandatory cooling-off period for companies is particularly inappropriate in connection with a principal (rather than agency) transaction entered into between a company and a financial institution (like an ASR), because the company does not, directly or indirectly, control any aspect of purchases made by the financial institution during the term of the transaction (as it would through a grid-based Rule 10b5-1 plan executed by a financial institution, as agent for the company, where the company specifies the terms of the grid). Rather, the financial institution makes such purchases solely in a manner necessary to hedge its exposure with respect to the relevant transaction. As such, if the Commission nevertheless determines to impose mandatory cooling-off periods for company Rule 10b5-1 plans, we would recommend that only Rule 10b5-1 plans executed directly by the company, or by a financial institution acting as agent for the company, be covered.

If the Commission nevertheless determines to impose mandatory cooling-off periods for some or all company Rule 10b5-1 plans, we do not think the Commission should also adopt proposed Rule 10b5-1(c)(1)(ii)(D), which would seem to prohibit all non-plan repurchases after signing a Rule 10b5-1 plan, during the cooling-off period or otherwise. As with our broader concern over mandated company cooling-off periods, prohibiting repurchases outside a Rule 10b5-1 plan then in effect will simply drive companies away from using Rule 10b5-1 plans for their repurchase activity.

Finally, if the Commission nevertheless determines to impose mandatory cooling-off periods for some or all company Rule 10b5-1 plans, the Commission should not also prohibit overlapping plans pursuant to proposed Rule 10b5-1(c)(1)(ii)(D) where purchases under the plans do not themselves overlap. Otherwise companies that reevaluate their repurchase activity on a quarterly basis would effectively be barred from repurchase activity four months out of every year, depriving them and their shareholders from potentially favorable trading opportunities. Similar to the points we make in our comment letter of today’s date on the Commission’s *Share Repurchase Disclosure Modernization* rulemaking proposal (Rel. No. 34-93783 (Dec. 15, 2021)), we do not believe the Commission should use its rulemaking authority in order to discourage share repurchase practices that the Commission does not have Congressional authority to regulate outright.

2. *Should the application of a cooling-off period be limited to directors, officers (as defined in Rule 16a-1(f)) and issuers, as proposed? Should the proposed cooling-off period instead apply to all traders who rely on the Rule 10b5-1(c)(1) affirmative defense?*

As discussed in response to question 1, we believe cooling-off periods are appropriate for officers and directors. Cooling-off periods are not necessary for company Rule 10b5-1 plans and should not be mandated for the reasons we describe. Similarly, mandating cooling-off periods for insiders who are not officers or directors would merely discourage such insiders from using Rule 10b5-1 plans in the first place, which we do not believe would further the goal of investor confidence in the integrity of the public markets.

3. *Is the Rule 16a-1(f) definition the appropriate definition of “officer” for purposes of the proposed amendment? Are there other corporate insiders or employees who also should be subject to the cooling-off period?*

We believe the proposed definition is the correct one. A company’s Section 16 officers are its senior-most executives, the individuals most likely to possess MNPI, and the only executives who along with directors are required to file transaction reports on Form 4. Therefore it is trading by these individuals that is likely to

give rise to public doubts about the integrity of the securities markets, which we believe should be the primary rationale for a decision by the Commission to impose mandatory cooling-off periods. Including other employees within the mandate would likely discourage companies from requiring these employees to use Rule 10b5-1 plans, which as discussed in response to question 1 above would not further investor interests.

4. *Is the proposed 120-day cooling-off period appropriate for directors and officers? Should we require a shorter or longer cooling-off period? For example, should we require a cooling-off period of sixty days after the adoption of a new/modified trading arrangement or a cooling-off period of 180 days?*

Please see our response to question 1 above.

5. *Is the proposed 30-day cooling off period appropriate for issuers? Would a different period be more appropriate? For example, would a 60-day, 90-day, or 180-day cooling off period be more appropriate for issuers relying on the 10b5-1(c)(1) affirmative defense? If issuers were subject to the proposed requirements, how would their use of Rule 10b5-1(c)(1) trading arrangements to conduct share repurchases be affected? Would the proposed cooling-off period affect existing practices regarding when a repurchase window is “open” or “closed”?*

Please see our response to question 1 above.

6. *Should we define “modify” or “a modification” for purposes of Rule 10b5-1(c)? If so, how should we define these terms?*

Please see our response to question 1 above.

7. *Should there be an exception from the cooling-off period for de minimis changes to a Rule 10b5-1(c) trading arrangement? If so, what should be the parameters of such an exception?*

Please see our response to question 1 above.

Officer and Director Certifications

8. *Is the proposed certification requirement an appropriate condition to the availability of the Rule 10b5-1(c)(1)(ii) affirmative defense for directors and officers? Are there other ways that an officer or director could demonstrate that they do not possess material nonpublic information when adopting a trading arrangement?*

The proposal would require officers and directors to certify to the company that they are not aware of MNPI and they are adopting the plan in good faith and not as part of a scheme to evade the provisions of Section 10 of or Rule 10b-5 under the Exchange Act, and would require them to keep that certification for 10 years. But an officer or director’s certification in no sense “demonstrates” that the individual does not have MNPI, or is not adopting the Rule 10b5-1 plan for an improper purpose. At most, such a certification serves to remind the individual that these are required elements of the rule. Because an officer or director would ignore these requirements at their own peril, we see no need for the Commission to mandate a reminder.

Similarly, if the Commission did require certifications, we do not see any basis to impose a novel recordkeeping requirement. If an individual one day needed to rely on the affirmative defense, the fact that the individual might not be able to produce a document created almost a decade earlier, which merely

acknowledged the individual's understanding of how Rule 10b5-1 works, should not result in the individual being held liable for insider trading. That sort of consequence for misplaced paperwork would obviously be wildly disproportionate.

11. *The proposed instruction provides guidance that a director or officer should retain the certification for ten years consistent with the ten-year statutes of limitations that govern the Commission's insider trading actions. Should we instead require the issuer to retain the certification, either instead of or in addition to the director or officer? If so, how long should the issuer be required to retain the certification? Should we allow the individuals and issuers to develop their own retention policies for the certification?*

As noted in response to question 8, we do not think the Commission should create a new paperwork requirement. If certifications become required under a revised Rule 10b5-1, companies should be permitted to retain them in accordance with their internal recordkeeping policies.

12. *Should we specifically provide in the proposed amendments to Rule 10b5-1(c)(1)(ii) that the certification does not establish an independent basis of liability for directors or officers under Exchange Act Section 10(b) and Rule 10b-5?*

This question encapsulates our argument that certifications are not necessary in the first place. An officer or director who makes the certification is not actually proving that they meet Rule 10b5-1's eligibility requirements. Moreover there can be no independent liability for the failure to comply with an element of a non-mandatory regulation such as Rule 10b5-1.

Restricting Multiple Overlapping Rule 10b5-1 Trading Arrangements and Single-Trade Arrangements

13. *Are there legitimate uses of multiple, overlapping Rule 10b5-1 trade arrangements? If so, what are they? Is it appropriate to exclude from the affirmative defense multiple concurrent trading arrangements for open market purchases or sales of the same class of securities as proposed? Would the proposal create incentives for corporate insiders to own different classes of stock? Are there alternative approaches to addressing the concerns with multiple trading arrangements discussed above?*

The proposal would disallow the Rule 10b5-1 affirmative defense where a company or insider has overlapping trading arrangements for open market purchases or sales of the same class of securities, whether or not these overlapping trading arrangements are entered into in reliance upon Rule 10b5-1. The proposal justifies this requirement by saying the Commission is "concerned that a person could circumvent the proposed cooling-off period by setting up multiple overlapping Rule 10b5-1(c)(1) trading arrangements, and deciding later which trades to execute and which to cancel after they become aware of material nonpublic information but before it is publicly released." In addition, the proposal notes concern over "corporate insiders using multiple overlapping plans to selectively cancel individual trades on the basis of material nonpublic information."

Perhaps the Commission is concerned that an insider might enter into two opposite-way plans, and later, acting on the basis of MNPI, cancel whichever plan looks like it will yield less profitable trades. In the first instance, we would advise that entering into two opposite-way plans in this manner would be inconsistent with the current prohibition in Rule 10b5-1(c)(1)(i)(C) on "corresponding or hedging" transactions and the current requirement in Rule 10b5-1(c)(1)(ii) that plans be entered into in good faith. As a result we do not think Rule 10b5-1 needs to be amended to address this type of behavior. And in any case, this proposed

amendment is certainly not needed for companies, who as noted in response to question 1 cannot enter into in opposite-way Rule 10b5-1 plans in the first place.

It is in any event not clear how an overlapping plan could be used to “circumvent” a cooling-off period, unless cooling-off periods are being proposed simply to periodically block companies and insiders from trading, which is not authority the Commission possesses. The purpose of a cooling-off period is to nullify the possibility that trading under a particular Rule 10b5-1 plan will benefit from the existence of MNPI—with respect to any particular plan, that purpose is satisfied by the plan’s cooling-off period even if another same-way plan is currently operating. Nor would trading outside of a currently effective Rule 10b5-1 plan—which as noted above appears to be covered by the prohibition on overlapping plans—in any way “circumvent” the cooling off period. If a company or insider trades during the cooling off period outside of a Rule 10b5-1 plan, those trades will not have the benefit of the affirmative defense. The defense would be available only for the trades that followed the cooling-off period. As described above, the imposition of a mandatory 120-day cooling-off period along with additional company-imposed blackout periods on insiders, coupled with the prohibition on having overlapping plans, would mean that plan adoption and therefore transactions could only take place during limited times of the year, making plans unattractive for financial planning purposes and increasing the likelihood that companies and insiders would decline to use them.

And in fact there are legitimate and customary uses of multiple, overlapping Rule 10b5-1 company repurchase plans. For example, companies often enter into agency open-market repurchase plans with financial institutions at the same time they are party to ASR agreements to achieve the benefits of dollar-cost averaging (which cannot be achieved through an ASR). Companies may also choose to enter into multiple, overlapping share repurchase plans or ASRs—including multi-dealer, alternating day ASRs—in order to further reduce the cost of share repurchases using an ASR and limit credit exposure to any one financial institution counterparty. As a result, an unintended consequence of the adoption of a prohibition on overlapping plans could be that companies would forgo using Rule 10b5-1 for certain trading plans when entering into multi-plan strategies for share repurchases.

If the Commission nevertheless moves forward with prohibiting companies from operating overlapping Rule 10b5-1 plans, in addition to excluding employee stock ownership and dividend reinvestment plans from the prohibition, the Commission should exclude trading plans entered into in order to satisfy tax withholding obligations relating to equity incentive compensation awards. Many companies permit, or even require, employees to use “sell-to-cover” arrangements, which typically rely on Rule 10b5-1, to satisfy tax withholding obligations that arise in connection with the vesting or settlement of equity incentive awards. Under these arrangements, the company will typically direct a third-party broker in advance to sell on the applicable vesting or settlement date a number of shares sufficient to satisfy the applicable tax withholding obligation. Notably, the vesting or settlement date is set by the documentation governing the equity incentive award and not the volition of the insider. Some insiders have multiple plans that are each tied to a specific grant of equity awards, solely for this purpose. Under the proposal, insiders who seek to implement another type of trading plan during an overlapping period will no longer be able to use the Rule 10b5-1 affirmative defense in connection with these “sell-to-cover” arrangements. As a result, they would be required to satisfy withholding taxes on their equity incentive awards in cash or rely on their employers to withhold shares to pay taxes, which may pose undue burdens on companies in administering their compensation plans.

15. *Is it appropriate to limit the availability of the Rule 10b5-1(c)(1) affirmative defense for single-trade plans as proposed? If not, are there alternative approaches to addressing concerns about the potential abuse of single-trade plans? Would the proposed cooling-off periods sufficiently mitigate the potential to misuse single-trade plans to execute trades based on material nonpublic information? Alternatively, would the limited availability of the*

Rule 10b5-1(c)(1) affirmative defense for single-trade plans as proposed still allow for potential abuse? Should we consider prohibiting the use of single-trade plans entirely?

We believe the prohibition on single-trade plans will simply introduce uncertainty into the availability of the Rule 10b5-1 affirmative defense. Certainly if such a prohibition is introduced into the rule, no one will enter into a plan that explicitly says the entire trade is to be executed “in a single transaction,” in the words of proposed Rule 10b5-1(c)(1)(ii)(D), and in fact it may become commonplace to insert language in Rule 10b5-1 plans specifying that multiple transactions must be used to buy or sell all shares covered by the plan even if, after any required cooling-off period, the plan’s objectives can be satisfied in a single trade. Whether this type of solution will ensure the availability of the affirmative defense, or will be viewed in hindsight as an “evasion,” is unknowable.

Requiring That Trading Arrangements Be Operated in Good Faith

16. *Would the addition of “and operated” to the good faith requirement in Rule 10b5-1(c)(1)(ii), as proposed, have a meaningful impact? If not, what are alternative approaches that would address the concern over the manipulation of the timing of corporate disclosures to benefit a trade under a Rule 10b5-1(c)(1) trading arrangement?*

The proposal would require that Rule 10b5-1 plans be “operated” in good faith. Since Rule 10b5-1 provides an affirmative defense and not a safe harbor, and current Rule 10b5-1(c)(1)(ii) already includes an anti-evasion element, we do not see how this proposal would improve the rule. Certainly if an insider were manipulating the release of corporate disclosures in order to benefit their trading returns, we would advise that the affirmative defense would be useless. Instead, we think including this language in the rule would make availability of the rule’s potential protections less certain, and therefore likely disincentivize companies from using Rule 10b5-1 trading plans or requiring their officers and directors to use them. We don’t see how that would foster investor confidence in the public markets.

It is worth noting that some companies shut down trading under Rule 10b5-1 plans when extraordinary events occur. For example, if a company receives an attractive takeover proposal (even one that is very preliminary or uncertain and therefore not yet “material” under traditional concepts of materiality), it may halt ongoing buyback activity under a Rule 10b5-1 plan in order to prevent repurchases at prices lower than the takeover bid. On the other hand, if a company becomes aware of significant and unexpected unfavorable information, it may want to halt sales of stock by its insiders for reputational reasons. Analyzing whether any of these courses of action would violate an “operational” good-faith requirement separate and apart from the existing anti-evasion requirement would be a challenge, and ultimately render the rule less attractive. We believe the Commission should look for ways to make the rule more attractive to use, not less.

17. *Is there evidence to suggest that corporate insiders influence the timing of corporate disclosures to benefit their trades under a Rule 10b5-1 trading arrangement? Is there evidence to suggest that any efforts to time corporate disclosures would not be sufficiently mitigated by the 120-day cooling-off period?*

We know of no evidence to suggest that corporate insiders influence the timing of corporate disclosures to benefit their trades under a Rule 10b5-1 plans. If this sort of behavior were to occur, the benefits of the rule would already be forfeited by virtue of the anti-evasion provisions of current Rule 10b5-1(c)(1)(ii). Therefore we believe that adding this language to Rule 10b5-1 would only introduce uncertainty as to the availability of the rule, thereby decreasing the rationale for using it. We do not see how that would benefit investors.

Additional Disclosures Regarding Rule 10b5-1 Trading Arrangements

Quarterly Reporting of Rule 10b5-1(c) and Non-Rule 10b5-1(c) Trading Arrangements

21. *Would the disclosures in proposed Item 408(a) provide useful information to investors and the markets? Does the proposed disclosure requirement specify all of the information that should be disclosed as to registrants' trading arrangements? Does the proposed disclosure requirement specify all of the information that should be disclosed as to trading arrangements of officers and directors? Are there other disclosures that we should require that would provide more transparency into the use of Rule 10b5-1 and non-Rule 10b5-1 trading arrangements? Is there any information that we have proposed to require be disclosed that we should not require? We are proposing disclosure about trading arrangements both for registrants and for officers and directors. Should we instead require disclosure about only one of those categories of traders? Should we consider requiring disclosure of trading arrangements of insiders who are not officers or directors? If so, at what level of specificity?*

The proposal would require quarterly disclosure of any Rule 10b5-1 and non-Rule 10b5-1 plans adopted in the prior quarter, including disclosure of the “material terms” of any such plans. The pricing terms of a transaction are typically considered material in the context of that transaction. We hope the Commission is not suggesting that the pricing parameters in a Rule 10b5-1 plan need to be disclosed, and would appreciate clarity on this point. Disclosing pricing terms would obviously expose companies and their insiders to front-running by hedge funds and other professional traders. If the pricing is set lower than the current stock price, insiders may be publicly criticized as anticipating stock price declines. Wide variation in pricing terms among executives established for personal financial planning reasons may fuel additional public speculation, and ultimately executives would therefore feel forced to set pricing terms that are highly optimistic for reputational reasons, which would limit their ability to actually sell shares under the plans. And in any event, the public will receive actual pricing information through Form 4 reports and periodic reporting pursuant to Item 703 of Regulation S-K and similar requirements in Form 20-F.

22. *Would a description of the material terms of a trading arrangement encourage front-running of trades under the trading arrangement? Should the required disclosures be limited to particular terms of a trading arrangement?*

Please see our response to question 21 above.

24. *Is it appropriate to require disclosures regarding both Rule 10b5-1 trading arrangements and non-Rule 10b5-1 trading arrangements? Is the scope of the term “non-Rule 10b5-1” sufficiently clear? Should we define the term?*

We do not understand what the Commission means by “non-Rule 10b5-1 trading arrangements,” which is how the release refers to “pre-planned trading contracts, instructions, or plans” not carried out in accordance with Rule 10b5-1. All securities trading is done via a pre-planned trading contract, instruction or plan. Trading doesn't happen accidentally or unexpectedly.

Disclosure of Insider Trading Policies and Procedures

27. *Would the proposed disclosure requirements regarding a registrant's insider trading policies and procedures or lack thereof provide useful information to investors? Is there other information that would be useful to include in Item 408(b)?*

The proposal would require annual disclosure of a company's insider trading policies and procedures. The proposed rules do not specify which details a company should disclose about its plan, although the proposal does specify that companies should try "to provide detailed and meaningful information" about any such plans. While we believe that the disclosure of the existence of an insider trading policy could be of some benefit, we do not think that the specifics of individual corporate trading policies would provide much useful information to investors. For example, the proposal states that "investors may find useful, to the extent it is included in the issuer's relevant policies and procedures, information on the issuer's process for analyzing whether directors, officers, employees, or the issuer itself when conducting an open-market share repurchase have material nonpublic information; the issuer's process for documenting such analyses and approving requests to purchase or sell its securities; or how the issuer enforces compliance with any such policies and procedures it may have." Whether or not some investors might find this level of detail "useful," the touchstone for disclosure mandates is materiality to reasonable investors, not usefulness to particular investors, and it is exceedingly difficult to see how there would be a "substantial likelihood" that a "reasonable shareholder" would consider minute details such as those cited in the release to be "important" in making an investment or voting decision, in the words of the Supreme Court in *TSC Industries, Inc. v. Northway, Inc.* (1976).

Disclosure Regarding the Timing of Option Grants and Similar Equity Instruments Shortly Before or After the Release of Material Nonpublic Information

37. *To what extent does the board of directors or compensation committee currently consider the impact of granting option awards made close in time to disclosure of material nonpublic information? What type of effect would the proposed disclosures have on the timing and granting of option awards if this requirement for Item 402(x) were adopted?*

The proposal would require companies to include in their annual proxy statements tabular disclosure under new Item 402(x) of Regulation S-K relating to stock option awards granted to the company's named executive officers and directors within 14 calendar days before or after (i) the filing of a periodic report (e.g., Form 10-K or Form 10-Q), (ii) the filing or furnishing of a current report on Form 8-K that includes MNPI (e.g., the earnings release, but potentially including any Form 8-K report) and (iii) an issuer share repurchase program (we refer to this time period as the "coverage window"). The new Item 402(x) would also require a company to provide narrative disclosure regarding its option-granting policies and practices, including the timing of option grants and the release of MNPI, how the board determines when to grant stock options and whether and how MNPI is taken into account.

As currently proposed, we believe that the proposal mistakenly suggests that suspect granting practices are involved or that stock options are otherwise intended to be "spring-loaded" or "bullet-dodging" merely because the stock options were granted near the time of a company's release of MNPI.

We are concerned that, as a practical matter, the coverage window of 14 calendar days both before and after the release of MNPI (i.e., a total period of 28 calendar days for each issuance of MNPI) is overly broad. As noted by the Commission in the proposing release, a typical company issues multiple filings with MNPI in any given year. In fact, when a company files or furnishes a report with the Commission, the presumption is that it contains material information that it has not yet disclosed—otherwise the information would not need to be included in the report. As a result, and perhaps contrary to what the Commission expects, most companies will not be able grant options in what the Commission may think of as a "clear" window, because most companies would only have a limited number of periods in a year (if any) when it could grant stock options to officers and directors without triggering the new proposed disclosure. In addition, it is not uncommon for a company to file a Form 8-K with its earnings release and then, several days or weeks later, file a periodic report that does not disclose any additional MNPI. However, under the proposal, the coverage window would be triggered by both filing dates even though no additional MNPI is

disclosed in the later periodic report versus the Form 8-K, and trying to parse whether the additional disclosures in the periodic report might be “material” would be sufficiently time-consuming that most companies will simply assume that they are. These concerns may have a direct impact on a company’s design of its compensation program, causing companies to be more reluctant to grant stock options, which have served as a useful compensatory tool for many companies.

Moreover, it is a common practice for a company’s board of directors (or its compensation committee) to make annual compensation determinations for the company’s named executive officers during the beginning of the company’s fiscal year, which often will overlap with the timing of the Company’s filing of its annual report on Form 10-K and its earnings release. Given the scope of the proposed rule (particularly, the length of the coverage window), a company that has a long-standing, consistent year-over-year practice for approving annual named executive officer compensation (including the grant of stock option awards) would nonetheless be required to provide the additional proposed disclosure for routine annual stock option grants.

Because the proposal would capture a large number of ordinary course stock option grants, we would not expect the additional disclosure to help investors distinguish the infrequent scenarios that involve “spring-loaded” or “bullet-dodging” grants from legitimate and routine option grants. Instead, the additional disclosure would likely result in companies (including the directors who approve the grants) and the individual executives receiving those grants facing unwarranted scrutiny from investors and potential reputational harm.

Accordingly, we respectfully request that the Commission remove the proposed additional option grant disclosure requirements under Item 402(x) from the final rule. If, however, the additional option grant disclosure under Item 402(x) is kept in the final rule, we would suggest that the Commission tailor the scope of the proposed new tabular and narrative disclosure rules, including by reducing the length of the coverage window.

39. *The proposed disclosure requirements under new Item 402(x) would apply to option awards made within a 14-day period before or after the filing of a Form 10-Q or the filing (or furnishing) of a Form 8-K containing material nonpublic information with the Commission. Is the proposed 14-day time period appropriate? Should the period be longer or shorter than 14 days, and if so, what time period would be appropriate? What percent of option grants would be included in this disclosure based on these reporting windows?*

As noted in response to question 37, we expect that for most companies, all or nearly all option grants will be made within the 28-day period specified in the proposed rule, with the result that the disclosures will be meaningless and therefore ignored by the market.

40. *Is a one-day period after the disclosure of material nonpublic information a sufficient period for the material nonpublic information to be reflected in the market price of the issuer’s securities? Is a one-day period prior to the disclosure too late to reflect the change in the share price to the extent that the material nonpublic information may have been previously disclosed to the market (e.g., leaked)? Should the window for measuring the change in market price based on the release of material nonpublic information be longer or shorter?*

We believe one trading day is long enough for MNPI to be assimilated by the market and so advise clients. We would however caution the Commission against presuming that investors will be able to discern problematic pay practices based on share price movements following a company’s filing or furnishing of a Form 8-K or other report. Stock prices go up and down, and more often than not this is the result of macroeconomic, industry or market factors having nothing to do with a specific company’s SEC reporting.

As a result we are concerned that the new disclosures to be required by proposed Item 402(x) will be of more interest to the plaintiffs' bar than to investors.

Reporting of Gifts on Form 4

43. *Should we require dispositions by gifts of equity securities to be disclosed Form 4 instead of Form 5, as proposed?*

The proposal would significantly change Section 16(a) reporting requirements for gifts by requiring insiders to disclose any bona fide gift on a Form 4 within two business days after the gift is made. This despite the fact that the Commission has long been of the view, reflected in Rule 16b-5, that a bona fide gift of securities by a Section 16 insider is an exempt transaction and therefore not subject to the short-swing profit disgorgement rules under Section 16(b). As the Commission noted in the course of adopting Rule 16b-5, bona fide gift transactions "generally do not provide opportunities for speculative abuse."⁶

Neither the Commission nor the federal courts have historically considered gifts to be the type of transaction that gives rise to the same level of concern as the open market transactions that Section 16 was intended to address. As a result, a bona fide gift of securities is currently eligible for deferred reporting on Form 5, which must be filed with the Commission within 45 days after the end of issuer's fiscal year. (Notwithstanding this flexibility, many insiders currently voluntarily report gifts earlier on a Form 4.)

We note that the Commission is proposing this reporting change to provide investors with information to evaluate gift transactions in light of perceived "problematic" practices, which the Commission indicates could include gifting while in possession of MNPI or backdating gifts in order to maximize donor's tax benefit. The proposal does not take into account that reportable gift transactions under Section 16(a) are not only triggered upon gifts made to third-party charitable organizations, but also in connection with certain gifts made by an insider to estate planning vehicles established by the insider (e.g., trusts, limited partnerships, limited liability companies or similar vehicles) or gifts between such trusts or estate planning vehicles, where the insider retains control and economic interest over the shares after the gift. We do not believe these types of gifts should be subject to the two-day reporting requirement because they do not present the same type of "problematic" practices for which the Commission appears to be concerned as in the context of gifts to third-party charitable organizations. Moreover, as it relates to the Commission's concerns in respect of perceived abuses relating to an insider-donor maximizing his or her tax benefits in connection with a gift, we think this concern would be better addressed by the Internal Revenue Service.

We also believe that the proposed reporting deadline for bona fide gifts would pose significant compliance and administrative burdens on Section 16 insiders (as well companies who routinely make Section 16(a) filings on behalf of their insiders). Specifically, given the complexity of certain estate planning transactions involving gifts (including, for example, gifts of equity securities among trusts established by an insider and gifts of interests in limited partnerships or limited liability companies established by an insider for estate planning purposes), insiders, companies who file on their behalf and their advisors will often spend substantial time and resources analyzing these transactions to ensure proper reporting in compliance with Section 16. By providing for a sweeping requirement that all bona fide gifts be reported on a Form 4 within two business days, the proposal places undue administrative burdens and compliance costs on insiders and issuers in respect of transactions that are exempt from the short-swing profit disgorgement rules under Section 16(b).

⁶ *Ownership Reports and Trading by Officers, Directors and Principal Security Holders*, Rel. No. 34-27148 (Aug. 18, 1989).

General Request for Comment

Transition Considerations

The proposal does not clarify how the amendments would apply to Rule 10b5-1 plans already in effect at the time of the proposed amendments' effectiveness. In particular, the proposal does not address the status of trades made after effectiveness of the amendments but pursuant to a trading plan finalized previously. We believe it would be helpful for the adopting release to clarify that Rule 10b5-1 plans adopted prior to effectiveness of the amendments need only comply with the terms of the rule in effect at the time of adoption, including with respect to trading that occurs under such plans after the effectiveness of the proposed amendments.

Charitable Giving and Due Process

Finally, we wish to note a particular concern involving the Commission's interest in charitable giving of stock by corporate insiders. Similar to the preliminary note in current Rule 10b5-1, paragraph (b) of the proposed revision to Rule 10b5-1 states as follows:

"Subject to the affirmative defenses in paragraph (c) of this section, a purchase or sale of a security of an issuer is on the basis of material nonpublic information for purposes of Section 10(b) and Rule 10b-5 if the person making the purchase or sale was aware of the material nonpublic information when the person made the purchase or sale. The law of insider trading is otherwise defined by judicial opinions construing Rule 10b-5 and this section does not modify the scope of insider trading law in any other respect."

Because illegal insider trading is a crime, we believe important due process considerations underlie the Commission's clear statement in the current preliminary note, and in the proposed revision to paragraph (b), that the rule does not modify the scope of insider trading law other than to equate trading while "aware" of MNPI with trading "on the basis of" such MNPI. In other words, the Constitutional guarantee of due process means, at a minimum, that the public must have unambiguous advance notice of what kind of activity is sanctionable under the criminal law.

We are concerned that language in the proposing release purporting to illustrate the application of Section 10(b) to gifts of securities is inconsistent with the statement quoted above, because it appears to represent an extension or modification of the law of insider trading. As the Commission may be aware, it is not uncommon for shareholders to make charitable gifts of stock in late December in order to obtain an income-tax deduction for the current year, and it is also not uncommon for charitable organizations to sell securities upon receiving them. Many companies are in a "blackout" period at the end of December because of the potential existence of MNPI as the fiscal quarter or year draws to a close, and as a result it is not uncommon for charitable giving to occur during a blackout period. Yet in footnote 55 of the proposing release, the Commission states that:

"[A] donor of securities violates Exchange Act Section 10(b) if the donor gifts a security of an issuer in fraudulent breach of a duty of trust and confidence when the donor was aware of material nonpublic information about the security or issuer, and knew or was reckless in not knowing that the donee would sell the securities prior to the disclosure of such information."

The proposing release does not cite judicial (or Commission) precedent for this statement, or explain the circumstances under which a charitable gift would involve a "fraudulent breach of a duty of trust and confidence." If the Commission intends to criminalize commonplace activity, we do not think it fair to do so in a brief sentence in a footnote to a proposing release. Instead, we believe the Commission should clearly

explain the basis for its conclusion, and also provide guidance as to how a shareholder who may be aware of MNPI is able to make a charitable donation of securities without running afoul of the insider trading laws.

For example, consider a charitable gift of securities made by a donor who is an officer or director of the issuer. If the donation is made in accordance with the issuer's insider trading policy which permits charitable gifts during a blackout period, we believe the Commission should clarify that this would be sufficient to demonstrate that the donation was not made in fraudulent breach of a duty of trust and confidence. We also believe the Commission should clarify that the donor is able to avoid insider trading liability by obtaining the charitable donee's commitment not to dispose of the securities until any MNPI known by the donor at the time of the donation has become public or stale.

* * *

We appreciate the opportunity to participate in the Commission's rulemaking process, and would be pleased to discuss our comments or any questions that the Commission or its staff may have, which may be directed to Joseph A. Hall, Michael Kaplan, Mark M. Mendez, Ning Chiu or Travis Triano of this firm at [REDACTED].

Very truly yours,

Davis Polk & Wardwell LLP