BANK OF AMERICA

RETIREMENT & BENEFIT PLAN SERVICES

Workplace Insights™

Navigating company stock regulations with Rule 10b5-1 trading plans

Best practices for helping your key executives create well-structured trading programs

Competitive equity compensation is essential for companies looking to attract, reward and retain top executives. To ensure executives' interests are aligned with the shareholders', packages frequently include complex performance awards. Maximizing the value of those equity awards plays a critical role in executives' ability to build wealth and achieve their financial goals.

But managing equity programs can be complicated for employers and executives, who must carefully follow U.S. regulations as well as the company's insider trading policy. In fact, more than 70% of companies cited compliance factors as the biggest challenge in offering equity awards.[1]

Rule 10b5-1 trading plans can help employers and executives make the most of equity compensation programs while safely navigating these challenges. These written contracts allow executives to plan in advance the amount, price and dates on which they trade securities. Structured properly, the plans offer a way for executives to monetize equity compensation while providing an affirmative defense against charges of trading based on material, nonpublic information about the issuer and its securities.**

Bank of America has years of experience working alongside employers to create effective Rule 10b5-1 trading plans for thousands of top executives. In this paper, we present key considerations for supporting your executives through the plan design and adoption process. You may then be in a better position to help them integrate the plans within their broad, long-term financial strategies.

What's in a name?

Rule 10b5-1 trading plans are named for Rule 10b5-1 under the Securities Exchange Act of 1934 (Exchange Act), which provides an affirmative defense to a claim of insider trading under section 10(b) of the Exchange Act and Rule 10b-5 thereunder for stock transactions made pursuant to plans or instructions entered into when the insider had no material, nonpublic information. Concern over running afoul of insider trading laws and rules can lead executives to forgo company stock sales, hampering their liquidity and ability to diversify.*

Use of Rule 10b5-1 trading plans has grown.

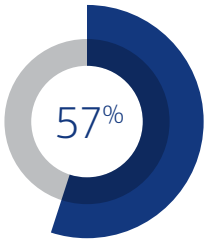
The percentage of publicly traded companies with insiders using Rule 10b5-1 trading plans is increasing.

Source: Rule 10b5-1 Growth, Companies with Rule 10b5-1 Plans as of December 31, 2020, The Washington Service.

More insiders are using Rule 10b5-1 trading plans

Use of Rule 10b5-1 trading plans at publicly traded companies is on the rise:

- 15% of companies had insiders using Rule 10b5-1 trading plans in 2009.[2]
- 28% of companies had insiders using Rule 10b5-1 trading plans in 2020.[2]



They are most commonly used at large companies such as those that make up the S&P 500 (57% of companies in the S&P 500 had insiders using Rule 10b5-1 trading plans in 2020[3]) and in sectors with relatively frequent trading blackouts, such as technology and pharmaceuticals. Senior executives, such as CEOs, CFOs and other titled executives, are typically the greatest users of Rule 10b5-1 trading plans at companies that allow them.

"A 10b5-1 trading plan can be an effective way to liquidate company stock holdings for insiders who otherwise might get shut out of open market sales because of inside information," says David H. Engvall, a partner with Covington & Burling LLP, who specializes in securities law. "Although each company's circumstances are unique, very often executives — even CEOs — can find a window in which to safely enter into a plan."

Despite their increased use, many top executives are still unaware that Rule 10b5-1 trading plans exist or are unsure of how to take advantage of them. That's where you, the employer, can offer guidance.

Rule 10b5-1 trading plans defined

A Rule 10b5-1 trading plan is a binding contract, instruction or written plan that specifies the amount, price and dates on which executives will trade company stock, or provides a formula for determining such items, and meets the other conditions of Rule 10b5-1. Once a plan is established, the executive cannot influence trading under the plan.

78% of companies that allow Rule 10b5-1 trading plans review and approve their insiders' plans.[4]

Source: thecorporatecounsel.net 2017 survey.

The important role of employers in Rule 10b5-1 trading plans

Unlike other executive benefit programs, Rule 10b5-1 trading plans are not set up by companies on behalf of their employees. Instead, company insiders establish their own plans and are responsible for ensuring that they align with U.S. Securities and Exchange Commission (SEC) rules and the company's insider trading policy. Properly structured plans can provide an affirmative defense against insider trading, but they do not prevent investigation for trades made under the plan. Executives still must demonstrate that their trades were made in good faith based on the plan and not on material, nonpublic information.

In fact, regulators in recent years increasingly have examined Rule 10b5-1 trading plans for signs of misuse. Some companies have responded to greater regulatory scrutiny by waiting to offer their insiders the ability to adopt the plans until the SEC provides greater clarity about whether it will tighten rules. But Engvall notes that most recent investigations that were publicized involved plans that were not properly structured or prudently applied.

Companies that choose to take a more proactive approach can help insiders create well-structured Rule 10b5-1 trading plans that are less likely to fall under regulatory scrutiny. "There's no reason not to proceed with Rule 10b5-1 trading plans as long as you follow best practices that help you stay within the letter and the spirit of the rule," says Engvall. Companies can use their insider trading policies to provide guidelines that help insiders and their brokers design compliant Rule 10b5-1 trading plans. Then, companies can review trading plans before implementation to ensure insiders have followed those guidelines appropriately.

An important note: Companies that approve trading plans should alert brokers when the plans must be suspended or canceled due to changing circumstances, such as a secondary offering, bankruptcy or a merger/acquisition. A small minority of employers prefer not to assume this burden. However, this hands-off approach is not likely to advance the goal shared by the insider, the company and the brokerage firm: to help insiders benefit fully from equity compensation while staying in compliance with insider regulations and policies.

"The company should be involved in the adoption of any plan, and there has to be coordination between the company, the insider and the broker once a plan goes into effect," says Engvall. "It's in the company's interest to stay on top of these plans to make sure there are no glitches that could create a risk that the plan does not provide the protection intended."

Consult with your legal counsel to make sure plans are well structured.

Key considerations for plan design

When setting guidelines for Rule 10b5-1 trading plans, companies must give careful thought to several key elements of the plans' designs. Consulting with legal counsel is necessary to ensure that the company's guidelines will result in well-structured plans. Here are some of the most important issues to consider:

Plan adoption, amendment and termination

A Rule 10b5-1 trading plan may only be created when the insider is not in possession of any material, nonpublic information about the company and its securities. As a result, insiders typically establish plans during open trading windows. Companies also can require that insiders starting a plan certify in writing to a compliance officer that they are not in possession of material, nonpublic information. (Most Rule 10b5-1 agreement forms used by brokerage firms also require that their clients make this representation.)

Changes or amendments to a plan most frequently occur under the conditions of an open trading window. The reason: When an insider changes or amends a plan, regulators consider it an entirely new plan. But even when handled properly, changes to an existing plan could call into question the insider's good faith and weaken his or her affirmative defense. For this reason, some companies limit the number of amendments an insider can make to an existing plan.

Likewise, terminating a plan can put an insider's prior trading activity under scrutiny. For that reason, some companies either prohibit plan terminations or allow them only in the open trading window, with prior approval from company counsel or upon receipt of a statement from the employee that he or she does not possess material, nonpublic information.

Because of the risks involved with plan amendments and termination, it's essential to minimize the need for them. To that end, companies should remind insiders to think carefully about all aspects of a plan's design when they establish it.

"Although each company's circumstances are unique, very often executives — even CEOs — can find a window in which to safely enter into a plan."

— David H. Engvall, Covington & Burling LLP

Many companies use plan durations that last from six months to two years.

Source: Covington & Burling LLP, 2020

Don't send the wrong message to the markets.

Consult your personal attorney as facts and circumstances for each insider and issuer can vary.

Length of plans

Rule 10b5-1 does not specify a minimum or maximum amount of time that a trading plan can cover. Insiders should align their plans with the spirit of the rule, which was intended to provide executives an opportunity to transact shares systematically over time.

A very short-term plan, such as one that covers only a month or two, could raise questions about an insider's lack of material, nonpublic information. On the other hand, a plan that covers several years is more likely to require amendments as the insider's or the company's circumstances change.

Many companies use plan durations that last from six months to two years, according to Engvall, but the ideal length for a plan will depend on each insider's personal circumstances. For example, a plan's time period must take into account the insider's upcoming equity events, which may include option grants expiring during a closed window, or lapsing restricted stock awards that will require the employee to "sell to cover" to satisfy his tax obligation. Or, executives at companies that recently have gone public might feel that the stock's short trading history makes it difficult to establish appropriate limit order prices, which is the minimum price that the shares need to reach in order for the trade to execute. These insiders could choose shorter plans — such as those lasting six or nine months — to provide an affirmative defense for the time being while allowing them to revisit limit order prices when they establish their next plans.

Selecting shares to sell

Insider sales are monitored closely, and an insider selling a large percentage of his or her holdings can send the wrong message to the markets. That's why companies should review the number of shares an insider intends to sell prior to approving a plan.

For example, an employer might suggest reducing the size of the sale if an insider's plan calls for liquidating more than 40% of his or her shares. Some companies help insiders determine an appropriate volume of shares to sell by including a yearly volume limit, such as 15% to 20%, in their trading plan guidelines, according to Debbie McGrath, director, Executive Advisory Services for Bank of America.

Companies also should review the specific shares or options that an insider intends to sell to ensure that a plan meets all ownership guidelines and regulatory or contractual restrictions, such as the Section 16 "short swing profit" rule and Rule 144 volume restrictions.*** Busy insiders are unlikely to remember all such rules and restrictions governing their sales.

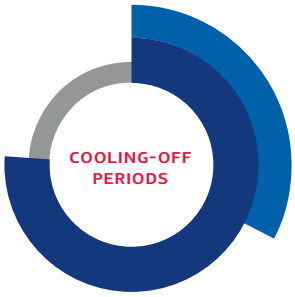
Consider the following hypothetical case study:

Hypothetical Case Study

A member of the board of directors at a company established a plan to divest a large block of shares. He had forgotten about a contractual restriction he had with an underwriter that prohibited him from selling more than $250,000 worth of the securities. Fortunately for the insider, legal counsel for the issuer reviewed the details of the plan and caught the error before the plan was enacted.

The case study presented is hypothetical and does not reflect an actual client. It is for illustrative purposes only and results will vary.

Legal experts recommend including cooling-off periods in plans.



76.1%

of companies with Rule 10b5-1 trading plans require cooling-off periods.

32.6%

of companies with cooling-off periods said the duration was one month.

Source: thecorporatecounsel.net 2017 survey.

Cooling-off periods

Cooling-off periods mandate a length of time during which trading is prohibited after a Rule 10b5-1 trading plan is adopted. The SEC does not require cooling-off periods, but many legal experts recommend them. David Engvall says including a cooling-off period that lasts from 30 to 90 days can help insulate the insider from doubts that he or she lacked material, nonpublic information when initiating the plan.

Consider the following hypothetical case study:

Hypothetical Case Study

A senior executive at a pharmaceutical company scheduled his new Rule 10b5-1 trading plan's first trade for the day after the plan was adopted. The trade was executed the following day in accordance with the plan's limit price parameters. That evening, the company issued a press release detailing disappointing results for a drug in the final stages of clinical trials.

The executive became concerned that regulators would assume he scheduled his sale based on advance knowledge of news that was likely to cause the stock to fall. He called his broker to attempt to cancel the trade and learned that the trade under his Rule 10b5-1 trading plan could not be canceled. So he had to face potential scrutiny of his plan — a situation that a cooling-off period may have prevented.

The case study presented is hypothetical and does not reflect an actual client. It is for illustrative purposes only and results will vary.

Simple vs. complex trading schedules

Insiders have a great deal of freedom when designing trading schedules for their Rule 10b5-1 trading plans: They can specify the number of shares to sell, the dates for transactions, the limit price for sales and other stipulations. That said, legal experts recommend keeping trading schedules simple and straightforward to avoid potential problems. "A consistent pattern of sales over time is generally less likely to raise concerns than quick sales that unload large volumes of shares at once," says Engvall.

Complicated trading instructions, such as those that use algorithms to determine when to sell and how many shares to include, could be difficult to administer and lead to trading errors. And if a plan is so complicated that regulators can't understand how an insider determined the price or timing of sales, it could potentially weaken the insider's affirmative defense.

"A consistent pattern of sales over time is generally less likely to raise concerns than quick sales that unload large volumes of shares at once."

— David H. Engvall, Covington & Burling LLP

By contrast, consider the following hypothetical case study that illustrates a simple trading schedule:

Hypothetical Case Study

The CFO of a publicly traded company is planning to retire in a year. He realizes that close to 78% of his assets come from company stock, stock options and restricted stock grants. He needs to diversify, so he works with his advisor to create a plan to sell 20% of his holdings, or 60,000 shares, over six months. The plan imposes the company's 30-day cooling-off period and subsequently sells 10,000 shares each month at the same $48 limit price, which is below the stock's current market price at the time the CFO enacted the plan.

Plan to diversify

Sec Type	Start Date	End Date	Price	Quantity	TIF
Shares	05/13/2020	10/30/2020	48 limit	10,000	GTC
Shares	06/03/2020	10/30/2020	48 limit	10,000	GTC
Shares	07/01/2020	10/30/2020	48 limit	10,000	GTC
Shares	08/05/2020	10/30/2020	48 limit	10,000	GTC
Shares	09/02/2020	10/30/2020	48 limit	10,000	GTC
Shares	10/05/2020	10/30/2020	48 limit	10,000	GTC

The case study presented is hypothetical and does not reflect an actual client. It is for illustrative purposes only and results will vary.

Public disclosure of plans and trades

Contrary to common belief, a Rule 10b5-1 trading plan is not a document filed for the public to see. Rather, the plan is a written agreement between an insider and the brokerage firm responsible for executing the trades. However, some companies publicly disclose in press releases or Form 8-K filings that their insiders have adopted plans.

Insiders who are subject to Section 16 may disclose on Form 4 any trades made under a plan. Brokerage firms that trade shares pursuant to Rule 144 under Rule 10b5-1 trading plans also will file the Rule 144 Form on behalf of clients. The Rule 144 Form indicates the plan's adoption date, as well as the number of shares the insider intends to sell over a 90-day period or the total quantity sold. This form must be filed on or before the trade date. Anyone questioning trades occurring during a blackout will see that the trades are pursuant to a plan previously adopted by the client.

Both insiders and companies tend to be concerned with the number of SEC filings, so it is best to discuss filing requirements and preferences with insiders and their brokers while they are drafting the plan.

There is no requirement to disclose Rule 10b5-1 trading plans to the public, though some companies do.

77.8%

41.7%

77.8% of companies with Rule 10b5-1 trading plans do not make public disclosures of their insiders' plans. Of those that do, 41.7% file a Form 8-K.

Source: thecorporatecounsel.net 2017 survey.

"Many companies with Rule 10b5-1 trading plans have embraced the concept of financial wellness and are providing employees with access to financial education and guidance."

— Debbie McGrath, director, Executive Advisory Services, Bank of America

Providing Rule 10b5-1 trading plan support and guidance

Because Rule 10b5-1 trading plans and related equity awards are so complex, insiders need ongoing education and guidance to fully understand their features and maximize the benefits. Many companies are turning to equity award providers and advisors for this support, especially if knowledge gaps exist internally.

"That is why companies frequently encourage their insiders to work with advisors to help them design Rule 10b5-1 trading plans that can help make the most of company stock awards. An advisor with experience in this area can help manage the regulatory interactions between Rule 10b5-1, Rule 144 and Section 16," says McGrath. "Likewise, an advisor can address technical questions, such as how to create a single Rule 10b5-1 trading plan that meets multiple needs." For example, she notes, an insider may want to sell shares as an individual while also selling shares as the trustee of a trust account. A skilled advisor can help draft a plan that sells shares in both capacities, from different accounts.

Bank of America is experienced in working with corporate executives and insiders who need to map out sound, long-term financial strategies that help take advantage of equity compensation and other benefits. According to Charles-Henry Courtois, managing director, head of Executive and Non-Qualified Benefit Solutions group for Bank of America, "Beyond assisting with the technical details of Rule 10b5-1 trading plans, advisors can give insiders important guidance on using equity awards to support their overall financial well-being. Advisors assisting with Rule 10b5-1 trading plans can play a key role in helping insiders integrate the plans with other goals, such as saving for college and retirement or making personal investments."

McGrath agrees. "Many companies with Rule 10b5-1 trading plans have embraced the concept of financial wellness and are providing employees with access to financial education and guidance," she says. "This integrated and balanced approach may lead to better overall outcomes."

"Advisors assisting with Rule 10b5-1 trading plans can play a key role in helping insiders integrate the plans with other goals."

— Debbie McGrath, director, Executive Advisory Services, Bank of America

How Bank of America can help

Bank of America provides potential solutions related to company stock holdings that help support executives' overall financial wellness. We can develop a custom plan designed to work with the details of your company's insider trading policy, provide financial guidance and support to insiders creating plans, and effectively execute trades under those plans.

For more information about Rule 10b5-1 trading plans, equity compensation services or our integrated workplace benefits, contact your Merrill advisor or Bank of America representative.

Visit us online at go.bofa.com/financiallifebenefits.

* Diversification and rebalancing do not ensure a profit or protect against loss.

** Implementing a Rule 10b5-1 trading plan does not prohibit or prevent legal or regulatory action related to the trades. Trading plans are intended to demonstrate that the purchase or sale of a security of any issuer was not on the basis of material, nonpublic information about that security or issuer and therefore, not in violation of section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5.

*** A Rule 10b5-1 trading plan does not relieve the seller from the requirements of Rule 144 under the Securities Act of 1933, as amended, which covers the sale of control or restricted stock held by an individual. Any affiliate of the issuing company and holders of restricted securities are subject to this rule. The seller remains responsible for all Rule 144 requirements, including volume limitations and Form 144 filing. Conditions for resale of restricted and control securities are separate requirements under Rule 144. However, a trading plan may be designed taking those issues into consideration.

[1] 2011 Global Equity Incentives Survey, PricewaterhouseCoopers.

[2] Rule 10b5-1 Growth, Companies with Rule 10b5-1 Plans as of December 31, 2020, The Washington Service.

[3] S&P 500 Companies, Companies with Rule 10b5-1 Plans in the S&P 500 Index as of December 31, 2020, The Washington Service.

[4] thecorporatecounsel.net/blog/2017/04/survey-results-rule-10b5-1-plan-practices-2.html.

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