



Tutorial of 10B5-1 Plans, Disclosures, and Academic Evidence

*“Guided tour of the academic research, and evidence from
20,000 plans... in 20 minutes or less”*

SEC IAC Open Meeting June 10, 2021

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Mechanics of 10B5-1 Plans

Mechanics of 10B5-1 Plans

- Federal securities laws prohibit trading on material non-public information (MNPI)
- Corporate officers and directors (“insiders”) are **routinely exposed to MNPI** in the course of normal business
- Insiders are compensated with equity, and may develop concentrated equity positions that they **need or want to diversify**
 - **E.g., Send kids to Wharton, buy a yacht, invest in real estate, etc**
- Purpose of **10B5-1 Plans** is to provide a method for diversifying equity positions without running a foul of securities laws

Mechanics of 10B5-1 Plans

- Plans consist of a set of instructions for **prescheduled trades** at **regular intervals**

➤ Date triggers or price triggers (limit orders) and quantities to trade

Global ePoint
<https://www.sec.gov/Archives/edgar/data/896195/000119312505149795/dex1.htm>

Rule 10b5-1 Plan

John Pan
 Global ePoint, Inc.
 Type of securities: Restricted Stock
 Maximum Number of Shares to sell under plan: 1,000,000
 Maximum Number of Employee Stock Options to sell under the plan: 0
 Account number: 43J-40772

Rule 10b5-1 Sales Plan and Client Representations

I, John Pan, as of the date below, establish this Sales Plan (“the Plan”) in order to sell shares of the Issuer’s common stock pursuant to the requirements of Rule 10b5-1 under the Securities Exchange Act of 1934, as amended (the “Exchange Act”).

I request that Merrill Lynch, Pierce, Fenner & Smith Incorporated (“Merrill Lynch”) execute the Plan as follows:

- Starting on July 1, 2005 and ending on June 30, 2006,
 - For common stock, **sell as follows:**

<u>Start Date</u>	<u>End Date</u>	<u>Number of Shares to be sold in the Plan</u>	<u>Sale Price - "Limit" or "Market"</u>
July 1, 2005	June 30, 2006	200,000	5.00
July 1, 2005	June 30, 2006	200,000	6.00
July 1, 2005	June 30, 2006	200,000	6.50
July 1, 2005	June 30, 2006	200,000	7.00
July 1, 2005	June 30, 2006	200,000	7.50
Total		1,000,000	

Mechanics of 10B5-1 Plans

- Plans consist of a set of instructions for **prescheduled trades** at **regular intervals**

➤ Date triggers or price triggers (limit orders) and quantities to trade

Old Dominion (TEMPLATE)

<https://www.sec.gov/Archives/edgar/data/878927/000119312510207408/dex993.htm>

C. Implementation of the Plan

- Seller hereby appoints Stifel to sell shares of Stock pursuant to the terms and conditions set forth below. Subject to such terms and conditions, Stifel hereby accepts such appointment.
- Stifel is authorized to begin selling Stock under this Sales Plan on _____, 20__ at the open of the Principal Market and shall cease selling Stock on the earliest to occur of: (i) the date on which Stifel is required to terminate sales under this Sales Plan pursuant to paragraph D.1.a below; (ii) the date on which Stifel receives notice of the death of Seller; (iii) the date that the Issuer or any other person publicly announces a tender or exchange offer with respect to the Stock; (iv) the date of public announcement of a merger, acquisition, reorganization, recapitalization or comparable transaction affecting the securities of the Issuer as a result of which the Stock will be exchanged or converted into shares of another company; (v) the date on which Stifel receives notice of the commencement of any proceedings in respect of or triggered by Seller's bankruptcy or insolvency; (vi) the date on which Stifel, Issuer or Seller reasonably determines that the Sales Plan does not comply with Rule 10b5-1 or applicable securities laws; and (vii) (specify, by checking one or more of the boxes below, the date upon which Stifel will cease selling stock):
 - _____ (Date) at the close of the Principal Market.
 - the date that the aggregate number of shares of Stock sold under this Sales Plan is _____ shares;
 - The date that the aggregate proceeds of sales pursuant to this Sales Plan (after deducting commissions and other expenses of sale) reaches \$_____.

(the period during which Stifel is authorized to sell stock under this paragraph C.2 is referred to in this Sales Plan as the "Plan Sales Period").

- Stifel shall sell the **Daily Sale Amount** (as defined below) for the account of Seller on each Sale Day (as defined below), subject to the following restrictions, if desired (check each applicable box):
 - Stifel shall not sell any shares of Stock under this Sales Plan at a price of less than \$ _____ per share (before deducting commissions and other expenses of sale) (the "Minimum Sale Price").
 - (insert any other restrictions) _____
 - A "Sale Day" is (Select One):
 - each Trading Day that the Principal Market is open for business.
 - each Trading Day succeeding any period of _____ consecutive Trading Days during which the closing price of the Stock on the Principal Market or, if applicable, as reported in the consolidated system was equal to or greater than _____.

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- the first weekday of each month during the Plan Sales Period, provided that if any Sale Day is not a Trading Day, such Sale Day shall be deemed to fall on the next succeeding Trading Day. A "Trading Day" is any day during the Plan Sales Period that the Principal Market is open for business.
- Insert Other Conditions: _____

- The "**Daily Sale Amount**" for any Sale Day shall be (please check the applicable box to indicate the amount of Stock that Stifel is to sell on each Sale Day):
 - _____ shares of Stock as per the price parameters set forth in the table below.
 - an amount of Stock resulting in aggregate proceeds (after deducting commissions and other expenses of sale and exercise prices, withholding taxes and other expenses of exercise) of \$_____.
 - the amount set forth on the grid below opposite the per share price range that corresponds to the reported price of the opening reported market transaction in the Stock on such Sale Day.

Limit Price	Number of Shares of Stock to be Sold
If the price of Stock is \$ _____ or higher	
If the price of Stock is \$ _____ or higher	
If the price of Stock is \$ _____ or higher	
<input type="checkbox"/> determined in accordance with the following formula: _____	

Mechanics of 10B5-1 Plans

- Using a plan provides an affirmative defense against allegations that trades were based on MNPI
 - If plan is not entered into good faith / adopted as part of a scheme to evade liability, plan is not valid
 - In practice very hard to defeat the affirmative defense
 - ❖ SEC pierced 10B5-1 plan defense at Countrywide Financial during subprime Crisis
 - ❖ Shifts the burden from establishing “trading while in possession on MNPI” to establishing “adoption of plan while in possession of MNPI”
 - ❖ **Places great emphasis on the adoption date of the plan**

Mechanics of 10B5-1 Plans

- Plans **can not** be **modified** while in possession of MNPI
- Plans ***can*** be **cancelled** while in possession of MNPI
 - Current SEC guidance C&DI 120.17 does not consider the decision to abstain from trading to constitute trading on MNPI

“Free cancellation option”

❖ The free option for cancellation allows the executive to time the market regardless of whether news is good or bad

>> At the beginning of a quarter, setup a plan to sell a few days **BEFORE** the earnings announcement, and cancel plan if the quarter turns out well. <<

❖ And there is **NO required disclosure**

Disclosure Requirements

Disclosure of Trades

- Corporate insiders of **US companies listed on US exchanges** are required to disclose all trades in their company's equity on Form 4 within two business days
 - **Not required** to disclose whether **trade** was pursuant to a 10B5-1 plan on Form 4
- Corporate insiders of **Non-US companies listed on US exchanges** are **NOT** required to disclose trades (e.g., LK, AZN)
 - **Pharma trades**: PFE and MRNA got all the attention, because no disclosures by AZN
 - **Chinese/HK cos**: No disclosures by corporate insiders at Luckin Coffee, or other Chinese headquartered companies listed on US exchanges

Disclosure of Plans

- **No Required Disclosure**

1. **Not required** to disclose **adoption, modification, or cancellation** of the plan
2. **Not required** to disclose **plans**, or even the **number of shares** that are covered under plans by key executives

Disclosure of Plans

- **Lack of disclosure prevents proactive risk assessment and policing**
 - **Investors can not see whether the executive has entered an agreement to liquidate substantial fraction of their equity**
 - **Enforcement can not** actively monitor adoption, modification, cancellation, or plan details (unless company voluntarily discloses)
- **Then where did you get data for your academic study?**



The Mysterious Form 144

- Executives (anyone) selling \$50,000 or more in **restricted stock** must report sale on Form 144
- Form 144 **requires** filer to indicate whether sale was part of a 10B5-1 plan, and **plan adoption/modification date !**
 - Provides a source of data on adoption/modification dates



The Mysterious Form 144

- Form 144 can be filed by mail
- Mail filings are **NOT DISSEMINATED ON EDGAR**

1. 700,000 mail-filed Form 144s from 2001 to 2020 not on EDGAR (99%)

❖ Many are handwritten

2. Viewable for last 90 days in SEC reading room

3. Data aggregators make daily trips to the reading room to scan the 144s

❖ Sell scanned imagines and machine readable files to institutional clients



UNITED STATES SECURITIES AND EXCHANGE COMMISSION Washington, D.C. 20549

FORM 144 NOTICE OF PROPOSED SALE OF SECURITIES PURSUANT TO RULE 144 UNDER THE SECURITIES ACT OF 1933

OMB APPROVAL OMB Number: 3235-0101 Expires: June 30, 2020 Estimated average burden hours per response: 1.00

SEC USE ONLY DOCUMENT SEQUENCE NO.

CUSIP NUMBER

WORK LOCATION

TELEPHONE NO. AREA CODE NUMBER

ATTENTION: Transmit for filing 3 copies of this form concurrently with either placing an order with a broker to execute the sale or executing a sale directly with a market maker.

Mail Processing AUG 08 2018

Form 144 header section containing issuer information: The Walt Disney Company, IRS ID 95-4545840, S.E.C. File No. 11-11695, address 500 South Buena Vista Street, Burbank, CA 91521, and contact info for Robert A. Iger, Chairman of the Board/CEO.

INSTRUCTION: The person filing this notice should contact the issuer to obtain the I.R.S. Identification Number and the S.E.C. File Number.

Table with 8 columns: (a) Title of the Class of Securities To Be Sold, (b) Name and Address of Each Broker Through Whom the Securities are to be Offered, (c) SEC USE ONLY Broker-Dealer File Number, (d) Number of Shares or Other Units To Be Sold, (e) Aggregate Market Value, (f) Number of Shares or Other Units Outstanding, (g) Approximate Date of Sale, (h) Name of Each Securities Exchange. Row 1: Common, Merrill Lynch, 3455 Peachtree Road NE Suite 1000 Atlanta, GA 30326, 437,679, 50,333,085, 1,490,523,320, 8-6-18, New York.

- INSTRUCTIONS: 1. (a) Name of issuer (b) Issuer's I.R.S. Identification Number (c) Issuer's S.E.C. file number, if any (d) Issuer's address, including zip code (e) Issuer's telephone number, including area code 2. (a) Name of person for whose account the securities are to be sold (b) Such person's relationship to the issuer (c) Such person's address, including zip code

- 3. (a) Title of the class of securities to be sold (b) Name and address of each broker through whom the securities are intended to be sold (c) Number of shares or other units to be sold (d) Aggregate market value of the securities to be sold as of a specified date (e) Number of shares or other units of the class outstanding (f) Approximate date on which the securities are to be sold (g) Name of each securities exchange, if any, on which the securities are intended to be sold

Potential persons who are to respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB control number.

TABLE I — SECURITIES TO BE SOLD

Furnish the following information with respect to the acquisition of the securities to be sold and with respect to the payment of all or any part of the purchase price or other consideration therefor:

Title of the Class	Date you Acquired	Nature of Acquisition Transaction	Name of Person from Whom Acquired (If gift, also give date donor acquired)	Amount of Securities Acquired	Date of Payment	Nature of Payment
Common	8-6-18	Stock Options	The Walt Disney Company	437,679	8-6-18	CASH

INSTRUCTIONS: If the securities were purchased and full payment therefor was not made in cash at the time of purchase, explain in the table or in a note thereto the nature of the consideration given. If the consideration consisted of any note or other obligation, or if payment was made in installments describe the arrangement and state when the note or other obligation was discharged in full or the last installment paid.

Furnish the following information:	<p>8-6-18</p> <p>DATE OF NOTICE 12-18-17</p> <p>DATE OF PLAN ADOPTION OR GIVING OF INSTRUCTION, IF RELYING ON RULE 10b5-1</p>	are to be sold.
Name and		Gross Proceeds

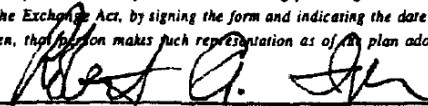
REMARKS:

INSTRUCTIONS:

See the definition of "person" in paragraph (a) of Rule 144. Information is to be given not only as to the person for whose account the securities are to be sold but also as to all other persons included in that definition. In addition, information shall be given as to sales by all persons whose sales are required by paragraph (e) of Rule 144 to be aggregated with sales for the account of the person filing this notice.

ATTENTION: The person for whose account the securities to which this notice relates are to be sold hereby represents by signing this notice that he does not know any material adverse information in regard to the current and prospective operations of the issuer of the securities to be sold which has not been publicly disclosed. If such person has adopted a written trading plan or given trading instructions to satisfy Rule 10b5-1 under the Exchange Act, by signing the form and indicating the date that the plan was adopted or the instruction given, that person makes such representation as of the plan adoption or instruction date.

8-6-18
DATE OF NOTICE 12-18-17
DATE OF PLAN ADOPTION OR GIVING OF INSTRUCTION, IF RELYING ON RULE 10b5-1


 (SIGNATURE) SIGN HERE

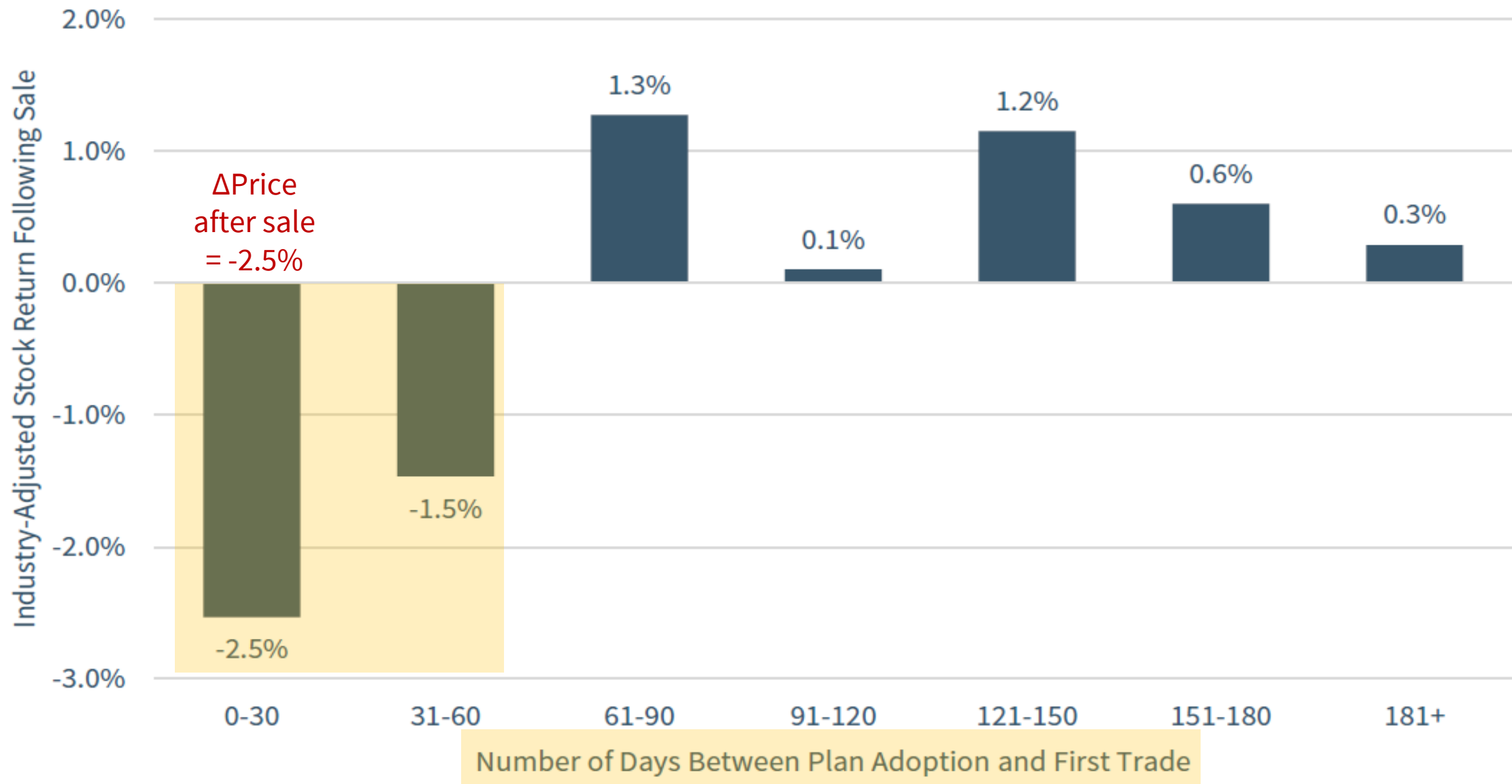
The notice shall be signed by the person for whose account the securities are to be sold. At least one copy of the notice shall be manually signed. Any copies not manually signed shall bear typed or printed signatures.

ATTENTION: Intentional misstatements or omission of facts constitute Federal Criminal Violations (See 18 U.S.C. 1001)

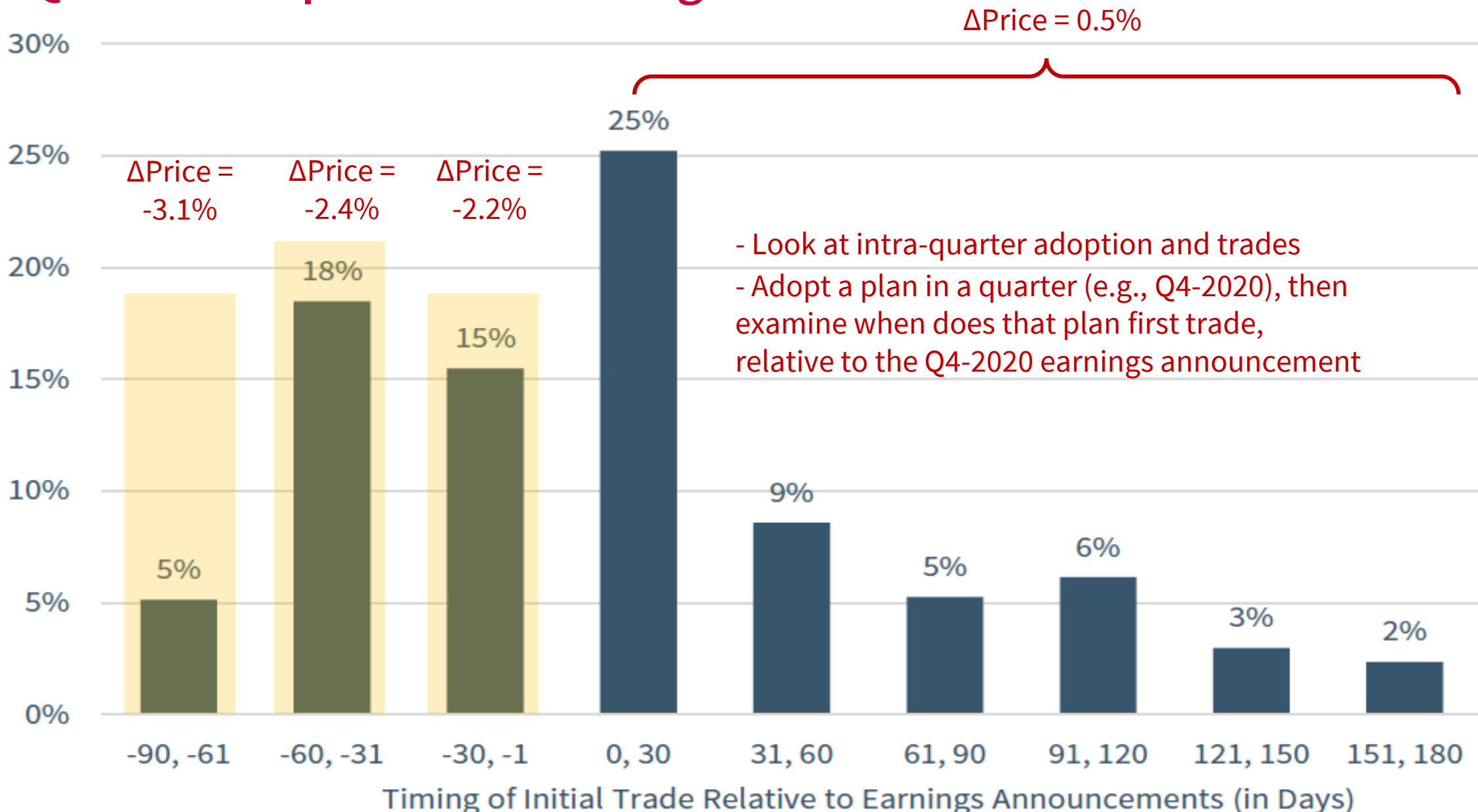
Evidence-based Policy Making

- **Use paper filings to conduct first large-scale data analysis of 10B5-1 plan adoptions**
- Data analysis on over 20,000 10B5-1 plans and associated trades
 - 20,595 unique plans, covering 55,287 trades
 - 2,140 firms, 10,123 unique individuals,
 - \$105 billion in trading volume
- “Let the data speak”
 - Examine subsequent changes in price after the sale—based on plan characteristics. Allows us to identify which plan characteristics are hallmarks of opportunistic/aggressive trading

Effective Cooling-Off Periods



Intra-Quarter Adoption and Trading



- Look at intra-quarter adoption and trades
- Adopt a plan in a quarter (e.g., Q4-2020), then examine when does that plan first trade, relative to the Q4-2020 earnings announcement

Evidence-based Recommendations

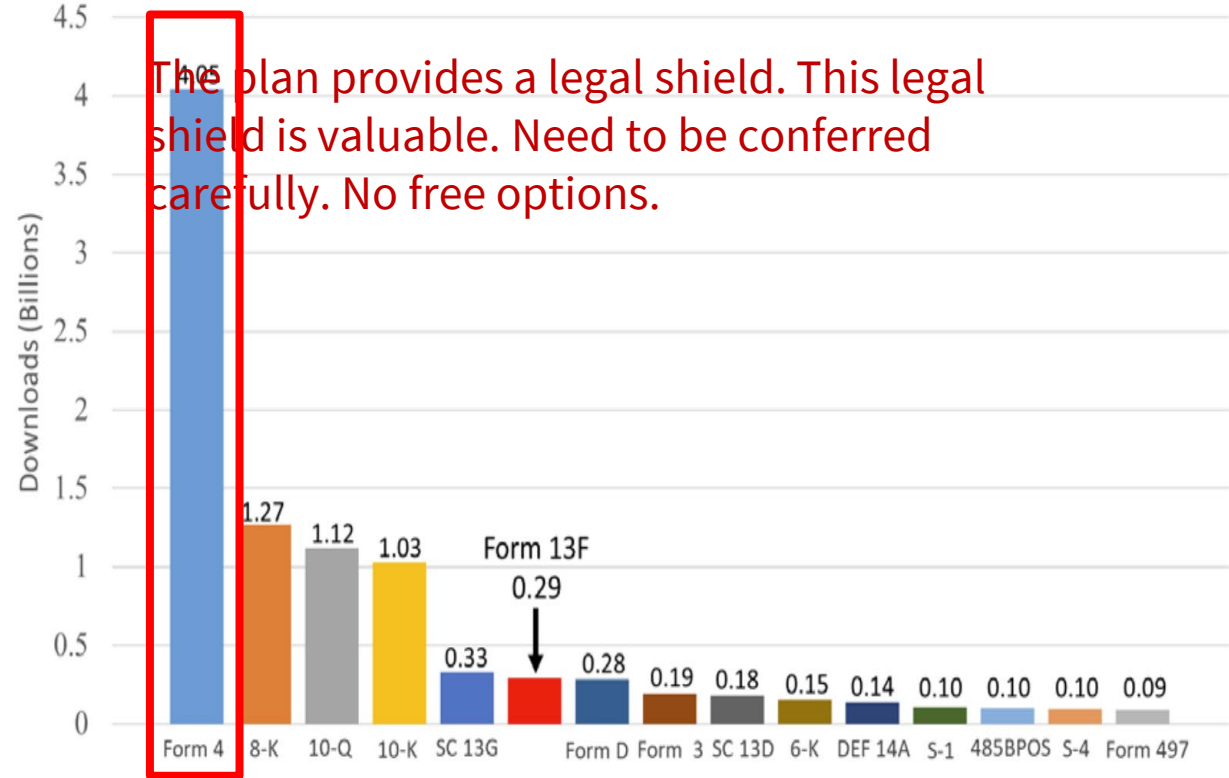
Evidence-based Policy Making

- Recommendations need to balance:

- Needs of senior executives for liquidity/diversification
- Value of giving an executive an “affirmative defense” against insider trading
- Investors need for information with respect to executives’ equity trades

Information on executives’ trades is more highly demanded than 8-Ks, 10-Q, 10-Ks COMBINED
Insiders can sell equity in the open market outside of the plan. But need a way to sell without arising suspicion.

Figure 1. Patterns in EDGAR Usage from 2003-2017: Downloads by Form



The plan provides a legal shield. This legal shield is valuable. Need to be conferred carefully. No free options.

Evidence-based Policy Making: Trades

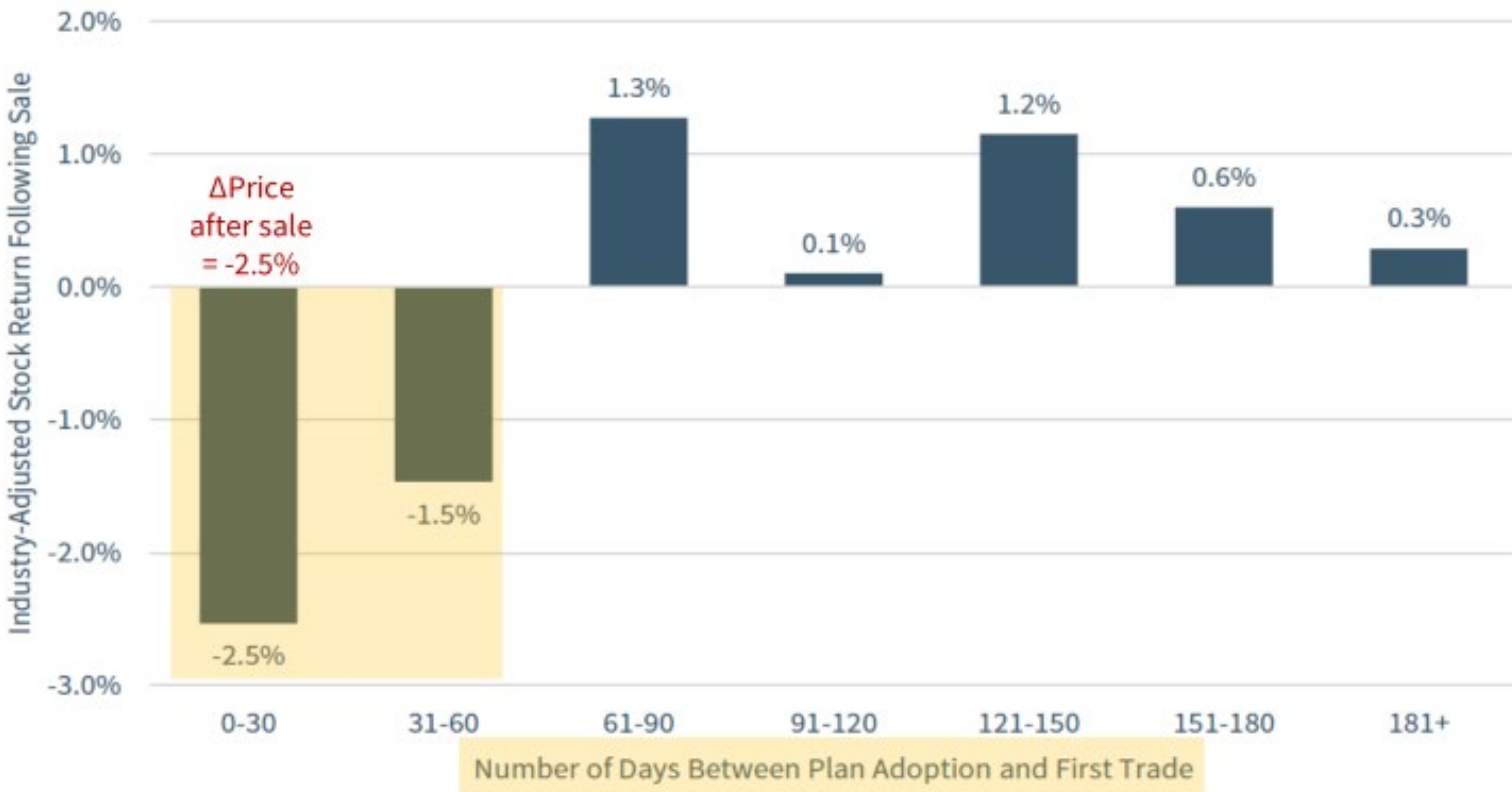
- 1. All companies trading on US exchanges (including foreign issuers) disclose trades of officers and directors on EDGAR**
- 2. Mandatory electronic filing of Form 144s, posting on EDGAR**
 - SEC's December 2020 Proposed Amendments to Rule 144, proposed under Chair Clayton, would mandate electronic submission
- 3. Modify Form 4 to require:**
 - A. Checkbox for trades made pursuant to a 10B5-1 plan**
 - B. Disclosure of adoption/modification date for 10B5-1 trades**

If the trade was made through a plan, then plan details should be readily available at the time of trade.

Evidence-based Policy Making: Trades

Adoption date is material

Effective Cooling-Off Periods



Evidence-based Policy Making: Plans

1. Disclosure of number of shares covered by 10B5-1 for “Named Executive Officers” in annual proxy statement

- Prior to voting on compensation package, useful to know whether the executive has signed a plan to liquidate substantial fraction (e.g., 90%) of his existing equity
- See e.g., Under Armour CEO used plan(s) to liquidate >\$100M; CBS CEO used plan(s) to liquidate >\$150M

Plan Administrator (or GC) will have this information for C-suite executives

Evidence-based Policy Making: Plans

2. Section 16 insiders disclose adoption of plan on Form 8-K, along with any subsequent modifications or cancellations

- Some companies already disclose the plan on 8-Ks.
- **Companies can redact or omit sensitive information**

C. Implementation of the Plan

1. Seller hereby appoints Stifel to sell shares of Stock pursuant to the terms and conditions set forth below. Subject to such terms and conditions, Stifel hereby accepts such appointment.

2. Stifel is authorized to begin selling Stock under this Sales Plan on _____, 20__ at the open of the Principal Market and shall cease selling Stock on the earliest to occur of: (i) the date on which Stifel is required to terminate sales under this Sales Plan pursuant to paragraph D.1.a below; (ii) the date on which Stifel receives notice of the death of Seller; (iii) the date that the Issuer or any other person publicly announces a tender or exchange offer with respect to the Stock; (iv) the date of public announcement of a merger, acquisition, reorganization, recapitalization or comparable transaction affecting the securities of the Issuer as a result of which the Stock will be exchanged or converted into shares of another company; (v) the date on which Stifel receives notice of the commencement of any proceedings in respect of or triggered by Seller's bankruptcy or insolvency; (vi) the date on which Stifel, Issuer or Seller reasonably determines that the Sales Plan does not comply with Rule 10b5-1 or applicable securities laws; and (vii) (specify, by checking one or more of the boxes below, the date upon which Stifel will cease selling stock):

_____ (Date) at the close of the Principal Market.

the date that the aggregate number of shares of Stock sold under this Sales Plan is _____ shares;

The date that the aggregate proceeds of sales pursuant to this Sales Plan (after deducting commissions and other expenses of sale) reaches \$_____.

(the period during which Stifel is authorized to sell stock under this paragraph C.2 is referred to in this Sales Plan as the "Plan Sales Period").

3. a. Stifel shall sell the **Daily Sale Amount** (as defined below) for the account of Seller on each Sale Day (as defined below), subject to the following restrictions, if desired (check each applicable box):

Stifel shall not sell any shares of Stock under this Sales Plan at a price of less than \$ _____ per share (before deducting commissions and other expenses of sale) (the "Minimum Sale Price").

(insert any other restrictions) _____

b. A "Sale Day" is (Select One):

each Trading Day that the Principal Market is open for business.

each Trading Day succeeding any period of _____ consecutive Trading Days during which the closing price of the Stock on the Principal Market or, if applicable, as reported in the consolidated system was equal to or greater than _____.

MEMBER SIPC AND MEMBERS, NEW YORK STOCK EXCHANGE, INC., CHICAGO AND AMERICAN STOCK EXCHANGE

the first weekday of each month during the Plan Sales Period, provided that if any Sale Day is not a Trading Day, such Sale Day shall be deemed to fall on the next succeeding Trading Day. A "Trading Day" is any day during the Plan Sales Period that the Principal Market is open for business.

Insert Other Conditions: _____

c. The "Daily Sale Amount" for any Sale Day shall be (please check the applicable box to indicate the amount of Stock that Stifel is to sell on each Sale Day):

_____ shares of Stock as per the price parameters set forth in the table below.

an amount of Stock resulting in aggregate proceeds (after deducting commissions and other expenses of sale and exercise prices, withholding taxes and other expenses of exercise) of \$_____.

the amount set forth on the grid below opposite the per share price range that corresponds to the reported price of the opening reported market transaction in the Stock on such Sale Day.

Limit Price	Number of Shares of Stock to be Sold
If the price of Stock is \$ _____ or higher	_____
If the price of Stock is \$ _____ or higher	_____
If the price of Stock is \$ _____ or higher	_____
<input type="checkbox"/> determined in accordance with the following formula: _____	_____

Evidence-based Policy Making: Plans

- 2. Section 16 insiders disclose adoption of plan on Form 8-K, along with any subsequent modifications or cancellations**

If plan is NOT modified or cancelled, only a **single filing** would be required at time of adoption.

Intentionally greater disclosure burden on those who are frequently modifying or cancelling.

More modifications, more required disclosure. Both ensures transparency and provides an incentive against frequent modification/cancellation.

Alternatively, outright prohibition on modification/cancellation

Evidence-based Policy Making: Plans

3. Adopt Chair Clayton's recommendation of a 4-6 month cooling off period

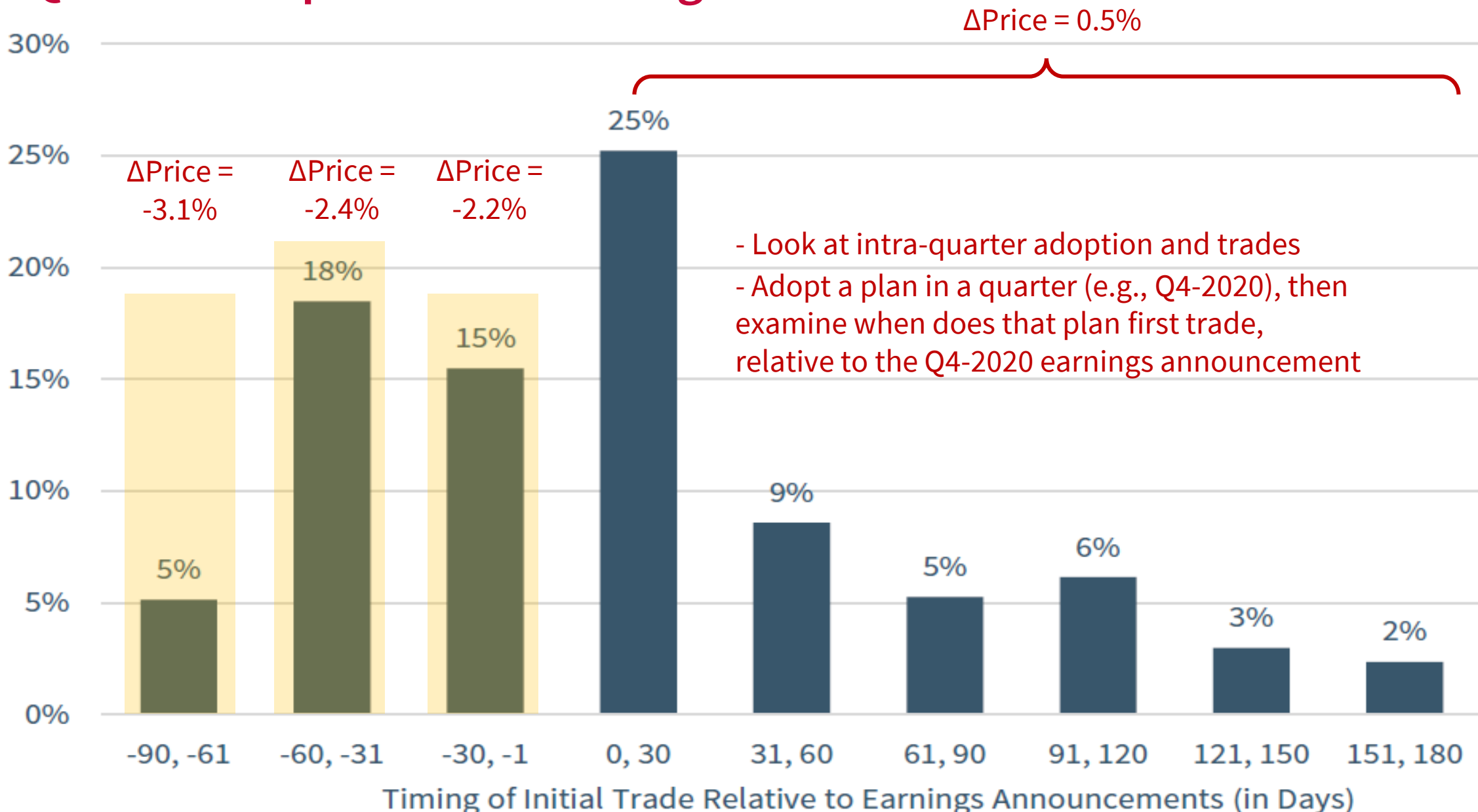
- Why 4-6 months? **4 months** ensures that the plan can not be adopted and trade prior to the same quarter's earnings announcement

Qualifying for Affirmative Defense

3. Adopt Chair Clayton's recommendation of a 4-6 month cooling off period

- **Why 4-6 months?** 4 months ensures that the plan can not be adopted and trade prior to the same quarter's earnings announcement
- **Evidence-based policy making:** loss avoidance is largest in **plans that are adopted and trade before the quarter's earnings announcement**
- E.g., Anticipating a bad Q4, adopt plan in Nov 2020 to sell \$100 million. Plan entails a scheduled sale 5 days before Q4 earnings announcement (Feb 2021). If quarter goes surprising well, **use free cancellation option** to cancel the planned sale.

Intra-Quarter Adoption and Trading



- Look at intra-quarter adoption and trades
- Adopt a plan in a quarter (e.g., Q4-2020), then examine when does that plan first trade, relative to the Q4-2020 earnings announcement

Evidence-based Policy Making: Plans

3. Adopt Chair Clayton's recommendation of a 4-6 month cooling off period

- Yes, this will be an inconvenience for executives. But it can be viewed as **the price of the affirmative defense legal shield**.
- No free options. In order to get the affirmative defense, plan should meet some basic requirement designed to minimize use of MNPI
- If the executive can not wait 4 months to sell (e.g., unexpected bill for Wharton tuition... due now!) can always place a regular, non-planned, market order to sell.

THANK YOU

Sources:

D. Larcker, B.Lynch, and D. Taylor (2021) *Comment Letter of Rule 144 Holding Period and Form 144 Filings - File No. S7-24-20*

<https://www.sec.gov/comments/s7-24-20/s72420-8488827-229970.pdf>

D. Larcker, B.Lynch, P. Quinn, B. Tayan, and D. Taylor (2021) *Gaming the System: Three “Red Flags” of Potential 10b5-1 Abuse*

<https://www.gsb.stanford.edu/sites/default/files/publication-pdf/cgri-closer-look-88-gaming-the-system.pdf>