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10b5-1 planning for corporate executives

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Along with running a successful company and answering to shareholders, corporate executives of public companies have something else to worry about — their significant equity positions in their own companies. Used properly, a 10b5-1 plan is a tool that can help executives strategically plan and execute concentrated equity position sales.

Rule 10b5-1 was established by the Securities Exchange Commission (SEC) for insiders of publicly traded corporations to sell their stock at predetermined dates and prices. If properly designed and implemented, a 10b5-1 trading plan can provide a corporate executive with an affirmative defense against insider trading as well as an opportunity to sell their stock during periods they would normally be restricted (blackout periods). These plans, available from the custodian where the stock is housed, can provide a great way for executives to diversify their holdings in a flexible manner consistent with their financial objectives.

Though 10b5-1 plans are flexible for the executive — they can be cancelled at any time — the plans can only be initiated while the executive is in an open window and is not in possession of non-public, i.e. inside, information. The plans must specify the amount, prices, and date of the shares to be sold.

There are three important dates that need to be outlined in a plan:

1) The adoption date (the date the executive and the issuer signs the plan. New 10b5-1 plans need to be adopted while the executive is in an open window and is not in possession of non-public information).

2) The effective date (date the first trade is initiated).

3) The termination date (typically no longer than 2 years from the adoption date).

Insider trading restrictions set forth by both the SEC and individual companies have become more stringent and arduous for executives that receive a significant portion of their compensation in the form of restricted stock or stock options. In fact, we've noticed the following trends that savvy companies have instituted when it comes to insider trading:

1) They typically have a cooling period between the adoption date and the effective date. A typical cooling period is 30-60 days for a new plan. If an executive is cancelling and replacing a plan, then a cooling period is typically 60 days to 6 months, depending on the company's tolerance for risk.

2) Plans should be in place at least one year after adoption date and should not exceed two years. These plans can be cancelled at any time but canceling and replacing a plan should be avoided if possible.

3) The 10b5-1 plan should be the exclusive means by which the officers and directors can sell stock. This helps reduce the risk of a violation of Section 16b (short swing profit rule).

Some companies establish plans concurrent with their initial public offering (IPO), when all information is publicly disclosed. This provides the executive with extra protection against insider trading because the cooling period needs to exceed the underwriter lock up (greater than 6 months). The longer the cooling period, the less likely it is for shareholders to make the claim that an executive has acted on inside information.

Establishing a plan concurrent with an IPO is particularly important for companies with constantly evolving non-public information, such as certain life science companies involved in drug trials. In situations like this, executives might have limited windows for selling stock absent of a 10b5-1 plan.

Because of more rigid insider trading policies, 10b5-1 plans have become a common practice for corporate executives who work with an advisory firm. 10b5-1 planning, under the umbrella of financial planning, has emerged as a way to help executives be more strategic in their planning and protect themselves against insider trading. Since the plans can be complex, most executives receive guidance from the investment advisory firm with which they work.

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