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

Daniel Taylor
Associate Professor
Arthur Andersen Chair
Director, Wharton Forensic Analytics Lab
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

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**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: 43J40772

**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:

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

<table>
<thead>
<tr>
<th>Start Date</th>
<th>End Date</th>
<th>Number of Shares to be sold in the Plan</th>
<th>Sale Price - &quot;Limit&quot; or &quot;Market&quot;</th>
</tr>
</thead>
<tbody>
<tr>
<td>July 1, 2005</td>
<td>June 30, 2006</td>
<td>200,000</td>
<td>5.00</td>
</tr>
<tr>
<td>July 1, 2005</td>
<td>June 30, 2006</td>
<td>200,000</td>
<td>6.00</td>
</tr>
<tr>
<td>July 1, 2005</td>
<td>June 30, 2006</td>
<td>200,000</td>
<td>6.50</td>
</tr>
<tr>
<td>July 1, 2005</td>
<td>June 30, 2006</td>
<td>200,000</td>
<td>7.00</td>
</tr>
<tr>
<td>July 1, 2005</td>
<td>June 30, 2006</td>
<td>200,000</td>
<td>7.50</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>1,000,000</td>
<td></td>
</tr>
</tbody>
</table>
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
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 cannot 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

Is the 10B5-1 Plan selling restricted shares

Yes  
File Form 144  
(must disclose if trade pursuant to a plan, and date of plan adoption/modification)

No  
File Form 4  
(no 10B5-1 disclosures needed)
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 images 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

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

<table>
<thead>
<tr>
<th>1.</th>
<th>NAME OF ISSUER</th>
<th>(Please type or print)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>The Walt Disney Company</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>2.</th>
<th>ADDRESS OF ISSUER</th>
<th>STREET</th>
<th>CITY</th>
<th>STATE</th>
<th>ZIP CODE</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>500 South Buena Vista Street</td>
<td>Burbank</td>
<td>CA</td>
<td>91521</td>
<td>91521</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>2a</th>
<th>NAME OF PERSON FOR WHOSE ACCOUNT THE SECURITIES ARE TO BE SOLD</th>
<th>(Please type or print)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Robert A. Iger</td>
<td></td>
</tr>
</tbody>
</table>

### 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>
<thead>
<tr>
<th>3a</th>
<th>Title of the Class of Securities To Be Sold</th>
<th>(Please type or print)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Common</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>3b</th>
<th>Name and Address of Each Broker Through Which the Securities are to be Offered or Each Market Maker Who is Acquiring the Securities</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Merrill Lynch</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>3c</th>
<th>SEC USE ONLY</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Broker-Dealer File Number</td>
<td>Number of Shares or Other Units To Be Sold</td>
</tr>
<tr>
<td></td>
<td>437,679</td>
<td>50,333,085</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>3d</th>
<th>Aggregate Market Value (See instr. 3b)</th>
<th>Number of Shares or Other Units Outstanding (See instr. 3b)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1,480,523,368</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>3e</th>
<th>Aggregate Date of Sale (See instr. 3b)</th>
<th>Name of Each Securities Exchange (See instr. 3b)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>8-6-18</td>
<td>New York</td>
</tr>
</tbody>
</table>

### 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 telephone number, including area code

2. (a) Name of person for whose account the securities are to be sold:
   (b) Each person's relationship to the issuer (e.g., officer, director, 10% stockholder, or member of immediate family of any of the foregoing)
   (c) Each person's address, including zip code

3. (a) Title of the class of securities to be sold:
   (b) Number and address of each broker through which the securities are intended to be sold
   (c) Number of shares or other units to be sold (if debentures, give the aggregate face amount)
   (d) Aggregate market value of the securities to be sold as of a specified date within 10 days prior to the filing of this notice
   (e) Number of shares or other units outstanding, or if such securities are the face amount thereof outstanding, as shown by the most recent report or statement published by the issuer
   (f) Applicable 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:

<table>
<thead>
<tr>
<th>Title of the Class</th>
<th>Date you Acquired</th>
<th>Nature of Acquisition or Transaction</th>
<th>Name of Person from Whom Acquired (if any, also give date given reported)</th>
<th>Amount of Securities Acquired</th>
<th>Date of Payment</th>
<th>Nature of Payment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Common</td>
<td>8-6-18</td>
<td>Stock Options</td>
<td>The Walt Disney Company</td>
<td>437,679</td>
<td>8-6-18</td>
<td>CASH</td>
</tr>
</tbody>
</table>

**INSTRUCTIONS:**

If the securities were purchased and full payment thereof was made in cash at the time of purchase, explain in the table or in a note therein 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, if any, with respect to the plan or instructions under which the securities are to be sold.

<table>
<thead>
<tr>
<th>Name and Address of Person Making the Plan or Instructions</th>
<th>Great Proportions</th>
</tr>
</thead>
</table>

**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 (c) 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 in respect Rule 144 under the Exchange Act, by signing the form and indicating the date that the plan was adopted or the instruction given, such person makes such representation as of the plan adoption or instruction date.

**SIGNATURE**

**DATE OF NOTICE**: 12-18-17

**DATE OF PLAN ADOPTION OR GIVING OF INSTRUCTION**: 8-6-18

**DATE OF PLAN ADOPTION OR GIVING OF INSTRUCTION, IF RELYING ON RULE 10B5-1**

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

SEC 1147 (02-08)
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

$\Delta \text{Price after sale} = -2.5\%$

![Bar chart showing industry-adjusted stock return following sale over different periods of number of days between plan adoption and first trade.](chart)
- 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.

Graph showing the timing of initial trade relative to earnings announcements:

- **0, 30**: 25\% with ΔPrice = 0.5\%
- **-90, -61**: 18\% with ΔPrice = -2.4\%
- **-60, -31**: 15\% with ΔPrice = -2.2\%
- **-30, -1**: 5\%
- **31, 60**: 9\%
- **61, 90**: 5\%
- **91, 120**: 6\%
- **121, 150**: 3\%
- **151, 180**: 2\%
Evidence-based Recommendations
Evidence-based Policy Making

- Recommendations need to balance:

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

Insiders can sell equity in the open market outside of the plan, but need a way to sell without arising suspicion.

Information on executives’ trades is more highly demanded than 8-Ks, 10-Q, 10-Ks COMBINED.

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

- \( \Delta \text{Price after sale} = -2.5\% \)

- Industry-Adjusted Stock Return Following Sale

- Number of Days Between Plan Adoption and First Trade
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
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
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 cannot 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
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