

Client Alert

House Passes Bill to Close 8-K Trading Gap and Prohibit Insider Trading

January 23, 2020

On January 13, 2020, the House of Representatives, in a vote of 384 to 7, passed the 8-K Trading Gap Act (the “Bill”). The Bill is designed to address the trading of equity securities of a company by its corporate insiders between the occurrence of a reportable event requiring the filing of a Form 8-K and the filing (or furnishing, as applicable) of the Form 8-K itself (the “8-K Trading Gap”). Form 8-K permits up to four business days to pass following the occurrence of an 8-K reportable event until the filing is required. Although many public companies already have internal policies and procedures designed to prevent executives and directors from trading company stock before the public disclosure of a significant corporate event on Form 8-K (or otherwise), the Bill, if enacted, would require as a matter of law that all public companies maintain such policies and procedures.

Overview

The Bill would amend the Exchange Act to require the SEC to adopt rules, within one year of the Bill’s enactment, requiring reporting companies to “establish and maintain policies, controls, and procedures reasonably designed” to prevent its executive officers and directors from trading in or transferring, directly or indirectly, any of the company’s equity securities, during the 8-K Trading Gap.

For filings required under Section 1 through 6 of Form 8-K, the prohibition on trading would apply from the occurrence of the triggering event to the filing of the Form 8-K. Sections 1 through 6 of Form 8-K cover events such as, among others, the entry into or termination of a material definitive agreement; bankruptcy; M&A transactions; financial results; notice of delisting; changes in accountants; non-reliance on financials; changes in control; and new and departing officers and directors. The Bill however does include certain exemptions if the triggering event is announced in compliance with Reg FD prior to the filing of the Form 8-K.

For Section 7 (Reg FD disclosure) furnished disclosures and Section 8 (other events) filings, the prohibition on trading would apply from the date the company determines it will disclose the event on Form 8-K to the date on which it files (or furnishes) the Form 8-K.

The Bill, as drafted, permits the SEC to include exemptions for certain transactions, including transactions that occur automatically, are made under an advance election, or involve a purchase or sale of equity securities made pursuant to a 10b5-1 plan (except for plans adopted during an 8-K Trading Gap).

Implications of the 8-K Trading Gap Act

Although most reporting companies have policies designed to prevent insider trading, including pre-clearance policies and blackout or restricted trading periods, the Bill would in effect codify certain aspects of those policies as a matter of federal securities law and require their inclusion in what the SEC will determine are “reasonable” policies.

It remains to be seen what constitutes a “reasonable” policy, however, many insider trading policies tend to focus on relatively broad concepts relating to the misuse of “material” information. Under the proposed legislation, a company that is required or elects to file (or furnish) a Form 8-K will have to make sure its

policies address not only material information but also potentially nonmaterial information that is nonetheless required, or determined by the reporting company, to be disclosed in a Form 8-K.

While it is not yet certain whether (and when) the Bill will become law as the Senate must also vote to pass the Bill and the President must then sign the Bill into law, public companies may want to review their insider trading policies in anticipation of the Bill's enactment, particularly in light of the substantial bipartisan support the Bill received in the House of Representatives.

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