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Insider Trading Policies

Unlawful insider trading has historically been, and continues to be, a focus of the SEC and DOJ

While there are no SEC rules or regulations requiring that public companies have insider trading policies, most public companies adopt such policies and procedures to prevent and detect unlawful trading by directors, executive officers and employees, or insiders. These policies typically provide that trading by insiders take place during certain pre-established "open trading windows," and that such trading is prohibited during pre-established "blackout periods," with the goal being to minimize the likelihood that unlawful insider trading will occur and to provide companies with a good faith defense against insider liability for the actions of their employees.

What Is Unlawful Insider Trading?

Rule 10b-5 under the Exchange Act in effect provides that anyone who possesses "material nonpublic information" regarding the company abstain from trading in company securities, for as long as such material nonpublic information remains undisclosed. Determining what information is "material" is often difficult, but the basic test is whether it is information a reasonable investor would consider important in determining whether to purchase or sell securities.

Company Liability for Insider Trading

Government and private actions alleging insider trading have targeted not only individual violators, but companies as well for trading by their directors, executive officers and employees. Companies may be the target of insider trading charges if, among other reasons, a person "controlled" by the company engages in unlawful insider trading or the company "aids and abets" insider trading.

Scope and Content of Insider Trading Policies

The scope and content of a company's insider trading policy will vary depending on a number of factors, including size, maturity, number of employees and the trading market for the company's securities, and should be adapted to fit a company's particular facts and circumstances. A brief policy highlighting key principles may be enough for some companies, while a more robust policy with detailed procedures may be more suitable for others. A company may also embed its insider trading policy within its code of conduct rather than adopt a stand-alone insider trading policy, which is becoming an increasingly common practice.

The policy should include an overview or statement of purpose that contains a "plain English" definition or explanation of what constitutes insider trading. This section should also provide guidance on what "materiality" and "non-public" mean, concepts that are fundamental to an understanding of insider trading. Consider using examples to aid in setting forth these definitions.

- **Who will be subject to the policy?** A policy's general prohibition of insider trading while possessing material nonpublic information applies to all employees, as well as the board of directors. The policy's blackout periods and pre-clearance procedures should apply, at a minimum, to all executive officers and directors of the company, as well as any individuals below the executive level who may have access to sensitive financial information prior to its public release (e.g. finance and accounting staff). For new public companies with a relatively small number of employees, it may be appropriate for the blackout periods and pre-clearance procedures to cover all employees. The policy should also extend to trades made by close family members and others sharing the household of covered persons. The company may also want to consider whether its consultants should be covered by the policy.

- **Who will be subject to pre-clearance rules?** Most public companies require that the covered persons discussed above, primarily consisting of executive officers and directors, "pre-clear" trades with a designated compliance officer. This protects the covered persons from executing a trade during a period that would otherwise be an open trading window, but in which there is a material undisclosed transaction.

- **What blackout period is appropriate?** The extent of the blackout period varies by industry, but is generally tied to the period in which insiders might be expected to know the quarterly financial results. A typical blackout period might extend from the first day of the last month of the quarter until two trading days after the public release of the earnings information.

Once an insider trading policy is in place, it is recommended that companies develop onboarding and ongoing training programs to provide education regarding insider training and the company's policy. The company should also task someone, likely someone in the legal department or a compliance officer, with administering the policy and should also identify a back-up contact in case the primary contact is unavailable. These final steps are integral to enforcement of a company's insider trading policy.

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