Morgan Stanley

WEALTH MANAGEMENT

PRIMER

Global Investment Office | November 09, 2023

Demystifying 10b5-1 Plans

Steve Edwards, CFA
Senior Investment Strategist

Patrick Gremban
Investment Strategist

Helen K. Donnelly
Investment Strategist

When selling company shares, corporate executives, directors and other insiders must pay careful attention to ensure compliance with corporate policies and Securities and Exchange Commission (SEC) rules. First, insiders can only sell during "open windows," lasting usually only four to six weeks after each earnings release. In addition, insiders cannot sell when they have material nonpublic information (MNPI). 10b5-1 plans may offer a solution and are designed to address these issues.

The authors would like to acknowledge Joshua Shek and Richard Baker for their contributions to this report.

The History of 10b5-1 Plans

10b5-1 plans allow corporate executives and other insiders to establish preset trading plans for transacting in company stock holdings. The SEC created this opportunity in 2000, with the introduction of Rule 10b5-1, which clarified that executives who transacted in their company stock while in possession of MNPI would trigger insider-trading rule violations. Moreover, the SEC included guidelines within the Rule that, if followed, would provide an affirmative defense against claims of insider trading.

Benefits for Executives

10b5-1 plans can help executives and other insiders to meet their goals, particularly with regard to potentially diversifying holdings and reducing idiosyncratic risks associated with concentrated positions.

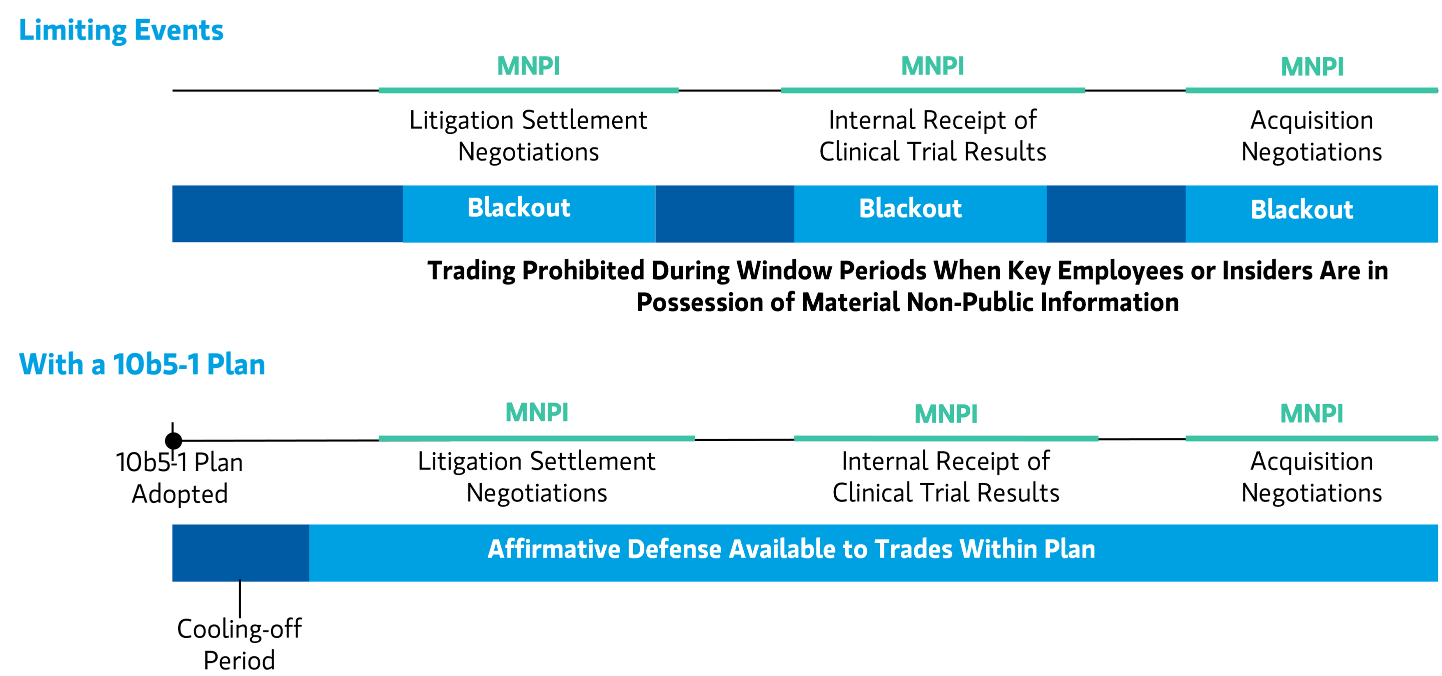
As noted above, these plans may provide an affirmative defense against claims of insider trading. Once established, they permit insiders to trade outside of "open windows" (also known as blackout periods). In addition, insiders may exercise employee stock options—and effect the immediate sale of their equity proceeds—during otherwise prohibited periods while protecting against hitting option expiry dates.

Given their preset nature, these plans automate insiders' trading plans, customized to an individual's particular objectives, down to specific amounts and timing. That feature protects investors against "emotional" selling and mitigates potential negative signaling from liquidating their holdings.

Establishing a 10b5-1 Trading Plan

Executives and other insiders may implement a plan when they are not in possession of material nonpublic information and are acting in good faith with respect to the plan. The plan, including its subsequent trading schedule, may be highly customizable. When establishing a 10b5-1 plan, insiders may consider the following variables: the number of shares to be sold, frequency of sales and the duration of the plan. Inputs can be formula-driven or static.

Exhibit 1. 10b5-1 Plans Broaden Insiders' Opportunities for Liquidating Concentrated Positions, Potentially Leading to Greater Diversification and Lower Exposure to Idiosyncratic Risks



Source: Morgan Stanley Global Investment Office

Exhibit 2. 10b5-1 Plans Offer Multiple Levers for Individual Customization

Four Key Items to Consider in Establishing a 10b5-1 Plan

1

SHARES TO BE SOLD

Determined by specifying a set number of shares over the plan's life or by a formula

2

FREQUENCY OF SALES

Set within daily, weekly, monthly, quarterly, semi-annual or annual timeframes, known as "interim sales periods"

3

DURATION OF THE PLAN

Defined either by set dates or a formula

4

SELLING METHODS

Structured, drafted and executed in line with customized plan trading strategies, in sync with insiders' risk management and investment objectives

Source: Morgan Stanley Global Investment Office

Executives and other insiders should consider the following steps when adopting 10b5-1 plans, which may extend to multiple types of equity, such as restricted stock units and founder shares, as well as to stock options:

1. Determine diversification objectives. The plan's goal could include the desired amount of total liquidity to generate, the quantity of shares intended for sale in a given sales period or the amount of company exposure to maintain. Of course, should the insider increase the liquidation amount, he or she will maintain a smaller amount of company exposure.

2. Look beyond assets held in your name. Insiders may consider related entities, including trusts and family members that hold shares, in their diversification strategies, potentially including those shares in any 10b5-1 plan. We recommend working with a financial advisor to develop a holistic strategy for your entire balance sheet.

3. Establish a selling frequency. For 10b5-1 plans, the time between sales is measured typically in months or quarters, based on the timing of individual liquidity needs. Shorter times between sales generate liquidity more frequently and may serve as a method of dollar-cost averaging out of a concentrated position rather than selling at a single point, which may increase vulnerability to price fluctuations.

4. Set the minimum price ("limit price"). This price represents the level at which the investor would be willing to liquidate shares, given the following:

- Sale information will become publicly available after the trade execution.
- Other investors will scrutinize Form 144- or Form 4-reported sales in the context of recent valuation points, such as the initial public offering (IPO) price or the price of any secondary offering.

5. Consider including upper-limit prices. These levels, set above the minimum price, indicate the prices at which additional shares may be sold. Upper limits allow clients to account for potential stock appreciation and upside volatility.

6. Determine the plan length. 10b5-1 plans typically have a 12-month duration, and other investors and regulators will pay close attention to any modifications or terminations.

- Longer plans may become susceptible to modifications or terminations, due to changes in investor or company circumstances.
- Shorter plans may increase the possibility of the insider being prevented from adopting a subsequent plan in a timely manner given possession of MNPI.

7. Review any tax implications with trusted tax advisors. Given the complexity of equity compensation, we recommend that insiders work closely with tax professionals to optimize the tax implications related to any liquidity or option-exercise strategy.

In terms of putting together the plan, there are a variety of common selling strategies to consider, which the plan may incorporate or combine, tailored to an executive's needs and goals:

- **Periodic selling,** in which sales have date-based triggers (Example: Sell 5,000 shares on the first of each month)
- **Limit orders,** in which sales are made at or above a specified price (Example: Sell 10,000 shares at $45)
- **"Accelerated selling"**, in which multiple limit orders are used together with increasing amounts of stock at each limit price (example: Sell 5,000 shares at $20; then sell 10,000 shares at $30)
- **Quantity limits,** in which insiders specify the number of shares that can be sold in a designated period (Example: Sell no more than 50,000 shares in a calendar month or target 10% of daily volume)

Below, we present a quick case study that compares different trading strategies, with the intention to showcase each one's advantages and disadvantages. In this case study, our hypothetical client has 500,000 shares in her company and wishes to sell 120,000 shares over a one-year period to help generate liquidity for upcoming expenses.

Recent SEC Amendments to Rule 10b5-1

Although 10b5-1 trading plans offer many benefits, the SEC recently amended the Rule to include additional requirements.[1] Since its adoption in 2000, many commentators have alleged that insiders have abused it—by adopting a plan without any "cooling-off" period, for example. The amendments, partially in response to those allegations, extend to the following:

- **Mandatory cooling-off period**. Plans must now honor a mandatory cooling-off period, measured from a plan's execution to the potential start of any trades. A cooling-off period is required for all purchase / sale plans, except for the issuer's own plans. Non-Section 16 officers and directors are subject to a 30-day cooling-off period. For Section 16 officers and directors, the potential start of any trades is determined as the later of a) 90 days after plan adoption or b) two business days following the filing of the 10-K/Q or 20-F/6-K for the fiscal quarter of adoption. The cooling-off period is subject to a 120-day maximum, regardless of timing of financial results.
- **Single trade-plan restriction**. Insiders may only adopt one, single trade plan in any 12-month period, with certain exceptions.
- **Insiders must act in good faith with respect to the plan and no MNPI certification**. Section 16 directors and officers must certify in writing that they are not aware of MNPI and are adopting the plan in good faith.
- **No overlapping sales plans**. The amendments restrict the use of multiple, overlapping trading plans.
- **Disclosure requirements.** The amendment includes expanded issuer disclosure requirements, mandating a) quarterly disclosures of whether any director or officer has adopted or terminated a plan and b) a description of the terms of each plan. Material terms include name and title, adoption/termination date, duration and the amount of securities to be sold or purchased. Importantly, issuers are not required to disclose sale or purchase prices.
- In addition, any modifications to amount, price or timing of purchases/sales will be treated as a termination and an adoption of a new plan, subject to the applicable cooling-off period. Although these requirements may appear daunting at first, 10b5-1 plans remain useful for most corporate executives and other insiders.

Exhibit 3. Different Strategies to Sell 120,000 Shares

No.	Strategy	Advantages	Disadvantages
1	On a monthly basis, sell 10,000 shares at market; an additional 10,000 shares at $30 or better; an additional 10,000 shares at $40 or better	Facilitates stock sales on a predictable basis, while allowing for accelerated selling if stock trends higher	May not generate desired proceeds if stock price is lower than anticipated
2	Sell 10,000 shares at $20 or better and sell all unsold shares at $40 or better (the "upper-limit price"), no more than 50,000 shares sold in any month	Offers the ability to sell stock on a predictable basis, while allowing for greater liquidation if the stock hits an "upper-limit" price but limiting the total quantity sold to mitigate large-volume sales	May not generate any liquidity since it prohibits sales below $20 per share
3	Sell 40,000 shares at $25 or better; an additional 40,000 shares at $30 or better; and an additional 40,000 shares at $40 or better	Capitalizes on desired price limits, regardless of timing	May reduce the ability to benefit from a longer-term upward price trend, as all shares could potentially be sold quickly, leading to finishing the plan sooner than anticipated. Furthermore, requires upward price movement for sales to occur at all.

Source: Morgan Stanley Global Investment Office

Not all insiders may benefit from 10b5-1 plans, however. There are also considerations relating to 10b5-1 plans beyond those requirements of the rule itself. For example, insiders should consider company trading policies applicable to 10b5-1 plans as these policies often impose additional requirements on these plans (e.g., company approval of adoptions and terminations, no-sale periods around earnings). In addition, issuers are now required to disclose in public annual 10-K and quarterly 10-Q reports with the SEC when Section 16 directors and officers have adopted a plan, and the material terms of the plan (excluding pricing), as well as plan terminations. Lastly, employees who typically do not encounter MNPI or are not subject to corporate window policies may not require a 10b5-1 plan.

Conclusion

Corporate executives and other insiders may consider using 10b5-1 plans to reach their diversification goals. Tailoring an optimal strategy will depend on the client's specific circumstances, needs and preferences. Please reach out to your Morgan Stanley Financial Advisor or our 10b5-1 team to see how we can help sort through the details.

End Note

[1] "Final Rule: Insider Trading Arrangements and Related Disclosures." Available at https://www.sec.gov/files/rules/final/2022/33-11138.pdf.

Disclosure Section

Risk Considerations and Important Information

Individuals executing a **10b5-1 trading plan** should keep the following important considerations in mind:

(1) 10b5-1 trading plans should be reviewed and approved by the legal and compliance department of the individual's company.
(2) Most companies will permit 10b5-1 trading plans to be entered into only during open window periods.
(3) Recent rule changes will require a mandatory cooling-off period between the execution of a 10b5-1 trading plan (or a modification) and the first sale pursuant to the plan (or the first sale following such modification).
(4) 10b5-1 trading plans do not alter the nature of restricted and/or control stock or regulatory requirements that may otherwise be applicable (e.g., Section 16, Section 13, Rule 144).
(5) 10b5-1 trading plans that are terminated early may weaken or cause the individual to lose the benefit of the affirmative defense.
(6) 10b5-1 trading plans may require a cessation of trading activities at times when lockups may be required at the company (e.g., secondary offerings).
(7) Recent rule changes will require companies to publicly disclose material terms of Section 16 director and officer 10b5-1 trading plans, and the early termination of such plans.

Alternative investments may be either traditional alternative investment vehicles, such as hedge funds, fund of hedge funds, private equity, private real estate and managed futures or, non-traditional products such as mutual funds and exchange-traded funds that also seek alternative-like exposure but have significant differences from traditional alternative investments. The risks of traditional alternative investments may include: can be highly illiquid, speculative and not appropriate for all investors, loss of all or a substantial portion of the investment due to leveraging, short-selling, or other speculative practices, volatility of returns, restrictions on transferring interests in a fund, potential lack of diversification and resulting higher risk due to concentration of trading authority when a single advisor is utilized, absence of information regarding valuations and pricing, complex tax structures and delays in tax reporting, less regulation and higher fees than open-end mutual funds, and risks associated with the operations, personnel and processes of the manager. Non-traditional alternative strategy products may employ various investment strategies and techniques for both hedging and more speculative purposes such as short-selling, leverage, derivatives and options, which can increase volatility and the risk of investment loss. These investments are subject to the risks normally associated with debt instruments and also carry substantial additional risks. Investors could lose all or a substantial amount of their investment. These investments typically have higher fees or expenses than traditional investments.

Equity securities may fluctuate in response to news on companies, industries, market conditions and general economic environment.

Asset allocation and **diversification** do not assure a profit or protect against loss.

Hyperlinks

This material may provide the addresses of, or contain hyperlinks to, websites. Except to the extent to which the material refers to website material of Morgan Stanley Wealth Management, the firm has not reviewed the linked site. Equally, except to the extent to which the material refers to website material of Morgan Stanley Wealth Management, the firm takes no responsibility for, and makes no representations or warranties whatsoever as to, the data and information contained therein. Such address or hyperlink (including addresses or hyperlinks to website material of Morgan Stanley Wealth Management) is provided solely for your convenience and information and the content of the linked site does not in any way form part of this document. Accessing such website or following such link through the material or the website of the firm shall be at your own risk and we shall have no liability arising out of, or in connection with, any such referenced website.

By providing links to third-party websites or online publication(s) or article(s), Morgan Stanley Smith Barney LLC ("Morgan Stanley") is not implying an affiliation, sponsorship, endorsement, approval, investigation, verification with the third parties or that any monitoring is being done by Morgan Stanley of any information contained within the articles or websites. Morgan Stanley is not responsible for the information contained on the third-party websites or your use of or inability to use such site. Nor do we guarantee their accuracy and completeness. The terms, conditions, and privacy policy of any third-party website may be different from those applicable to your use of any Morgan Stanley website. The information and data provided by the third-party websites or publications are as of the date when they were written and subject to change without notice.

Disclosures

Morgan Stanley Wealth Management is the trade name of Morgan Stanley Smith Barney LLC, a registered broker-dealer in the United States. This material has been prepared for informational purposes only and is not an offer to buy or sell or a solicitation of any offer to buy or sell any security or other financial instrument or to participate in any trading strategy. Past performance is not necessarily a guide to future performance.

The Global Investment Committee is a group of seasoned investment professionals from Morgan Stanley & Co. LLC, Morgan Stanley Investment Management and Morgan Stanley Wealth Management whom meet regularly to discuss the global economy and markets. The committee determines the investment outlook that guides our advice to clients. They continually monitor developing market and economic conditions, review tactical outlooks, and recommend asset allocation model weightings, as well as produce a suite of strategy, analysis, commentary, portfolio positioning suggestions, and other reports and broadcasts.

The author(s) (if any authors are noted) principally responsible for the preparation of this material receive compensation based upon various factors, including quality and accuracy of their work, firm revenues (including trading and capital markets revenues), client feedback and competitive factors. Morgan Stanley Wealth Management is involved in many businesses that may relate to companies, securities or instruments mentioned in this material.

This material has been prepared for informational purposes only and is not an offer to buy or sell or a solicitation of any offer to buy or sell any security/instrument, or to participate in any trading strategy. Any such offer would be made only after a prospective investor had completed its own independent investigation of the securities, instruments or transactions, and received all information it required to make its own investment decision, including, where applicable, a review of any offering circular or memorandum describing such security or instrument. That information would contain material information not contained herein and to which prospective participants are referred. This material is based on public information as of the specified date, and may be stale thereafter. We have no obligation to tell you when information herein may change. We make no representation or warranty with respect to the accuracy or completeness of this material. Morgan Stanley Wealth Management has no obligation to provide updated information on the securities/instruments mentioned herein.

The summary at the beginning of the report may have been generated with the assistance of artificial intelligence (AI).

The securities/instruments discussed in this material may not be appropriate for all investors. The appropriateness of a particular investment or strategy will depend on an investor's individual circumstances and objectives. Morgan Stanley Wealth Management recommends that investors independently evaluate specific investments and strategies, and encourages investors to seek the advice of a financial advisor. The value of and income from investments may vary because of changes in interest rates, foreign exchange rates, default rates, prepayment rates, securities/instruments prices, market indexes, operational or financial conditions of companies and other issuers or other factors. Estimates of future performance are based on assumptions that may not be realized. Actual events may differ from those assumed and changes to any assumptions may have a material impact on any projections or estimates. Other events not taken into account may occur and may significantly affect the projections or estimates. Certain assumptions may have been made for modeling purposes only to simplify the presentation and/or calculation of any projections or estimates, and Morgan Stanley Wealth Management does not represent that any such assumptions will reflect actual future events. Accordingly, there can be no assurance that estimated returns or projections will be realized or that actual returns or performance results will not materially differ from those estimated herein.

This material should not be viewed as advice or recommendations with respect to asset allocation or any particular investment. This information is not intended to, and should not, form a primary basis for any investment decisions that you may make. Morgan Stanley Wealth Management is not acting as a fiduciary under either the Employee Retirement Income Security Act of 1974, as amended or under section 4975 of the Internal Revenue Code of 1986 as amended in providing this material except as otherwise provided in writing by Morgan Stanley and/or as described at www.morganstanley.com/disclosures/dol. Any type of continuous or periodic investment plan does not assure a profit and does not protect against loss in declining markets. Since such a plan involves continuous investment in securities regardless of fluctuating price levels of such securities, the investor should consider his/her financial ability to continue his/her purchases through periods of low price levels.

Morgan Stanley Smith Barney LLC, its affiliates and Morgan Stanley Financial Advisors do not provide legal or tax advice. Each client should always consult his/her personal tax and/or legal advisor for information concerning his/her individual situation and to learn about any potential tax or other implications that may result from acting on a particular recommendation.

This material is disseminated in Australia to "retail clients" within the meaning of the Australian Corporations Act by Morgan Stanley Wealth Management Australia Pty Ltd (A.B.N. 19 009 145 555, holder of Australian financial services license No. 240813).

Morgan Stanley Wealth Management is not incorporated under the People's Republic of China ("PRC") law and the material in relation to this report is conducted outside the PRC. This report will be distributed only upon request of a specific recipient. This report does not constitute an offer to sell or the solicitation of an offer to buy any securities in the PRC. PRC investors must have the relevant qualifications to invest in such securities and must be responsible for obtaining all relevant approvals, licenses, verifications and or registrations from PRC's relevant governmental authorities.

If your financial adviser is based in Australia, Switzerland or the United Kingdom, then please be aware that this report is being distributed by the Morgan Stanley entity where your financial adviser is located, as follows: Australia: Morgan Stanley Wealth Management Australia Pty Ltd (ABN 19 009 145 555, AFSL No. 240813); Switzerland: Morgan Stanley (Switzerland) AG regulated by the Swiss Financial Market Supervisory Authority; or United Kingdom: Morgan Stanley Private Wealth Management Ltd, authorized and regulated by the Financial Conduct Authority, approves for the purposes of section 21 of the Financial Services and Markets Act 2000 this material for distribution in the United Kingdom.

Morgan Stanley Wealth Management is not acting as a municipal advisor to any municipal entity or obligated person within the meaning of Section 15B of the Securities Exchange Act (the "Municipal Advisor Rule") and the opinions or views contained herein are not intended to be, and do not constitute, advice within the meaning of the Municipal Advisor Rule.

This material is disseminated in the United States of America by Morgan Stanley Smith Barney LLC.

Third-party data providers make no warranties or representations of any kind relating to the accuracy, completeness, or timeliness of the data they provide and shall not have liability for any damages of any kind relating to such data.

RSI1699387895872 11/2023