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RULE 10B5-1 TRADING PLANS

Eases Executive Trading Woes

In an age when corporate scandals are top of mind and full financial disclosure is a must, executives may find it difficult to trade their company's stock without raising eyebrows about how their insider knowledge may have affected their stock trading actions.

The good news is that the Securities and Exchange Commission (SEC) approved Rule 10b5-1, effective October 2000, to ease trading concerns.

Rule 10b5-1 provides an executive with an affirmative defense to claims of trading on the basis of material nonpublic information provided that the executive executes his or her trading in accordance with the rule.

It is important that executives carefully consider the benefits and risks of a 10b5-1 trading plan to determine whether or not it is right for their individual needs.

WHAT ARE THE BENEFITS OF A 10B5-1 TRADING PLAN?

By adopting Rule 10b5-1, the SEC has essentially made it easier for company executives to trade securities without the fear of insider trading accusations. In the past, executives were permitted to trade securities during a preset trading window, which was typically on a quarterly basis at a time when a company is least likely to have nonpublic, material information.

Now, executive insiders can establish trading plans during times they are not aware of nonpublic company information, under which they can still sell company stock. This greater ability to trade company stock on a preset timeframe allows executives to trade stock at times they normally couldn't, helping them to better meet their financial objectives.

Additionally, Rule 10b5-1 prevents company stock activities from being bunched. Because there were specific trading windows in place, all executives would be restricted to selling and purchasing stock at the same time, therefore giving off a suspicious appearance that the company's executives were moving in tandem on the basis of insider information. But Rule 10b5-1 eliminates this bunching by enabling insiders to preset their trading schedule so they can buy and sell stock throughout the year.

Another benefit to Rule 10b5-1 is that it can better enable an executive to pursue his or her financial objectives and goals. For the most part, Rule 10b5-1 enables executives to maintain greater portfolio diversification and liquidity — both of which can have important financial implications for an executive's present and long-term financial needs, including retirement.

Because a large portion of a public executive's net worth is typically tied up in his or her company's stock, Rule 10b5-1 permits the executive to have greater opportunities to sell stock throughout the year. In other words, it prevents the executive's portfolio from becoming overly concentrated in company stock, which permits better portfolio diversification.

WHAT ARE THE POTENTIAL DOWNSIDES TO RULE 10B5-1 PLANS

Beware that Rule 10b5-1 plans may lock an executive into selling shares during a time when the company's stock is experiencing an ongoing, downward trend.

In addition, if the executive changes the preset trading formula established in his or her 10b5-1 plan, this may cause enhanced scrutiny of the trading.

IS A 10B5-1 TRADING PLAN RIGHT FOR YOU?

Rule 10b5-1 plans are different and depend on the executive and the company's plans and policies, so it is important to work with a financial advisor to determine if this one is right for you.

Remember, some companies may set a date and volume for regular selling and buying of stock, while others may offer specifics depending on the executive's accumulation of company shares over time.

Some plans also may require the number of shares sold to be tied to a certain share-price range or give an executive the approval to sell a specific number of shares on a regular basis within a specific time period in the amounts and prices determined appropriate at the time.

In general, to comply with Rule 10b5-1, your plan must follow these three rules:

- Rule 1.** The plan must be established at a time when the executive is not aware of any material, nonpublic information.
- Rule 2.** The plan must include clear instructions or formulas for determining the number of shares, pricing, and date on which securities must be bought or sold.
- Rule 3.** The executive cannot have the ability to influence or control when or whether to trade company stock.

STAYING KNOWLEDGEABLE

By understanding and using Rule 10b5-1, your stock trades can be made in a financially beneficial and defensible way. Be sure to work with an experienced and knowledgeable financial advisor to help you set up your 10b5-1 trading plan.

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