

Desktop Reference: Summary of Section 16 Rules

This is a summary only. Due to the complexity of Section 16, please consult with us regarding the application of Section 16 to your particular circumstances.

Who qualifies as an “Insider” subject to Section 16?

- **Directors** of the company
- **Officers**, including each executive officer of the company and, if there is no principal accounting officer, the controller
- **Beneficial owners** of more than 10% of the company’s securities. A person is deemed to beneficially own securities if, directly or indirectly, that person has or shares the power to vote or sell those securities.

What types of reports need to be filed with the SEC and what triggers these filings?

- **Form 3** – This is the initial report that must be filed when a person becomes an Insider. The Form 3 must list all equity securities (including derivatives) of the company owned by the Insider immediately prior to becoming an Insider. If no securities are held, a Form 3 must still be filed reporting no securities owned.
- **Form 4** – Transactions by Insiders in the company’s equity securities (including derivatives) — that result in a change in beneficial ownership for the Insider — must be reported on a Form 4.
- **Form 5** – Transactions by Insiders eligible for deferred reporting and transactions that should have been reported on a **Form 4**, but were not, may be reported on a Form 5 (though all transactions eligible for deferred reporting can and should — as a best practice — be reported early voluntarily on a Form 4).

What is the filing deadline for Section 16 reports?

- Section 16 reports must be filed on EDGAR no later than 10:00 pm Eastern time on the due date. The due dates for the Forms are:
 - **Form 3** (normal course): within 10 calendar days of becoming an Insider
 - **Form 3** (in connection with an IPO): on the day the Exchange Act registration statement is declared effective (usually the day of pricing)
 - **Form 4**: by the close of the second business day following the transaction (e.g. a sale on Wednesday must be reported by 10:00 pm on Friday)
 - **Form 5**: within 45 days after the end of the company’s fiscal year
- When the due date falls on a weekend or federal holiday, the filing deadline is the next business day.

What happens if a Section 16 report is filed late?

- The company must disclose in its 10-K or annual proxy the names of Insiders who failed to timely file any Section 16 reports and the number of reports and transactions that were not timely filed.
- The SEC has the authority to fine directors and executive officers for violations of their Section 16 reporting obligations, up to US\$150,000 for individuals and US\$725,000 for entities.

What are the short-swing rules under Section 16(b)?

- Subject to limited exceptions, the purchase and sale, or sale and purchase, of equity securities of the company within a period of less than six months will result in “matchable” transactions under Section 16.
- The highest sale price will be matched against the lowest purchase within that period to determine if the Insider received “short-swing profits.”
 - This formula can result in deemed profits, even if the Insider lost money on the transactions.
- The Insider must disgorge any such short-swing profits to the company.
 - The company cannot waive its right to recover the short-swing profits, and any stockholder of the company can bring suit in the name of the company to recover short-swing profits on behalf of the company.
 - Section 16 imposes a strict liability standard — good faith mistakes or misunderstandings of the law are not defenses.