

Section 16 Short-Swing Liability Rules Likely To Be Extended to Foreign Private Issuers and Their Affiliates

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Legislation that will subject non-US companies that publicly report in the U.S. to short-swing profits liability rules under Section 16 of the Exchange Act is embedded in the annual defense funding bill that has passed in the House and goes to the Senate as early as next week. The requirement would apply to companies that qualify as “foreign private issuers,” which have been exempt from reporting and liability under Section 16.

Although similar bills in the past have failed, we expect this legislation to be adopted due to the sentiment in Congress that foreign issuers and their affiliates should be subject to the same rules as U.S. companies. This sentiment was for example clear in the Senate hearing held in the proceedings earlier this year to confirm the appointment of Chairman Paul Atkins, where one Senator specifically urged the application of Section 16 to foreign issuers.

Under the House bill as currently drafted, the SEC would have 90 days following enactment to adopt rules to implement the new legislation. Although the SEC’s rules would almost certainly include a transition period, foreign private issuers and their insiders would have to begin filing trading reports on Forms 3, 4 and 5 at some point next year, and will be subject to liability for profits generated by trades within 6-month periods.

Insiders subject to Section 16 generally include executive officers, directors, and holders of more than 10% of the issuer’s outstanding shares. Because of the differing governance structures of many non-U.S. companies, the identification of insiders may require complex analysis.

If the legislation is enacted, we recommend that foreign private issuers begin to prepare for compliance, including analysis of the scope of covered insiders.

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