

May 2010

## **ZALE CORPORATION SEC COMPLIANCE PROGRAM**

**To:** Board Members  
Management Group

### **INTRODUCTION**

As you are aware, there are a variety of insider trading rules that govern or prohibit certain transactions in the Company's stock and apply to anyone in possession of "material" information about the Company that is "non-public." This memo is to provide you a refresher on the rules most likely to affect you, which are summarized below. Please see our Insider Trading Policy for additional detail.

In general terms, "material" information has been interpreted to include information that a reasonable investor would consider important in deciding whether to buy, sell or hold stock. In other words, material information is any information that, if known, might affect the stock price. Information is "non-public" when it has not been widely disseminated to the public.

For our purposes, there are several categories of individuals who these rules affect (considered "Insiders"). These categories are as follows:

1. "Section 16 Insiders," consisting of board members and those individuals who are "executive officers," including the Company's principal accounting officer (if not an executive officer for other purposes). Section 16 Insiders are subject to extensive rules and regulations regarding transactions in the Company's stock;
2. "Management Group Members," consisting of all of the Company's officers and employees at or above a director level, buyers and all other employees who have access to the Company's financial data\*, and the related accounts of such persons, each of whom is subject to trading windows established by the Company and to various insider trading rules. Board members also are subject to this restriction;
3. Other individuals who could be considered insiders can include any individual who possesses material, non-public information regarding the Company. Thus, if you are aware of confidential matters concerning the Company or are working on a confidential project which would be considered material, you are

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\* The Human Resources Department maintains the list of Management Group Members and provides it to others as needed.

an Insider for the purposes of insider trading rules until that information becomes public.

If you are ever uncertain of your Insider status, please contact Investor Relations and the General Counsel before trading in the Company's securities.

## **INSIDER TRADING RULES**

Under the Securities Exchange Act of 1934 there are several laws that govern insider trading which are discussed below:

- Section 16 Insiders are subject to several requirements under Section 16:
  - a. the Section 16(a) filing requirements (Forms 3, 4 and 5);
  - b. Section 16(b) prohibitions against short swing profits;
  - c. Section 16(c) prohibition against short sales; and
  - d. Rule 144 filing requirements.
- Management Group Members and Board members are subject to mandatory pre-clearance procedures.
- **All** insiders are subject to the Rule 10b-5 insider trading prohibitions.

## **RULES APPLICABLE TO SECTION 16 INSIDERS**

### 1. **Broker Interface Procedures**

The short time period discussed below for the reporting of transactions requires close interaction between the Company and brokers handling transactions for Insiders. A knowledgeable, alert broker can act as a gatekeeper, helping ensure compliance with our pre-clearance procedures and helping prevent inadvertent violations.

Each Section 16 Insider is required to sign a Broker Instruction Letter and deliver it to his or her broker. The letter instructs the broker handling a transaction in Company stock:

Not to enter any order without

- (a) first verifying with the Company's Investor Relations Department that the transaction was pre-cleared, and
- (b) complying with the brokerage firm's compliance procedures (e.g., Rule 144).

To report immediately the details of every transaction involving Company stock, including gifts, transfers and pledges, to the Company's Investor Relations Department via

- (a) telephone, and
- (b) in writing (via e-mail or fax).

## 2. Section 16(a): Filing Requirements

Section 16(a) requires that Section 16 Insiders file public reports of stock ownership and certain trading activities. These requirements, discussed below, are very specific and the Legal Department will help you prepare and file the appropriate forms. Please note that the failure to file any of the following forms in a timely manner must be disclosed in the Company's proxy statement in a separate captioned section, naming violators and may result in other liability under the securities laws.

- Form 3: Initial Statement of Beneficial Ownership

A Section 16 Insider must file a Form 3 **within ten calendar days** of becoming a director of the Company or being designated as an "executive officer," including being designated as principal accounting officer. If a stock option or other award is granted in connection with the appointment, the Form 3 must be filed **by the end of the second business day** following the appointment.

- Form 4: Changes in Beneficial Ownership

A Section 16 Insider must file a Form 4 **by the end of the second business day** following the execution of a "reportable transaction." Generally, any purchases or sales of stock, including the exercise of any stock options, must be reported on a Form 4. In addition, under SEC rules, the two-day requirement applies to any change in "Beneficial Ownership," including gifts, stock and option grants, and other transfers. The term "Beneficial Ownership" applies to the Section 16 Insider, immediate family members, and trusts, partnerships or other entities in which a Section 16 Insider has an equity interest. As a result, if a member of a Section 16 Insider's family buys or sells the Company's stock, it is likely that a Form 4 will have to be filed.

- Form 5: Annual Statements of Changes in Beneficial Ownership

All transactions which are not earlier reported on a Form 4 must be reported on a Form 5 **within 45 days** after the fiscal year-end.

- All Forms 3, 4 and 5 must be filed electronically with the SEC. The Company has compliance procedures in place for these requirements. Any questions regarding these procedures should be directed to Investor Relations.

Ultimately, it is each Section 16 Insider's responsibility to ensure that the forms are filed. The forms can be filed late, but a failure to file on time must be disclosed in the Company's proxy statement and may result in other liability under the securities laws. In addition, the SEC has been granted authority under the Sarbanes-Oxley Act to seek "any equitable relief that may be appropriate or necessary for the benefit of investors" for violations of the Section 16 reporting requirements.

- Termination of Section 16 Insider Status

If Section 16 Insider status terminates (e.g., due to separation from the Company), that fact must be indicated on the next Form 4 or Form 5. For the six months following the termination of insider status, any changes in beneficial ownership of the Company's stock may need to be reported.

### 3. Section 16(b): Short Swing Prohibitions

- Rule: Any combination of a purchase and sale of Company stock OR a sale and purchase within a six month period by a Section 16 Insider is likely to result in personal liability.
- Note: The grant of options, restricted stock or restricted stock units pursuant to the 2003 Stock Incentive Plan or the Non-Employee Director Equity Compensation Plan and the exercise of those options do not constitute a "purchase" under the above rule. However, the sale of the stock acquired by an exercise of options (or as part of a cashless exercise) or in settlement of restricted stock units does constitute a "sale."
- A violator of Section 16(b) is required to repay the Company the "profit" resulting from the violation. "Profit" is calculated by matching the highest sale price and the lowest purchase price regardless of whether the prices relate to the same shares and regardless of whether there was an actual profit or net economic loss. Moreover, the Company cannot waive its right to recover the profit or settle for a smaller amount. If the Company fails to seek recovery, any shareholder may step in the Company's shoes and do so (and an active plaintiffs' bar reviews all filings and will pursue recovery).

Examples:

- a. In order to avoid liability, if a Section 16 Insider exercised options and sold the stock, he or she may not, for six months, purchase any Company stock on the open market. He or she may, however, exercise additional options and sell the stock within six months, or he or she may sell additional stock he or she has been holding irrespective of how it was acquired (i.e., on the open market or through an exercise of options). He or she simply is restricted from purchasing stock on the open market for six months.
- b. In order to avoid liability, if a Section 16 Insider purchases stock on the open market, he or she may not sell it for six months. Similarly, if he or she purchases stock on the open market he or she may not sell stock acquired from an exercise of options (or as part of a cashless exercise) for six months.

To protect against short swing violations, prior to transacting any business in the Company's securities, you should discuss the situation with your broker, your own lawyer, Investor Relations and the General Counsel.

4. Section 16(c): Short Sales

Section 16 Insiders are also subject to the prohibitions of Section 16(c) which prohibits unlawful "short sales" or "sales against the box" of the Company's stock. Specifically, a Section 16 Insider may not sell stock he or she does not yet own ("short sale") and he or she may not fail to deliver stock against a sale within 20 days after the sale.

5. Rule 144

Section 16 Insiders may only sell shares of the Company's stock in accordance with Rule 144, the requirements of which are listed below.

Accordingly, for those individuals, any sale of the Company's stock, even in connection with an exercise of options, must adhere to the following:

- Rule 144 Requirements:
  - a. The stock must be sold through an ordinary broker's transaction;
  - b. The Company must be current in its SEC filings; and
  - c. The aggregate number of shares sold, within a three month period, cannot be more than the greater of one percent of the

Company's outstanding stock or the average weekly trading volume in the Company's common stock in the preceding four weeks.

- Section 16 Insiders should inform their brokers that compliance with Rule 144 is necessary, and must file a Form 144 with the SEC if the transaction (or any series of transactions within a three month period) either exceeds 5,000 shares traded or results in an aggregate sales price of \$50,000 or more.
- Again, brokers should be able to help with any Rule 144 questions and the Form 144 filing if necessary. To be safe, however, Section 16 Insiders may always discuss a proposed transaction with Investor Relations and the General Counsel.

## **RULES APPLICABLE TO MANAGEMENT GROUP MEMBERS AND BOARD MEMBERS**

### **Mandatory Pre-clearance Procedure**

All Management Group Members and Board members, and their related accounts, may not engage in any transaction involving the Company's securities (including a stock plan transaction such as an option exercise, a gift, a loan or pledge or hedge, a contribution to a trust, or any other transfer) without first obtaining pre-clearance of the transaction. A request for pre-clearance should be submitted to Investor Relations at least two days in advance of the proposed transaction. Investor Relations, in consultation with the General Counsel, the Chief Financial Officer, and the Head of Human Resources (or their delegates), will determine whether the transaction may proceed and, if so, assist in complying with the reporting requirements. The approval generally is valid for a ten day period; thereafter a new request must be submitted.

## **RULES APPLICABLE TO ALL INSIDERS**

### **Rule 10b-5**

Generally, Rule 10b-5 prohibits the buying or selling of securities while in possession of material non-public information. The prohibition includes passing along insider information to others who then use it in the purchase or sale of stock ("tipping"). A violation of Rule 10b-5 can result in significant civil and criminal penalties.

## **CONCLUSION**

SEC Rules regarding Insider trading can be confusing and risky for the unwary. To protect yourself, it is always best to ensure that you consult with Investor Relations and the General Counsel prior to transacting any business in the Company's stock

even if you do not believe you are an Insider pursuant to the law and even if the “window” is open. In addition, you should always fully disclose your situation to your broker.

If you have any questions concerning the above, please contact the General Counsel.