PUTTING INVESTORS FIRST: REVIEWING PROPOSALS TO HOLD EXECUTIVES ACCOUNTABLE

HEARING

BEFORE THE

SUBCOMMITTEE ON INVESTOR PROTECTION, ENTREPRENEURSHIP, AND CAPITAL MARKETS

OF THE

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PUTTING INVESTORS FIRST: REVIEWING PROPOSALS TO HOLD EXECUTIVES ACCOUNTABLE

Wednesday, April 3, 2019

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON INVESTOR PROTECTION,
ENTREPRENEURSHIP, AND CAPITAL MARKETS,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 2:32 p.m., in room 2128, Rayburn House Office Building, Hon. Carolyn B. Maloney [chairwoman of the subcommittee] presiding.

Members present: Representatives Maloney, Sherman, Scott, Himes, Foster, Vargas, Gottheimer, Gonzalez of Texas, San Nicolas, Porter, Axne, Casten, Ocasio-Cortez; Huizenga, Wagner, Hill, Mooney, Davidson, and Hollingsworth.

Ex officio present: Representative McHenry.

Also present: Representative Green.

Chairwoman MALONEY. The Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets will come to order.

Without objection, the Chair is authorized to declare a recess of the subcommittee at any time. Also, without objection, members of the full Financial Services Committee who are not members of this subcommittee are authorized to participate in today's hearing.

Today's hearing is entitled, "Putting Investors First: Reviewing Proposals to Hold Executives Accountable." I now recognize myself for 2 minutes to give an opening statement.

This is a legislative hearing on six different bills that are aimed at improving the accountability of public companies and executives. First, we have a draft bill that I have authored called the 8-K Trading Gap Act of 2019. Right now, when there is a significant corporate event at a public company, the company has to disclose that significant event to the public by filing a Form 8-K within 4 days of the event occurring.

And there has been research from academics at Columbia and Harvard showing that executives do actually trade profitably in this 4-day gap. My bill would address this problem by simply prohibiting executives from trading during this 4-day gap.

Next, we have a bill by Mr. Himes that would, for the first time ever, codify insider trading law. I think this is really important because up to now, all insider trading law has been developed by the courts and not by Congress. Mr. Himes' bill would set out a statutory definition of insider trading and would also reverse the harmful *U.S.* v. *Newman* court decision from 2014.

Next, we have a bill by Mr. Foster which would prohibit brokers and investment advisers from using forced arbitration clauses in their customer agreements. The bill would also prohibit public companies from inserting forced arbitration clauses in their company bylaws, which I believe is illegal already, but which could benefit from additional clarity.

Mr. Green also has a bill to protect whistleblowers by clarifying that their employers can't retaliate against them even if they report suspected wrongdoing internally first before they report it to the SEC. This would fix a recent Supreme Court decision which found that only whistleblowers who report wrongdoing to the SEC are protected against retaliation by their employers.

And, we have two discussion drafts that would finally force the SEC to finalize two important Dodd-Frank Act rulemakings on executive compensation.

I very much look forward to hearing from our witnesses on all of these bills.

And with that, the Chair now recognizes the ranking member of the subcommittee, Mr. Huizenga, for 4 minutes for an opening statement. Thank you.

Mr. HUIZENGA. Thank you, Madam Chairwoman.

In a challenging global economy, America's capital markets are the key to our long-term economic growth. However, many of today's rules and regulations governing startups, entrepreneurs, small businesses, and investors were conceived in the 1930s and 1940s, and parenthetically, a Senator from Michigan, from Grand Rapids, a part of my district area, Arthur Vandenburg, was instrumental in that.

Well, the telephone was cutting edge for Arthur Vandenburg and times have definitely changed. If the U.S. wants to compete principally with China and win in a 21st Century global marketplace, then the U.S. needs to break free from old constraints and modernize our capital markets.

Now, we all know that small businesses are what drive the American economy. These innovators, entrepreneurs, and risk takers are critical for our country's economic prosperity. Small businesses make up 99 percent of all enterprises and helped create more than 60 percent of the nation's net new jobs over the past 2 decades. Approximately three quarters of all small businesses relied on financing in the last 12 months. However, nearly 70 percent of startups received less financing that they initially requested, while 28 percent received no financing at all.

It is important to note that 80 percent of business debt financing comes from investors in our capital markets, not lenders at our banks. These numbers do not bode well for American innovation and business. The U.S. continues to witness a slump in the number of new businesses, which in 2016 hit a record 40-year low. The U.S. is only seeing half the number of domestic IPOs that it had 20 years ago, while the U.S. doubled the regulatory compliance costs a business must undertake.

With more companies opting for private fundraising rather than the public market, the number of public companies has decreased to levels not seen since the 1980s when the economy was literally half the size of what it is now, today. This means everyday investors on Main Street are missing out on valuable opportunities to invest in the next Microsoft, Amazon, Google, or other such companies.

IPOs have historically been one of the most meaningful steps in the life cycle of a company, which meant that going public was the ultimate goal for many entrepreneurs. You start a business from scratc, you build it up as a successful enterprise, and then you open up the opportunity for the public to share in that success.

Going public not only affords companies many benefits, including access to the capital markets, but IPOs are also important to the investing public. By completing an IPO, a company is able to raise much-needed capital for job creation and expansion opportunities all while allowing Main Street investors the opportunity to have an economic piece of the action and the ability to participate in the growth phase of a company.

For a myriad of reasons, the public model is no longer viewed as an attractive means of raising capital. Instead, small and emerging growth companies are choosing to go public much later in their life cycle or choosing not to go public at all. And many of them, I might add, are now not just millions, not tens of millions, hundreds of millions, but sometimes billions of dollars. And when we refer to them as "unicorns," I am not sure we can do that anymore. When you see the number of "unicorns," we have a herd of unicorns out there and at some point, we need to allow these folks to go public.

So, we must work to change that trajectory. While speaking at the New York Economic Club, SEC Chairman Clayton stated that, "Regardless of the cost, the reduction in the number of U.S. listed public companies is a serious issue for our markets and the country more generally. To the extent companies are eschewing our public markets, the vast majority of Main Street investors will be unable to participate in their growth. The potential lasting effects of such an outcome on the economy and society are in two words, 'not good'."

While today's hearing is entitled, "Putting Investors First: Reviewing Proposals to Hold Executives Accountable," we can all agree that we should put investors first, but these six proposals in my opinion will do very little to truly protect investors. As currently drafted, these bills in many cases will do more harm than good by creating more barriers to capital formation, and will further deter smaller private companies from going public, in turn, ultimately limiting options and access for Main Street investors as well as "Mr. and Mrs. 401(k)."

With that, I yield back.

Chairwoman MALONEY. The Chair now recognizes the gentleman from California, Mr. Sherman, for one minute.

Mr. SHERMAN. The ranking member is correct that we need good capital markets, although I don't think the private equity is inferior. But perhaps the biggest problem with our public markets is that so many investors are making decisions based upon quarterly considerations or even in a quarter second buying and selling stock, and I can see how some companies would rather have owners that were more stable and more committed and allowed them to think in a 5-year horizon, rather than a 5-minute horizon.

The bills before us today will make our system fair. Capitalism will not succeed if it is regarded as rigged. We need to prevent insider trading. We need to protect whistleblowers. And as to putting something in the bylaws requiring arbitration, that is illegal under just about every State's corporate law. But some States will no doubt try to compete for businesses to incorporate in that State by lowering their standards even further, if we don't act to make it plain that you do not give up your right to sue just by buying stock, especially if you are buying stock under false pretenses, which is the nature of what you are suing for to begin with.

With that, I yield back.

Chairwoman MALONEY. The Chair recognizes the ranking member of the full Financial Services Committee, Mr. McHenry, for 1 minute.

Mr. MCHENRY. Thank you, Chairwoman Maloney.

And, look, our capital markets are decaying. The average age of listed stocks is getting older and yet, we have fewer stocks as the economy still grows. We have a problem with our public markets. And at the same time, we have what is really essentially the new stock market with the greatest upside potential in the path to prosperity and that is happening in the private markets, places where only the wealthy and connected get a chance to succeed.

This is happening while at the same time our government allows people to invest in lottery tickets. We spend $80 billion annually as Americans on lottery tickets, yet we are preventing average everyday investors from actually investing in our economy, investing in America, and having the upside opportunity to make sure that they can grow with a growing economy and grow with prosperity and have capital at work in our systems. We need to fix this and we need to have a more vibrant capital market structure so that small businesses and everyday investors can succeed.

Chairwoman MALONEY. The Chair now recognizes the gentleman from Connecticut, Mr. Himes, for 1 minute.

Mr. HIMES. Thank you, Madam Chairwoman, and I am grateful for this hearing. And to Ranking Member McHenry, I am hoping I can persuade you that a prohibition on insider trading is not in fact an argument about regulation unless we want to contemplate regulating insider trading as opposed to forbidding it.

And the reason I say that is because remarkably, there is no statutory prohibition today on insider trading. We prosecute insider trading using fraud provisions in Sections 10(b) and 16b of the Securities and Exchange Act of 1934. This has led to a judicial mess. Just to give you a little bit of a flavor in my remaining 30 seconds, in August of 2017, in *U.S.* v. *Martoma,* the 2nd Circuit overruled its own 2014 decision in *U.S.* v. *Newman* which was a case that was seen as a test of the Supreme Court's 2016 decision in *Salman* v. *U.S.* on insider trading.

All of this activity involved people having their convictions overturned and a great deal of expenditure of judicial resources. If we are going to send people to jail for breaking the law, we should make that law very clear, and this is our opportunity to do so.

Professor Coffee, thank you for being here. Ranking Members, I hope I can persuade you of this, and that we can create some clarity around something that creates a great deal of confusion and loss of confidence in our capital markets. And with that, I yield back.

Chairwoman MALONEY. Thank you.

Today, we welcome the testimony of a distinguished panel of witnesses. First, we have Professor John Coffee from the great City of New York. He is the Adolf A. Berle Professor of Law at Columbia Law School, and the director of Columbia's Center on Corporate Governance. Welcome back, Professor Coffee.

Second, we have Melanie Lubin, who is the Maryland Securities Commissioner and is testifying today on behalf of the North American Securities Administrators Association. Next, we have Remington Gregg, who is counsel for civil justice and consumer rights at Public Citizen. And last, we have Tom Quaadman, who is the executive vice president of the Center for Capital Markets Competitiveness at the U.S. Chamber of Commerce.

Witnesses are reminded that your oral testimony will be limited to 5 minutes. And without objection, your written statements will be made a part of the record.

Professor Coffee, you are now recognized for 5 minutes to give an oral presentation of your testimony, and thank you for returning to testify once again before us.

STATEMENT OF JOHN C. COFFEE, JR., ADOLF. A. BERLE PROFESSOR OF LAW, AND DIRECTOR OF THE CENTER ON CORPORATE GOVERNANCE, COLUMBIA LAW SCHOOL

Mr. COFFEE. Chairwoman Maloney, Ranking Member Huizenga, and members of the subcommittee, I am both happy and honored to be back here today. I have been asked to talk about several bills, all of which I favor, some of which needs some significant tweaks, but I am going to spend my time dealing with the insider trading statute.

And here, I want to commend Congressman Himes for having supervised the drafting of a careful, balanced, and sophisticated bill that should serve as a model for the long overdue—I underline—long overdue effort to codify the law of insider trading. To date, as was just noted, law is entirely judge made and that has some cost. When you rely on judge-made law, it goes in five different directions. There are 10 different circuits at least. It goes in many directions at once and it can often be inconsistent.

Frankly, this inconsistency has a number of problems. I have to note here briefly that I am not without some conflict here, because I have consulted on this statute over the last several years. I am not the primary draftsman, but I do think this is a statute that has evolved carefully and should be looked at with a great deal of care.

Now, that being said, I want to take you through the backdrop of where we are today. There is general agreement that the law of insider trading has grown overly complex and technical. As a result, it is hard for the public to understand its logic or for practitioners to give advice to their clients. Even worse, when you depend on judge-made law, you are going to get disparities and inconsistencies.

Let me just illustrate in a sentence. Since 2014, the 2nd Circuit has done an 180-degree about-face from its decision in *Newman* in 2014 that very much interfered with the prosecution of insider trading, to its more recent decisions in *Martoma* in 2017 and *Gupta* in 2018 which has expanded the law considerably more than many of us thought it was going to go. But it is far from clear whether other circuits will accept these latest precedents or whether the Supreme Court will sustain them.

All of this means it is a propitious time today for Congress to set standards. When Congress sets standards, there is less uncertainty. When courts make up the law on their own, they can follow any direction they want, confined only by whatever limits are in the statute.

Okay. Now, I should also point out that I am a member of the Task Force on Insider Trading which has been assembled by Preet Bharara, the former U.S. Attorney in the Southern District of New York. And although I cannot speak for that task force, we are focused only on insider trading and I think we basically all agree that we need to move the law in a direction of greater clarity and simplification.

In this light, the key virtues of the Insider Trading Prohibition Act that we have before us are: one, it is comparatively easy to understand; and two, it extends the criminal prohibition to reach clearly egregious conduct or misbehavior that is outside the law of fraud but is instead on the matter of computer hacking or theft or extortion or something else, equally egregious but not within the scope of Section 10(b).

Now, what does this new statute do? Essentially two things: one, it eliminates the need that the tippee pay or be promised some personal benefit by the tipper. This requirement has proved to be a very difficult obstacle, both because those payments can be hidden and even more so, because there is a norm of reciprocity on Wall Street. That is, one hedge fund may tip another without getting any promise or any payment because it expects pursuant to this norm of reciprocity that it will get something in the future.

Sometimes, Wall Street resembles a giant favor bank, and in favor banks you know that if you are going to make withdrawals and receive a favor, you have to pay it back eventually if you want to continue access, and that has been going on. You just need to understand the scale of these transactions.

In *Martoma*, the most important recent case, the profits made and losses averted by Steven A. Cohen who runs something called SAC Capital, now shut down, exceeded $270 million—$270 million—in just a day or two of trading. That's more than the mafia has ever done. Okay. That is the first point about the need to eliminate this personal benefit rule.

The second point is there is some expansion of liability here, but it shouldn't be controversial because it only expands liability to cover other forms of egregious misbehavior. The statute 10(b) only precludes manipulation, deception, or contrivances. That leaves out computer hacking, theft, and extortion. And what makes the law simpler here in this statute is that it has to be a wrongful stealing or misappropriation of the information which may not involve fraud. But there has to be a wrongful taking of the information and then you can have—

Chairwoman MALONEY. The gentleman's time has expired.

Mr. COFFEE. My time is up.

[The prepared statement of Mr. Coffee can be found on page 36 of the appendix.]

Chairwoman MALONEY. Ms. Lubin, you are recognized for 5 minutes for your testimony.

STATEMENT OF MELANIE SENTER LUBIN, MARYLAND SECURITIES COMMISSIONER, ON BEHALF OF THE NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION

Ms. LUBIN. Thank you, Chairwoman Maloney. Good afternoon, Chairwoman Maloney, Ranking Member Huizenga, and members of the subcommittee. Thank you for the opportunity to testify today.

My name is Melanie Lubin. For the past 33 years, I have worked with the Securities Division in the Office of the Maryland Attorney General, serving since 1998 as the Maryland Securities Commissioner.

I also represent Maryland within the North American Securities Administrators Association known as NASAA, where I currently serve as a board member and a member of the association's Committee on Federal Legislation. Since 2015, I have also served as the association's representative to the Financial Stability Oversight Council.

NASAA members include State securities regulators, who for more than 100 years have served on the frontlines of investor protection, safeguarding the financial futures of hardworking Americans and assisting local businesses and entrepreneurs in raising investment capital.

NASAA applauds the subcommittee on its decision to hold its initial hearings of the 116th Congress on proposals that explicitly put the interests of Main Street investors first. These investors are an engine of prosperity helping to drive our nation forward. When we put the interests of Main Street investors first, our capital markets, our economy, and our country all win.

I will use the remainder of my statement to summarize NASAA's perspective on the six legislative proposals that are the subject of today's hearings. First, NASAA is very supportive of the Investor Choice Act of 2019, introduced by Representative Foster. The bill is a modernized and expanded version of legislation that NASAA supported when it was introduced in 2013.

Like the 2013 proposal, this bill will prohibit broker-dealers and investment advisers from including binding pre-dispute arbitration clauses in customer account agreements. These clauses deprive investors of the opportunity to pursue their day in court and instead force them into arbitration. Arbitrators are not instructed and do not have to follow the law. There are limited appeal rights and limited opportunities for discovery.

The current bill goes further by prohibiting the use of pre-dispute arbitration clauses in relation to shareholder disputes with corporate issuers. We strongly support the bill and we look forward to working with the chairwoman and the committee in passing the legislation this year.

Second, NASAA shares the committee's interest in creating a statutory definition of insider trading, an explicit definition that will add great clarity and consistency to this important area of the law. By proposing to codify much of the existing case laws surrounding insider trading, the Insider Trading Prohibition Act is a major step forward.

Third, NASAA welcomes the introduction of the 8-K Trading Gap Act of 2019 by the chairwoman. This bill aims to close the so-called 8-K trading gap, which is the 4-day period between the occurrence of a material event and when the event must be publicly disclosed pursuant to the SEC's rules. We agree that there appears to be compelling evidence that this trading gap exists and that it unfairly advantages corporate insiders by enabling them to enter into securities transactions before the public release of that information. Closing this gap is a basic issue of fairness for retail investors.

Fourth, NASAA is similarly supportive of draft legislation sponsored by Representative Green entitled, "A Bill to Amend the Securities and Exchange Act of 1934 to amend the definition of whistleblower." The bill would revise Section 922 of the Dodd-Frank Act to clarify that whistleblowers are protected by any retaliation provisions when they report alleged misconduct to their employers. This bill is a necessary response to the Supreme Court's 2018 holding of *Digital Realty Trust, Inc.* v. Somers, that only whistleblowers reporting directly to the SEC are protected.

Last, two of the legislative proposals before the committee concern outstanding rulemakings to address executive compensation. Specifically, these bills seek to strongly encourage the SEC to complete rulemakings mandated by Dodd-Frank Sections 953(a) and 954. NASAA strongly supported the Dodd-Frank Act. The preceding financial crisis had made it clear that the existing regulatory landscape required an overhaul to prevent another economic crisis and to restore the confidence of Main Street investors. The Dodd-Frank Act has largely achieved its goals, and where appropriate, Congress has taken steps to adjust certain of its provisions.

Just as the 111th Congress was correct to reform our financial system in 2010, the 116th Congress is correct to insist that the SEC fully implement the law, including by completing these mandatory rulemakings.

Thank you for the opportunity to testify before the subcommittee. I will be pleased to answer any questions that you may have.

[The prepared statement of Commissioner Lubin can be found on page 64 of the appendix.]

Chairwoman MALONEY. Thank you.

Mr. Gregg, you are now recognized for 5 minutes for your testimony.

STATEMENT OF REMINGTON A. GREGG, COUNSEL FOR CIVIL JUSTICE AND CONSUMER RIGHTS, PUBLIC CITIZEN

Mr. GREGG. Good afternoon, Chairwoman Maloney, Ranking Member Huizenga, and members of the subcommittee. On behalf of Public Citizen and our 500,000 members and supporters, thank you for giving me the opportunity to testify.

My written testimony lays out why we support all of the bills that we are discussing today. But for a few moments, I would like to talk about the need to protect everyday investors from forced arbitration.

Forced arbitration is a secretive, privatized system of justice. It deprives people of their day in court. There are no rules of evidence and almost no procedural safeguards, no requirement that the arbitrator follow law or precedent, virtually no ability for you to appeal if you lose. And guess what? You will lose.

Forced arbitration is ubiquitous in consumer and worker contracts. According to Cornell's Alexander Colvin, "When forced into arbitration, workers prevail just 21 percent of the time." According to the Economic Policy Institute, consumers prevail just 9 percent of the time; when corporations make claims or counterclaims, however, they win 93 percent of the time. So, it is easy to understand why corporate America likes forced arbitration clauses so much.

That is why Congress must pass the Investor Choice Act. It would protect everyday investors by placing firmly into law the SEC's longstanding policy, ensuring that everyday investors can continue banding together in order to vindicate their rights. It is hard for the retail investor, "Mr. and Mrs. 401(k)," the everyday investor, whatever you want to call us, to bring a claim alone under the Federal securities laws.

If everyday investors can now band together against corporate bad actors, we will see what we see in the consumer and worker context. That is namely, very few actually enforcing their rights and letting bad actors get off the hook. And is that what we want? Because what we will get is less accountability of corporate wrongdoers, less incentive for them to do the right thing, and more emboldened corporate malfeasors.

At a time when more than 80 percent of all people, that is Republicans and Democrats, oppose forced arbitration, Congress and the subcommittee must protect everyday investors, protect their families, and safeguard their hard-earned savings.

Thank you and I look forward to your questions.

[The prepared statement of Mr. Gregg can be found on page 46 of the appendix.]

Chairwoman MALONEY. Our last witness is Mr. Quaadman. You are now recognized for 5 minutes for your testimony.

STATEMENT OF THOMAS QUAADMAN, EXECUTIVE VICE PRESIDENT, CENTER FOR CAPITAL MARKETS COMPETITIVENESS, U.S. CHAMBER OF COMMERCE

Mr. QUAADMAN. Good afternoon, Chairwoman Maloney, Ranking Member Huizenga, and members of the subcommittee. Thank you for the opportunity to testify today and for the subcommittee's continued focus on issues related to investor protection and capital formation.

Business growth is a dynamic engine of American economic prosperity. Launching a business doesn't guarantee an outcome, but it provides an owner, employees, and their community with the chance to fulfill the American dream. Laws, regulations, and oversight provide the certainty for investors to allocate the capital for those firms to start and to grow. In other words, investors provide the gas for the engine to run.

If a business is successful and can grow into a public company, we all benefit. When a business goes public, it reaches its apex of job creation, revenue growth, and wealth distribution. Yet today, we have half the number of companies that we did in 1996. Of the 2,700 businesses that went through the IPO process between 1996 and 2010, they created 2.2 million and their revenue increased by over $1 trillion.

Today, the Hong Kong Stock Exchange outpaces any U.S. stock exchange in terms of number of IPOs. Regional IPOs, those between $50 million and $100 million, were prevalent in the 1980s and 1990s and they distributed wealth to retail investors in all the different parts of our country. Those IPOs today no longer exist.

We appreciate the intent of the bills that are before us today, but we have concerns with several of them. The Chamber strongly agrees that there is no place for insider trading. Insider trading benefits neither investors nor businesses, and we appreciate the clarity that Mr. Himes is trying to bring to the subject since our insider trading rules are a conglomeration of regulation and court precedent.

However, we have concerns with the bill, namely three of them: one, that this bill would treat insider trading as a strict liability crime; two, that it would create an endless causation chain stemming from the action between the tipper and the tippee; and three, that it would actually outlaw 10(b)(5) plans which are specifically designed to prevent insider trading.

We also have concerns with Trading Gap Act of 2019, though we understand the intent of the bill. Our concerns are that there is material nonpublic information which is actually not publicly disclosed and furthermore, there is a cohort of officers who may not be privy to material, nonpublic information as a 4-day window—decision window is underway.

We also oppose the Investors Choice Act of 2019. Securities class actions actually deprive investors of return. This bill would make it harder for investors to have their wrongs redressed. Arbitration allows them to have their wrongs repressed in a quick fit manner and instead, it would incentivize class action lawsuits and wouldn't provide investors compensation.

Securities class action lawsuits are a top reason why businesses do not go public and why international capital sometimes seeks not to come to the United States. The Chamber also supports claw-backs as a tool to help address wrongs and also to act as a deterrent. However, the bill that is before us today is over-inclusive. It includes many executives who have nothing to do with financial reporting, such as human resources executives.

Furthermore, the SEC in its proposal failed to recognize its own recommendations for reporting, for financial reporting modernizations which are necessary for claw-backs to be effective. We also have concerns with pay versus performance, though we do think ultimately this could be a good disclosure for investors.

We believe for pay versus performance to work, it should have a principles-based approach. However, the SEC proposal would in fact put short-term-ism on steroids. We also have concerns with the whistleblower amendment. We agree that it is important for employees to report to the company first or simultaneously with the SEC, and even with the Digital Realty decision, whistleblowers still have protections under the Sarbanes-Oxley Act.

We do think that there is an important loophole in the Dodd-Frank whistleblower rules that should be fixed, namely that a criminal who is engaged in criminal activities can in fact become a whistleblower and seek a bounty and profit from a crime twice. We do not think that wrongdoers should be able to profit from their own wrongdoing.

The current bills collectively we believe would create further disincentives for businesses to go or remain public. We are willing to work with Chairwoman Maloney and the drafters of the bills to address our concerns, and we hope we can come to a resolution on these issues as well as address the reasons why companies are not going public. Thank you.

[The prepared statement of Mr. Quaadman can be found on page 73 of the appendix.]

Chairwoman MALONEY. Thank you. I thank all the panelists.

I now recognize myself for 5 minutes for questions.

Ms. Lubin, I want to ask you about the 8-K Trading Gap Act. As you know, SEC rules give public companies 4 days to disclose significant corporate events on an 8-K, and sometimes, companies actually need this time to prepare for the filings, especially if they are filing a complicated merger and they need to summarize all the terms. So, there are legitimate reasons for giving companies 4 days to file an 8-K.

But is there any reason to allow company executives to trade during this 4-day gap? Wouldn't it be simpler to just prohibit executives from trading at all during this 4-day gap as my bill would do?

Ms. LUBIN. Thank you for your question. There may be very valid reasons for allowing 4 days for a company to prepare a filing. But whether that delay should be 4 days as in the current rule or something shorter, for example, the 2 days that the SEC had originally requested, can be open to debate.

But the key point here really is that whatever the amount of time, there is no valid reason that insiders with knowledge of a material event should be able to trade during that time period. When they are aware that there you have market moving information that is not publicly available to other investors, they really shouldn't be trading. Your bill is a straightforward approach to address the issue. The issue is about fairness and confidence in our capital markets, and the policies your bill would require firms to implement would help level the playing field between insiders and Main Street investors.

Chairwoman MALONEY. Thank you.

Professor Coffee, I want to ask you about Mr. Himes' insider trading bill. I personally think that a bill that formally codifies insider trading is long overdue and I want to congratulate my colleague for doing such a great job on this bill. Can you talk a little bit about why it is so important for laws like insider trading which can carry criminal consequences to be explicitly defined by statute?

Mr. COFFEE. As early as 1812, our Supreme Court said that common law crimes are unconstitutional. No one has ever created this crime. No question about it that the Supreme Court has upheld it at least three times. But, we want the legislature to pass criminal statutes because courts are not in the business of representing the community and deciding what is criminal. And moreover, when you have 10 different circuits, you are going to get disparities and inconsistencies, and that has characterized the last 10 years.

When you have a statute passed by Congress, there will be courts everywhere coalescing around the mainstream of that statute. Yes, there will be issues, but it will be clear that you will have less disparities and less possibilities of people being surprised by new interpretations. So, I think that is the core of the reason why you should prefer legislation of criminal law than judicial construction of it.

This is not a question about whether insider trading should be unlawful. This is a question about whether Congress should do it or every individual judge should write in the blanks what he thinks works best. That is my analysis.

Chairwoman MALONEY. Thank you.

And, Mr. Gregg, as you know, forced arbitration clauses are common in brokerage agreements, but some people want companies to go even further by inserting forced arbitration clauses directly into company bylaws.

I strongly oppose this, and I think it is already illegal under Federal law. This would prevent shareholders of public companies from bringing class action lawsuits against the company for any security claims including securities fraud. Can you give us some examples of class action lawsuits for securities fraud that have been successful for shareholders?

Mr. GREGG. Well, there have been several, and what we have seen is that when everyday investors are able to bring those securities fraud violations, whether you are talking about WorldCom or Enron, they are able to recoup significantly more when they are able to bring those claims. So, there is no doubt that we are able to see an increase in recoupment.

Right now, actually, Google shareholders are seeking to sue for what they have done, hiding systemic discrimination and harassment.

Chairwoman MALONEY. My time has expired.

And I now recognize the distinguished ranking member of the subcommittee for 5 minutes for questioning.

Mr. HUIZENGA. Thank you, Madam Chairwoman. I appreciate the opportunity to be here, and I would be remiss not to say that I would encourage the Majority to give us a little more notice than 5 p.m. on Friday with a hearing notice to be able to be prepared to fully explore some of these issues. I just would ask the Chair to take that into consideration. She and I have a great working relationship. I want to continue with that.

And I do agree with my colleague from California about his concern about quarterly statements that he was talking about. This has been something I have talked about for years, when you have more focus on quarterly statements rather than, and quarterly results, rather than long-term thinking and long-term planning and long-term strategy, it does change that, and we have had various discussions about possibly changing some of those reporting requirements. I would like to explore that at some point.

And I do believe that this subcommittee at its heart is well summed up by saying investor protection, entrepreneurship, and capital markets, and we must preserve our edge, our advantage that we have as a country with the capital markets that we have.

Mr. Quaadman, I am going to direct a couple of questions towards you about that and about some of the challenges of being a public company here in the United States. But I do also want to maybe touch quickly on the 10(b) situation and Rule 10(b)(5) and have you address some of that, and I know my colleague from Connecticut had a dialogue with Mary Jo White at the time back in 2015 pursuing the line of questioning that he had and her answer about whether there was an argument for codifying that.

She said, "I think 'the Devil is in the details' is maybe not quite the right expression to apply to this. I think it is challenging to codify it clearly in a way that is both not too broad and retains the strength of the common law." And that was Mary Jo White in 2015, and the SEC has had some other discussions on it.

So, Mr. Quaadman, if you could maybe touch on that first, and then I want to talk a little bit about IPOs as well.

Mr. QUAADMAN. Sure. So, first off, I have tremendous respect for Mary Jo White. She was one of the foremost criminal prosecutors before she became SEC Chair. I do think she is right that the Devil is in the details.

Our concern with the current bill here is that it is both over-inclusive and under-inclusive. And I raise the issue about 10(b)(5) plans because we have to think about 10(b)(5) plans as being almost like a blind trust that you can automatically sell shares according to a program without having any input into that.

Both the insider trading bill as well as the 8-K gap bill create problems with 10(b)(5) plans. I think the insider trading bill would actually outlaw them. So, we need to be consistent with that, and I think that is something that should be addressed.

In terms of the IPO issues, let me also put it in this way, we are beginning to as a country lose our ability to address these issues in a very forceful way. This committee has done a lot over the years in terms of the JOBS Act to address some of these issues, which has arrested the decline of public companies in the United States. We haven't seen the number of IPOs go up, but when we start to look at the two issues that are really vexing it, one is research—well, the research rules are being run by the Europeans through MIFID II and they are going to go through a rewrite in 2020.

And when we start to look at capital, Chinese venture capital over the last 2 years has become larger than American venture capital. So, we have sat back for decades saying we have the deepest, most liquid, most fluid capital markets. That is increasingly no longer the case, and we need to take the policy steps to correct that as well as get rid of those obstacles which are preventing businesses from going public.

Mr. HUIZENGA. I have about 1 minute left here. Ed Knight, who was executive vice president and general counsel of NASDAQ New

York, testified on the fifth anniversary of the JOBS Act that, "in talking to various corporations, you learn that the primary challenge is not about going public, but it is oftentimes about staying public and being public."

Can you maybe explain a little bit about that? And then, if we are looking at IPO cost of $2.5 million to go public and $1.5 million to remain public, how is that viable for these non-unicorn type companies? So, the challenges there.

Mr. QUAADMAN. That is exactly the reason why we are no longer seeing those $50 million to $100 million IPOs that I had mentioned earlier, the regional IPOs. The disclosure cost as well as the shareholder proposal pressures no longer make it one that is—it is viable for that model.

The other thing you have to remember with the unicorns as well, is that it is no longer a cash-raising exercise. To some degree, is is a cashing-out exercise. So, we are no longer even seeing that as a funding mechanism and as a growth mechanism. We are seeing it really as an allocation issue, and that actually harms the ability of the economy to grow.

Chairwoman MALONEY. The gentleman's time has expired.

And the gentleman from Georgia, Mr. Scott, is recognized for 5 minutes.

Mr. SCOTT. Thank you, Madam Chairwoman. This is indeed a very interesting and timely hearing. There is nothing more important right now for our committee than to make sure we offer our consumers, our financial consumers the absolute best in terms of investor protection.

Professor Coffee, you were the only one of our panelists who mentioned the *Newman* court case. And the reason I say that is because I have just been given some very important information, the Securities and Exchange Commission has given this very pertinent information, they are saying, "We are warning that the *Newman* court decision will negatively affect the Securities and Exchange Commission's ability to effectively police and deter insider trading."

So, I think to really grasp the meaning of why we are here, we need to get some understanding of what the Securities and Exchange Commission is saying here. Could you enlighten us on this? And any of the other panelists, let us try to find out, because these are the folks who have to police investor protection. And if they are saying from the *Newman* case that there is a very serious problem, we need to find out what they are saying.

So, could you enlighten us?

Mr. COFFEE. Certainly. The Commission is, I think, clearly right. I should add that last year, 2 years ago now, the Supreme Court partially overruled *Newman,* but they left a large part of it to be still a barrier.

Now, in light of *Newman,* the southern district of New York had to reverse something like 50 convictions that it had obtained and the SEC didn't feel it could sue because you had to prove under *Newman* not only did a remote to be new that there had been a personal benefit paid by the original tipper to the original tippee, but also that there was some expected benefit that was going to go back the other way, that there was a reciprocal benefit that had been promised.

It is very hard to know that. What's more, it gave rise to a natural defense tactic, "Don't ask, don't tell." If you do not ask how the person knew it, you do not know whether or not they had gotten this in return for paying a personal benefit to the tipper. It was an impossible burden to put on the prosecution.

Mr. SCOTT. Okay. So, what I want to get to here is that we have Mr. Himes' bill, of which I am supportive. Are we addressing that appropriately enough? Is there something we need to do so that we are responding to the warning of the Securities and Exchange Commission on this?

Mr. COFFEE. Good question, and the answer is definitely, because by abolishing the personal benefit rule, that is the key provision that *Newman* elaborated and made a major, major obstacle by saying not only there had to be a personal benefit but that everybody in the remote chain of tippees had to know exactly what that benefit was and had to have some awareness that there was a promise going back the other way.

So, the Himes bill will definitely solve what remains of the *Newman* problem, although the Supreme Court already has partially reversed *Newman.*

Mr. SCOTT. Okay. Ms. Lubin?

Ms. LUBIN. I think it is a very helpful bill, because as a career civil prosecutor, it helps us when we bring cases and it helps people when they are trying to comply with the law to know what the parameters are and not have to worry about—I'm sorry.

Mr. SCOTT. No. Go ahead. And so, where our Himes bill addresses that to your satisfaction, Mr. Gregg, are we on target here? We take care of that?

Mr. GREGG. Yes. You are on track.

Mr. SCOTT. All right. Mr. Quaadman?

Mr. QUAADMAN. Yes.

Mr. SCOTT. Let us hear from you.

Mr. QUAADMAN. Mr. Scott, as I outlined in my opening statement, we have three major concerns with the Himes bill. We also have a couple of concerns with the 8-K gap bill. We agree with the intent of both bills, because we believe that insider trading should be prohibited, I would also say to the 8-K gap issue, there are two executives with Equifax who have been charged with a crime because they were trading during that 4-day period.

So, I think we would like to maybe address some of the issues particularly with the Himes bill where we can get it right because we think at some points, it is over-inclusive, and at other points, it is under-inclusive, and we need to get it right.

Mr. SCOTT. But I want to make sure that you are clear that the Himes bill definitely takes care of the Securities and Exchange Commission issue that was brought out in the *Newman* court case.

Mr. QUAADMAN. Part of the fix that we see there, we think actually deals with the mens rea issue in a wrong way and that is part of the issue that we want to talk about.

Mr. SCOTT. Okay. Thank you.

Chairwoman MALONEY. Thank you. The gentleman's time has expired.

And the Chair recognizes the ranking member out of order.

Mr. HUIZENGA. Well, thank you, Madam Chairwoman, and I appreciate the point of personal privilege.

I just wanted to welcome a couple of families from West Michigan who are visiting here, the Keiper and Davies families—teachers back in my district—and their kids. It is very exciting here in the Financial Services Committee, kids. I promise you that at least at some point in life, it will become so. But they, along with so many other people, are here in Washington, D.C., enjoying spring break. So, I appreciate that opportunity to introduce my friends.

Chairwoman MALONEY. Well, welcome to the committee.

The gentlewoman from Missouri, Mrs. Wagner, is recognized for 5 minutes.

Mrs. WAGNER. I thank the chairwoman.

Mr. Quaadman, I have a number of questions here. So, please, if you could briefly discuss how the JOBS Act of 2012 has helped American companies and startups to reduce cost, gain access to capital, and grow as public companies.

Mr. QUAADMAN. It did a few things. One is the road show and testing the waters provisions has actually allowed investors and businesses to go and have discussions and test things out ahead of time, which has been helpful. It has also allowed for certain onramp provisions to allow companies to grow into certain disclosures rather than to have the burden of the cost right upfront.

Mrs. WAGNER. Despite some of the clear benefits that the JOBS Act of 2012 had for startups, what are some of the regulatory concerns that startups will still have today?

Mr. QUAADMAN. Well, we are talking about some of these here today. Securities class action lawsuits are a very big reason why companies don't go public. Proxy advisory firms are another reason and in fact, the pay versus performance provisions here—

Mrs. WAGNER. Yes.

Mr. QUAADMAN. —would actually make—would entrench the proxy advisory firms further without any oversight from the SEC. There have also been some auditing issues coming out of the PCOB that have caused some problems. But those three things combined are amongst the reasons why we are not seeing businesses go public.

Mrs. WAGNER. Would the bipartisan capital formation bills that originated in this committee and passed the House last Congress as the Jobs and Investor Confidence Act build on the success of the 2012 JOBS Act for small and emerging companies, do you believe?

Mr. QUAADMAN. Yes. And that bill passed with over 400 votes. Those were small, incremental steps, as we were calling it, a JOBS Act 3.0 at that point, that would again incrementally help reverse that situation.

Mrs. WAGNER. What do you believe are the biggest deterrents to companies going public?

Mr. QUAADMAN. We have an out-of-kilter shareholder proposal process. We have proxy advisory firms that are running rampant. We have a number of other issues in terms of disclosure costs. We have a disclosure system we have to really talk about, that is rooted in the 1930s. It is no longer—it doesn't serve the needs of the 21st Century economy.

As I have said before, when companies have to pick a historic stock price on one date every year, I could tell you what the cost—what the stock price of Alcoa was on June 17, 1972, it shows how out of date that system is, and then start to replicate that hundreds and thousands of times. So, there are obsolete disclosures we need to address.

Mrs. WAGNER. And what size companies suffer the most from the regulatory costs associated with going public?

Mr. QUAADMAN. The smallest, and that is the reason why I said we are no longer seeing the regional IPOs. And that is why you are seeing companies grow to be unicorns and then they are going to take their time to decide if they want to go public or not.

Mrs. WAGNER. And that is my concern, is the small companies, the startups, those emerging growth companies. Would the bills discussed in today's hearing create additional requirements on American public companies, adding to their regulatory compliance cost, do you believe?

Mr. QUAADMAN. Yes, they would, and they would be significant. And one other point, just to go back to your last question just to hit one other point there, when unicorns go public, retail investors can't get the benefits of that IPO. It was the smaller IPOs that allowed the retail investor to reap the rewards. That is why you saw people, everyday people getting wealth distributed their way.

We are now seeing a closed system where certain large investors reap the rewards and the retail mom and pop investor is left in the dust.

Mrs. WAGNER. As everyone knows on this committee, and I certainly have expressed over and over again through the Reg BI proposal and the long fiduciary struggle we have been through between the SEC and the Department of Labor, I care deeply about those low- and middle-income investors in my district and across the country.

So, none of the proposals discussed today would apply to private companies. So, would these increased compliance costs for public companies deter private companies from going public?

Mr. QUAADMAN. Yes. Those private companies won't go public. And I think what we have to recognize is, we still have the gold standard when it comes to public capital markets, but we are beginning to fall behind, and both Chairman Clayton at the SEC and Chairman Duhnke at the PCAOB are trying to address these issues.

But it is very important for Congress to set the appropriate policy objectives, that we start to reverse these trends.

Mrs. WAGNER. And to go back to the five-point, how does a company going public not only benefit the economy in terms of jobs, but also America's Main Street investors?

Mr. QUAADMAN. Correct. Well, one of the things that we are also seeing with this calcification of the IPO process, is that 50 percent of all business startups are occurring in 20 counties representing 17 percent of the American population.

Mrs. WAGNER. Wow. Thank you. My time has expired. I yield back.

Chairwoman MALONEY. The gentleman from Connecticut, Mr. Himes, is recognized for 5 minutes.

Mr. HIMES. Thank you, Madam Chairwoman, and thank you to the panel for your comments on my insider trading bill.

I am determined to get this through with bipartisan support. I am telling my Republican friends that this is really not a regulation bill. This is a question of making sure that the activity that we all agree should be illegal, is in fact illegal because the Congress passes a law making it illegal, rather than ongoing interpretations by judges.

Mr. Quaadman, in my effort, because I know you raised some objections in my effort to clear up possible objections to my bill, you raised three objections that I would like to ask you about. You said in your testimony that my Act would, "establish insider trading as a strict liability crime and remove any scienter requirement."

I had to review the second year law school I never took as a non-lawyer on scienter and mens rea, but I want to read to you from Section 16a of my proposed legislation that reads that one is liable only if such person "knows or recklessly disregards that such information has been obtained wrongfully." So, that looks to me, and I am told that this is the very standard set by *SEC* v. *Obus* for scienter and this by the way is repeated back on pages four and five of my bill.

So, my question is, why do you think that the bill established insider trading as a strict liability crime?

Mr. QUAADMAN. Because we think that some of the efforts made in the bill to address the *Newman* issues, and I understand what you are trying to do there, take away from a mens rea requirement. Our reading of it was different than yours or maybe Professor Coffee's which is why we thought that that impacted mens rea.

Now, I would be willing to have a further discussion with you offline about that, because we think that you do need a mens rea requirement in order for insider trading legislation to be effective.

Mr. HIMES. But isn't "knowing or recklessly disregarding" the definition of mens rea?

Mr. QUAADMAN. Well, it is the measurement of intent that the court would have to find and we do not necessarily think when you take a look at the bill in total that it gets there.

Mr. HIMES. Okay. Can you be more specific and point out a line or a section you think is problematic in that regard?

Mr. QUAADMAN. What I can do is I can maybe get back to you on that, but it was the reading of the total bill and in addressing the *Newman* issue that we felt was affecting the mens rea requirement.

Mr. HIMES. Okay. I will follow up on that.

Mr. QUAADMAN. Yes.

Mr. HIMES. Because I think we are pretty clear about knowledge and intent here. But nonetheless, I am not a lawyer. So, I will be deferential on the question. I assume by the way that if we can satisfy each other on this point, this also deals with the concern you had, your third concern on 10(b)(5) plans, that 10(b)(5) plans are just plans that predetermine a number of shares to be sold at a predetermined time?

So, if I am not acting wrongfully under my bill as my bill defines it, that presumably wouldn't impact 10(b)(5) plans, in fact, only if you altered a 10(b)(5) plan would you be liable, I think.

Mr. QUAADMAN. Well, clearly, if you are altering a 10(b)(5) plan and you have information, you are certainly in a grey area there. But if you take a look at the two actions separately, if you are in possession of knowledge that is not public and you have a 10(b)(5) plan going on, whether or not you are, and let us say you are not even addressing that or trying to change that, under our reading of the bill, you actually couldn't go forward with the 10(b)(5) sales.

Now, I think what that would do, we would have to do is tweak the language somewhat that if you make the 10(b)(5) plan, almost consider it like a blind trust, even if that member has, if that person has knowledge and they are not affecting the plan in any way or not adjusting the plan in any way, then, you would then allow the 10(b)(5) plans to move forward.

Mr. HIMES. Okay. Obviously, the intention here, in fact, if you have a 10(b)(5) plan, by definition you have said, "I will sell these number of shares on this date without knowledge." So, this feels to me like a solvable problem.

Mr. QUAADMAN. Yes. I didn't think it was your intent to—

Mr. HIMES. No, of course not.

Mr. QUAADMAN. —deter 10(b)(5) plans at all.

Mr. HIMES. Yes.

Mr. QUAADMAN. As a matter of fact, I think you would want to encourage them.

Mr. HIMES. Yes. Yes, absolutely. So, I will follow up on your offer for specific language, because this feels like a solvable problem.

In the last 40 seconds I have here, let me just give Professor Coffee an opportunity to reflect on the exchange we just had.

Mr. COFFEE. I think it has been ignored so far that the Himes bill doesn't stand by itself. There can be no criminal prosecution under the Securities and Exchange Act without running it through Section 32a. And 32a requires for criminal prosecution the mens rea level is willfully, your standards are the standards for civil liability in your bill. But a criminal prosecution would require that the prosecution show that you willfully violated this rule and that means really a corrupt purpose or intent.

A technical violation won't create criminal liability. So, I do not think the mens rea problem is really any different here than any other criminal prosecution all of which run through Section 32a.

Mr. HIMES. Thank you.

Mr. Quaadman, I am going to take you up on your offer first on written suggestions on how to address whatever concerns you have. And with that, I yield back.

Chairwoman MALONEY. The gentleman from Arkansas, Mr. Hill, is recognized for 5 minutes.

Mr. HILL. I thank the Chair. Thanks for holding this hearing, and thanks for bringing this fine panel before us. Could we put up my draft?

So, we have been talking today about public companies and of course there are 50 percent fewer public companies than when I graduated back in 1979 and went into corporate finance. And this chart in the golden yellow line, it is 7,000 back in 2000. It shows the last peak in public companies at the height of the dot-com boom and small public offerings.

But it has been flat here since the financial crisis of companies public and that is despite great efforts on a bipartisan basis here to enact the JOBS Act legislation and we have seen emerging growth companies. But we see this private equity line in blue has continued since 2000 upward and upward.

Mr. Quaadman, I am curious—you talked about some of the things, but I am curious if not only the cost of being public, you talked about litigation cost. You talked about compliance cost within a post-Sarbanes-Oxley environment. We have exempted a lot of that burden through the emerging growth company definition. We have moved the market cap size up.

And so, I am curious what else is contributing to companies not going public, and I wonder if it is a consolidation in the investment banking community where there are fewer companies taking smaller companies public because they really—can't really make a profit making a market in small and midcap companies now as they could years ago.

So, has Reg NMS or some of the capital market systems impacted the ability to go public?

Mr. QUAADMAN. So, yes, and I would also add some others with that. First off, I would say with the private equity line going up, it is important for us all to have vibrant private markets too.

Mr. HILL. Right. This is not a criticism of private capital, obviously.

Mr. QUAADMAN. No. No. We need to have both. I think you are right Reg NMS, market structure issues which remain unaddressed, even issues let us say with the Volcker Rule which affect the ability for businesses go into the debt and equity markets.

You have a combination of all those, then it starts to make public capital that much more expensive versus private capital.

Mr. HILL. Right.

Mr. QUAADMAN. So, yes, you are correct. We have dealt with so many disclosure issues and are dealing with some of them but it is the cost of capital that is also driving this.

And that is why I mentioned the Chinese venture firms, capital firms before, because they are also beginning to spend a lot of money here in the United States and it is that disparity in the cost of capital that is driving this.

Mr. HILL. Well, I think it is just something for all of us on the committee to be concerned about. With the package of capital formation bills that we call informally JOBS 3.0 that we passed before the House last September, that Chairwoman Waters and former Chairman Hensarling worked on together, would they be at the margin beneficial to this?

Mr. QUAADMAN. I think they would be. As I said, incremental steps forward. I think the two problems as we have been talking about, liquidity in terms of the cost of capital as well as the lack of research with smaller companies.

I think JOBS Act 3.0 start to take steps to help reverse that trend. The other thing I would say with that chart when you take a look at the public company side, when you see that slight bump up and then the flattening, that is when the JOBS Act came in.

So when you take a look and you even went back to 1996, the number of public companies went down every year up until then. So what we need to do and this is what the intent of JOBS Act 3.0 was to now to start to have the curve start to go back up again rather than just being flat.

Mr. HILL. Right. Good. Thank you for your work on behalf of the Chamber for that. I was reflecting on the arbitration bill, and my view of arbitration having been subject to it and part of it for 3 decades is that we have so many small owners and we have 4,000 firms and 600,000 registered people, that this was a way to speed access to a just award, and in my reading of the statistic, about 43 percent, 44 percent of FINRA arbitration claims result in a damage award to a consumer.

So it doesn't seem like it is tilted any way there, we have public members of those panels, and class actions are exempted. You are not eligible for arbitration if there is a class action about a stock. So is this helping to lower cost for investors and the investing public?

Mr. QUAADMAN. Arbitration helps lower the cost and it helps for speedier awards. I would also say too when you take a look at securities class action lawsuits, $50 billion is given to the class action bar as a result of that.

That actually comes from the investors' pockets. I think people don't actually make that connection. And even with the FINRA arbitration awards, there is a significant number of FINRA arbitration cases that are settled before they even go to the arbitration process.

Mr. HILL. Thank you, and I yield back.

Chairwoman MALONEY. Now the gentlewoman from Iowa, Mrs. Axne, is recognized for 5 minutes.

Mrs. AXNE. Thank you, Madam Chairwoman, and thank you to the panel for being here today, I appreciate it.

I absolutely appreciate all of the proposals that we are reviewing today, but I would like to focus a little bit more attention on two of the bills regarding executive compensation. As I am sure everyone here is aware, Wells Fargo's CEO just announced his retirement. However, considering that despite all of the scandals that we have seen, he made more than $50 million as a CEO, including $2 million in bonuses just 2 weeks before he retired.

I think we should all be concerned about if his performance was worth that pay. So my first question is this to the panel members, this seems to me like exactly the problem with investors and the public not having full disclosure about the relationship between a company's performance and their CEO's executive pay.

Professor Coffee in particular, considering that Dodd-Frank was signed into law almost 9 years ago, and the rule was proposed 4 years ago now, why has this process taken so long?

Mr. COFFEE. The SEC has gone very slowly the last 2 years, and you can speculate why, but it is not just the ratio of performance to payment, it is the clawback rules, because there are lots of reasons why there may be clawbacks yet from all the senior management but there is no mechanism for enforcing it.

So I am very much agreeing with what you are saying, but I would put a little bit more weight on clawback rights. If you have been there when there has been a major restatement and major scandal and you have had to pay it all back to the government, I think your bonuses should be clawed back and that can't happen without more rules than we have.

Mrs. AXNE. Okay. I appreciate that. So Mr. Gregg, can you talk about why it is important for the SEC to have these commonsense rules for the clawback of improperly obtained incentive compensation?

Mr. GREGG. Well, I think it is pretty simple, because there are two important reasons. The first one is the link, shareholders should be able to know what is the link between performance and compensation.

Now, that is just simple information that they should know so that they can judge for themselves if someone is actually being compensated well or for a good job or poor job or if they are being wildly compensated for no apparent reason.

And the second is transparency, that they have the right to know this information. I will just put this out there that for example last year from the compensation of Boeing executives, part of the Form 14(a) said that one of the metrics for executive compensation was reducing costs. So that is something that I think shareholders would want to know, that reducing costs is something that went into compensation of Boeing executives given what is happening right now at Boeing.

Mrs. AXNE. I appreciate that, thank you. Any other comments on either of those questions from the group here?

Mr. QUAADMAN. Well, I would just say, first off in terms of Wells Fargo, there are na umber of different investigations that are going on that haven't been concluded yet.

Second, there haven't been allegations that Mr. Sloan has necessarily done anything wrong as of yet. Furthermore, I would say with the pay versus performance issue, it wouldn't actually get to the issue that you are talking about because pay versus performance on the SEC proposals actually dealt with total shareholder return.

And I would actually say too, that is a misnomer because if you take a look at a company that is in a bad way and they have to go out and hire a new CEO, their TSR wouldn't look right. But you know what, they are having to go out and hire the talent to turn the company around.

So under the proposal the SEC proposed in 2015, before this SEC, that was not a workable proposition, which is why we said it should be a principles-based approach. I would also say too, if you take a look at companies, you have say on pay votes, and in almost every company, say on pay votes are passing by 80 percent or 90 percent from investors, in which case investors are saying we have either the right person on board and we are paying them what we should be paying, and investors have not walked away from that.

Mrs. AXNE. Ms. Lubin?

Ms. LUBIN. I think these proposals are important because they provide transparency to investors. They could understand how executives are compensated, they could understand how much risk an executive is willing to take to drive up the stock price in order to make whatever bonus they are going to make based on their compensation arrangements.

So it helps an investor understand, am I looking at a company that is going to be steady, do what they need to do, or am I looking at a company to invest in where they are going to do something that is really risky in order to drive the price up, so the CEO or someone else can get their bonuses.

Mrs. AXNE. Yes. I appreciate that. I can tell you and Mr. Quaadman, I can tell you as an investor that I certainly don't feel that the information I need is very transparent to certainly make any vote as an investor in any company. So, thank you so much, and I yield back my time.

Chairwoman MALONEY. The gentleman from Guam, Mr. San Nicolas, is recognized for 5 minutes.

Mr. SAN NICOLAS. Thank you, Madam Chairwoman. I first wanted to discuss the slide that was up earlier because I had some observations on it and those observations are based on me actually being in the financial services industry as an investment advisor with my series 7 and 66 licenses.

We had to weather two major occurrences that I think were primarily responsible for the actual shifting down of the number of companies that were public. We had the financial crisis most recently and prior to that, we had the bursting of the dot-com bubble. And if we pull up that slide, you can see that both of those downdrafts were as a result of those two crises.

And so we need to be very clear of the fact that if we are going to be talking about what is impacting a number of public companies in both of those instances, what impacted them the most was recklessness, recklessness in the industry. And so Ms. Lubin, I very much appreciate your recent comments about how increased transparency to investors is a good thing.

Another thing that I think we need to take away from this chart is the fact that while we do see an increase in the private equity relative to public companies, we also need to understand that a lot of the way small and medium-sized companies are going public these days has changed. In the past, they used to go public and hope that their business model whether it was profitable or unprofitable, especially in the dot-com bubble, they were hoping that was going to be sufficient for them to raise public capital.

Today, a lot of companies are first relying on private equity to be able to finance themselves during their growth phases when the earnings are inconsistent and when they are still trying to get their bearings on their business model. And that is important to understand, because when we are talking about going public as a company, you have to meet quarterly targets.

You have to meet earnings expectations and you have to show almost a continuous trend of growth otherwise your stock prices are going to suffer. In private equity, you don't have that kind of baggage. And so a lot of our small and medium-sized companies that are under the private equity model right now are still trying to work out their business models and smooth out their earnings history so they can get to a place where they can go public.

And while oftentimes, that is a cash-out event for a private equity that is invested in those companies, it hasn't turned out to be necessarily a bad thing, our markets at our historic highs at this point. So perhaps the evolution of the way companies go public has changed and it is not necessarily a reflection of the market being overregulated.

I did have a concern with respect to the arbitration component, having worked in the industry, and I wanted to post this to Mr. Gregg and that is that while I can understand that we want to always ensure that everybody has the ability to file the lawsuits and the class actions, I also as an advisor and also as a shareholder, I would receive notices from these law firms that are just circling looking to file whatever class action they could against a company and then try and settle those class actions in order to just get their check and move on.

And so I wanted to ask, while there is a strong case to be made for allowing for class actions and for lawsuits and doing away with arbitration, how much frivolous class actions and frivolous lawsuits do you think might have been avoided with arbitration being something that was in place? And perhaps arbitration might not necessarily be a bad thing altogether, perhaps it is just something that needs to be more tilted towards balance for the consumer. So if you could provide some insight into that please.

Mr. GREGG. Well, thank you for the question. I would say number one, every person should have the opportunity to enter into arbitration post-dispute. Knowledge is power. And so, if you have a dispute and you then decide that this is the best thing for you, you should be able to do that.

We are talking about pre-dispute, we are talking about the fine print of your app so that you never even see that you are being forced into it. So that would be number one. Number two is to the question of litigiousness, our courts, the Supreme Court has ascribed very high bar over the last few years in order to get into court and stay in the court, the heightened plead.

So it is very hard to, one, get into court; and two, stay in the court. So I would respectively disagree on that claim that there would be a lot of litigation, because our courts are dealing with that and the Supreme Court has already dealt with that in terms of our pleading standards.

Mr. SAN NICOLAS. The bar may be set higher, but that is the bar to get into court. Just the mess of having to go through the process of getting there and dealing with the challenge and the acquisition and the reputation risk and public scrutiny, those all incur cost to a company that they all sit down and they factor based on what decision they are going to make with respect to whether they are going to just settle the suit or move forward and actually climb over that high bar.

And so I just wanted to have the dialogue because it is something that I am trying to reconcile given my experience. Thank you, Madam Chairwoman.

Chairwoman MALONEY. The gentleman from Illinois, Mr. Casten, is recognized for 5 minutes.

Mr. CASTEN. Thank you, Madam Chairwoman. Thank you all for being here. I am going to try to be a little bit scattershot and hit hopefully all of you here before this is done. I want to start with some questions about my friend, Congressman Foster's, bill.

Professor Coffee, in your opinion, what impact would permitting forced arbitration classes and corporate documents and IPO documents have on an investor's ability to recover damages for securities fraud?

Mr. COFFEE. In my view, investors will not exercise that. People have pointed earlier to FINRA arbitration, I think I am the only person in the room who has been a FINRA arbitrator and I think it does work, but that is against the broker and that is being run by basically a government-sponsored organization, FINRA.

If you just put this in a corporate charter, there is no one there to establish the mechanism and make it fair. And what happens with most arbitration procedures is that the consumer, or here, the shareholder, never exercises arbitration, and neither wins nor loses, just doesn't try it, and I think that is likely to be the most probable consequence of putting it in to the corporate charter. Well, I will turn it to—

Mr. CASTEN. Thank you. My second question is for Mr. Gregg. I have negotiated far too many contracts in my prior career outsourcing energy assets in the industrial space, and we often included either mandatory arbitration provisions or waiver of jury trial provisions, and we did that between two very sophisticated, heavily lawyered-up companies.

I note that in Mr. Foster's bill, he provides the option for investors to choose to select arbitration or not. In your view and if there is no black and white line, that is a fine answer, are there conditions where you think it is appropriate to defer to mandatory arbitration? Do you think it is always negative? Are there conditions where you think it is appropriate to have volunteer choices? Or do you think we should stay as we are right now?

Mr. GREGG. Well, we definitely shouldn't stay where we are right now. I think it is important. So the SEC has said that their longstanding policy is it is contrary to the Federal securities laws, to force people into arbitration at least in the cross section context.

But what we are seeing is a push by corporate entities, very hard, to try to get the SEC to change their longstanding policy. So I believe it is important for this body to say unequivocally that they are protecting investors.

Again, if people want to go into arbitration after an event, after a dispute, that is fine. The point is, what we have right now is people being forced into a system that they know really nothing about. In a nursing home, when you are seeking employment you get 10, 15 documents and they say, "Sign here, here, here." And you have no idea that there you are being forced into something until there is a problem. You have been discriminated against. There is wage theft.

So, first and foremost, it is about transparency and ensuring that every person understands what they are entering into.

Mr. CASTEN. Okay. Thank you. My question is for Ms. Lubin. There has been a lot of discussion here today about what to make of this decline in public company listings, and I think the implication that several have raised is that this says something about the regulatory burden of going public.

I would ask unanimous consent to enter into the record a Harvard law article from May 2017, looking behind the declining number of public companies and I want to specifically just call out three things from the article. They note, number one, that there are more foreign companies doing cross-border listings than ever before.

Number two, there is a significant decline in delistings in public markets in recent years, and number three, they described, "The growth in alternative financing methods has extended the private financing stage of the investments," and they conclude that, "The trend towards IPOs of higher quality more sustainable companies is likely to benefit investors."

So essentially what they are saying is, yes, there are fewer companies listed, but we have between private equity, master limited partnerships, all these vehicles that have emerged, we just have a more diverse financial environment than we used to and that that is the result of it.

Now, these are two pretty different views. There is one view that says that the decline in IPOs is because of regulatory burden, that hurts investors, there is another view that says investors are actually better off because we have more stable companies, they are not delisting. and more options. Do you have an opinion on which of those two extremes is closer to the truth?

Ms. LUBIN. Thanks for the question. In all the years I have been looking at these things, and I have been looking at them for a lot of years, there has been a decline in IPOs but there has been an increase in all the other mechanisms before somebody wants to go public and I think it has served investors well.

In the early stages, venture capital stages, private placements, things like that, it is a much riskier stage and isn't really the kind of thing most advisors would advise a Main Street investor to jump into. So it is appropriate for those things to stay private and then when they really are matured, then go public and then subject the Main Street investor's moneys to those kinds of offerings.

Mr. CASTEN. Okay. And I had a question for you, Mr. Quaadman, but I believe I am out of time.

Chairwoman MALONEY. Thank you. And now the gentlewoman from New York, Ms. Ocasio-Cortez, is recognized for 5 minutes.

Ms. OCASIO-CORTEZ. Thank you. Thank you very much, Madam Chairwoman. I would like to seek unanimous consent to submit to the record a New York Times reporting on arbitration entitled, "Arbitration Everywhere Stacking the Deck of Justice."

What we are seeing here and I am interested in the interplay between everyday people, everyday consumers and arbitration clauses. The arbitration clauses that are tucked in everywhere from whenever you sign a credit card or a debit card says here even in the report on page five of a credit card contract used by American Express beneath and explain on interest rates and late fees passed the details about annual membership is a clause that most consumers probably miss.

It says that the company may, "elect to resolve any claim by individual arbitration." Now, a lot of folks, to just clarify for the general public what an arbitration clause is, arbitration clauses have been used—would you say, Mr. Gregg, that arbitration clauses have been used to circumvent the courts on a wide range of issues?

Mr. GREGG. Correct.

Ms. OCASIO-CORTEZ. Like potential misconduct?

Mr. GREGG. Yes. So, it is used against workers when it relates to sexual harassment or discrimination, wage theft, it is used in the consumer context when you have a dispute over your credit card or student loan.

Ms. OCASIO-CORTEZ. So, if you are a company and you tuck this clause into virtually anything that you can make an employee or a consumer sign, whether it is a credit card agreement, whether it is an employment contract, you can essentially absolve yourself from almost any form of corporate misconduct, is that correct?

Mr. GREGG. That is correct. That is what will happen.

Ms. OCASIO-CORTEZ. I find this extremely concerning, that you can almost before misconduct happens already waive your right to seek justice in court. And in fact, William G. Young, a Federal Judge in Boston who was appointed by President Reagan said, ominously, "Business has a good chance of opting out of the legal system altogether and misbehaving without reproach." Would you agree with that, Ms. Lubin?

Ms. LUBIN. Thank you for the question. I think the way that predispute arbitration clauses have developed in the brokerage business, that is what has happened.

Ms. OCASIO-CORTEZ. Thank you. I'm sorry, I just have to reclaim my time very quickly, but thank you. So, you would agree?

Ms. LUBIN. Yes.

Ms. OCASIO-CORTEZ. Mr. Gregg, I am interested here in the wider impact. We are talking about not just issues of discrimination and work reviews, but even on a macro level or potentially macroeconomic level. In fact, a Federal Court now is allowing a lawsuit by Exxon investors to move forward.

Investors claim that Exxon knew and kept secret for years internal reports showing that they knew that climate change was real and that the fossil fuels and their role in producing fossil fuels contributes to the role of climate change, yet they undertook a misinformation campaign to hide those internal findings and reports including lying to their own shareholders.

Mr. Gregg, are you familiar with this lawsuit at all?

Mr. GREGG. I am.

Ms. OCASIO-CORTEZ. So, I have a question here, if we do nothing about forced arbitration and allow this practice to continue, could this mean that information about how companies are deceiving the public about issues like climate change or any other could remain hidden from the public and public scrutiny?

Mr. GREGG. It could if we don't pass the—currently, shareholders are allowed to go together, to band together in a class action but there are attempts to stop that so that is why it is important to pass laws to protect.

Ms. OCASIO-CORTEZ. So, you would recommend that we support the legislation that we are entertaining today on investor protection to make sure that shareholders can be protected as well?

Mr. GREGG. I would, because if we don't do that and the SEC reverses this policy, for example, then the systemic issues would be able to be hidden and you would never be able to find out about these things.

Ms. OCASIO-CORTEZ. And even on a macroeconomic level, beyond the justice of it, beyond making sure that shareholders who have been damaged by this deception and misconduct can recoup their costs via class actions, do you think that this has overall consequences for market integrity, so much of our macroeconomic, and to make sure that we have a sound market depends on us trading on the truth.

And if forced arbitration can prevent the public from knowing the truth about issues, it means that the values of many different industries could be manipulated and seen as more valuable than they are. Would you agree with that?

Mr. GREGG. I would agree.

Ms. OCASIO-CORTEZ. Thank you very much.

Chairwoman MALONEY. The gentleman from Illinois, Mr. Foster, is recognized for 5 minutes.

Mr. FOSTER. Thank you, Madam Chairwoman, and thank you to our panel.

Mr. Gregg, as you note, some commentators have argued that public companies should be allowed to insert forced arbitration clauses in their bylaws, which would obviously prevent shareholders from suing the company in Federal Court for violations of the security laws including securities fraud.

It would also prevent shareholders from bringing class action suits against the company for securities fraud. Firt, can you just tell us in general terms why it is important for shareholders to be able to join class action lawsuits against public companies? And second, could you give some examples of class action lawsuits for securities fraud that have been successful for shareholders?

Mr. GREGG. So, on your first question, it is important for two reasons. The first is that, as Professor Coffee said, people are not going to go into it alone, they just won't. They don't understand the process. They sometimes won't receive any help because attorneys won't be able to represent them, because if you are cheated out of $100 or $200, that is a lot of money, but it is still not enough to hire a lawyer to go to court. So, you are just going to let it go. You will be angry, but you will let it go.

Then number two, especially in the securities context, this is hard, this is hard stuff. And being able to prove a material misstatement, intent to deceive, economic loss and causation, it is not something that: number one, you could do by yourself; and number two, oftentimes it is something for which you will need help from experts and potentially forensic accountants. So, this is not something that you can do on your own.

And then to your second question, as I mentioned earlier, WorldCom, Tyco, Enron, these were significant returns for cheated investors.

Mr. FOSTER. Could you say a little bit about the relative effectiveness of arbitration versus a court proceeding as a deterrent, both because the difference in how the results may end up being public as well as the ultimate result?

Mr. GREGG. Well, that's a good question, and one thing that I do mention in my testimony is if something is in arbitration, there are two things here. If it is in arbitration, number one, we are not able to follow the, I mean, we won't know the development of the law.

There will be no development of the law because arbitrations aren't bound by the law. So, especially in the securities context, this would be particularly harmful if we don't have development of the law.

And then, number two, since so much of this is secretive, and a lot of times there are gag clauses, someone can be suffering the same harm in the next office, the next cubicle, next door, and they will never know because you are prevented from even talking about it.

Mr. FOSTER. Right. And so, the crime could be committed by your neighbor, they could be appropriately punished for that crime and you would never know about it, and so you wouldn't be aware and avoid that behavior yourself.

Ms. Lubin, can you tell us why it is important that Main Street investors have the right to bring a private enforcement action if we have public enforcement by Federal agencies?

Ms. LUBIN. Thank you for the question. I could say as a regulator for my entire career, we can't be everywhere. In a lot of ways it is like being a mom, it takes a village and you need a lot of people to keep an eye on what is going on.

So, you want the regulators, but the regulators, we have our regulatory interest in stopping bad behavior and moving on to another case, and that doesn't always involve restitution. If you look at the numbers that the SEC has recovered through Fair Fund actions, they pale in comparison to what has been recovered for investors through private actions.

So it is really a three-legged stool: it is the SEC; it is the State securities regulators; and it is private enforcement. And we have to make sure that private enforcement has the option of going to court, going to arbitration, and let investors decide.

It really depends on the nature of the case for a customer to decide with their attorney which form do they want to select, that they shouldn't be locked in, in the beginning, to having to only go to arbitration.

Mr. FOSTER. Right. And this issue of having the choice, the name of the bill, if, for example, you are very interested in getting a rapid resolution of your case and you believe that arbitration will be faster, you have that choice under this legislation. I think that is a very fundamental point to be made here.

Ms. LUBIN. I agree. It is important that they have the choice and frankly, I have seen a lot of cases that lawyers don't want to go near, that somebody could probably have gone into small claims court if they didn't sign a pre-dispute arbitration clause in their customer agreement.

In that way, that is inexpensive. You could do it yourself. Sometimes they are very clear cut cases. And it gets resolved very quickly.

Mr. FOSTER. Thank you. I am basically out of time here. I yield back.

Mr. CASTEN [presiding]. The gentleman from Ohio, Mr. Davidson, is recognized for 5 minutes.

Mr. DAVIDSON. Thank you. Thank you all for your thoughtful comments on this. And Mr. Quaadman, as I was looking through your remarks and things that you highlighted about the decline in

IPOs, things that you highlighted about how accredited investors have benefited I would say disproportionately from the tech bubble, the tech craze and the things that haven't proved to be bubbles at all that have been enduring, whether it has been on the way up knowing, when to get down, knowing how to participate.

And I think about the nature of an accredited investor. This is someone who is already wealthy, so the criteria isn't knowledge. The criteria is the possession of wealth, primarily. And so as I listen to colleagues repeatedly talk about the giant gap in income, in inequality, I think back to the fall.

In September, we hosted a roundtable for the ICO market, how do we deal with the right way to regulate what has been abusive, has been fraudulent, has been asymmetry of information at times in the ICO market. But what is dying for lack of regulatory certainty. And we heard from investors who were at the top of the food chain on skill, knowledge, and wealth, venture firms like Andreessen Horowitz.

But we heard from early stage venture folks and one of them pulled me to the side and he said, "Why do Republicans lock out regular people like me from deals? Why do they protect their rich investor buddies?"

And they were referring to the accredited investor rules. So this person who is a political novice is just trying to be part of an early stage company, writing code for a program, fand rustrated with the fact that he couldn't participate.

Although he helped write the code for it, he doesn't meet the accredited investor rules. And his perception was that the rich Republicans were doing stuff for their rich Wall Street buddies. And I tried to explain it. This is actually counterintuitive, democratic access to capital like so many other things that are out there in the false narrative is actually a Republican idea. The idea that markets are for everyone, not just the special people.

And he was shocked. He said that this starts to chip away at his world view. And I said, 'Iif you look at a number of other issues, you will probably conclude the same thing. I am certain you and I will not agree on all things."

But that is one that is there. Could you comment about how accredited investors have been the disproportionate beneficiaries of our current structure?

Mr. QUAADMAN. Sure. So, number one, just to make a point that was made earlier about the decline in IPOs, the decline in the number of public companies actually started in 1996, 4 years before the tech bubble burst.

But to your point, and there was an earlier discussion here and they were discussed, when there was a discussion about all of these different vehicles, there were vehicles that were only accredited investors could use, right?

And we have very specific income and asset levels of which people can invest in, and what we effectively have done over the last 20 years is just start to create a closed system where the accredited investors get the benefits of certain deals, whatever, and that the retail investor is not able to access that, which is why I was talking earlier about the decline or disappearance of the smaller IPO.

Now, one of the things that the JOBS Act 3.0 did last year was actually start to modify some of the definitions of the accredited investor rules where you actually start to allow for certain levels of education and experience, expertise that they can start to maybe avail themselves to some of that which I think is one way to start to solve some of it, but we do need to also deal with the other macro issues as well to help the retail investors.

Mr. DAVIDSON. Yes. Thank you for that and thanks for the expertise you have lent to it. Congressman French Hill has certainly been a champion for that on our side of the aisle, and Congressman David Schweikert, who is now on the Ways and Means Committee.

And we would love to have a collaborative nonpartisan way to make sure that all Americans have access to our capital markets, I mean, really, historically that is a big part of why capital has flourished in the United States.

And unfortunately, you do see this concentration of wealth in hedge funds and the narrative of ideologies, not monolithic. There are folks with all political persuasions, but the reality is there are Main Street investors, people with retirement funds, pension funds, who are being locked out of access to these deals.

And I think it is an incredibly important reform that we need to get done to make sure that our markets function. Absolutely protect consumers, full disclosure, but full democratic access to capital. My time has expired, and I yield back.

Mr. CASTEN. The gentlewoman from California, Ms. Porter, is recognized for 5 minutes.

Ms. PORTER. Mr. Quaadman, I have noticed that the U.S. Chamber of Commerce is fairly active and, in fact, is quite active with litigation. It has an entire center devoted to litigation and the Chamber sues the government on a regular basis, 5 times in the last 30 days alone it has filed suits in the U.S. courts.

In all of the cases that the Chamber has brought, are you aware of any in which the Chamber has appeared before arbitration panels?

Mr. QUAADMAN. I would have to check with our litigation center on that. I am not aware of that, but I would have to check with them.

But let me also say too, with the cases that we do file, we are following what the law allows us to do and we tend to win.

Ms. PORTER. You tend to win in court.

Mr. QUAADMAN. Yes. But as I said, I don't know—

Ms. PORTER. Because that is where you choose to file as plaintiff.

Mr. QUAADMAN. That is where the law allows us to file.

Ms. PORTER. Okay.

Mr. QUAADMAN. But we are suing the government. I don't know of any instance under the sovereignty laws if the government actually allows for arbitration in cases where there is a dispute with the government.

Ms. PORTER. Correct, but the Chamber is also an intervener in private plaintiff suits. So, my question is—

Mr. QUAADMAN. I don't know. I would have to check with the litigation center. I don't know if we are an intervener in private plaintiff suits. We actually sue the government.

Ms. PORTER. Okay, but my question is—

Mr. QUAADMAN. It doesn't allow arbitration.

Ms. PORTER. Correct. Why do you think that is?

Mr. QUAADMAN. Why the government doesn't allow for arbitration? I don't know. I would have to check the history on that.

Ms. PORTER. When the Chamber sues the government, does it expect the judges to follow the law?

Mr. QUAADMAN. Of course.

Ms. PORTER. Do people who have their grievances heard in arbitration, can they count on the arbitrator to follow the law?

Mr. QUAADMAN. An arbitrator is supposed to be fair. If an arbitrator is not fair, there are—

Ms. PORTER. I am just asking, can they count on the arbitrator to follow the law?

Mr. QUAADMAN. They should, and if they are not, they can go to court to actually overturn the award and actually take the arbitrator off the case.

Ms. PORTER. Mr. Gregg, would you like to respond to that?

Mr. GREGG. I respectfully disagree. There is no requirement to follow law or precedent. And in fact, the requirements for appeal are very, very limited. In fact, Justice Kagan said that in several Supreme Court cases and simply getting it wrong, the Supreme Court has said, is not enough.

Ms. PORTER. Is not enough. Mr. Quaadman, do you think that the development of law is important to—and certainty of law is important to allowing companies to make decisions about their capital structure?

Mr. QUAADMAN. I would say in terms of the capital structure for the company and for the capital markets, you know, the companies are going to follow what Congress dictates, what the SEC is coming out with in terms of rules.

Ms. PORTER. Let me ask it another way.

Mr. QUAADMAN. Yes.

Ms. PORTER. Is legal uncertainty, is uncertainty about the legal standard positive for the business community?

Mr. QUAADMAN. Well, I think we are talking about apples and oranges here, because legal uncertainty does create problems and it creates problems not only for businesses, it creates problem for consumers as well. But I would say with arbitration, arbitration allows for a speedy redress of grievances and as talked about earlier with the FINRA arbitration process, number one, there is a fairly high rate of where investors are winning their cases. And there is also a very high rate where there are settlements of cases before it even goes to the arbitrator, and that is much faster than when, if this was just allowed to go to court.

Ms. PORTER. Mr. Gregg, would you like to respond?

Mr. GREGG. I would. One significant problem is uncompensated awards in FINRA. In fact, Senator Warren and Senator Kennedy introduced a bill last Congress to help people who were in FINRA actually get the awards that they never have gotten.

Ms. PORTER. I yield back the remainder of my time.

Mr. CASTEN. The gentleman from Texas, Mr. Green, the Chair of our Subcommittee on Oversight and Investigations, is recognized for 5 minutes.

Mr. GREEN. Thank you very much, Mr. Chairman. And I thank the subcommittee for allowing me to interlope today. I am not a part of this subcommittee, but I am very much concerned about the ruling of the Supreme Court in 2018 in a case styled, *Digital Realty Trust, Inc.* v. *Somers.* In that case, the court held that the protections against retaliation in Section 922 of Dodd-Frank are applicable to persons who report these egregious offenses to their employers.

This hearing affords us an opportunity to rectify and to adjust the law such that justice can prevail. It is my belief that we should allow these protections for those who report to their employers. So let me start if I may with a lawyer par excellence, Mr. Gregg, you are considered a strategic thinker. Can you kindly tell me at this time, what do you think about this legislation that we have proposed and the Supreme Court's decision to a very limited extent, because I do have a second question?

Mr. GREGG. Thank you for the question, Congressman. We do support the legislation. The Supreme Court actually got it right. The language is very clear in the statute and that is why Congress must act, and that is why Senator Grassley, for example, in his amicus brief in *Digital Realty* basically said the same thing that you are saying. There are a lot of protections in the Dodd-Frank law for anti-retaliation that are not in Sarbanes-Oxley, and that is why we need to have this law.

Mr. GREEN. Ms. Lubin, if I may, you have a reputation for justice and fairness, so give me your thoughts if you would, please, on whether this would, if not implemented, have an adverse impact on reporting by employees?

Ms. LUBIN. Thank you for the question and for the compliment. I think it would have a very adverse effect because it is a chilling effect. The employees are not going to come forward when they are faced with a balance, am I going to lose my job or am I going to try and fix what is going on in the company because they will figure whatever is wrong is somebody else's problem.

So there won't be reporting—the companies won't have the opportunity to fix it before it becomes a very big deal which is something that will be lost if the whistleblower so to speak doesn't know that they are going, that they will be protected if they go ahead and tell management that something adverse is going on. So I think it is very important that we, that the legislation encompasses taking care of employees if they whistleblow internally or not just to the SEC.

Mr. GREEN. Thank you very much. Professor Coffee, thank you for your service and for being here today. I thank all the witnesses for being here today. I may not get to question all of you, but I do thank you for coming. I am interested in your commentary on this.

Mr. COFFEE. I think it is imperative that Congress reverse *Digital Realty.* It was probably correct on that statutory structure, but this is not a constitutional decision. The statute didn't recognize how this could get in effect get reversed. And actually, the irony here is that most of the business community wants employees to report internally, and because of this decision, employees represented by counsel will never report internally. It is probably better if you have protection from, full protection under Dodd-Frank, that you go first to the company because things can get worked out cheaply, easily, and effectively.

So we have come up with an outcome here that injures employees and does not benefit corporations because corporations find that they will no longer get any internal reporting. No one wins under this outcome, and thus I think it is imperative that Congress reverse it.

Mr. GREEN. Thank you. And if I may, I will thank all of my colleagues who have indicated that they will be supportive of this legislation. It is my hope that we will get it passed. And Mr. Chairman, I yield back the balance of my time.

Mr. CASTEN. I have a minor piece of housekeeping. Without objection, I ask unanimous consent that the article that I submitted when I was not sitting in this chair, be entered into the record. Without objection, it is so ordered.

And I want to recognize the ranking member, whom I understand has some documents to submit as well.

Mr. HUIZENGA. Thank you, Mr. Chairman. Yes, and without objection, I would like to submit a testimony from the Securities Industry and Financial Markets Association, SIFMA, as well a letter from the Small Business and Entrepreneurship Council.

Mr. CASTEN. Without objection, it is so ordered.

And before we wrap up, I would like to take care of one other administrative matter. Without objection, I would like to submit letters and statements for the record from the American Association for Justice and the Public Investors Arbitration Bar Association.

Without objection, it is so ordered.

I would like to very much thank our witnesses for their testimony and their time today.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

And this hearing is now adjourned.

[Whereupon, at 4:16 p.m., the hearing was adjourned.]

A P P E N D I X

April 3, 2019

Statement of Professor John C. Coffee, Jr.
Adolf A. Berle Professor of Law
Columbia University Law School

at

Hearings Before the Subcommittee on Investor Protection,
Entrepreneurship, and Capital Markets

of the

Committee on Financial Services

of the

United States House of Representatives

Putting Investors First: Reviewing Proposals to Hold Executives Accountable

April 3, 2019
Room 2128 of the Rayburn House Office Building
Washington, D.C.

Chairman Maloney, Ranking Member Huizenga, and Fellow Members of the Committee:

I. INTRODUCTION

I am very happy and honored to be back before this committee. I have been asked to comment on several proposed bills, all of which I basically support, but I will focus my limited time today primarily on Congressman's Himes's Discussion Draft of an "Insider Trading Prohibition Act." I want to commend Congressman Himes for having supervised the drafting of a very careful, balanced and sophisticated bill that should serve as a model for a long overdue effort to codify the law of insider trading. To date, the law of insider trading has been solely the product of judicial law-making, and courts have been confined by the words set forth in Section 10(b) of the Securities Exchange Act. In effect, insider trading is the best example of a common law crime that survives today.

As a matter of full disclosure, I should disclose at the outset that I have been involved with the drafting of this bill over the last several years (but I am in no sense its primary draftsman). Nonetheless, I do have some suggestions for its possible modification and improvement.

I. The Insider Trading Prohibition Act

There is general agreement today that the law of insider trading has grown overly complex and technical. As a result, it is hard for the public to understand its logic or for practitioners to give advice with respect to the scope of the prohibition. Moreover, to the extent that insider trading is judge-made law, disparities and inconsistencies among the Circuit courts becomes inevitable because there is little in the way of a definitive statutory text to provide precise guidance. Currently I serve as a member of a Task Force on Insider Trading, assembled by Preet Bhahara, the former S.D.N.Y. U.S. Attorney, which is attempting to answer some of these problems. Although I cannot speak on behalf of that Task Force, I am convinced that the members of the Task Force (many of them ex-U.S. Attorneys and SEC enforcement specialists) share this view about the need for greater clarity and simplification. In this light, the key virtues of the Insider Trading Prohibition Act are that (1) it is comparatively easy to understand, and (2) it extends the criminal prohibition to reach certain clearly egregious forms of misbehavior that are largely beyond the powers of courts to reach because courts are constrained by the narrow wording of Section 10(b) of the Securities Exchange Act of 1934.

A. What Does The Insider Trading Prohibition Act Do?

Essentially, the Act eliminates the need to show that the tippee paid or promised some "personal benefit" to the tipper. This requirement has proven a significant barrier to insider trading enforcement, both because such payments can be artfully hidden and because a norm of reciprocity pervades Wall Street. Thus, one hedge fund may "tip" material, non-public information to another without soliciting or receiving any such payment because it is relying on this norm of reciprocity and expects that someday it will receive a reciprocal gift of information in return from the hedge fund that it is today benefitting.

This simplification that the Act effects does not threaten innocent parties who mistakenly share material nonpublic information because Section 32(a) of the Securities Exchange Act requires that any criminal violation be "willful," and courts have long read this "willfulness" requirement to require an intent to violate the law and/or engage in corrupt predatory conduct.

The Insider Trading Prohibition Act expands liability in ways that should not be controversial. Because Section 10(b) prohibits only use of "any manipulative or deceptive device or contrivance," these are words of fraud, and much egregious misconduct is not covered by Section 10(b) because the conduct does not involve fraud. For example, if a non-fiduciary breaks into an investment banker's office at 2 A.M. in the morning, steals a file on a pending secret merger, and trades on that material information, this conduct amounts to theft, not fraud, and it is therefore not reached by Rule 10b-5. But it is reached -- and properly so -- by the Insider Trading Prohibition Act. Similarly, if a computer hacker hacks into a law firm's computer system to learn material information, this could under some circumstances violate Rule 10b-5, but under other circumstances, it would not.[1] Such conduct will always, however, violate the Insider trading Prohibition Act -- and again properly so. Any deceptive taking of material, non-public information is reached by the proposed Act.

B. Some Suggestions

1. Eliminating The Personal Benefit Requirement. Section 16A(c)(2) of the proposed Act seeks to make it clear that it is not necessary for the prosecutor to show that the defendant knew "whether any personal benefit was paid or promised by or to any person in the chain of communication." This does respond to the prosecutor's problem that it is difficult to show at trial what a remote tippee actually knew. But there is at least a mild ambiguity here under the Act. Section 16A(c)(2) of the Act explicitly eliminates only the need for the defendant to have knowledge of the personal benefit, not the need

[1] See SEC v. Dorozhko, 574 F.3d 42 (2d Cir. 2009) (recognizing that computer hacking to obtain an earnings report in advance of its public release could under some circumstances violate Rule 10b-5). Dorozhko, however, requires that some misrepresentation that is deceptive be made by the defendant. The Act is broader and covers all acts of theft to obtain material, nonpublic information.

for the personal benefit. Although nothing in proposed Section 16A requires the prosecution to prove a personal benefit to the tipper, it can at least be argued that this need to show such a benefit is implicit, because there would be no need to eliminate knowledge on the defendant's part of the personal benefit unless there was such a personal benefit requirement. Knowledge of the personal benefit is a secondary element, which only becomes important if there was such a personal benefit requirement.

If a requirement for the prosecutor to show a personal benefit were to remain, then this proposed legislation would lose much of its impact. The Wall Street "favor bank" would remain in full operation because investment bankers could tip material information lawfully in the hope of future reciprocal favors -- so long as there was not a provable promise of such a future benefit.

The best way to cure this ambiguity is to rewrite Section 16A(c)(2) so that its first sentence reads as follows:

> "It shall not be necessary that any person trading while in possession of such information (as proscribed by subsection (a), or making the communication (as proscribed by subsection (b), (i) have paid or promised any benefit (monetary or otherwise) to the tipper (or on its behalf) or any person in the chain of communication, or (ii) know the specific means by which the information was obtained or communicated, so long as the person trading while in possession of such information or making the communication, as the case may be, was aware, or recklessly disregarded, that such information was wrongfully obtained or communicated."

I believe this would only do what the draftsman of the Act intended, but imperfectly expressed.

2. Derivative Liability. Subsection 16A(d) of the Act sets a different standard for "controlling person" liability from that specified in Section 20(a) of the Securities

Exchange Act. Suppose an institutional investor employs a trader to trade for it (with discretionary authority) and compensates this trader by agreeing to pay him 20% of its trading profits obtained through his trading. This trader then engages in insider trading in violation of Section 16A. What is the institution's liability?

Under existing Section 20(a), the institution would have a defense if it "acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action." Under 16A(d), the defense is narrower; the institution as the employer has the defense that it "did not participate, profit from, or indirectly induce the acts constituting the violation of this section." On the above facts, the institution did "profit from" the insider trading and would be liable for damages and penalties. It no longer has a "good faith" defense. I am not certain that it should lose this defense. Language here could be easily changed to restore a "good faith" defense.

Possibly, there is concern here that some "controlling persons," such as Stephen A. Cohen, escaped liability too easily, even though several of his employees were found to have engaged in insider trading.[2] If this is a concern, the standard for the "good faith" defense could be tightened so that any awareness by a controlling person of acts by an employee or agent that could plausibly amount to insider trading (even by a different employee or agent) would deny the controlling person the "good faith" defense.

SEC Rule-Making. Under proposed Section 16A(e) of the Act, the Commission is given authority, by rule, to exempt certain persons or transactions. That is fine, but it is only one-way authority: authority to downsize the provision. In contrast, Section 14(e) of the Securities Exchange Act gives the Commission authority to adopt rules and regulation

[2] Mr. Cohen is the founder of S.A.C. Capital Advisors; his net worth has been estimated by Wikipedia at $13 billion. Despite settling charges with the SEC for failing to supervise employees who engaged in insider trading, he continues in business as the founder of Point 72 Asset Management.

to "prescribe means reasonably designed to prevent, such acts and practices as are fraudulent, deceptive or manipulative." Pursuant to this authority, the SEC adopted Rule 14e-3, which is the other major rule directed at insider trading (besides Rule 10b-5).

The key point here is that the SEC's rule-making authority under Section 14(e) permits it to go beyond simply defining a practice to be "fraudulent, deceptive, or manipulative" and to prescribe rules that have a degree of overbredth, so long as they are "reasonably designed" to prevent fraud, deception or manipulation. The SEC today lacks this authority under Section 10(b), but has it under Section 14(e). Given that the world of insider trading and securities manipulation is changing at a very rapid rate, I submit that it would be wise to arm the SEC with the same authority that it already has under Section 14(e). With the Internet, new forms of securities manipulation are appearing constantly, and the SEC needs to be better armed.

II. Other Proposed Statutory Amendments

1. Whistleblowers. One bill before this Subcommittee would protect whistleblowers who report internally within the corporation and are terminated before they report to the SEC. A recent Supreme Court decision, Dig. Realty Trust v. Somers, 138 S. Ct. 767 (2018), has denied such persons the protections given by the Dodd-Frank Act to employees who report directly to the SEC. This decision was strictly a matter of statutory interpretation. Even if the Court correctly interpreted the Dodd-Frank provision, nothing precludes Congress from amending the statute to change this outcome. The proposed bill would do that by amending Section 21F(a)(6) of the Securities Exchange Act to broaden its definition of "whistleblower," and thus cover those employees who report only internally.

Although there may be some controversy within the business community, most corporations want the employee to report internally first. Today, after the Dig. Realty Trust decision, no employee represented by counsel will do that, because it exposes this employee to retaliation for which there is no federal remedy. As a result, corporations lose early notice and the opportunity to correct (or at least revise) their procedures before the Government is advised of their possible failure. This legislation costs the corporation only the chance for a quick firing (or other retaliation against) the employee before the Government is on notice. It is hard to see this dubious interest as deserving protection.

2. Mandatory Arbitration. Also before this Committee is a more sweeping provision that precludes arbitration provisions, both in agreements with brokers and investment advisers and in corporate charters. I cannot deny that this bill will be controversial, but I favor it and have two small suggestions: First, Section 4 of this bill provides that no security may be registered under the Securities Act of 1933 if an issuer's "bylaws, registration statement or other governing documents mandates arbitration for any disputes between the issuer and the shareholder of the issuer." First, I suggest that you strike the word "registration statement" and substitute "certificate of incorporation or charter." Registration statements mandate nothing; they only disclose information. Certificates of incorporation do mandate (but are probably picked up by the phrase "other governing documents").

Second, this provision may discourage some private companies from "going public." To reduce that pressure, I suggest that Section 4 of this bill provide both that issuers may not go public with such a mandatory arbitration provision and that an issuer with more than one hundred shareholders of record may not "mandate arbitration for any disputes between the issuer and the shareholders of the issuer." Although the number one hundred may seem low, this is a number of the shareholders of record, and companies can keep this number low by using "street names" or other devices to limit their shareholder of record.

Finally, simply as a drafting matter, I would strike "disputes" in line eleven on page four and substitute "dispute." This is broader language.

3. Completion of Rulemaking. Two bills before this Subcommittee would require the SEC to complete rulemaking with respect to Sections 10D and 14(i) of the Securities Exchange Act. Section 10D addresses clawbacks, and Section 14(i) address "pay versus performance." I certainly support the need for rulemaking in both areas, but I suggest that 60 days after enactment may be too short a period (perhaps 180 days would be more realistic about the pace at which the SEC can realistically proceed). The proposed sanction (forcing the SEC's Chairman to testify before you) is certainly a nuclear theat. But a lesser alternative would be to suspend the pay of the SEC's Commissioners so long as this deadline is not met. That will work!

4. The "8-K Trading Gap Act of 2018"

This bill seeks to preclude trading by officers and directors "when in possession of material nonpublic information." I suspect that its primary goal is to restrict trading during corporate stock buybacks. This is speculative inference on my part because the bill does not fully explain its purposes (and trading on material nonpublic information is already prohibited by Rule 10b-5).

Structurally, this bill applies to trading during a "covered period," which is defined in Section 2(a)(2) of this Act to mean "the period beginning on the date on which an issuer determines that the issuer possesses material nonpublic information and ending on the date on which that information is publicly disclosed or no longer material." An initial problem is that the first date may never be declared by the corporation and its determination may be very difficult. In general, corporations do declare "covered periods," but seldom do so in these terms. I respectfully suggest that some revisions in this phrasing would be useful. If the goal is to preclude trading before or during a stock buyback, this restriction should be specified in those terms, as public corporations do not concede that their announcements convey material information. Alternatively, one could define "covered period" in terms of the filing of a Form 8-K and begin the period one week before such filing and continue the period until one week after it.

PUBLIC CITIZEN

Written Testimony of

Remington A. Gregg

Counsel for Civil Justice and Consumer Rights, Public Citizen

before the

Subcommittee on Investor Protection, Entrepreneurship and Capital Markets

Committee on Financial Services

U.S. House of Representatives

on

Putting Investors First: Reviewing Proposals to Hold Executives Accountable

April 3rd, 2019

Good afternoon Chair Maloney, Ranking Member Huizenga, and Members of the Subcommittee:

Thank you for inviting me to testify before you. My name is Remington A. Gregg, and I am counsel for civil justice and consumer rights at Public Citizen. Public Citizen is a national non-profit organization with more than 500,000 members and supporters. We represent the public interest through legislative and administrative advocacy, litigation, research, and public education on a broad range of issues including ensuring access to justice for all people. Pertinent to this hearing, Public Citizen has had a long interest in holding corporate bad actors accountable by reining in corporate misconduct, ensuring transparent corporate policies, safeguarding whistleblowers from retaliation for exposing wrongdoing, and stopping the insidious practice of forced arbitration. While my testimony will identify several issues where Public Citizen believes Congress can act to put investors first while holding corporate executives accountable, my testimony's main focus is on why Congress should ban corporate wrongdoers from forcing investors into pre-dispute binding arbitration (commonly known as forced arbitration).

I. PROTECTING EVERYDAY INVESTORS FROM FORCED ARBITRATION

1. Forced arbitration is an inherently unfair practice

Forced arbitration clauses and bans on class actions (forced arbitration clauses) use fine-print "take-it-or-leave it" agreements to abolish investors' fundamental rights and remedies. Forced arbitration clauses have become ubiquitous in such varied settings as agreements governing bank accounts, student loans, cell phones, employment, and even nursing home admissions. These clauses deprive people of their day in court when they are harmed by violations of the law, no matter how widespread or egregious the misconduct may be. The contracts that contain forced arbitration clauses are written by corporate entities, so it is unsurprising that its terms are generally corporate friendly. Arbitration provisions generally:

- Limit the type of damages that a person can receive, such as punitive or compensatory damages;

- Prohibit individuals from banding together in a class or collective action, which may be the only realistic avenue for bringing small claims;

- Limit discovery and other attempts to obtain evidence;

    - A Public Citizen report details that "54 percent of arbitration clauses discussed discovery or evidentiary standards, in most instances to 'alert consumers that discovery may be limited and evidentiary standards may be relaxed by comparison to litigation'";[1]

- Include arbitration fees that are "are dramatically higher than court costs"[2] and may include a "loser pays" provision which creates a significant disincentive for an individual to bring a claim for fear that they will be on the hook for all fees if they do not prevail.

Justice Hugo Black summed up the unfairness of arbitration well:

> "For the individual, whether his case is settled by a professional arbitrator or tried by a jury can make a crucial difference. Arbitration differs from judicial proceedings in many ways: arbitration carries no right to a jury trial as guaranteed by the Seventh Amendment; arbitrators need not be instructed in the law; they are not bound by rules of evidence; they need not give reasons for their awards; witnesses need not be sworn; the record of proceedings need not be complete; and judicial review, it has been held, is extremely limited."[3]

If a worker, consumer, or small business brings a claim in arbitration and loses—and the odds are very likely that they will—an arbitrator's decision is given "limited judicial review."[4] Rather, "[u]nder the [Federal Arbitration Act], courts may vacate an arbitrator's decision 'only in very unusual circumstances.'"[5] These circumstances include:

(1) where the award was procured by corruption, fraud, or undue means;

(2) where there was evident partiality or corruption in the arbitrators, or either of them;

(3) where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced; or

(4) where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.[6]

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[1] Taylor Lincoln & David Arkush, *The Arbitration Debate Trap: How Opponents of Corporate Accountability Distort the Debate on Arbitration* 38 (2008), *available at* https://www.citizen.org/sites/default/files/arbitrationdebatetrapfinal.pdf.
[2] *Id.* at 39.
[3] Republic Steel Corp. v. Maddox, 379 U.S. 650, 664 (1965) (Black, J., dissenting).
[4] Oxford Health Plans LLC v. Sutter, 133 S. Ct. 2064, 2068 (2013).
[5] *Id.* (*quoting* First Options of Chicago, Inc. v. Kaplan, 514 U.S. 938, 942 (1995)).
[6] 9 U.S.C. § 10 (2012).

Forcing everyday investors into arbitration would deprive them not only of basic procedural rights that they are normally guaranteed in neutral, open court, but would all but prevent them from exercising their rights to appeal if they believe the arbitrator erred.

2. **Forcing all investors into individual arbitration would effectively prevent them from holding corporate wrongdoers accountable**

Thus, it is clear that workers, consumers, and small businesses are often at a disadvantage in arbitration. If everyday investors were forced into individual arbitration, they would be at a greater disadvantage because individual investors often lack the ability to bring complex securities claims on their own. "Class actions," however, "are a particularly appropriate and desirable means to resolve claims based on the securities laws, 'since the effectiveness of the securities laws may depend in large measure on the application of the class action device.'"[7] That is because federal securities law is complex. It often requires significant discovery, reliance on expert witnesses, and specialized counsel. Therefore, joining together in a class action may be the only feasible way for everyday investors to vindicate their rights against a corporate wrongdoer that has cheated them.

If everyday investors were forced to agree to arbitrate their claims individually, it would mean that many could never effectively vindicate their rights against a corporate wrongdoer.

Moreover, forcing all investors into arbitration is contrary to federal securities law because it would force them to give up their ability to vindicate their rights under the law. The Securities Act of 1933 (Securities Act) and the Securities Exchange Act of 1934 (Exchange Act) includes so-called "anti-waiver" provisions that nullify a contract that seeks to waive compliance with those laws.[8] The statutes state in near-similar fashion that "[a]ny condition, stipulation, or provision binding any person acquiring any security to waive compliance [with the statute] shall be void." In addition, the Supreme Court has recognized that "barring waiver of a judicial forum" to protect investors is permissible, but that it is possible "only where arbitration is inadequate to protect the substantive rights at issue."[9] Forcing investors into a system that would prevent them from exercising class remedies, which is a critical tool for effectively enforcing their rights, would effectively prohibit an investor from vindicating their rights.

Even where the SEC has allowed the use of arbitration under the securities laws, it has acted to ensure that the availability of class actions in court is not impaired.[10] Most notably regarding Financial Industry Regulatory Authority (FINRA) rules authorizing the use of customer arbitration agreements by broker-dealers, critically, the courts have protected the right of investors to bring

[7] Eisenberg v. Gagnon, 766 F.2d 770, 785 (3d Cir. 1985) (*quoting* Kahan v. Rosenstiel, 424 F.2d 161, 169 (3d Cir.), *cert. denied*, 398 U.S. 950 (1970)).
[8] *See* 15 U.S.C. §§ 77n, 78cc ("Waiver Provisions").
[9] Shearson/Am. Express, Inc. v. McMahon, 482 U.S. 220, 230 (1987).
[10] *See* Charles Schwab & Co. Inc. v. FINRA Inc., 861 F. Supp. 2d 1063, 1068–69 (N.D. Cal. 2012).

their claims as a class. For its part, FINRA, a self-regulating entity authorized by Congress to police the broker-dealer industry, has sought to shine greater transparency on the individual arbitration process in the expungement context.[11] Nevertheless, the FINRA process is far from perfect. According to its 2018 statistics, claimants were only awarded damages in 40% of cases, a decline over the last three years.[12] And there is concern that a significant number of investors are unable to collect their unpaid arbitration awards. It is for that reason that last Congress, Sen. Elizabeth Warren (D-MA) introduced, and Sen. John Kennedy (R-LA) co-sponsored, the Compensation for Cheated Investors Act (S. 2499), which would require FINRA to use its existing authority to compensate investors who never received their just arbitration award.[13] Thus, it hardly seems useful to place a large swath of everyday investors bringing complex claims into a system that already has significant flaws.

3. Private enforcement actions are a powerful and "indispensable" complementary tool to public sector enforcement

Congress and the federal courts have acknowledged that investors play a critical role in policing the marketplace to ensure that public companies play by the rules. Allowing everyday investors the opportunity to bring claims as a class is a powerful complementary tool to public enforcement of the nation's securities laws because private lawsuits play an indispensable role in policing misconduct, deterring bad actors, and returning ill-gotten corporate gains to investors. The conference report for the Private Securities Litigation Reform Act of 1995 (PSLRA) noted that "[p]rivate securities litigation is an indispensable tool with which defrauded investors can recover their losses without having to rely upon government action. Such private lawsuits promote public and global confidence in our capital markets and help to deter wrongdoing and to guarantee that corporate officers, auditors, directors, lawyers and others properly perform their jobs."[14] Notably, in passing the PSLRA and the Securities Litigation Uniform Standards Act of 1998 (SLURA), which gives the federal courts almost exclusive jurisdiction for securities class actions, Congress

[11] *See Regulatory Notice: Expungement of Customer Dispute Information*, FINRA (Dec. 6, 2017),http://www.finra.org/sites/default/files/notice_doc_file_ref/Regulatory-Notice-17-42.pdf; *see also* Letter from Susan Harley, Pub. Citizen, Deputy Dir., Cong. Watch, and Remington A. Gregg, Pub. Citizen, Counsel for Civil Justice and Consumer Rights, to Marcia E. Asquith, FINRA, Exec. Vice President, Bd. and External Relations (Feb. 5, 2018) (on file with authors).

[12] *Dispute Resolution Statistics*, FINRA, https://w https://www.finra.org/arbitration-and-mediation/dispute-resolution-statistics ww.finra.org/arbitration-and-mediation/dispute-resolution-statistics (last visited Mar. 29, 2019).

[13] *Kennedy Joins Warren on Legislation to Compensate Investors Cheated by Brokers and Dealers*, ELIZABETH WARREN NEWSROOM (May 16, 2018), https://www.warren.senate.gov/newsroom/press-releases/kennedy-joins-warren-on-legislation-to-compensate-investors-cheated-by-brokers-and-dealers; *see also Compensation for Cheated Investors Act Summary*, https://www.warren.senate.gov/imo/media/doc/2018.3.6%20Compensation%20for%20Cheated%20Investors%20Act%20One%20Pager.pdf (last visited Mar. 29, 2019) (noting that "According to a December 2015 report by FINRA's Dispute Resolution Task Force, investors were unable to collect more than $62 million in unpaid arbitration awards in 2013 alone.").

[14] H.R. Rep. 104-369, at 31 (1995) (Conf. Rep.).

chose to make changes to the class action process, not ban it. In doing so, this body acknowledged the importance of private enforcement to protect market forces and investors.[15]

The U.S. Supreme Court has supported this commonsense policy, saying that "implied private actions provide 'a most effective weapon in the enforcement' of the securities law and 'are a necessary supplement to Commission action.'"[16] The indispensable role that private enforcement plays in policing wrongdoers is a bipartisan-held principle. Former SEC Chairmen William Donaldson and Arthur Levitt, Jr., and former Commissioner Harvey Goldschmid, who were nominated to serve by presidents of both political parties, clearly stated in an *amicus curiae* brief the importance of private enforcement. They said:

> "Investors must rely primarily on private actions to recover when defrauded. The SEC's disgorgement and civil money penalty powers, although enhanced by the Sarbanes-Oxley Act, are limited, and will generally cover only a fraction of the damage done to investors by serious securities fraud. Moreover, the SEC with limited resources cannot possibly undertake to bring actions in every one or even most of the financial fraud cases that have proliferated over the past few years. ...Private cases, so long as they are well grounded, are an important enforcement mechanism supplementing the SEC in the policing of our markets."[17]

And then-commissioner Luis A. Aguilar said: "[i]t is unrealistic to expect that the Commission will have the resources to police all securities frauds on its own, and as a result, it is essential that investors be given private rights to complement and complete the Commission's efforts."[18]

4. <u>Private enforcement not only provides complementary enforcement of federal securities laws, but provides significantly more relief to everyday investors</u>

In 2012, The Carlyle Group sought to include a forced arbitration clause in their revised draft registration statement. The attempt (which is explained further below) was unsuccessful. In response to Carlyle's request, 29 law professors voiced strong opposition to then-SEC Chair Mary Jo White, saying that forcing investors into arbitration was inconsistent with the anti-waiver provisions in the Securities and Exchange Acts. They said that allowing everyday investors to bring forward their claim in a neutral, open court was important because it "is essential to maintaining the integrity of our nation's financial markets that investors and shareholders have

[15] *Id.* ("[P]rivate lawsuits promote public and global confidence in our capital markets and help deter wrongdoing and to guarantee that corporate officers, auditors, directors, lawyers and others properly perform their jobs.").
[16] Bateman Eichler, Hill Richards, Inc. v. Berner, 472 U.S. 299, 310 (1985) (*quoting* J.I. Case Co. v. Borak, 377 U.S. 426, 432 (1964)).
[17] Brief for Former SEC Commissioners et al. as Amici Curiae Supporting Respondents at 7-8, Stoneridge Inv. Partners, LCC v. Scientific-Atlanta, Inc., 128 S. Ct. 761 (2007) (No. 06-43).
[18] *Statement by Commissioner: Defrauded Investors Deserve Their Day in Court*, U.S. SECURITIES AND EXCHANGE COMMISSION (Apr. 11, 2012), https://www.sec.gov/news/public-statement/2012-spch041112laahtm.

access to the courts to resolve claims under the federal securities laws."[19] They argued that access to the courts ensures "independence and transparency" in the capital markets. Moreover, they asserted the importance that private litigation has on "advanc[ing] the development of the federal securities law." It is worth reemphasizing this last point. Arbitration hearings are held in secret. Oftentimes, the contract that the workers, consumers, or small businesses signed that forced them into arbitration prohibits them from disclosing the contents of the proceeding, and an arbitrator is not required to issue a written decision. As a result, arbitration is neither "an equivalent medium for meaningful oversight of the rights of investors and shareholders"[20] nor the proper venue to ensure meaningful interpretation and development of federal securities laws.

Instead, forcing investors into arbitration would "fundamentally alter investor confidence in the corporate form."[21] Forcing everyday investors into arbitration would alter the corporate form in several ways. First, the public would have less confidence that the market was being policed for wrongdoing. The SEC employs 4,600 individuals. This workforce is less than those serving in the military marching bands and roughly a third the size of the Los Angeles Police Department, yet these individuals oversee:

- approximately $72 trillion in securities trading each year;
- disclosures of 8,100 public companies; and
- the activities of 26,000 registered entities.[22]

It is implausible to believe that the agency would be able to police the markets robustly in a way that gives the public confidence that their savings was being closely guarded if the only "cop" on the beat was an extremely under resourced agency.

Second, private enforcement actions recover significantly more ill-gotten gains from corporate wrongdoers than SEC enforcement. Rick Fleming, the SEC Investor Advocate, recently remarked that "our regulatory framework assumes that investors themselves will serve an important role in policing the markets" and "have typically borne a large share of the responsibility of policing the markets and rooting out misconduct."[23] Not only do private

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[19] Letter from 29 law professors to Mary Jo White, Chair, U.S. Securities and Exchange Commission (Oct. 30, 2013), *available at* https://law.duke.edu/sites/default/files/centers/gfmc/session_2/4_letter_to_sec_re_arbitration_bylaws-10-30-2013.pdf.

[20] *Id.*

[21] *Id.*

[22] *Testimony on Examining the SEC's Agenda, Operation, and Budget Before the Comm. on Fin. Serv. U.S. House of Representatives*, U.S. SECURITIES AND EXCHANGE COMMISSION (Oct. 4, 2017), https://www.sec.gov/news/testimony/testimony-examining-secs-agenda-operation-and-budget (statement of Jay Clayton, Chairman).

[23] Rick Fleming, SEC Investor Advocate, Mandatory Arbitration: An Illusory Remedy for Public Company Shareholders (Feb. 24, 2018), *available at* https://www.sec.gov/news/speech/fleming-sec-speaks-mandatory-arbitration.

lawsuits complement government enforcement, but at least one empirical study has shown that private lawsuits have provided "*greater deterrence* against more serious securities law violations" than SEC enforcement actions.[24] And according to Commissioner Robert Jackson, "roughly sixty cents of every dollar returned to investors in corporate-fraud cases came through private rather than SEC settlements."[25]

Third, the rights of investors to help police misconduct are even more important when the government is prevented from taking action.[26] Finally, settling disputes in open court not only holds wrongdoers accountable, but "tells the public that we take corporate fraud seriously—and sends a signal to insiders, the bar, and investors, that being unfaithful to investors doesn't pay."[27]

Private lawsuits play an indispensable role in policing misconduct, deterring bad actors, and returning ill-gotten corporate gains to investors. Allowing companies to force investors into arbitration would sideline them from carrying out their indispensable role as a complementary enforcement mechanism.

5. <u>Congress must take action to protect investors</u>

The SEC has been asked on several occasions to allow forced arbitration clauses to be included in corporate governance documents. Each time, the company has asked the SEC to issue a "no-action" letter stating that the SEC would take no enforcement action if the company resisted the proposal.[28] On two occasions, the SEC refused to accelerate the IPO filings of those companies, Franklin First Financial Corp. and The Carlyle Group, after they indicated a desire to include forced arbitration clauses in their governance documents. Both companies subsequently did not move forward with placing forced arbitration clauses in their documents. Up until this time, the SEC—with overwhelming concurrence from academics, consumer advocates, and institutional investors—has asserted that forcing investors into arbitration would be contrary to federal securities laws.

However, the SEC's stance could change. After public statements from then-Commissioner Michael Piwowar and current Commissioner Hester Peirce that they would be willing to overturn

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[24] Stephen Choi & Adam Pritchard, *SEC Investigations and Securities Class Actions: An Empirical Comparison* 36 (Law & Economics Working Papers, No. 55, 2012) (emphasis added), *available at* https://repository.law.umich.edu/cgi/viewcontent.cgi?article=1168&context=law_econ_current.
[25] Robert J. Jackson, Jr., SEC Commissioner, Keeping Shareholders on the Beat: A Call for a Considered Conversation About Mandatory Arbitration (Feb. 26, 2018), *available at* https://www.sec.gov/news/speech/jackson-shareholders-conversation-about-mandatory-arbitration-022618.
[26] *See* Kokesh v. S.E.C., 137 S. Ct. 1635, 1645 (2017) (finding that "[d]isgorgement, as it is applied in SEC enforcement proceedings," operated as a penalty and therefore was barred by statute of limitations).
[27] Jackson, *supra* note 23.
[28] *See* Barbara Roper & Micah Hauptman, *A Settled Matter: Mandatory Shareholder Arbitration is Against the Law and the Public Interest,* 17-19 (2018), *available at* https://consumerfed.org/wp-content/uploads/2018/08/cfa-mandatory-shareholder-arbitration-white-paper.pdf

longstanding SEC policy, last December, a trustee of The Doris Behr 2012 Irrevocable Trust sought to include a forced arbitration clause in Johnson & Johnson's proxy materials. In February 2019, Chairman Jay Clayton announced that SEC staff "would not recommend enforcement action [against Johnson & Johnson] should the company decide to exclude the proposal on the grounds that it would violate New Jersey state law."[29] To be clear, Chairman Clayton left the door wide open for shareholders to take another bite at the apple and force the SEC to re-examine whether including a forced arbitration provision in corporate governance documents would violate federal law. Last month, The Doris Behr 2012 Irrevocable Trust sued Johnson & Johnson seeking declaratory relief that the company violated the federal securities laws by failing to include a forced arbitration clause proposal in its proxy materials and injunctive relief requiring the company to: (1) "issue supplementary proxy materials that include the Trust's proposal;" (2) "announce" that the Trust's proposal is legal under federal and state laws, and (3) prevent "Johnson & Johnson from excluding proposals of this sort from future proxy materials."[30] Even if the court denies the Trust's prayers for relief, this issue—and the danger that it poses to everyday investors and their savings—will not go away until Congress acts.

Investors' rights will only be truly protected if Congress passes the Investor Choice Act, which has been introduced in three previous Congresses. This legislation would amend federal securities laws to prohibit issuers, brokers, dealers, or investment advisers from the use of pre-dispute arbitration agreements. The bill would not prohibit investors from choosing to arbitrate *post-dispute*; this decision would remain up to the investor. But everyday investors who are relying on brokers, dealers, and investment advisors to safeguard their life savings would be able to choose the forum that is right for them if they are wronged by those they entrust with their hard-earned savings.

Many organizations oppose allowing corporate actors to sneak forced arbitration clauses into IPO documents. Among them is the Council of Institutional Investors, which recently wrote to the Commission, stating that forced arbitration represents a "potential threat to principles of sound corporate governance that balance the rights of shareowners against the responsibility of corporate managers to run the business."[31] More broadly, Public Citizen, along with almost 90 consumer, worker rights, and civil rights organizations supported the recent introduction of the Fair Arbitration Injustice Repeal (FAIR) Act, which would prohibit the use of forced arbitration in

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[29] *See Statement on Shareholder Proposals Seeking to Require Mandatory Arbitration Bylaw Provisions*, U.S. SECURITIES AND EXCHANGE COMMISSION (Feb. 11, 2019), https://www.sec.gov/news/public-statement/clayton-statement-mandatory-arbitration-bylaw-provisions (statement of Jay Clayton, Chairman); *see also* Letter from Gurbir S. Grewal, N.J. Attorney Gen., to Jay Clayton et al., Chair, U.S. Sec. and Exch. Comm'n (Jan. 29, 2019), *available at* https://www.sec.gov/divisions/corpfin/cf-noaction/14a-8/2019/dorisbehrjohnson022219-14a8.pdf.

[30] Complaint against Johnson & Johnson, The Doris Behr 2012 Irrevocable Trust v. Johnson & Johnson, No. 3:2019-cv-08828 (D. N.J. Mar. 21, 2019).

[31] Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors, to William H. Hinman, Director, Div. of Corporate Finance (Jan. 29, 2018), *available at* https://www.cii.org/files/issues_and_advocacy/correspondence/2018/January%2029%202018%20letter%20to%20Mr_%20Hinman%20on%20forced%20arbitration%20(final).pdf.

consumer, civil rights, employment, or antitrust disputes. And according to a national survey, 84 percent of the public supports federal legislation that ends the practice of forcing consumers and workers into arbitration. Republicans support the legislation more than Democrats (87% to 83%).[32]

II. PROTECTING EVERYDAY INVESTORS FROM INSIDER TRADING

Illegal insider trading undermines the integrity of financial markets. When corporate insiders and others who wrongfully obtain inside information trade on it, they engage in theft. Insider trading is akin to an owner selling a car that the person knows is defective for an inflated price. More broadly, illegal insider trading contributes to income inequality because senior management profits at the expense of everyday investors outside of elite circles.

Currently, the law governing illegal insider trading lacks definition. This has forced the SEC and the Department of Justice (DOJ) to rely on general anti-fraud statutes and decades of case law subject to interpretation by judges. Under current SEC interpretations, illegal insider trading is "buying or selling a security, in breach of a fiduciary duty or other relationship of trust and confidence, on the basis of material, nonpublic information about the security."[33] For nearly fifty years, federal prosecutors who have brought criminal insider trading charges under Section 10(b) of the Exchange Act and the SEC's implementing rule governing the law, Rule 10b-5, and more recently, litigation has focused on a personal benefit test.[34]

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[32] Guy Molyneux & Geoff Garin, *Nat'l Survey on Required Arbitration*, HART RESEARCH ASSOC. (Feb. 28, 2019), https://www.justice.org/sites/default/files/2.28.19%20Hart%20poll%20memo.pdf.

[33] *Fast Answers: Insider Trading*, SECURITIES AND EXCHANGE COMMISSION, https://www.investor.gov/additional-resources/general-resources/glossary/insider-trading (last visited Mar. 27, 2019).

[34] In Dirks v. S.E.C., 463 U.S. 646, 662 (1983), the Supreme Court held that a breach of duty occurs when, based on objective criteria, "the insider personally will benefit, directly or indirectly, from his disclosure." The Court explained that the relationship between the insider and the tippee involves a quid pro quo. This could either been in the form of money, or friendship. In 2014, the Second Circuit narrowed the definition of a personal benefit. In United States v. Newman, 773 F.3d 438 (2d Cir. 2014), the government charged Todd Newman and Anthony Chiasson with insider trading after material, nonpublic information had been shared with acquaintances, rather than good friends or relatives. These acquaintances later passed the tips along to others who ultimately told Newman and Chiasson. For Newman, the insider initially gave the information to a colleague and fellow alumnus of the same school while receiving casual career advice. In Chiasson's case, the initial tip was given from one acquaintance to another through a church relationship. Each tip eventually reached the defendants, who traded on it and were convicted in December 2012. The Second Circuit voided the convictions. The court argued that the initial exchange of information did not turn on a personal benefit. The court explained that the career advice given between colleagues and a conversation between acquaintances at church acquaintances did not qualify as a personal benefit. While the Supreme Court declined to review *Newman* directly, it did address the general issue in a case from the Ninth Circuit, Salman v. United States,137 S. Ct. 420 (2016). The insider-tipper in *Salman* was an investment banker who gave information to his brother. The investment banker testified that he gave the information to his brother to "fulfill whatever needs he had," along with the knowledge that his brother would trade on it. The brother also passed the information along to another person related to the banker. This person traded on that information and was convicted in the Northern District of California in 2013. The Ninth Circuit affirmed the conviction in an opinion that rejected the Second Circuit's formulation of *Newman*. The Supreme Court then decided to resolve the circuit split in favor of the Ninth Circuit. The Second Circuit's next opportunity to revisit *Newman* came in United States v. Martoma, 894 F.3d 64 (2d Cir. 2018). This year, on January 24, former SAC Capital Advisors portfolio manager Mathew Martoma petitioned the Supreme Court to review his 2014 conviction for insider trading. This conviction

We believe the personal benefit test unjustly limits the boundaries of what should be illegal insider trading. Insiders should not divulge inside information. When a person receives inside information, they should not trade with this knowledge, and each person engaged in such action should be prosecuted. Legislation was previously introduced by Rep. Jim Himes achieves these goals, and Public Citizen strongly supports this bill, which:

- Makes it unlawful for a person to trade on material, nonpublic information when the information was wrongfully obtained, or when the use of such information to make a trade would be deemed wrongful;

- Makes it unlawful for a person who wrongfully obtains material, nonpublic information to communicate that "tip" to another person when it is reasonably foreseeable that the person is likely to trade on that information;

    - The bill defines "wrongful" as information that has been obtained through "theft, bribery, misrepresentation or espionage, a violation of any federal law protecting computer data or the intellectual property or privacy of computer users, conversion, misappropriation or other unauthorized and deceptive taking of such information, or a breach of any fiduciary duty or any other personal or other relationship of trust and confidence."

- Removes the requirement outlined in the *Newman* decision.

- Authorizes the SEC to exempt any person or transaction from liability under this bill at the Commission's discretion.

III. PROTECTING WHISTLEBLOWERS

Dodd-Frank recognized the mistreatment of financial industry whistleblowers and passed strong protections for them into law. The goal was to institutionalize greater accountability by the financial industry and encourage and protect whistleblowing within the financial industry. However, in February 2018, in *Digital Realty Trust, Inc v. Somers,* the U.S. Supreme Court unanimously ruled that employees are only protected from retaliation under Dodd-Frank if they

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stemmed from 2008 activity when Martoma paid a doctor from the University of Michigan for inside information about clinical trial results for an experimental Alzheimer's medication. United States v. Martoma, 894 F.3d 64 (2d Cir. 2018), *petition for cert. filed,* (U.S. Jan. 24, 2019) (No. 18-972). Before the trial results were published, Martoma directed SAC Capital investments in instruments that led to $275 million in gains and losses avoided. The Second Circuit upheld the conviction, holding that the personal benefit requirement was satisfied by Martoma's payments to the doctor. The court attempted to reconcile the *Salman* and *Newman* cases with a further discussion of the personal benefit test.

make a whistleblower disclosure to the SEC; employees are not protected if they only make an internal disclosure.[35] This ruling brings to light a gap in Dodd-Frank that hurts companies and whistleblowers, and Congress should enact legislation to remedy this injustice.

According to a report by the Ethics & Compliance Initiative (ECI, formerly the Ethics Resource Center), 97 percent of employees blow the whistle internally at first.[36] More often than not, they are performing their job and report a perceived error and want to give their superior an opportunity to fix the problem before taking measures outside of the organization. Regardless of the motivation, internal whistleblowing provides a significant opportunity for the company to be informed of the misconduct and to engage in voluntary compliance before the problem escalates. Notably, the business community also supports this procedure of internal notification first since no company wants to be blindsided by accusations of misconduct without first having an opportunity to review the allegations and take corrective action.

Unfortunately, some companies respond to internal disclosures by trying to silence the messenger, rather than heeds their warnings. Take for instance the experience of Wells Fargo whistleblower Jessie Guitron, whose warnings could have prevented the 2016 Wells Fargo banking scandal. Shortly after she began working for Wells Fargo in 2008, Ms. Guitron noticed that her colleagues and she faced a company-mandated quota to sign up new accounts, often with misleading terms that came with large fees and ruined customers' credit. She told CBS News, "I kept complaining and complaining, and nothing ever gets done ... I was doing what my conscience was telling me to do. It's fraud. That's what it is." After she reported her concerns to Wells Fargo, she was terminated in 2010 without warning and subsequently blacklisted from the financial industry, according to news reports.[37] Ms. Guitron's experience underscores the significance of protecting whistleblowers who make internal disclosures; otherwise, companies will have an incentive to make an example out of workers who are brave enough to report fraud and other misconduct.

Despite the Supreme Court's decision, it is doubtful that Congress intended to limit whistleblower protections under Dodd-Frank. Indeed, Senator Charles Grassley (R-IA), co-author of the whistleblower provisions of the Sarbanes-Oxley Public Company Accounting Reform and Investor Protection Act of 2002 (Sarbanes-Oxley) and co-Chair of the Senate Whistleblower Protection Caucus, asserted in an *amicus curiae* brief in support of the respondent in *Digital Realty Trust, Inc.*:

[35] 138 S.Ct. 767.

[36] Ethics Resource Center, *Inside the Mind of a Whistleblower: A Supplemental Report of the 2011 Nat'l Business Ethics Survey* 7, 13 (2012), *available at* https://bit.ly/2TFKIjQ.

[37] *Whistleblower: Wells Fargo fraud "could have been stopped,"* CBS NEWS (Aug. 3, 2018), *available at* https://cbsn.ws/2LSCfdU.

> "In Dodd-Frank, Congress sought to enhance the whistleblower protections and reporting provisions of the Sarbanes-Oxley Act, which apply with equal force to internal and external reports. Thus, Dodd-Frank's anti-retaliation provision expressly covers 'disclosures that are required or protected' under Sarbanes-Oxley, the Securities Exchange Act of 1934 (15 U.S.C. § 78a et seq.), and other key federal laws..."[m]any of these disclosures are internal because Congress understood that robust internal reporting can facilitate a culture of voluntary compliance, deter wrongdoing, and protect investors while conserving scarce government resources." [38]

It has long been established in whistleblower protection statutes that employees are protected for making internal disclosures, and there is no reason to maintain this unintended loophole. Public Citizen, in conjunction with the National Employment Lawyers Association and the Government Accountability Project submitted public comments to a related SEC rulemaking proposal that argued that it is more urgent than ever that Congress close this gap, given that Dodd-Frank now requires public companies to maintain internal compliance programs.[39]

Whistleblowers must be protected in the process of making internal disclosures, or employees will be discouraged from sounding the alarm in the first place. We cannot afford to deter would-be whistleblowers since they serve as our eyes and ears to Wall Street abuses. In the current deregulatory climate, whistleblowers are consumers' most effective watchdogs. We urge Congress to pass legislation that would strengthen whistleblower rights by amending the definition of "whistleblower" in Dodd-Frank to clarify that it also applies to internal reporting under the anti-retaliation provision of the law.

IV. HOLDING CORPORATE EXECUTIVES ACCOUNTABLE

In addition to ending forced arbitration, protecting investors from insider trading, and protecting whistleblowers, Public Citizen supports legislation and regulation that ensures corporate executives are accountable to their shareholders, workers, customers, and the public, such as:

- Legislation designed to ensure that the SEC promulgates rules that are mandated by Congress under the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank). These rules, which include, Sec. 953(a) regarding pay for performance and Sec. 954 regarding claw backs of executive compensation of Dodd-Frank, among others, also require the SEC chair to appear monthly before the House Financial Services Committee to report on progress finalizing these rules.

[38] Brief for Senator Charles Grassley as Amicus Curiae In Support of Respondent at 2, Digital Realty Trust, Inc. v. Somers, 138 S. Ct. 767 (2018) (No. 16-1276).

[39] Letter from James H. Kaster, President, National Emp't Lawyers Ass'n, et al. to Emily Pasquinelli, Office of the Whistleblower, Div. of Enforcement, and Brian A. Ochs, Office of the Gen. Counsel, U.S. Securities and Exchange Comm'n (Sept. 18, 2018), *available at* https://bit.ly/2Ujiakm.

- Rulemaking at the SEC requiring public companies to disclose their political spending to shareholders and the public.

- Rulemaking at the SEC that creates a standard set of environmental, social, and governance risk disclosure guidelines for public companies.

1. Implementing Dodd-Frank Section 953 (Executive compensation)

Congress enacted Dodd-Frank as a direct result of the 2008 Wall Street crash and Great Recession. Dangerous compensation plans were at the heart of the global catastrophe. Mortgage brokers won higher fees for selling expensive mortgages. Therefore, they sold mortgages to those who couldn't afford them, which generated fees for the brokers and the investment bankers packaging the mortgage-backed securities. These generated short-term profits that boosted the stock price. In turn, this generated bonuses for senior managers which were paid through stock-based compensation. Congress approved Section 953(a) to provide investors with a means of measuring senior management pay in the context of firm performance.[40] This rule would require companies to clearly and publicly state the nexus between executive compensation and financial performance of the company, thereby giving shareholders the necessary information that they need to assess an executive's compensation. Moreover, it would ensure that shareholders have clear information about how senior executive pay is absorbing increasing percentages of shareholder capital.

Currently, the ability of a shareholder to rein in CEO pay is limited. Shareholders even lack a convenient means of assessing whether management pay accords with performance. Some publicly traded companies do discuss compensation philosophy and offer metrics by which they measure performance, but without a consistent performance standard, it is difficult for investors to assess the validity of compensation levels at a single company or across peers. Together with the SEC's rule on executive pay ratio, which has already been finalized, shareholders will be better equipped to make informed evaluations about executive pay.[41]

[40] S. Rep. No. 111-176, at 135 (2010), *available at* https://www.govinfo.gov/content/pkg/CRPT-111srpt176/pdf/CRPT-111srpt176.pdf.

[41] Compelling congressional testimony on the issue addressed in 953(a) came from the Council of Institutional Investors, an amalgam of pension funds and other investors that collectively serve as stewards of some $3 trillion in beneficiary capital. The Senate report references this testimony and in it, the Executive Director of the Council stated: "Of primary concern to the Council is full and clear disclosure of executive pay. As U.S. Supreme Court Justice Louis Brandeis noted, "sunlight is said to be the best of disinfectants." *Other People's Money and How the Bankers Use It*, 92 (1914). Transparency of executive pay enables shareowners to evaluate the performance of the compensation committee and board in setting executive pay, to assess pay-for-performance links and to optimize their role of overseeing executive compensation through such means as proxy voting. *See* Protecting Shareholders and Enhancing Public Confidence by Improving Corporate Governance: Hearing Before the S. Subcomm. on Securities, Insurance, and Investment of the Comm. on Banking, Hous., & Urban Affairs, 111th Cong. 9-11 (2009) (testimony of Ann Yerger, Exec. Dir. of the Council) (emphasis added), *available at*

In addition, we believe that a finalized rule—which the agency has taken no action on since the proposal rule was published on April 29, 2015—should require companies to post any financial performance metric they use to determine CEO pay[42] because many companies do not. Where no concrete financial metric is public, we believe that any legislation on executive compensation should require the Commission to require a declaration that end that the company does not bind pay to strict financial metrics. Where firms lack such a consistent metric, shareholders have a right to know.[43]

2. Implementation of Dodd-Frank Section 954 (Executive compensation clawbacks)

We also support legislation that would implement of Section 954, which mandates that the SEC adopt rules requiring all publicly traded companies to adopt a clawback policy. A clawback is where a firm takes money already paid to an employee and clearly serve the interest of shareholders and they should be correspondingly enforced with rigor by corporate boards which serve as fiduciaries for shareholders. Enforcement, however, has been anemic.[44] Congress has attempted to bring rigor to clawback enforcement by federalizing this aspect of corporate governance. The first attempt came through Section 304 of Sarbanes-Oxley. Section 304 requires public company chief executive officers (CEOs) and chief financial officers (CFOs) to disgorge bonuses and other incentive compensation they receive within the 12-month period following the public release of financial information if there is a subsequent restatement of those results.

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https://www.govinfo.gov/content/pkg/CHRG-111shrg55479/pdf/CHRG-111shrg55479.pdf; *see also* S. Rep. No. 111-176, at 135 (2010), *available at* https://www.govinfo.gov/content/pkg/CRPT-111srpt176/pdf/CRPT-111srpt176.pdf.

[42] Eleanor Bloxham, The SEC can't stop screwing up, FORTUNE (May 28, 2015), *available at* http://fortune.com/2015/05/28/sec-keeps-screwing-up/.

[43] For example, JP Morgan does not post any clear connection between what the board decided to pay CEO Jamie Dimon and the firm's performance. The board does apparently believe shareholders are interested in the subject enough to devote pages 30 through 44 to this very question. This 15 page discussion includes many charts and numerous normative declarations. However, the board does not provide concrete information that would allow an investor to determine numerically how the CEO's pay was determined. One could not forecast what the CEO would be paid next year based on company financial results. Still, the board would have the company owners understand that the CEO compensation is appropriate. "Mr. Dimon has generated more profit per dollar of compensation paid than other CEO in our financial services peer group." (Such an accomplishment is especially noteworthy given that the firm has more than 240,000 employees who, by extrapolation, apparently generated little or no value as measured by company earnings.) Under the cold lens of professional compensation analysts, however, the board is squandering shareholder money on Dimon. Institutional Shareholder Services, a firm employed by owners of some 20 percent of JP Morgan's outstanding stock, graded Dimon's pay package an "F." The analysts found: "The Company paid more compensation to its named executive officers than the median compensation for a group of companies. . . The CEO was paid more than the median CEO compensation of these peer companies. Overall, the Company paid more than its peers, but performed moderately worse than its peers." ("Proxy Paper: JP Morgan," published by Institutional Shareholder Services. (April 2015)(on file with author).

[44] J. Robert Brown, Jr., *Waiting for Dodd-Frank Clawbacks*, THE RACE TO THE BOTTOM (Sept. 29, 2014), https://www.theracetothebottom.org/rttb/waiting-for-dodd-frank-clawbacks.html?rq=Waiting%20for%20Dodd-Frank%20Clawbacks.

The Sarbanes-Oxley law was written in an earlier time when clawback reform was less necessary. Prior to 2005, only three Fortune 100 companies disclosed clawback policies.[45] Now, most major companies have basic clawback policies (though stronger policies would be preferred), and they have begun adopting them because of the clear need.[46] However, Sarbanes-Oxley provides no enforcement mechanism for shareholders and, as noted above, without disclosure they may not even know that such a policy is in place. Only an active SEC can mandate and enforce such transparent policies. According to Audit Analytics, there have been 700 to 1,500 restatements a year for the last decade.[47] The SEC brought its first clawback case in 2007, five years after enactment of Sarbanes-Oxley. From that time until 2011, the SEC enforced the Sarbanes-Oxley clawback provision only three times.[48] The pace increased to 31 cases through the end of 2013. However, of all of those cases, only eight executives have actually returned pay. A stronger and more robustly enforced policy is clearly needed. [49] [50] In 2012, JP Morgan Chase clawed back certain compensation from three traders involved in the so-called London Whale fraud, but the firm did not detail the amount of the clawback.[51] Walmart reportedly clawed back certain pay, but it was unclear if this was related to the Mexican bribery case.[52] Even in the case of Wells Fargo, shareholders are only informed of those individuals that the firm chooses to publicize.

We believe Congress should compel completion of this simple rule, as well as require a monthly progress report from SEC officials at a public hearing.

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[45] Ed DeHaan et al., *Does Voluntary Adoption of Clawback Provision Improve Financial Reporting Quality?*, (Contemporary Accounting Research, Forthcoming,2012), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2049442.

[46] PricewaterhouseCoopers *Executive Compensation: Clawbacks: 2013 Proxy Disclosure Study*, PRICEWATERHOUSECOOPERS (Apr. 2014), http://www.pwc.com/en_US/us/hr-management/publications/assets/pwc-clawbacks-2013-proxy-disclosure-study.pdf.

[47] Gretchen Morgenson, *Clawbacks? They're Still a Rare Breed*, THE NEW YORK TIMES (Dec. 28, 2013), *available at* http://www.nytimes.com/2013/12/29/business/clawbacks-theyre-still-a-rare-breed.html?pagewanted=all&_r=0.

[48] Wayne M. Carlin, *Another SEC Clawback Settlement*, HARVARD L. SCHOOL FORUM ON CORPORATE GOVERNANCE AND FINANCIAL REGULATION (Dec. 13, 2011), http://blogs.law.harvard.edu/corpgov/2011/12/13/another-sec-clawback-settlement/.

[49] Morgenson, *supra* note 47.

[50] In a recent case involving Babak Yazdani, former CEO of Saba Software Inc., the SEC ordered repayment of $2.5 million following a multi-year fraud that led to an earnings restatement. *See Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C Securities Exchange Act of 1934, Making Findings, and Imposing A Cease-and-Desist Order*, SECURITIES AND EXCHANGE COMM'N. (Sept. 24, 2014), http://www.sec.gov/litigation/admin/2014/34-73201.pdf.

[51] Dan Fitzpatrick, *J.P. Morgan: 'Whale' Clawbacks About Two Years of Compensation*,THE WALL STREET JOURNAL (July 13, 2012), http://www.wsj.com/articles/SB10001424052702303740704577524730994899406.

[52] Letter from UAW Trust and Ill. State Board of Inv. to Walmart S'holders Urging Support for S'holder Proposal on Clawbacks Disclosure (May 22, 2014), *available at* http://www.uawtrust.org/AdminCenter/Library.Files/Media/501/Press%20Releases/2014/14maylettershareholderwmtrecoupdisclosureproposal.pdf).

3. Corporate political spending disclosure

Since the U.S. Supreme Court's 2010 *Citizens United* decision, corporations have been allowed to spend unlimited undisclosed amounts of money to influence American elections and policy outcomes. In 2011, a bipartisan committee of law professors filed the first petition requesting a rulemaking at the SEC requiring all public companies to disclose their political expenditures.[53] The petition has garnered a staggering 1.2 million comments[54]—the most in the agency's history. This rulemaking was placed on the agency's agenda in 2013 by the agency's former chair Mary Schapiro, but it was then removed by then-chair Mary Jo White in 2014.

Additional obstruction occurred when conservatives in Congress inserted a policy rider into the past four appropriations bills that prohibited the SEC from finalizing, but not from working on, the rule. Public Citizen urges Congress to remove the policy rider from the budget so that the SEC can continue to work to craft a rule, which should be quickly finalized."

4. Long-term risk disclosure

For years, investors have been calling on the SEC to require companies to disclose various types of environmental, social, and governance (ESG) risks, such as climate, human capital management, political spending, tax, human rights, and gender pay ratios. The SEC received more than 26,500 comments in response to its Regulation S-K concept release,[55] the overwhelming majority of which expressed a demand for more and better disclosure in general.[56]

Despite the strong support for the SEC to require these different types of disclosure, the SEC has yet to issue comprehensive, standard guidance for public companies' disclosure of ESG risk.

In 2018, investors representing more than $5 trillion in assets under management submitted a new petition for a rulemaking at the SEC that would create a standard disclosure framework on all ESG issues for public companies.[57] The petition was drafted with the guidance of American securities law experts Professors Cynthia Williams Professor Jill Fisch.

Public Citizen urges the SEC to begin work on this rulemaking and would support legislation from Congress that mandates this rule.

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[53] Lucian A. Bebchuck et al., *Committee on Disclosure of Corporate Political Spending Petition for Rulemaking,* SECURITIES AND EXCHANGE COMMISSION, https://bit.ly/2ctSUiS.

[54] *Comments on Rulemaking Petition: Petition to require public companies to disclose to shareholders the use of corporate resources for political activities*, SECURITIES AND EXCHANGE COMMISSION, https://bit.ly/2cGUr9G.

[55] *Id.*

[56] Tyler Gellasch, *Towards a Sustainable Economy: A Review of Comments to the SEC's Disclosure Effectiveness Concept Release* 17 (2016), *available at* https://bit.ly/2yoDbfd.

[57] Cynthia A. Williams et al., *Request for rulemaking on environmental, social, and governance (ESG) disclosure*, SECURITIES AND EXCHANGE COMMISSION, https://bit.ly/2Pg52qz.

V. CONCLUSION

We are at a moment of reckoning in our society. Workers, consumers, and everyday investors, joined by small businesses, are standing up to corporate behemoths who have historically been able to use their corporate power and money to silence dissent and keep systemic wrongdoing in the shadows. We strongly support access to justice for all people, the ability to bring their claims in open, neutral court, and protections for everyday investors.

Thank you for the opportunity to provide comments and I look forward to your questions.

Written Testimony of Melanie Senter Lubin

Board Member, North American Securities Administrators Association

and

Maryland Commissioner of Securities

to

The U.S. House of Representatives; Committee on Financial Services;

Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets.

"Putting Investors First: Reviewing Proposals to Hold Executives Accountable."

April 3, 2019

Washington DC

I. Introduction:

Good morning Chairwoman Maloney, Ranking Member Huizenga, and Members of the Subcommittee. Thank you for the opportunity to testify today. My name is Melanie Lubin. For the past 33 years, I have worked in the Securities Division in the Office of the Attorney General of Maryland, serving since 1998 as the Maryland Securities Commissioner. I also represent Maryland within the North American Securities Administrators Association ("NASAA"),[1] where I currently serve as a Board member and a member of NASAA's Committee on Federal Legislation. Since 2015, I have also served as NASAA's representative to the Financial Stability Oversight Council ("FSOC").

NASAA members include state securities regulators who, for more than 100 years, have served on the frontlines of investor protection, safeguarding the financial futures of hardworking Americans and assisting local businesses and entrepreneurs in raising investment capital. My NASAA colleagues and I enforce state securities laws by investigating complaints, examining broker-dealers and investment advisers, registering certain securities offerings, and providing investor education programs. Our position as the regulators closest to the investing public provides us with a unique window into the concerns of Main Street investors and small businesses.

State securities regulators bring civil and administrative enforcement actions and may bring criminal prosecutions or provide substantial assistance with those cases. Our most recently compiled enforcement statistics reflect that in 2017 alone, state securities regulators conducted nearly 4,790 investigations, leading to more than 2,000 enforcement actions (including 255 criminal prosecutions). Of these enforcement actions, 150 involved broker-dealer agents, 187 involved investment adviser representatives, 120 involved broker-dealers, and 190 involved investment advisers.

II. Summary:

As a preliminary matter, NASAA applauds the Subcommittee on its decision to hold its first several hearings of the 116th Congress on policy questions that explicitly aim to place the interest of Main Street investors first. Main Street investors are an engine of prosperity helping to drive our nation forward; when we put their interests first, our capital markets, our economy and our country all win.

NASAA is very supportive of the ***"Investor Choice Act of 2019"*** introduced by Representative Foster. The bill is a modernized and expanded version of legislation that NASAA supported when it was introduced in 2013. The 2013 bill would have prohibited broker-dealers and investment advisers from mandating arbitration of disagreements with customers by including binding pre-dispute arbitration clauses in customer account agreements. The current

[1] The oldest international organization devoted to investor protection, NASAA was organized in 1919. Its membership consists of the securities administrators in the 50 states, the District of Columbia, Canada, Mexico, Puerto Rico and the U.S. Virgin Islands. NASAA is the voice of securities agencies responsible for grass-roots investor protection and efficient capital formation.

bill goes further by applying this prohibition not only to customer account agreements but also to governing corporate documents. We strongly support the current bill, and we look forward to working with the Chairwoman and the Committee in passing the legislation this year.

NASAA also shares the Committee's interest in defining "insider trading" for purposes of clarifying the types of activities that are prohibited. We support the goal of the ***"Insider Trading Prohibition Act of 2019,"*** sponsored by Rep. Himes (D-CT), which seeks to codify in federal statutes the insider trading standards that exist today as a result of case law. Defining the standards for insider trading liability by statute would add greater clarity and consistency to this important area of the law.

NASAA welcomes the introduction of ***"The 8-K Trading Gap Act of 2019"*** by Chairwoman Maloney. This bill aims to close the so-called "8-K trading gap." We agree that there appears to be compelling evidence that this trading gap does exist and that it unfairly advantages corporate insiders by enabling them to enter into securities transactions before the public release of market moving information.[2] Closing this gap is a basic issue of fairness for retail investors.

NASAA is similarly supportive of draft legislation sponsored by Rep. Green (D-TX) entitled ***"A bill to amend the Securities Exchange Act of 1934 to amend the definition of whistleblower,"*** which would revise Section 922 of the Dodd-Frank Act of 2010 to clarify that whistleblowers who report alleged misconduct to their employers but not also to the U.S. Securities and Exchange Commission ("SEC") are protected by the anti-retaliation provisions in Section 922. The bill is a necessary response to the U.S. Supreme Court's 2018 holding in *Digital Realty Trust, Inc. v. Somers* that only reports made directly to the SEC are protected.

Finally, several of the legislative proposals before the Committee concern outstanding rulemakings to address executive compensation that arose during Congress's consideration of the Dodd-Frank Act. Specifically, the Committee is considering draft legislation entitled ***"A bill to require the SEC to complete rulemaking required by section 10D of the Securities Exchange Act of 1934,"*** and ***"A bill to require the SEC to complete rulemaking required by section 14(i) of the Securities Exchange Act of 1934."*** These bills seek to compel the SEC to complete rulemakings mandated by Dodd-Frank Sections 954 and 953(a), respectively.

NASAA strongly supported the Dodd-Frank Act.[3] The preceding financial crisis had made it plainly evident that the existing regulatory landscape required an overhaul to prevent another economic crisis and to restore the confidence of Main Street investors. The Dodd-Frank Act has largely achieved its goals, and where appropriate Congress has taken steps to adjust certain of its provisions. Further, just as the 111th Congress was correct to reform our financial

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[2] Cohen, Alma, et al., *The 8-K Trading Gap*, Columbia Law and Economics Working Paper No. 524 (2015).

[3] *See* NASAA Letter to House Speaker Nancy Pelosi (D-CA), House Minority Leader John Boehner (R-OH), Senate Majority Leader Harry Reid (D-NV), and Senate Minority Leader Mitch McConnell (R-KY) urging support for the Dodd-Frank Wall Street Reform and Consumer Protection Act Conference Report (June 29, 2010), http://www.nasaa.org/wp-content/uploads/2011/07/6-29-11-NASAA_Supports_Conference_Report062910.pdf.

system in 2010, the 116th Congress is correct to insist that the SEC fully implement the law, including by completing rulemakings mandated therein.

III. Analysis of Certain Legislative Proposals:

(1) The Investor Choice Act of 2019

The Investor Choice Act of 2019 would amend the Securities Exchange Act of 1934 ("Exchange Act"), the Securities Act of 1933 ("Securities Act"), and the Investment Advisers Act of 1940 ("Advisers Act") to prohibit mandatory pre-dispute arbitration agreements in a variety of contexts related to the offer and sale of securities.

Specifically, the Investor Choice Act would amend the Exchange Act to specify that "Notwithstanding any other provision of law, it shall be unlawful for any broker, dealer, funding portal, or municipal securities dealer to enter into, modify, or extend an agreement with customers or clients of such entity with respect to a future dispute between the parties that: (1) mandates arbitration for such dispute; or (2) restricts, limits, or conditions the ability of a customer or client of such entity to select or designate a forum for resolution of such dispute." The bill would make analogous amendments for investment advisers in the Advisers Act.

In addition, the Investor Choice Act of 2019 would prohibit public companies from including mandatory arbitration clauses in their bylaws or other corporate governance documents. The extension of the bill's prohibition on forced arbitration contracts in such corporate documents and bylaws is essential to counter recent efforts by some parties to reverse decades of SEC opposition to such provisions.[4]

Mandatory Arbitration in Customer Agreements

Customer disputes are oftentimes resolved in court or through alternative dispute resolution processes (*i.e.*, negotiation, mediation or arbitration). Before 1987, securities investors' claims against stockbrokers were, similarly, generally pursued as either lawsuits or through arbitration. However, in 1987, the Supreme Court upheld the enforceability of agreements to arbitrate investors' claims arising under the Exchange Act,[5] and since then, the use of mandatory pre-dispute arbitration clauses have become commonplace in agreements between broker-dealer and their customers.

Today, the rules of the Financial Industry Regulatory Authority ("FINRA") permit broker-dealers to include mandatory pre-dispute arbitration provisions in their customer account agreements and virtually all FINRA members have incorporated such provisions into their customer account agreements. The effect of the proliferation of such clauses has served to practically eliminate investor choice regarding the forum for dispute resolution.

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[4] *See, e.g.*, David Michaels and Gabriel Rubin, *SEC Allows Rejection of Mandatory Shareholder Arbitration*, Wall Street Journal (Feb. 12, 2019).

[5] *See* Shearson/Am. Express Inc. v. McMahon, 482 U.S. 220 (1987).

NASAA has long been concerned with the use of mandatory pre-dispute arbitration clauses in customer contracts, whether by broker-dealers or by investment advisers. Such provisions deprive investors of a choice when it comes to selecting a forum for resolving disputes with their investment professionals. Such provisions stand in contrast to the preference of most investors, who place a premium on having a choice when it comes to selecting a dispute resolution forum. In fact, national polling conducted on behalf of NASAA reflects that 83 percent of respondents agreed that they want a choice on whether to pursue their dispute in court or in arbitration rather than being forced into arbitration.[6]

Investor confidence in fair and equitable recourse is critical to the stability of the securities markets and long-term investments by "mom and pop" investors. Retail participation in our capital markets and by extension, job growth, is directly tied to investors' trust in having reasonable avenues through which to seek recovery if they are victimized by securities fraud or other unethical conduct.

Section 921 of the Dodd-Frank Act was included in response to congressional concern that mandatory pre-dispute arbitration agreements were unfair to investors.[7] Specifically, Section 921 granted the SEC explicit rulemaking authority to "prohibit, condition or limit the use of mandatory pre-dispute arbitration agreements" if it finds that doing so protects investors and is in the public interest." Unfortunately, although Congress gave the SEC an important tool to act in this area, in the nearly nine years since the Dodd-Frank Act was enacted, the SEC has not exercised its authority to conduct rulemaking. In light of continued inaction on Section 921 by the SEC, NASAA strongly supports the Investor Choice Act's statutory resolution of this issue.

Mandatory Arbitration in Corporate Governance or Offering Documents

The Investor Choice Act would extend the prohibition against mandatory arbitration to securities issuers. NASAA supports this as well. Forcing investors into mandatory arbitration or otherwise precluding investors from joining class actions is bad policy, as this would harm retail investors and be disruptive to the marketplace. The SEC and state securities regulators have limited resources and cannot combat all securities frauds entirely on their own. The Supreme

[6] A national opinion poll of investors was conducted on behalf of NASAA by Engine, a national opinion firm based in New York. The telephone survey of 1,000 investors was conducted between February 7, 2019 and March 3, 2019.)

[7] As the Committee Report accompanying the Dodd-Frank Act noted:

> "For too long, securities industry practices have deprived investors of a choice when seeking dispute settlement, too. In particular, pre-dispute mandatory arbitration clauses inserted into contracts have limited the ability of defrauded investors to seek redress. Brokerage firms [hold] powerful advantages over investors. Brokerages often hide mandatory arbitration clauses in dense contract language. Moreover, arbitration settlements generally remain secret, preventing other investors from learning about the performance of a particular brokerage firm. If arbitration truly offers investors the opportunity to efficiently and fairly settle disputes, then investors will choose that option. But investors should also have the choice to pursue remedies in court." *See* H. Rep. No. 111-687, Part 1, at 50.

Court has long recognized that securities class actions are "an essential supplement" to government enforcement powers,[8] which is a point that Congress has also recognized.[9]

Securities class actions serve as a deterrent to violative conduct and a primary mechanism by which investors are compensated for the misconduct of fraudsters. While funds recovered by federal and state regulators can be returned to investors, such as through an SEC Fair Fund or a court appointed receiver, these amounts have historically paled in comparison to the amounts recovered directly by investors.[10]

Shareholder class actions also serve an important role in maintaining investor confidence and supporting an efficient capital market system. Class actions are the primary means of upholding securities disclosure standards and contribute materially to the development of the common law. In contrast, arbitrators can deviate from the law, their opinions may be unexplained, and their decisions are essentially unreviewable.[11]

Basic questions of shareholder rights are foundational "rules of the game" issues that should be kept uniform across publicly traded companies. To require that investors research every issuer's articles of incorporation and bylaws to know what their rights are vis-à-vis the company would be grossly inefficient and contrary to their reasonable expectations when making investment decisions.

(2) The Insider Trading Prohibition Act of 2019

State securities regulators combat securities violations on a daily basis. These violations encompass a dizzying array of bad behavior – including fraud, Ponzi schemes, theft or conversion, and breach of a fiduciary or other duty by a securities professional. These nefarious activities, which can include insider trading, erode retail investor confidence in the markets and market participants and keep much needed investment capital on the sidelines. Therefore, NASAA supports codification of a clear, appropriate and effective insider trading definition in the federal statutes.

Insider trading generally refers to buying or selling a security in breach of a fiduciary duty or other relationship of trust and confidence based on material, nonpublic information about the security. Often, it is corporate insiders and the individuals whom they have tipped that commit illegal insider trading. Insider trading also may be done by others such as corporate outsiders who misappropriate information they have otherwise legitimately acquired through the services they perform for the company.

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[8] Tellabs, Inc. v. Makor Issues & Rights, Ltd., 551 U.S. 308, 313 (2007).

[9] *See, e.g.*, S. Rep. No. 104-98 (June 19, 1995), reprinted at 1995 U.S.C.C.A.N. 679.

[10] *See* John C. Coffee, Jr., Reforming the Securities Class Action: An Essay on Deterrence and its Implementation, 106 Colum. L. Rev. 1534, 1542-43 (2006).

[11] *See* AT&T Mobility LLC v. Concepcion, 563 U.S. 333, 350 (2011).

Currently, no statute or SEC rule explicitly prohibits insider trading. Rather, insider trading is considered fraud within the broad contours of Exchange Act Section 10(b) and SEC Rule 10b-5.[12] Under either the classical or misappropriation theories, this conduct "satisfies § 10(b)'s requirement that chargeable conduct involve a 'deceptive device or contrivance' used 'in connection with' the purchase or sale of securities."[13] The deceptive device in insider trading is feigning fidelity to the source of the information. Case law has attempted to define the precise boundaries of insider trading over the past four decades; however, meaningful disputes persist as to what is/is not unlawful.[14]

The Insider Trading Prohibition Act would formally codify much of the existing case law on insider trading and outlaw by statute what has to date been illegal only because of judicial applications of the Exchange Act's general antifraud provisions. Specifically, the bill would amend the Exchange Act to prohibit any person from trading securities while in possession of related material, nonpublic information: by knowingly or recklessly disregarding that the information has been obtained wrongfully; or by engaging in transactions that would constitute a wrongful use of such information.

NASAA supports codification of a clear, appropriate and effective insider trading definition for both courts and market participants. By proposing to codify much of the existing case law surrounding insider trading, the Insider Trading Prohibition Act is a major step forward.

(3) The 8-K Trading Gap Act of 2019

The 8-K Trading Gap Act seeks to prohibit officers and directors of SEC-registered issuers from trading their companies' securities during the so-called "8-K trading gap." This gap refers to the period (currently set by SEC regulation at four days) between when an issuer determines a material event has occurred that requires disclosure on Form 8-K and the time when disclosure is actually made through a public SEC filing.[15] Notably, all prohibitions on insider trading apply during this period, but research has indicated that insiders tend to trade more profitably during this gap than at other points in time.[16] The unfairness of such trading is patently clear.

The SEC instituted the current four-day filing deadline for Form 8-Ks in 2004. The SEC had wanted a two-day filing deadline, but issuers and their legal counsel objected that this was

[12] Dirks v. SEC, 463 U.S. 646 (1983).

[13] United States v. O'Hagan, 521 U.S. 642, 653 (1997).

[14] *See, e.g.*, Salman v. United States, 137 S. Ct. 420 (2016).

[15] SEC registrants must file Form 8-K whenever a specific category of information changes in between filing of their periodic reports (the 10-Qs and 10-Ks). Form 8-K lists nine categories of material information for which the registrant must file the form to disclose the changes. For a quick overview of these categories of information, see: https://www.sec.gov/fast-answers/answersform8khtm.html.

[16] *See* Cohen, Alma, et al., *The 8-K Trading Gap*, Columbia Law and Economics Working Paper No. 524 (2015).

too onerous, and the SEC assented.[17] In retrospect, the issuer's objections seem unreasonable and excessive. Although the SEC may have felt compelled by corporate issuers and their counsel to permit a 4-day filing period, Congress is not so constrained. Congress should close the Form 8-K trading gap because doing so will help ensure the playing field is level between corporate insiders and retail investors.

(4) A Bill to Amend the Securities Exchange Act of 1934 to Amend the Definition of Whistleblower

The SEC's Whistleblower Program, instituted under the Dodd-Frank Act, is an extremely effective tool for uncovering corporate wrongdoing. The program has led to SEC enforcement actions requiring over $1.7 billion in monetary sanctions, including more than $901 million in disgorgement of ill-gotten gains and interest, half of which has been (or is being) returned to investors.[18] According to the SEC, the agency received over 5,200 whistleblower tips in FY 2018, and whistleblowers have alerted it to numerous securities frauds, supplying information and documentation that the SEC's investigators otherwise may never have uncovered.[19]

Section 922 of the Dodd-Frank Act sought to protect whistleblowers from retaliation by their employers if they make a whistleblower report.[20] Unfortunately, imprecision in the drafting of Section 922 resulted in competing interpretations as to the scope of whistleblowers protected by it. The SEC interpreted Section 922 broadly to include whistleblowers who report to the agency as well as whistleblowers who report internally to their corporations (such as through a corporate whistleblower hotline). But in 2018, the U.S. Supreme Court disagreed by finding that the plain text of Section 922 affords protection only to whistleblowers who report directly to SEC.[21] The Court's decision therefore opens the door to corporate retaliation against whistleblowers who seek to do the right thing by reporting misconduct to their employers. The SEC's whistleblower program has proven effective in efforts to address fraud and misconduct in the securities markets, and whistleblowers should be protected from retaliation regardless of how they report misconduct.

In addition to the reforms currently envisioned by the legislation, NASAA urges the Subcommittee to examine whether the bill should also amend Section 922 of the Dodd-Frank Act to clarify that workplace and confidentiality provisions apply to reports made to state

[17] *See* https://www.sec.gov/rules/final/33-8400.htm#P98_9054.

[18] *See* https://www.sec.gov/sec-2018-annual-report-whistleblower-program.pdf

[19] Ibid.

[20] In 2014, the SEC for the first time used its authority under Dodd-Frank to take enforcement action against employers who retaliate against whistleblowers. Specifically, the SEC took action against hedge fund advisory firm Paradigm Capital Management Inc. for retaliating against an employee who reported violations to the SEC.

[21] *See* Digital Realty Trust, Inc. v. Somers, 138 S. Ct. 767 (2018).

securities regulators, including where such reports lead to referrals to the SEC whistleblower program.

IV. Conclusion:

NASAA applauds the Subcommittee for holding this important hearing and for this Subcommittee's ongoing efforts *to assert and reassert* the importance of investor rights in the modern securities marketplace. The financial crisis that struck our country a decade ago is not a distant memory in the minds of hard-working Americans, but rather very much a reminder of lost opportunities. The adverse financial effects, and the distress that comes with the loss of retirement savings built up over many years, was devastating. Many Americans are still working to recover from these losses. It is incumbent upon Congress and regulators to demonstrate an unwavering commitment to Main Street investors and to continue taking the steps necessary to protect them. In this regard, NASAA and its members look forward to working closely with the Committee and Subcommittee on these important issues.

Thank you again for the opportunity to testify. I will be pleased to answer any questions.

Statement of the U.S. Chamber of Commerce

ON: Putting Investors First: Reviewing Proposals to Hold Executives Accountable

TO: United States House Committee on Financial Services, Subcommittee on Investor Protection, Entrepreneurship and Capital Markets

BY: Thomas Quaadman, Executive Vice President, Center for Capital Markets Competitiveness, U.S. Chamber of Commerce

DATE: April 3, 2019

1615 H Street NW | Washington, DC | 20062

The Chamber's mission is to advance human progress through an economic, political and social system based on individual freedom, incentive, initiative, opportunity and responsibility.

The U.S. Chamber of Commerce is the world's largest business federation, representing the interests of more than 3 million businesses of all sizes, sectors, and regions, as well as state and local chambers and industry associations. The Chamber is dedicated to promoting, protecting, and defending America's free enterprise system.

More than 96% of Chamber member companies have fewer than 100 employees, and many of the nation's largest companies are also active members. We are therefore cognizant not only of the challenges facing smaller businesses, but also those facing the business community at large.

Besides representing a cross-section of the American business community with respect to the number of employees, major classifications of American business—e.g., manufacturing, retailing, services, construction, wholesalers, and finance—are represented. The Chamber has membership in all 50 states.

The Chamber's international reach is substantial as well. We believe that global interdependence provides opportunities, not threats. In addition to the American Chambers of Commerce abroad, an increasing number of our members engage in the export and import of both goods and services and have ongoing investment activities.

The Chamber favors strengthened international competitiveness and opposes artificial U.S. and foreign barriers to international business.

Chairman Maloney, Ranking Member Huizenga, and members of the Subcommittee on Investor Protection, Entrepreneurship and Capital Markets: my name is Tom Quaadman, executive vice president of the Center for Capital Markets Competitiveness ("CCMC") at the U.S. Chamber of Commerce ("Chamber"). Thank you for the opportunity to testify today about ways to put investors first and hold executives accountable.

The public company model has been a key source of strength and growth, which has made the American economy the strongest and most prosperous in world history. A 2012 Kauffman Foundation report found that the 2,766 companies that went public from 1996-2010 cumulatively increased employment by over 2.2 million workers, and that revenue increased by over $1 trillion during that period.[1] And a report by the IPO Task Force – a group whose recommendations contributed greatly to passage of the JOBS Act – found that the post-IPO job growth for companies is 92%.[2] Whatever the exact impact on hiring and growth may be, there is little doubt that an IPO greatly increases a company's ability to expand its workforce and grow from small to large.

Not only does "going public" benefit the economy from a jobs and growth standpoint, but it also affords Main Street investors and employees of companies that hold IPOs greater opportunities to invest in America's next great companies. During the 1980s and 1990s, stories of the Microsoft executive assistant or the UPS driver becoming a millionaire were not uncommon after a company went through the IPO process. And millions of retail investors and retirees can benefit directly by owning stock in individual companies, or more indirectly when stock is owned by their pension or 401(k) plan.

While the public company model has been significant for retail investors and workers alike, the integrity of the public capital markets is equally important in order to ensure the confidence of investors. Investors must know that they are receiving accurate, decision-useful disclosures, and that executives are held accountable for actions they take that impact shareholders. In addition to capital formation and promoting competition, the SEC as part of its mission is equally tasked with protecting investors and maintaining fair, orderly and efficient markets.

[1] Post-IPO Employment and Revenue Growth for U.S. IPOs June 1996-2010, available at: https://www.kauffman.org/-/media/kauffman_org/research-reports-and-covers/2012/05/post_ipo_report.pdf

[2] Rebuilding the IPO On-Ramp: Putting Companies and the Job Market Back on the Road to Growth, available at: https://www.sec.gov/info/smallbus/acsec/rebuilding_the_ipo_on-ramp.pdf

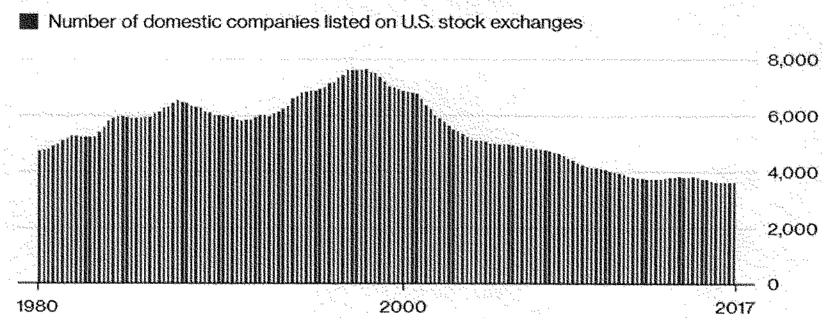
The Chamber views a strong and fair SEC as an essential element of maintaining efficient capital markets by providing investors and businesses with the certainty needed to transfer capital for its best use. A rigorous enforcement regime ensures efficient markets by rooting out fraudsters and other bad actors, but if not properly calibrated, could discourage public capital market activities. Additionally, further disclosures regarding public company corporate governance should allow for accurate metrics for evaluating companies without imposing a one-size-fits-all model.

Following the financial crisis, Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act or "Dodd-Frank") which imposed a number of new disclosure and other requirements on public companies. As this hearing points out, there are rulemakings from Dodd-Frank that have not yet been completed, particularly in regards to executive compensation. Additionally, Dodd-Frank gave the SEC discretionary authority to prohibit broker-dealers and investment advisers from including mandatory arbitration clauses in their customer agreements; however, the SEC has not used this authority to date. This hearing also raises other important issues such as insider trading and whistleblower protections that are important topics to discuss in overall protecting investors and holding executives accountable.

In considering these proposals, we must ensure that these proposals will protect investors and help businesses raise the capital they need to grow and create jobs. Ineffective disclosures or requirements that create burdens or obstacles to the promotion of investor protection, competition and capital formation will make the atmosphere for public companies unhospitable harming the economy.

Decline in Public Companies

One of the more pressing problems that has afflicted our capital markets has been the drastic decline in public companies over the last two decades. The United States is now home to roughly half the number of public companies than existed twenty years ago, and while the IPO market has recently shown signs of life, the Chamber remains concerned that the long term trajectory of this issue is not on a good path. The JOBS Act certainly helped make the public markets marginally more attractive to a number of companies, but Congress and the SEC must do more to revive the public company model. As part of Congress and the SEC deliberating further issues, they should be careful not to impose further burdens that ultimately do not protect investors or hold executives accountable, and instead impose further restrictions that would reverse gains made by the JOBS Act and continue the trend in the declining number of public companies.



Sources: Jay R. Ritter, Warrington College of Business Administration, University of Florida; University of Chicago Center for Research in Security Prices

When more companies choose to stay private, the investment returns generated are largely reserved for wealthier "accredited investors" and certain institutional investors. Main Street investors are typically left out. So the decline in public companies – and the dearth of investment options it leaves to most households – can actually exacerbate wealth disparities in the United States. It should also be noted that investors in general benefit from the transparency and disclosure requirements that are hallmarks of our public company regulatory regime. We think these are important points to consider in any discussion about putting investors first.

To be clear, we do not seek to minimize the strength of our private markets and do not believe that financing for businesses is a "zero sum game." Our economy clearly benefits when both public and private markets are strong. However, we believe that the roadblocks which have been placed in front of the public company model are largely self-inflicted, and it is completely within the control of Congress and the SEC to address them or at the very least to not contribute to the problem.

Federalization of Corporate Governance

The legislative mandates of the 2002 Sarbanes-Oxley Act ("Sarbanes-Oxley") and the Dodd-Frank Act have also contributed to the "federalization" of corporate governance and a one-size-fits-all regulatory approach that harms capital formation.

Traditionally, corporate governance was structured under the state laws where a business is incorporated, as well as the by-laws of the corporation. This system allowed directors and shareholders to create governance structures that fit the needs of individual businesses and its investors.

From the time of the New Deal up until the passage of Sarbanes-Oxley, with some exception in the area of compensation, the role of securities laws was a disclosure-based regime intended for investors to have the material information needed to make informed investment decisions.

Sarbanes-Oxley started a trend towards "federalizing" corporate governance by placing the federal government and the Securities and Exchange Commission ("SEC") in a more predominant role. This trend was exacerbated by the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), which mandated new rules on compensation committee independence, pay versus performance, compensation disclosures, claw-back policies, incentive compensation rules for financial firms, "say on pay" votes, new disclosure regarding the Chairman and CEO structures, conflict minerals disclosures, resource extraction disclosures, and mine safety report disclosures. Furthermore, the Investor Advisory Committee at the SEC – created by Dodd-Frank – has produced recommendations that would further expand the use of federal mandates, such as the mandated use of universal proxy ballots in contested director elections.

Executive Compensation

For decades, our American system of bifurcated corporate responsibilities between boards of directors, who owe a fiduciary duty to shareholders, and management, which runs the company's daily operations, has contributed to the collective success of an economy that has been, and today remains, the envy of the world. Thousands of innovators, entrepreneurs, Main Street businesses, and multinational companies have benefitted from the ability to tailor corporate decision-making to the particular needs of their respective firms, taking into account the unique competitive pressures of the industries and geographies in which they operate.

Across our diverse American business community, human capital is the foundational cornerstone of growth and organizational success. Every day, businesses in the financial services industry compete fiercely in an increasingly globalized market to attract and retain the services of talented professionals through the use of incentive-based compensation arrangements that are designed to align organizational and individual incentives. These compensation plans are uniquely designed by boards of directors and management and are tailored for the employees of a particular institution.

It should also be noted that companies compete on a global basis to attract the talent needed to fill CEO and senior management positions. Compensation is an important tool to attract the talented needed to keep companies competitive and make them successful.

In 2009, the Chamber released principles for effective corporate governance, investor responsibility and executive compensation. Those principles stated:

> Policy makers in the past have not adequately taken into account the unintended consequences of reform, which have included excessive executive compensation and poor governance practices. While effective corporate governance and executive compensation policies are important, extreme solutions will lead to a flight of talent as well as capital. Balancing the need for effective policy development with the goal of creating economic growth, the Chamber has developed the following principles for appropriate policy making related to corporate governance, investor responsibility and executive compensation:

- **Corporate governance policies must promote long-term shareholder value and profitability but should not constrain reasonable risk-taking and innovation.**

- **Long-term strategic planning should be the foundation of managerial decision-making.**

- **Corporate executives' compensation should be premised on a balance of individual accomplishment, corporate performance, adherence to risk management and compliance with laws and regulations, with a focus on shareholder value.**

- **Management needs to be robust and transparent in communicating with shareholders.**

> These principles provide a template for policies that will allow for reasonable risk taking, continued innovation, the ability to acquire and retain talent and the protection of investor rights.[3]

The Chamber believes that executive compensation is already strongly evaluated by shareholders through "say-on-pay" votes, which for the vast majority of companies are held annually. Indeed investors have overwhelmingly voted in favor of pay packages through say on pay votes. These votes are typically 80-90% in favor of pay packages. To the extent that further disclosure of executive compensation metrics are warranted, the Chamber believes that the SEC and other regulators should ensure flexibility for individual companies, rather than a one-size-fits-all approach, in order to provide investors with decision useful information. Disclosures surrounding executive compensation ultimately should be rooted in the Supreme Court-articulated materiality standard, otherwise investors risk becoming inundated with information that does not inform their voting and investment decisions.

It is therefore essential that any regulator charged with writing compensation rules (or any corporate governance rules, for that matter) comprehensively study all relevant issues and data and analyze the likely effects of its regulations on the highly competitive market for talent. If they don't, and if the costs of a rule outweigh its benefits, professionals may flee covered businesses in favor of other financial firms, other industries or seek opportunities in jurisdictions whose regulators more appropriately balance the putative governmental interest in regulating compensation plans with management's ability—and, under prevailing corporation law, its statutory duty—to make business judgments for the benefit of the firm's owners. This result could actually have the effect of undermining the regulator's goals by discouraging the most talented individuals—those most capable of preventing or managing the types of losses the regulator is trying to proscribe—from working in the financial services sector. It might also chill the kind of risk-taking—lending, financing, investing—that spurs economic growth and job creation, resulting in a "freezing in place" or corporate stagnation.

The American economy is the strongest, most diverse, and most innovative economy in the world. We benefit from having well-regulated capital markets as the foundation of our free enterprise system. Our economy is built to encourage prudent risk-taking, entrepreneurship, and opportunity, which yield positive externalities like

[3] See letter from U.S. Chamber of Commerce to Treasury Secretary Timothy Geithner, February 6, 2009

job creation, productivity, and financial stability. That is why many foreign nationals, especially those with backgrounds in the STEM fields, seek attractive employment opportunities in the United States. Other nations' economies have different ontologies and social purposes and thus are regulated quite differently.

We would like to we offer our perspectives on the following proposals before the committee today that relate to executive compensation and corporate governance.

H.R. ___, a bill to require the SEC to complete rulemaking required by section 14(i) of the Securities Exchange Act of 1934

Section 953(a) of the Dodd-Frank Act mandated that the SEC amend its executive compensation disclosure rules to more clearly demonstrate the "relationship between compensation actually paid and the financial performance of the issuer." In 2015, the SEC proposed rules implementing the Dodd-Frank pay versus performance requirements. The legislation under consideration would require the SEC within 60 days of enactment to finalize pay versus performance rulemaking, and if unable to do so, the SEC Chairman would be required to testify once per month in front of the Senate Banking Committee and House Financial Services Committee until the rulemaking has been finalized.

The CCMC believes that a pay versus performance disclosure can assist investor decision making, but that the current proposal fails to do so. The proposal would increase the complexity of disclosures (counter to the SEC's current efforts to promote disclosure effectiveness), fails to provide investors with decision useful information on compensation or performance and may incentivize short-termism. Rather, the CCMC believes that the pay for performance disclosure should follow a principles-based format allowing companies to describe the performance metrics they use and to explain their processes for establishing compensation guidelines in a way that best expresses how pay and performance are aligned for their individual circumstances.

In the eight decades since the securities laws were enacted, public company disclosure requirements have increasingly expanded and become more complex, as evidenced by the voluminous annual and quarterly reports filed today. This expansion and increased complexity of disclosure has contributed to the phenomenon of "disclosure overload", whereby investors are so inundated with information it becomes difficult for them to determine the most salient factors they need to make informed voting and investment decisions. Retail investors are particularly vulnerable, as they often do not have the resources to help them make sense of the detailed SEC filings of the companies they invest in. In fact, we believe the disclosure overload phenomenon is the leading contributor to why retail shareholder participation has dropped to levels as low as five percent at some annual shareholder meetings. In a very real way, information overload has led to the disenfranchisement of retail shareholders at many public companies.

We believe that the current proposal will fail to provide investors with decision-useful information to understand the companies in which they invest. On the contrary, the proposal will layer more complex disclosures into the proxy statement and make it even more difficult for investors to decipher and understand the surrounding information in that disclosure document.

A formulaic approach fails to show the worth of a CEO or management team to a company. A business in need of a turn-around may go out and hire a new CEO and have to pay a premium to attract the talent needed to execute a plan critical to the success of the firm. Under a formula as envisioned by the SEC proposal, such a firm would be cast as an outlier. Yet, the company in taking this action is doing exactly what it should do to help the company. Therefore, the question must be asked if the disclosure is meeting its intended purpose. Under a more principles based approach, we believe the data can be provided within the appropriate context providing investors with decision-useful information.

Entrench Proxy Advisory Firms The Chamber also believes that the current proposal will continue to entrench proxy advisory firms' influence over corporate governance structures of U.S. public companies. Proxy advisory firms currently develop voting policies and make recommendations on executive compensation and total shareholder return. Some of the activities of proxy advisory firms have been controversial, and the Chamber has previously been critical of proxy advisor policies including "one size fits all" recommendations, a lack of due process around the development of voter policies and recommendations, failure to link recommendations with the economic interests of the firm's clients and failure to disclose specific conflicts of interests. In 2014, the SEC Staff issued Staff Legal Bulletin No. 20 to address some of these issues, as well as the concerns of other stakeholders

In September 2014, the Chamber filed a comment letter with Institutional Shareholder Services ("ISS") on its policies for the upcoming proxy season and raised serious concerns with the ISS recommendations on Pay Versus Performance. The Chamber's letter raised concerns that the ISS view on Pay Versus Performance did not accurately look at CEO pay and also failed to develop and construct information in a manner that was beneficial to investors. We believe that these points are important for two reasons. First, ISS's treatment of the Pay Versus Performance issue has some of the same flaws as the proposed rule. Second, if the proposed rule is adopted, proxy advisory firms' recommendations on executive compensation under Item 402(v) will be a significant factor in how companies draft their Pay Versus Performance disclosures in practice and whether shareholders support a company's advisory vote on executive compensation (Say-on-Pay)[4]. Therefore, we believe it is important for issuers and investors to understand both how the SEC views the role of proxy advisory firms in the implementation of the proposed rule and how Staff Legal Bulletin No. 20 will apply to ensure executive compensation matters on the topic of pay versus performance are reviewed by proxy advisory firms in a balanced manner.

The pay versus performance rules mandated by the Dodd-Frank Act can be enacted in a way that provides necessary flexibility, creates fewer burdens on companies (particularly smaller reporting companies), and avoids unnecessary investor confusion. Unfortunately, the SEC's past proposal does not achieve these objectives. The CCMC believes that the concerns with the proposal can be easily addressed and that when it ultimately finalizes these rules, the Commission should modify the proposal to create a pay versus performance reporting regime that balances the desire to provide useful information to investors with the need to accurately reflect the complexities of companies' compensation policies.

H.R. ___, a bill to require the SEC to complete rulemaking required by section 10D of the Securities Exchange Act of 1934

The Sarbanes Oxley Act allowed the SEC to require claw backs of CEO and CFO compensation in the event of misconduct by the company results in a material financial restatement. Additionally, Section 954 of the Dodd-Frank Act included a claw back provision which requires the SEC to implement rules requiring stock exchanges to adopt listing standards that require listed companies to adopt "no-fault" claw back policies for current and former executive officers, triggered in the event of an accounting restatement due to "material noncompliance" with a financial reporting requirement. On July 1, 2015, the SEC proposed rulemaking that would implement the Dodd-Frank claw back provision. The legislation under consideration would

[4] It should also be noted that the proxy advisory firms frustrated the intent of Congress regarding the frequency of say on pay votes. Congress allowed shareholders to determine the frequency of say on pay votes ranging from one to three years. The advisory firms decided on a standard of one year without any data existing as to what frequency is best for an individual company. That in turn set the standard.

require the SEC within 60 days of enactment to finalize the Dodd-Frank claw back rulemaking, and if unable to do so, the SEC Chairman would be required to testify once per month in front of the Senate Banking Committee and House Financial Services Committee until the rulemaking has been finalized.

CCMC believes that claw back policies, appropriately calibrated for the circumstances of a company, can be an effective means of instilling good governance practices. However, we believe that the proposal, in its current form, is overly complex and prescriptive and may cancel out any potential benefits that may otherwise derive from the implementation of a balanced system, while being overly burdensome for smaller reporting companies. The proposal is not clear as to what would constitute a restatement for purposes of triggering a claw back, and the proposal would apply to all executive officers, regardless of whether they were involved in preparing the issuer's financial statements. We also believe that financial reporting policies should be modernized in order for a claw backs proposal to work as intended by Congress. Finally, we also believe that it is incumbent for the SEC to perform an analysis on how the rule will impact capital formation and competition and whether the rule will create conditions that will lead to an increase in the number of U.S. public companies.

H.R. ____, the 8-K Trading Gap Act of 2019

The Chamber believes it is important to root out bad actors from capital markets. However, we do not believe the 8-K Trading Gap Act will prevent future insider trading activity.

First, it is already unlawful to trade on the basis of material, non-public information (MNPI) in violation of a fiduciary duty. Corporate insiders may not trade or make tips on the basis of MNPI learned during the course of employment. A bad actor who has determined to violate the federal securities laws by engaging in conduct as serious as insider trading is not likely to be deterred by a second, redundant prohibition against the same misconduct that is found in an employer's internal policies, procedures, and controls.

Second, the Act assumes that all Form 8-K events are certain on Day 1 of what is often a four-business-day reporting cycle, but decisions may take several days and consultations with counsel. In many cases, a public company will not determine to file until closer to the reporting deadline of Day 4.

If this timing problem raises several questions and the company is unsure of the reporting status on Days 1, 2, and 3, how is it going to develop policies and procedures to bar insiders from trading? And how would insiders even know they are blacked out if their employer has not provided notice to them? What if the company unintentionally misses a filing deadline and the company makes a late filing months later? What are the consequences then? How do policies, procedures, and controls address these kinds of hypotheticals in any realistic, enforceable way?

The Chamber is concerned that this legislation adds unnecessary complexity regarding an activity that is already illegal under current law. While we cannot support the legislation in its current form, we look forward to working with Rep. Maloney and members of the Committee to find a workable solution.

H.R. ___, a bill to amend the Securities and Exchange Act of 1934 to amend the definition of whistleblower

Section 922 of the Dodd-Frank Act established a whistleblower program at the SEC to allow for monetary awards to whistleblowers that results in monetary sanctions of over $1 million, while also providing whistleblower protections particularly regarding retaliation. In 2018, the U.S. Supreme Court held in *Digital Realty Trust, Inc. v. Somers* that whistleblower protections in Dodd-Frank apply only to when the whistleblower disclosed potential securities law violations to the SEC, rather than protecting internal whistleblowing including disclosures made to a corporate ethics or compliance program, unless the whistleblower also made a disclosure to the SEC. The draft legislation would reverse this decision and continue to provide whistleblower protections provided by Dodd-Frank to those who report wrongdoing internally without also reporting directly to the SEC.

CCMC believes that employees should be able to first report any wrongdoing internally within their compliance departments at their company. Ideally, this would lead to quicker resolutions and stop misconduct from continuing for extended periods of time, with eventual reporting to the SEC being done for egregious cases or when misconduct continues. However, we have concerns regarding the scope of providing whistleblower protections under Dodd-Frank as proposed by the draft legislation and whether that would contribute to frivolous employment litigation as well as excessive internal reporting. It should be noted that whistleblowers already receive anti-retaliatory protections under Sarbanes-Oxley.

In addition, the Chamber has continuing concerns about the Whistleblower program as mandated by the Dodd-Frank Act and believe that other reforms should be undertaken as well. For instance, the Chamber believes that a person who knowingly participates in wrongdoing that harms investors should not profit from having unclean hands by being eligible for a bounty award of any kind. Rule 21F-2(a) should therefore be revised to make this point abundantly clear.

The bounty program established by the Dodd-Frank Act and administered by the SEC has operated on a broad set of nebulous and subjective criteria. While a certain degree of confidentiality is required under Section 21F of the Exchange Act the paucity of details in the orders granting (and denying) bounty awards provides little if any decision-useful information to regulated persons as to what conduct they should avoid.

We continue to be concerned about the ongoing impact the Commission's bounty rules have had on the efficacy of internal corporate compliance programs. The bounty program suffers from a significant structural flaw in that it permits a wrongdoer—one who actually planned, aided, abetted or caused a violation of law--to be eligible to receive a bounty.

H.R. __, the "Insider Trading Prohibition Act"

The U.S. Chamber strongly opposes any form of insider trading and believes that it weakens the integrity of our markets as well as investor confidence when there is an unfair system where some people benefit from being able to trade on information that others do not possess. In those instances where clear insider trading on material non-public information occurred, the U.S. Chamber supports strong enforcement against those individuals in order to protect investors and the viability of our public capital markets.

For more than 30 years, the Supreme Court's decision in *Dirks v. SEC* has guided the distinguishing between lawful trading and unlawful insider trading on whether the tipper has breached a duty in exchange for a "personal benefit." In recent years, a number of court decisions has further elaborated on the definition and threshold of insider trading, most notably the Second Circuit's 2014 decision in *United States v. Newman.*

In deciding these cases, courts have attempted to define the personal benefit requirement, particularly when there is an absence of a financial benefit, as well as relationship between tipper and tippee to determine when insider trading occurs. In these decisions, courts have sought to help provide clear lines to help market participants while limiting unintended consequences in chilling legitimate communications between market professionals and company insiders and blurring the line between lawful and unlawful trading. There is concern that innocent conduct would be swept up in insider trading actions, particularly in the context of communications between company insiders and market professionals.

However, this has left a situation where lower courts are determining the scope and threshold for insider trading and definitions are constantly changing based on new case law. The market, as well as investors, could certainly stand to benefit from a clearer definition of what constitutes insider trading, and it is certainly within the authority of Congress to consider these definitions.

That being said, the Chamber has some concerns with the Insider Trading Prohibition Act. The bill attempts to codify decades of insider trading cases and all of its nuances into a handful of general principles, and in doing so will inevitably lead to a standard that is both under-inclusive and over-inclusive. There are additional concerns that the bill would establish insider trading as a strict liability crime in removing any scienter requirement, or at least making it narrower than current law.

Additionally, by placing insider trading in a standalone section separate from Rule 10b-5 and Section 10(b), where insider trading has previously been deemed illegal, and by stating a Sense of Congress that the amendments by this Act are not intended to supersede section 10(b) or 14e of the Securities Exchange Act, it could create a scenario where prosecutors can choose which avenue to bring insider trading cases under. If the goal of the legislation is to make insider trading standards clearer, this potential dual approach for prosecutors to bring insider trading cases does not seem to lend itself to that goal.

A reading of the bill could also prohibit 10b-5 plans which themselves are designed to avoid insider trading. We don't believe this is the intent of the bill, but it is a potential consequence of the existing language. We hope to work with Congressman Himes to address these issues.

H.R. __, the "Investor Choice Act of 2019"

The Investor Choice Act of 2019 seeks to limit the use of arbitration agreements to resolve disputes between broker dealers, investment advisers, and their customers. The legislation also would prohibit public companies from requiring the use of an arbitration forum to resolve disputes that arise with their shareholders.

Arbitration is an important means of resolving disputes that provides significant benefits to consumers and businesses. Arbitration of customer disputes has been common practice for decades, and there are currently hundreds of millions of contracts currently in force—including many that relate to consumer financial products and service—that include arbitration agreements.

Many of the criticisms of arbitration are based upon the flawed premise that alternative mechanisms – such as litigating through the courts – provide better outcomes for consumers and investors and give them a meaningful and realistic option for resolving a dispute. In fact, the opposite is true. Litigation typically involves enormous costs, delays, and – in the case of class actions – the majority of cases result in no recovery at all for members of the class. In fact, according the American Arbitration Association, from 2011-2015 delays in the court system cost consumers up to $13.6 billion.[5]

The Financial Industry Regulatory Authority (FINRA), which oversees the arbitration system for broker-dealers, estimates that the average arbitration dispute is settled in a little over a year, and that a significant number of cases are resolved by other means (e.g. settlement or withdrawal) before an arbitration decision is necessary. This stands in stark contrast to class action lawsuits which can drag on for years without a resolution, and the best case for consumers is typically receiving a minimal portion of settlement funds.

In the context of public companies and arbitration, the impact of securities class action lawsuits on businesses has been significant. In the past decade, the settlements of securities class action lawsuits related to U.S. public companies have totaled more than $50 billion. That is money that comes directly from the pockets of American investors, and the current system serves as a disincentive for companies that may be looking to go public at some point in the future.

The Investor Choice Act of 2019 seeks to impose yet another federal corporate governance mandate by prohibiting public companies from including mandatory arbitration clauses as part of their bylaws. Such decisions are best left to be made between companies and their shareholders, taking into account the long-term interests of the company as well as relevant state and federal law. Investors can then make a

[5] Measuring the Costs of Delays in Dispute Resolution. American Arbitration Association, available at http://go.adr.org/impactsofdelay.html

decision as to whether or not they wish to invest in a certain company if has mandatory arbitration agreements as part of its bylaws.

This legislation would deprive consumers and investors of a valuable tool for resolving disputes and being compensated for harm done to them, and imposes new mandates upon businesses that further expands the federal government's role in corporate governance. For these reasons, the Chamber opposes the bill.

Conclusion

The Chamber appreciates the Committee's work to examine ways to protect investors and make our capital markets efficient. Those are important policy objectives to achieve long-term economic growth and job creation. We have concerns with some aspects of the legislation before us and we look forward to working with the authors and this subcommittee to address those issues.

AMERICAN ASSOCIATION *for* JUSTICE

April 2, 2019

The Honorable Carolyn Maloney
Chairwoman
House Financial Services Subcommittee
U.S. House of Representatives
Washington, DC 20515

The Honorable Bill Huizenga
Ranking Member
House Financial Services Subcommittee
U.S. House of Representatives
Washington, DC 20515

Dear Chairwoman Maloney, Ranking Member Huizenga, and Members of the Subcommittee:

The American Association for Justice (AAJ) thanks the committee for holding a hearing on fundamentally crucial investor protection issues. AAJ strongly supports the efforts of the committee to strengthen investor protections and encourage legislation such as the Investor Choice Act, which would allow investors to seek justice when defrauded and hold corporations accountable.

AAJ's members represent investors that have been harmed and even lost their life savings because of fraud and abuse law-breaking corporate actors. The victims of securities fraud and abuse are American families, that have spent years responsibly saving for retirement. We believe that corporations should never be permitted to force investors and consumers of brokerage services into a secretive system where their ability to protect their investment is essentially eliminated. The Investor Choice Act would ensure that investors' rights to protect their investment are fully restored and corporations may be held accountable.

While government regulation and enforcement are necessary, history demonstrates that government intervention alone is an insufficient remedy to ensure corporate accountability and recoup investors' losses. The government is not equipped to hold every law-breaking corporation accountable and return ill-gotten gains to investors. Private actions on the other hand, have proven a better mechanism to hold companies accountable for wrong-doing and recover investor money. For example, in five large securities fraud scandals, Securities and Exchange Commission (SEC) enforcement actions recovered a total of 1.75 billion dollars[1] while private actions recovered a total of 19.4 billion dollars.[2] In fact, federal securities class actions have returned over $100 billion to defrauded investors in the past 20 years alone.[3]

[1] Tyco SEC Settlement Fair Fund: http://www.tycosecsettlement.com/ ($55.8 million settlement); Enron SEC Settlement Fair Fund: http://enronvictimtrust.com/ ($570 million); WorldCom SEC Settlement Press Release: http://www.sec.gov/news/press/2003-81.htm ($750 million); Bank of America SEC Fair Fund: http://bankofamericafairfund.com/ ($375 million); Global Crossing SEC Settlement Press Release: http://www.sec.gov/litigation/litreleases/lr19179.htm ($300,000).

[2] In re: Tyco International, Ltd., Securities Litigation, U.S. District Court, District of New Hampshire, 02-266 ($3.2 billion settlement); In re: Enron Corporation Securities Litigation, U.S. District Court, Southern District of Texas, 01-3624($7.2 billion settlement); In re: WorldCom, Inc. Securities Litigation, U.S. District Court, Southern District of New York, 02-3288 ($6.1 billion); In re: Bank of America Corp. Securities, Derivative, and Employee Retirement Income Security Act (ERISA) Litigation, U.S. District Court, Southern District of New York, 09-2058 ($2.4 billion settlement); In re: Global Crossing Ltd. Securities Litigation, U.S. District Court, Southern District of New York, 02-910 ($447.8 million settlement).

[3] The Top 100 U.S. Settlements of All Time, ISS: Securities Class Action Services, (2017), available at: https://www.issgovernance.com/file/publications/SCAS-Top-100-US-Settlements-31Dec2016.pdf

Investors rely on private legal actions to protect their investments, and indeed it has proven an effective mechanism for investment recovery. The Investor Choice Act ensures that investors will retain this vital tool and maintain the value of Americans' investments.

The SEC has continued to uphold its longstanding policy of prohibiting forced arbitration clauses in corporate documents for companies interested in going public. The Investor Choice Act would simply reinforce this position in the face of corporate pressure to reverse longstanding policy, in addition to prohibiting forced arbitration in consumer contracts for brokerage and investment services.

We applaud the committee's efforts to bring this legislation forward and draw attention to the issues surrounding investor protection. We stand ready to support the Committee in moving this legislation forward.

Respectfully submitted,

American Association for Justice

CC: Chairwoman Maxine Waters
Ranking Member Patrick McHenry

Council of Institutional Investors®
The voice of corporate governance

Via Hand Delivery

April 9, 2019

The Honorable Carolyn B. Maloney
Chair
Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets
Committee on Financial Services
United States House of Representatives
Washington, DC 20515

The Honorable Bill Huizenga
Ranking Member
Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets
Committee on Financial Services
United States House of Representatives
Washington, DC 20515

Re: April 3, 2019 Hearing entitled: "Putting Investors First: Reviewing Proposals to Hold Executives Accountable"[1]

Dear Madam Chair and Ranking Member Huizenga:

I am writing on behalf of the Council of Institutional Investors (CII) to express our appreciation for holding the above referenced hearing and to provide you with our views on several of the legislative proposals on corporate governance related topics that are of great interest to our members and that were discussed at the hearing. We would respectfully request that this letter be made a part of the hearing record.

CII is a nonprofit, nonpartisan association of public, corporate and union employee benefit funds, other employee benefit plans, state and local entities charged with investing public assets, and foundations and endowments with combined assets under management of approximately $4 trillion. Our member funds include major long-term shareowners with a duty to protect the retirement savings of millions of workers and their families. Our associate members include a range of asset managers with more than $35 trillion in assets under management.[2]

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[1] Hearings, Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets, Putting Investors First: Reviewing Proposals to Hold Executives Accountable (Apr. 3, 2019), https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=402504.
[2] For more information about the Council of Institutional Investors ("CII"), including its board and members, please visit CII's website at http://www.cii.org.

1717 Pennsylvania Avenue, NW | Suite 350 | Washington, DC 20006 | Main 202.822.0800 | Fax 202.822.0801 | www.cii.org

Insider Trading

CII generally supports H.R. ___, the Insider Trading Prohibition Act, [3] *and H.R. ___, the 8-K Trading Gap Act of 2019.*[4]

Long-term investors like CII members can be harmed when there are ongoing practices that undermine confidence in the markets. That loss of confidence can occur when corporate executives are able to sell their company stock—often a significant component of their compensation—before their companies report bad news to the public. CII, therefore, generally supports proposed legislation that is reasonably designed to limit corporate executives from trading company stock while possessing inside information.

For example, earlier this year, CII publicly supported H.R. 624, the Promoting Transparent Standards for Corporate Insiders Act.[5] The bill, generally consistent with CII membership approved policies,[6] would require the Securities and Exchange Commission (SEC or Commission) to study and report on possible revisions to regulations regarding Rule 10b5-1 trading plans.[7] Those plans allow certain corporate executives to be shielded from insider trading liability when conducting certain trades of their companies' securities.[8]

H.R. 624 was prompted, in part, by concerns about a history of suspiciously fortuitous trading patterns by corporate insiders' pursuant Rule 10b5-1 plans.[9] As you are aware, on January 28, 2019, the United States (U.S.) House of Representatives approved H.R. 624 by a vote of 413 to 3.[10]

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[3] H.R. ___, Insider Trading Prohibition Act, 116th Cong. (2019) (DRAFT), https://financialservices.house.gov/uploadedfiles/bills-116pih-insidertrading.pdf.

[4] H.R. ___, 8-K Trading Gap Act of 2019, 116th Cong. (2019) (DRAFT), https://financialservices.house.gov/uploadedfiles/bills-116pih-8-k.pdf.

[5] *See* Promoting Transparent Standards for Corporate Insiders Act, H.R. 624, 116th Cong. (2019), https://www.congress.gov/bill/116th-congress/house-bill/624/text.

[6] CII, Corporate Governance Policies § 5.15b Stock Sales (updated Oct. 24, 2018), https://www.cii.org/files/10_24_18_corp_gov_policies.pdf ("10b5-1 program adoptions, amendments, terminations and transactions should be disclosed immediately, and boards of companies using 10b5-1 plans should: (1) adopt policies covering plan practices, (2) periodically monitor plan transactions and (3) ensure that company policies discuss plan use in the context of guidelines or requirements on equity hedging, holding and ownership.").

[7] Promoting Transparent Standards for Corporate Insiders Act, H.R. 624, 116th Cong. § 2(a), (c).

[8] *See, e.g.*, Nicole Vanatko, Reexamining the Rule 10b5-1 Trading Plans Defense to Insider Trading, CRS 2 (Jan. 31, 2019), https://fas.org/sgp/crs/misc/LSB10249.pdf ("the rule establishes a defense to insider trading for transactions executed pursuant to a prearranged plan adopted in good faith and, importantly, at a time when the person was not aware of material nonpublic information").

[9] *Id.* ("The SEC and others have questioned the plans' potential for abuse and possible weaknesses over at least the past decade, citing certain well-publicized reports and studies indicating that many executives achieve above-average returns when trading . . . pursuant to Rule 10b5-1 trading plans."); Cydney Posner, Blog: New House Bill to Curb Potential Abuse of 10b5-1 Plans, PubCo@Cooley (Jan. 24, 2019), https://www.jdsupra.com/legalnews/blog-new-house-bill-to-curb-potential-19688/ (commenting that articles "identified a number of problems with 10b5-1 plans, including the absence of public disclosure about the plan or changes to it and the absence of rules about how long the plans must be in place before trading under the plans can begin").

[10] *See, e.g.*, Craig M. Scheer, Rule 10b5-1 Trading Plans in the Current Environment: The Importance of Doing it Right, Bus. Law Today (Sept. 19, 2018), http://apps.americanbar.org/buslaw/blt/content/2013/02/article-06-scheer.shtml ("Critics have long viewed the rule as creating an opportunity for abuse, claiming that some insiders

Insider Trading Prohibition Act

The provisions of the Insider Trading Prohibition Act largely codifies the existing case law on insider trading. However, the bill also overturns the controversial requirement affirmed in 2016 by the 2nd Circuit decision in *United States v. Newman*[11] that a tippee know about the specific personal benefit that the tipper received.[12] CII generally supports the bill because it provides investors and other market participants with a clearer, simpler standard of the current law of insider trading. As Matt Levine of Bloomberg opined in response to a 2015 version of the bill:

> In that sense, the Himes bill seems like the best of the ban-insider-trading bills so far. It does the least violence to existing law: . . It just keeps as much of current law as possible consistent with throwing out the controversial Newman conclusion.
>
> . . .
>
> The law doesn't match people's intuitions, and it isn't written down anywhere, so people keep thinking that it's different from what it is. Writing it down in the form of the Himes bill might not make it match people's intuitions. But at least it would make the law less surprising, which is worth something.[13]

CII is pleased that all four witnesses at your April 3 hearing expressed support for the bill, including Professor John C. Coffee, Jr. who "serves as a member of the Task Force on Insider Trading, assembled by Preet Bharara, the former S.D.N.Y U.S. Attorney, . . . which includes ex-U.S. Attorneys and SEC enforcement specialists . . . ."[14] In addition, we do not oppose Professor Coffee's suggested revisions to the bill[15] or the suggestion by Thomas Quaadman of the U.S. Chamber of Commerce that there be some clarification that the bill is not intended to "prohibit" Rule 10b5-1 plans.[16]

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may in fact be aware of material non-public information at the time plans are established and that the rule can be used to provide cover for improper trades.").

[11] United States v. Newman, 773 F.3d 438 (2d Cir. 2014), *available at* https://www.scotusblog.com/wp-content/uploads/2015/08/15-137-op-below.pdf ("In sum, we hold that to sustain an insider trading conviction against a tippee, the Government must prove each of the following elements beyond a reasonable doubt: . . . the tippee knew of the tipper's breach, that is, he knew the information was confidential and divulged for personal benefit").

[12] Memorandum from FSC Majority Staff to Members, Committee on Financial Services 2 (Mar. 29, 2019), https://financialservices.house.gov/uploadedfiles/hhrg-116-ba16-20190403-sd002-u1_-_memo.pdf.

[13] Matt Levine, Cybersecurity, Another Politician Wants to Ban Insider Trading, Is insider trading law about fairness, or about theft?, BloombergOpinion, Apr. 1, 2015, https://www.bloomberg.com/opinion/articles/2015-04-01/another-politician-wants-to-ban-insider-trading.

[14] Putting Investors First: Reviewing Proposals to Hold Executives Accountable: Hearing Before the H. Subcomm. on Investor Protection, Entrepreneurship, and Capital Mkts. of the FSC, 116th Cong. (Apr. 3, 2019) (Statement of Professor John C. Coffee, Jr., Adolf A. Berle Professor of Law, Columbia University Law School at 1-2), https://financialservices.house.gov/uploadedfiles/hhrg-116-ba16-wstate-coffeej-20190403.pdf.

[15] *Id.* at 4-6.

[16] Putting Investors First: Reviewing Proposals to Hold Executives Accountable: Hearing Before the H. Subcomm. on Investor Protection, Entrepreneurship, and Capital Mkts. of the FSC, 116th Cong. (Apr. 3, 2019) (Statement of U.S. Chamber of Commerce at 15), https://financialservices.house.gov/uploadedfiles/hhrg-116-ba16-wstate-quaadmant-20190403.pdf.

8-K Trading Gap Act of 2019

The provisions of the 8-K Trading Gap Act of 2019 "would direct the SEC to issue a rule requiring public companies to put in place policies and procedures that are reasonably designed to prohibit officers and directors from trading company stock after the company has determined that a significant corporate event has occurred, and before the company has filed a Form 8-K disclosing such event."[17] CII generally supports the bill because it is based on empirical evidence and could enhance investor confidence in the markets.

A 2015 study, in which current SEC Commissioner Robert J. Jackson Jr. participated, found that over a six-year period, corporate executives who traded during the four-day gap between when a corporate event occurred and when the event was publicly reported, successfully earned $105 million in above market returns on those trades.[18] CII generally agrees with Chair Maloney's view that the 8-K trading gap can undermine '"investor confidence'"[19]

CII also generally agrees with the reported view of SEC Chairman Jay Clayton that "it was wrong for executives to make money based on significant, non-public information during the 8-K trading gap [and] . . . like[s] the 'concept' of a rule that would prohibit trading during that period."[20]

CII does not object to Professor Coffee's suggestions that the definition of "covered period"[21] in the bill be revised so that "phrasing [of the term] would be more useful."[22]

Mandatory Arbitration

CII generally supports H.R. ___, the Investor Choice Act of 2019[23]

CII strongly opposes shareowner arbitration clauses between U.S. public companies and investors. Our long-standing membership approved policies addressing this issue states: "[C]ompanies [should not] attempt to bar shareowners from the courts through the introduction of forced arbitration clauses."[24]

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[17] Memorandum from FSC Majority Staff to Members, Committee on Financial Services at 4.
[18] Robert J. Jackson et al., The 8-K Trading Gap, Colum. Law & Econ. Working Paper No. 524 (2015), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2657877 (finding "systematic abnormal returns of 42 basis points on average, per trade, from trades by insiders during the 8-K gap [and recommending] . . . lawmakers should reconsider the effects of information-forcing rules such as those governing Form 8-K on the incidence and profitability of trading by insiders").
[19] Andrew Ramonas, News, House Hearing to Probe Bill Banning Subset of Insider Trading, Bloomberg L., Apr. 3, 2019 (on file with CII).
[20] *Id.*
[21] H.R. ___, 8-K Trading Gap Act of 2019, 116th Cong. § 2(a) ("(a) COVERED PERIOD DEFINED.—In this section, the term 'covered period' means a period beginning on the date on which an issuer determines that the issuer possesses material nonpublic information and ending on the date on which that information is publicly disclosed or no longer material").
[22] Statement of Professor John C. Coffee, Jr., Adolf A. Berle Professor of Law, Columbia University Law School at 9.
[23] H.R. ___, Investor Choice Act of 2019, 116th Cong. (2019) (DRAFT), https://financialservices.house.gov/uploadedfiles/bills-116pih-investorchoice.pdf.
[24] CII, Corporate Governance Policies § 1.9 Judicial Forum.

CII's policies are based on the view that shareowner arbitration clauses in public company governing documents represent a potential threat to principles of sound corporate governance that balance the rights of shareowners against the responsibility of corporate managers to run the business.[25] More specifically, among the many problems that our members have identified with shareowner arbitration clauses is the fact that disputes that go to arbitration rather than the court system generally do not become part of the public record and, thereby, may lose their deterrent effect.[26] As Hillary Sale, a law professor at Georgetown University recently commented: Because arbitration is private, "[w]e won't have a good understanding of when companies are committing fraud or in fact behaving in an above-board manner."[27]

CII agrees with SEC Commissioner Jackson that the existence of private shareowner actions is a necessary supplement to the Commission's limited enforcement resources.[28] Those actions aid the SEC in identifying and addressing corporate wrongdoing and poor corporate governance practices, and decisions by courts in private actions have developed much of the law governing securities fraud.[29]

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[25] *See, e.g.,* Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors to Keith F. Higgins, Director, Division of Corporation Finance, U.S. Securities and Exchange Commission et al. 1 (Dec. 11, 2013), https://www.cii.org/files/issues_and_advocacy/correspondence/2013/12_11_13_CII_letter_to_SEC_forced_arbitration.pdf; *cf.* Letter from State Financial Officers Foundation to Chairman Clayton (Nov. 13, 2018), https://secureoursavings.com/wp-content/uploads/2018/11/SFOF-Letter-to-SEC-Chairman-Clayton-1.pdf (setting forth four "specific concerns in allowing companies to impose forced arbitration clauses that limit class action claims on investors").

[26] *See, e.g.,* Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Mr. Craig S. Phillips, Counselor to the Secretary, U.S. Department of Treasury 8 (Aug. 23, 2017), https://www.cii.org/files/August%2023%202017%20Letter%20to%20Treasury%20v3.pdf. ("Our policy is based, in part, on the fact that disputes that go to arbitration rather than to the court system generally do not become part of the public record and, thereby, may lose their deterrent effect.").

[27] Dave Michaels, Johnson & Johnson Drafted Into Fight Over Shareholder Lawsuits, Wall St. J., Dec. 13, 2018, https://on.wsj.com/2EAZGnY; *see* N. Peter Rasmussen, Corporate Transactions Blog, Mandatory Arbitration Proposal Creates Strange Bedfellows, Bloomberg L. (Jan. 8, 2019), https://www.bna.com/mandatory-arbitration-proposal-b57982095134/ (quoting Securities and Exchange Commission Commissioner Robert J. Jackson, Jr. that "as compared to closed-door arbitration proceedings, 'a public hearing gives judges a chance to tell corporate insiders what the law expects of them'"); *cf.* Carol V. Gilden, Partner, Cohen Milstein, A Clear and Present Danger: The Continued Threat of Forced Arbitration, Shareholder Advoc. 5 (Winter 2019) https://www.cohenmilstein.com/sites/default/files/A%20Clear%20and%20Present%20Danger.pdf (quoting James D. Cox, Professor of Law, Duke Law School: "'In the classic work, *Democracy in America,* Alexis de Tocqueville wrote nearly 200 years ago that a central strength of the democracy in America was our country's commitment to access to justice through mechanisms such as . . . making the courts available for everyone [and] [m]andated arbitration of investor and shareholder claims would be a grave departure from what makes America exceptional.'").

[28] *See* N. Peter Rasmussen; *see, e.g.,* Brief Amici Curiae of the Council of Institutional Investors et al. at 6, Halliburton Co. v. Erica P. John Fund, Inc., No. 13-317 (U.S. 2014) https://www.cii.org/files/issues_and_advocacy/legal_issues/02_05_14_CII_amicus_curiae_brief_halliburton.pdf (quoting Securities and Exchange Commission Chairman Arthur Levitt, Jr. that "'private rights of action are not only fundamental to the success of our securities markets, they are an *essential complement* to the SEC's own enforcement program'").

[29] *See* N. Peter Rasmussen; *see also* Letter from Michael Pieciak, NASAA President, Commissioner, Vermont Department of Financial Regulation to the U.S. Securities and Exchange Commission 4 (Jan. 30, 2019) ("Class action litigation . . . contributes materially to the development of the common law.") (on file with CII).

In addition, CII also agrees with the testimony of your April 3 hearing witness Melanie Senter Lubin who provided the following views based on her perspective as a state securities regulator:

> Forcing investors into mandatory arbitration or otherwise precluding investors from joining class actions is bad policy, as this would harm retail investors and be disruptive to the marketplace. The SEC and state securities regulators have limited resources and cannot combat all securities frauds entirely on their own. The Supreme Court has long recognized that securities class actions are "an essential supplement" to government enforcement powers, which is a point that Congress has also recognized.
>
> Securities class actions serve as a deterrent to violative conduct and a primary mechanism by which investors are compensated for the misconduct of fraudsters. While funds recovered by federal and state regulators can be returned to investors, such as through an SEC Fair Fund or a court appointed receiver, these amounts have historically paled in comparison to the amounts recovered directly by investors.[30]

Investor Choice Act of 2019

The provisions of the "Investor Choice Act of 2019 . . . would prohibit both broker-dealers and investment advisers from including mandatory arbitration clauses in their agreements with customers [and] . . . would prohibit public companies from including mandatory arbitration clauses in their bylaws or other corporate governance documents."[31] While CII has not taken a position on mandatory arbitration clauses in agreements with customers, we support the bill because it prohibits shareowners from being subject to mandatory arbitration clauses in corporate governance documents generally consistent with our membership approved policies.[32]

Clawbacks

CII generally supports H.R. ___, a bill to require the SEC to complete rulemaking required by section 10D of the Securities Exchange Act of 1934.[33]

CII continues to support prompt completed action on the SEC's required response to Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank) entitled, "Recovery of Erroneously Awarded Compensation."[34]

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[30] Putting Investors First: Reviewing Proposals to Hold Executives Accountable: Hearing Before the H. Subcomm. on Investor Protection, Entrepreneurship, and Capital Mkts. of the FSC, 116th Cong. (Apr. 3, 2019) (Written Testimony of Melanie Senter Lubin, Board Member, North American Securities Administrators Association and Maryland Commissioner of Securities at 5-6), https://financialservices.house.gov/uploadedfiles/hhrg-116-ba16-wstate-lubinm-20190403.pdf (footnotes omitted).
[31] Memorandum from FSC Majority Staff to Members, Committee on Financial Services at 3.
[32] CII, Corporate Governance Policies § 1.9 Judicial Forum.
[33] H.R. ___, a bill to require the SEC to complete rulemaking required by section 10D of the Securities Exchange Act of 1934, 116th Cong. (2019) (DRAFT), https://financialservices.house.gov/uploadedfiles/bills-116pih-secrulemaking-u1.pdf.
[34] Dodd-Frank Wall Street Reform and Consumer Protection Act, H.R. 4173, 111th Cong. § 954 (2010), https://www.gpo.gov/fdsys/pkg/PLAW-111publ203/html/PLAW-111publ203.htm.

We note that Section 954 was responsive to the recommendations of the Investors' Working Group (IWG).[35] In its seminal report on U.S. Financial Regulatory Reform, the IWG concluded:

> **Federal clawback provisions on unearned executive pay should be strengthened.** Clawback policies discourage executives from taking questionable actions that temporarily lift share prices but ultimately result in financial restatements. Senior executives should be required to return unearned bonus and incentive payments that were awarded as a result of fraudulent activity, incorrectly stated financial results or some other cause. The Sarbanes-Oxley Act of 2002 required boards to go after unearned CEO income, but the Act's language is too narrow. It applies only in cases where misconduct is proven—which occurs rarely because most cases result in settlements where charges are neither admitted nor denied—and only covers CEO and CFO compensation. Many courts, moreover, have refused to allow this provision to be enforced via private rights of action.[36]

The SEC's proposed rule to implement Section 954 (2015 Proposal) is generally consistent with CII's membership approved policies.[37] Those policies state:

> The compensation committee should ensure that sufficient and appropriate mechanisms and policies (for example, bonus banks and clawback policies) are in place to recover erroneous bonus and incentive awards paid in cash, stock or any other form of remuneration to current or former executive officers, and to prevent such awards from being paid out in the first instance. Awards can be erroneous due to acts or omissions resulting in fraud, financial results that require restatement or some other cause that the committee believes warrants withholding or recovering incentive pay. Incentive-based compensation should be subject to recovery for a period of time of at least three years following discovery of the fraud or cause forming the basis for the recovery. The mechanisms and policies should be publicly disclosed.[38]

Consistent with CII policies, we believe the final SEC rule should, as proposed,[39] apply broadly to the compensation of all current or former executive officers, whether or not they had control

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[35] S. Rep. No. 111-176, at 136 (Apr. 30, 2010), https://www.congress.gov/111/crpt/srpt176/CRPT-111srpt176.pdf ("The Investor's Working Group wrote 'federal clawback provisions on unearned executive pay should be strengthened.'")

[36] Report of the Investors' Working Group, U.S. Financial Regulatory Reform: The Investors' Perspective 23 (July 2009), http://www.cii.org/files/issues_and_advocacy/dodd-frank_act/07_01_09_iwg_report.pdf.

[37] Listing Standards for Recovery of Erroneously Awarded Compensation, Securities Act Release No. 9,861, Exchange Act Release No. 75,342, Investment Company Act Release No. 31,702, 80 Fed. Reg. 41,144 (proposed rule July 2015), https://www.federalregister.gov/articles/2015/07/14/2015-16613/listing-standards-for-recovery-of-erroneously-awarded-compensation.

[38] CII, Corporate Governance Policies § 5.5 Pay for Performance.

[39] *See* 80 Fed. Reg. at 41,153 ("the compensation recovery provisions of Section 10D apply without regard to an executive officer's responsibility for preparing the issuer's financial statements").

or authority over the company's financial reporting.[40] As we explained in our comment letter to the SEC in response to the 2015 Proposal:

> In our view, establishment of a broad clawback arrangement is an essential element of a meaningful pay for performance philosophy. If executive officers are to be rewarded for "hitting their numbers"—and it turns out they failed to do so—the unearned compensation should generally be recovered notwithstanding the cause of the revision.[41]

A broad clawback can be "a powerful tool for companies seeking to punish executives for wrongdoing."[42] In addition, we agree with legal experts that broad clawback arrangements may "keep executive officers focused on sound accounting company-wide."[43]

Moreover, requiring a broad clawback policy would appear to be consistent with the "Commonsense Principles of Corporate Governance 2.0" endorsed in October 2018 by a number of prominent leaders of U.S. public companies, including: Jamie Dimon, JPMorgan Chase; Alex Gorsky, Johnson & Johnson; Brian Moynihan, Bank of America; and David Taylor, Proctor & Gamble.[44] Those principles state that "[c]ompanies should maintain clawback policies for both cash and equity compensation."[45]

We believe the Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets (Subcommittee) and the Commission should consider the empirical studies indicating that the adoption of clawback provisions is generally associated with improved financial reporting quality, enhanced investor and auditor confidence in the quality of financial reporting, and reduced audit fees.[46] We note that one of the more recent studies indicates clawbacks generally protect accounting integrity while maintaining and even enhancing the advantages of performance based CFO pay.[47]

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[40] *See, e.g.*, Letter from Jeff Mahoney, General Counsel, Council of Institutional Investors, to Brent J. Fields, Secretary, U.S. Securities and Exchange Commission 5 (Aug. 27, 2015), http://www.cii.org/files/issues_and_advocacy/correspondence/2015/08_27_15_letter_to_SEC_clawbacks.pdf.
[41] *Id.* (footnotes omitted).
[42] *See, e.g.*, Jef Feeley & Anders Melin, Hertz Seeks $70M in Clawbacks Tied to Accounting Scandal, Acct.Today, Apr. 1, 2019, https://www.accountingtoday.com/articles/hertz-seeks-70m-in-clawbacks-tied-to-accounting-scandal.
[43] *See, e.g.*, Financial CHOICE Act of 2017, Hearing Before the H. Comm. on Fin. Servs., 115th Cong. (Apr. 26, 2017) (Testimony of Michael S. Barr, The Roy F. and Jean Humphrey Proffitt Professor of Law, University of Michigan Law School at 15) (on file with CII).
[44] Press Release, AT&T, Bank of America, Coca-Cola, IBM, Johnson & Johnson, P&G and Other Leaders Sign on to Updated Commonsense Corporate Governance Principles (Oct. 18, 2018), https://www.businesswire.com/news/home/20181018005402/en/ATT-Bank-America-Coca-Cola-IBM-Johnson-Johnson.
[45] Commonsense Corporate Governance Principles 2.0 VII(g) (2018), http://www.governanceprinciples.org/wp-content/uploads/2018/10/CommonsensePrinciples2.0.pdf.
[46] *See* Gregory L. Prescott & Carol E. Vann, Implications of Clawback Adoption in Executive Compensation Contracts: A Survey of Recent Research, 29 J. Corp. Acct. & Fin. 59, 67 (Jan. 2018), https://onlinelibrary.wiley.com/doi/full/10.1002/jcaf.22312.
[47] *See* Peter Kroos et al., Voluntary Clawback Adoption and the Use of Financial Measures in CFO Bonus Plans, 93 Acct. Rev. 213-235 (May/June 2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2312762; *see also* Ben Hiamowitz, Adoption of Clawbacks Means Stronger Link Between Firm Performance and CFO Pay, CPA

We acknowledge SEC Chairman Clayton's observation that "several companies . . . [have clawback] policies [that] go beyond what would be required under Dodd-Frank."[48] However, we believe that there are a multitude of potential benefits to long-term investors from the SEC requiring *all* companies to adopt, at a minimum, clawback policies consistent with the 2015 Proposal mandated by the U.S. Congress.

A bill to require the SEC to complete rulemaking required by section 10D of the Securities Exchange Act of 1934

The provisions of the "discussion draft would require the SEC to finalize the section 954 rulemaking within 60 days [and] [i]f the SEC has not finalized the rulemaking within 60 days, the SEC Chair is required to testify in the House Financial Services Committee and the Senate Banking Committee once a month until the rule is finalized."[49] CII generally supports the bill because implementing the 2015 Proposal is consistent with our membership approved policies,[50] and for far too long has been one of our rulemaking priorities.[51] We again generally agree with the testimony of Ms. Lubin that "just as the 111th Congress was correct to reform our financial system in 2010, the 116th Congress is correct to insist that the SEC fully implement the law, including by completing rulemakings mandated therein."[52]

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PracticeAdvisor, June 7, 2018, http://www.cpapracticeadvisor.com/news/12416039/adoption-of-clawbacks-means-stronger-link-between-firm-performance-and-cfo-pay.

[48] U.S. Securities and Exchange Commission, Chairman Jay Clayton, Testimony on "Oversight of the U.S. Securities and Exchange Commission," Before the Comm. on Fin. Servs., U.S. H.R. at n.50 (June 21, 2018), https://www.sec.gov/news/testimony/testimony-oversight-us-securities-and-exchange-commission; *see* Proxy Process and Rules: Examining Current Practices and Potential Changes: Hearing before the S. Comm. on Banking, Hous. & Urban Affairs, 115th Cong. (Dec. 6, 2018) (statement of Michael Garland, Assistant Comptroller, for Corp. Governance and Responsible Inv., In the Office of the N.Y.C. Comptroller Scott Stringer at 8), https://www.banking.senate.gov/imo/media/doc/Garland%20Testimony%2012-6-18.pdf (indicating that the successful negotiation of a broad clawback policy at Wells Fargo "enabled the Wells Fargo Board of directors to announce in September 2016 that it would recoup $60 million from two senior executives in order to hold them financially accountable for the fake account scandal that involved the loss of jobs by 5,300 lower-level employees and cost Wells Fargo $185 million in fines and penalties"); Kathryn Neel et al., The Business Case for Clawbacks, Harv. L. Sch. Forum on Corp. Governance & Fin. Regulation (May 6, 2018), https://corpgov.law.harvard.edu/2018/05/06/the-business-case-for-clawbacks/ (listing Cognizant Technology Solutions, Wells Fargo, Zions Bancorp, and EBay as companies that have adopted "detrimental conduct" clawback policies); *see also* Michael S. Melbinger, Update on Clawback Policy Issues, Executive Compensation Blog, Winston & Strawn (Oct. 19, 2017), https://www.winston.com/en/executive-compensation-blog/update-on-clawback-policy-issues.html (recommending that "directors should protect themselves and their companies by adopting a strong policy").

[49] Memorandum from FSC Majority Staff to Members, Committee on Financial Services at 4.

[50] CII, Corporate Governance Policies § 5.5 Pay for Performance.

[51] *See, e.g.*, Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Brent J. Fields, Secretary, Securities and Exchange Commission 1 (Dec. 13, 2018), https://www.cii.org/files/issues_and_advocacy/correspondence/2018/December%2013%202018%20SEC%20Reg%20Flex%20Letter.pdf ("We respectfully reiterate our requests that the following two individual agenda items currently listed under the "Division of Corporation Finance—Long Term Actions" be advanced to "Division of Corporation Finance— Final Rule Stage:" "Universal Proxy" and "Listing Standards for Recovery of Erroneously Awarded Compensation.").

[52] Written Testimony of Melanie Senter Lubin, Board Member, North American Securities Administrators Association and Maryland Commissioner of Securities at 3-4).

If we can answer any questions or provide additional information that would be helpful to you or the Subcommittee, please do not hesitate to contact me at 202.822.0800 or jeff@cii.org.

Sincerely,

Jeff Mahoney

Jeffrey P. Mahoney
General Counsel

Statement for the Record by the
Public Investors Arbitration Bar Association
Hearing before the House Financial Services Committee; Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets:
Putting Investors First: Reviewing Proposals to Hold Executives Accountable

April 2, 2019

Chairwoman Maloney
Ranking Member Huizenga
U.S. House Committee on Financial Services
Subcommittee on Investor Protection, Entrepreneurship,
and Capital Markets
2129 Rayburn House Office Building
Washington, DC 20515

Dear Chairwoman Maloney and Ranking Member Huizenga:

The Public Investors Arbitration Bar Association (PIABA)[1] appreciates the opportunity to submit this statement for the record in connection with the April 3, 2019 hearing, "Putting Investors First: Reviewing Proposals to Hold Executives Accountable."

PIABA is focusing its statement on the issue of mandatory arbitration clauses contained within contracts between investors and brokerage firms. Since the Supreme Court decided *Shearson/American Express v. McMahon*[2] in 1987, investors have increasingly been required to submit their disputes to arbitration. Restoring investor choice of forum is an important step to further investor protection.

[1] PIABA is an international bar association comprised of attorneys who represent investors in securities arbitrations. Since its formation in 1990, PIABA has promoted the interests of the public investor in all securities and commodities arbitration forums, while also advocating for public education regarding investment fraud and industry misconduct. Our members and their clients have a strong interest in rules which govern the conduct of those who provide advice to investors.
[2] 482 U.S. 220, 107 S. Ct. 2332, 96 L. Ed. 2d 185 (1987)

I. The history of investor choice

a. *The landscape pre-McMahon*

The Federal Arbitration Act ("FAA") provides that arbitration agreements "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."[3] The FAA "was designed to allow parties to avoid 'the costliness and delays of litigation,' and to place arbitration agreements 'upon the same footing as other contracts.'"[4] From the enactment of the FAA in 1925 until the Supreme Court's decision in *Wilko v. Swan*[5] in 1953, pre-dispute arbitration clauses were given full effect in the securities industry.

However, *Wilko* effectively changed the face of securities arbitration. In that case, the Supreme Court held that claims brought by investors under the Securities Act of 1933 (the "'33 Act") could not be referred to arbitration through the use of pre-dispute arbitration clauses. In reaching this conclusion, the Court cited several flaws in the arbitration process, which included concern for the ability of arbitrators to decide legal issues,[6] limited judicial review of arbitral decisions,[7] and the circumvention of the anti-waiver provision in the '33 Act.[8] Following *Wilko*, arbitration of claims brought under the '33 Act was strictly voluntary. During the years after *Wilko*, courts interpreted the Supreme Court's decision as also applicable to claims brought under the Securities Exchange Act of 1934 (the "'34 Act").[9]

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[3] 9 U.S.C.A. § 2

[4] *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 510-11, 94 S. Ct. 2449, 2453, 41 L. Ed. 2d 270 (1974) (quoting H.R.Rep.No.96, 68th Cong., 1st Sess., 1, 2 (1924)).

[5] 346 U.S. 427, 74 S. Ct. 182, 98 L. Ed. 168 (1953) overruled by *Rodriguez de Quijas v. Shearson/Am. Exp., Inc.*, 490 U.S. 477, 109 S. Ct. 1917, 104 L. Ed. 2d 526 (1989)

[6] *See id.* at 436 ("As their award may be without explanation of their reasons and without a complete record of their proceedings, the arbitrators' conception of the legal meaning of such statutory requirements as 'burden of proof,' 'reasonable care' or 'material fact' . . . cannot be determined.").

[7] *See id.* at 436-37 ("In unrestricted submission, such as the present margin agreements envisage, the interpretations of the law by the arbitrators in contrast to manifest disregard are not subject, in federal courts, to judicial review for error in interpretation.").

[8] *See id.* at 434-35 (Section 14 of the '33 Act voids any "'stipulation' waiving compliance with any 'provision' of the Securities Act. This arrangement to arbitrate is a 'stipulation,' and we think the right to select the judicial forum is the kind of 'provision' that cannot be waived under [Section 14] of the Securities Act.").

[9] *See e.g. Mansbach v. Prescott, Ball & Turben*, 598 F.2d 1017, 1030 (6th Cir. 1979) ("While *Wilko* arose under only the Securities Act of 1933, its holding and rationale are equally applicable to cases arising under the Securities Exchange Act of 1934." (citing *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Moore*, 590 F.2d 823, 827-29 (10th Cir. 1978); *Weissbuch v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 558 F.2d 831, 834-35 (7th Cir. 1977); *Ayres v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 538 F.2d 532, 536 (3d Cir.), Cert. den. 429 U.S. 1010, 97 S.Ct. 542, 50 L.Ed.2d 619 (1976); *Newman v. Shearson, Hammill & Co.*, 383 F.Supp. 265, 268 (W.D.Tex.1974); *Maheu v. Reynolds & Co.*, 282 F.Supp. 423, 426 (S.D.N.Y.1967); *Stockwell v. Reynolds & Co.*, 252 F.Supp. 215, 220 n. 2 (S.D.N.Y.1965)).

In 1968, FINRA (then NASD) adopted the Code of Arbitration Procedure. Section 12 of the Code was entitled "Required Submission", and provided that, upon the demand of a customer, a member and associated person was required to submit any dispute, claim, or controversy to arbitration. Today, this rule exists in substantially similar form as FINRA Rule 12200. Although brokerage firms were not permitted to enforce pre-dispute arbitration agreements with respect to federal securities law claims pursuant to *Wilko*, pursuant to FINRA (then NASD) rules, investors were able to compel brokerage firms to arbitrate any claims. From 1968 through today, in the absence of a pre-dispute arbitration agreement, investors have had the option of choosing either court or arbitration to resolve their claims, and firms have no say in the choice.

In 1979, the U.S. Securities and Exchange Commission (the SEC) issued a release to brokerage firms advising them that, "[r]equiring the signing of an arbitration agreement without adequate disclosure as to its meaning and effect violates standards of fair dealing with customers and constitutes conduct that is inconsistent with just and equitable principles of trade."[10] In 1983, the SEC adopted Exchange Act Rule 15c2-2, "Disclosure Regarding Recourse to the Courts Notwithstanding Arbitration Clauses in Broker-Dealer Customer Agreements", "in order to address regulatory concerns arising from the inclusion in standard form customer agreements of predispute arbitration clauses (i.e., agreements requiring customers to submit to arbitration all future disputes.)."[11] Thus, two layers of protection existed after *Wilko*: pre-dispute arbitration clauses would not be enforced by the courts as to federal securities law claims and, if a firm did include a pre-dispute arbitration clause, it had the duty of fully disclosing the clause to the investor prior to the investor signing the agreement.

b. Erosion of investor choice with McMahon

In 1987, the Supreme Court decided *Shearson/American Express v. McMahon*,[12] which revisited the issue of whether pre-dispute arbitration clauses were enforceable under the '34 Act. The Court effectively reversed decades of precedent that prohibited the enforcement of pre-dispute arbitration clauses in claims brought under the '34 Act and cited the increasing prevalence of arbitration in the securities industry in support of its holding.[13] The Court also addressed the concerns set out in the *Wilko* decision and found that "there is no reason to assume at the outset that arbitrators will not follow the

[10] "Notice to Broker-Dealers Concerning Clauses in Customer Agreements which Provide for Arbitration of Future Disputes", 1979 WL 174165 (S.E.C. Release No. 34-15984), p. 4.
[11] "Rescission of Rule Governing Use of Predispute Arbitration Clauses in Broker-Dealer Customer Agreements", 1987 WL 847512 (S.E.C. Release No. 34-25034), p. 1.
[12] 482 U.S. 220, 107 S. Ct. 2332, 96 L. Ed. 2d 185 (1987)
[13] *See id.* at 233 ("Thus, the mistrust of arbitration that formed the basis of the *Wilko* opinion in 1953 is difficult to square with the assessment of arbitration that has prevailed since that time. This is especially so in light of the intervening changes in the regulatory structure of the securities laws.").

law; although judicial scrutiny of arbitration awards is necessarily limited, such review is sufficient to ensure that arbitrators comply with the requirements of the statute," thus reinforcing the legitimacy of an arbitral award.[14]

However, the *McMahon* decision was by no means unanimous. It was a 5-4 decision, with Justice Blackmun authoring an important dissenting opinion.[15] Specifically, Justice Blackmun objected to the majority's holding on two bases. First, he noted that the majority erred in reading the *Wilko* decision as being decided solely on the basis of perceived inadequacy in the arbitration process.[16] Second, he criticized the majority's blind acceptance that the problems with arbitration cited in *Wilko* no longer existed.[17] With a prescient assertion that foreshadows the current state of affairs, he criticized SEC oversight of the securities arbitration process: "[T]he Court's complacent acceptance of the Commission's oversight is alarming when almost every day brings another example of illegality on Wall Street."[18] The validity of Justice Blackmun's concerns is even more apparent today than when *McMahon* was decided in 1987.

Shortly after *McMahon*, the Supreme Court officially overruled the *Wilko* decision in *Rodriguez de Quijas v. Shearson/American Express*.[19] As a result of *McMahon* and *Rodriguez*, brokerage firms have the unhindered ability to compel arbitration of investor claims through the inclusion of a simple pre-dispute arbitration clause in all customer agreements. The once voluntary submission to arbitration had become an industry mandate, leaving aggrieved investors with no other choice than to arbitrate their claims.

c. *The landscape after McMahon*

Shortly after *McMahon* was decided, the SEC found in a survey that "98% of the margin accounts, 95% of the options accounts and 39% of the cash accounts" were subject to pre-dispute arbitration clauses.[20] This means that at the time, over 60% of cash

[14] *See id.* at 232.
[15] *See id.* at 242 (Blackmun, J., dissenting).
[16] *See id.* at 249-50.
[17] *See id.*
[18] *See id.* at 265.
[19] 490 U.S. 477, 109 S. Ct. 1917, 104 L. Ed. 2d 526 (1989)
[20] Letter from SEC Chairman David Ruder to New York Stock Exchange, July 8, 1988, in ARBITRATION REFORM: HEARINGS BEFORE THE SUBCOMMITTEE ON TELECOMMUNICATIONS AND FINANCE OF THE COMMITTEE ON ENERGY AND COMMERCE, U.S. HOUSE OF REPRESENTATIVES, 100TH CONGRESS, SECOND SESSION, ON MARCH 31, JUNE 9 AND JULY 12, 1988 (U.S. G.P.O., 1989), at p. 510. Similarly, James Buck, Sr. V.P. of the New York Stock Exchange, testified in that hearing: "Most firms do not require arbitration agreements for cash accounts. Only in the case of margin accounts where the customer is borrowing money do you find overwhelming use of these clauses." Id., at p. 533. *See also* Self-Regulatory Organizations; Order Approving Proposed Rule Changes by the NYSE, NASD, and AMEX Relating to the Arbitration Process and the Use of Pre-dispute Arbitration Clauses, 54 Fed. Reg. 21144, n.51 (May 10, 1989)

accounts were not subject to pre-dispute arbitration clauses. Therefore, in every one of these accounts, investors were free to choose between court and arbitration if a dispute arose because of the FINRA (then NASD) rules. The survey did indicate a movement toward placing pre-dispute arbitration provisions in cash account agreements. Commission Chairman Ruder testified before Congress:

> I expressed vocally and vociferously my opposition to that trend. I believed then, and I believe now, that customer choice is an exceedingly important aspect of this industry and the movement apparently to push these clauses on the public so that they couldn't trade at all without them was in my mind simply terrible.[21]

The industry responded by assuring the SEC that it had no intentions of imposing arbitration clauses in cash accounts and depriving American investors of any choice.[22] In essence, firms accepted the fact that investors could choose the forum in which they wanted to resolve their disputes. Based on these assurances at the time, the SEC did not take any action to prohibit pre-dispute arbitration clauses.

Over the years this situation dramatically changed. Notwithstanding the industry's reassurances that it would not seek to include pre-dispute arbitration clauses in its contracts broadly, today virtually every brokerage firm in America includes a pre-dispute arbitration provision in its new account documentation for every type of account. If investors want to buy a stock or a bond or seek to participate in the capital markets in America, they must give up their Constitutional right to a jury trial by an independent and impartial judiciary and agree to mandatory arbitration.

Investor choice has been eroded in other ways as well. We have seen a consolidation of the American securities markets, which culminated in the 2007 NYSE-NASD merger. Today, the only SRO-sponsored forum is the one sponsored by FINRA. At the time *McMahon* was decided, there were at least ten different arbitration forums. Most stock exchanges and the Chicago Board of Options Exchange provided arbitration forums. Many arbitration clauses, and the rules of the American Stock Exchange, gave investors the option of avoiding arbitrating in an arbitration forum associated with the securities industry altogether by allowing arbitration before the American Arbitration Association. Now all these choices are effectively gone. Investors with pre-dispute arbitration clauses (virtually all customers) are now forced into FINRA arbitration. There is no

[hereinafter *Self-Regulatory Organizations*] (stating that, at the time of *McMahon*, only 39% of broker-dealers mandated arbitration of customer disputes involving cash accounts).

[21] *Id.*, p.512, Testimony of July 12, 1988. Chairman Ruder also testified on June 1, 1988: "I fail to see why one should deny access to the securities market to those people who are unwilling to waive their disputes in advance. I think it's unfair." *Id.*, at p. 524.

[22] *Id.*, pp. 474, 514-516.

competition; there is no alternative. In a relatively short time span, America's investors have seen their 'choices' dwindle to one.

The number and types of Americans who invest have also changed since the pre-*McMahon* years. The number of households holding stocks has increased more than three-fold since the early 1980s.[23] Today, between 57 and 62% of middle-aged households have direct or indirect stock holdings.[24] The number and demographics of investors have changed over time as well:

- Total Financial Assets: Americans over the age of 50 currently account for 77 percent of financial assets in the United States, according to the Securities Industry and Financial Markets Association (SIFMA).
- Retirement Assets: As of Dec. 31, 2017, retirement assets reached $28.2 trillion and accounted for 43.8 percent of all household financial assets in the United States for householders aged 65 and older.
- Total Household Net Worth: In 2011, the net worth of households headed by someone aged 65 or older totaled approximately $17.2 trillion.
- Median Household Net Worth: By 2013, households headed by someone aged 65 or older had a median net worth of $202,950, including $80,000 in retirement accounts.[25]

As greater numbers of Americans invest, it is important that they have access to a fair means of resolving any disputes that may arise.

II. *Investors should be given the choice of forum*

True investor choice returns the investor's ability to choose between court and arbitration to resolve any disputes that arise. There are costs and benefits to both arbitration and court resolution of disputes, and investors should be given the ability to weigh those costs and benefits and chose the forum best fitted to address any concerns.

[23] Investment Company Institute & Securities Industry Association, "Equity Ownership in America," (Nov. 2005), p. 1.
[24] Federal Reserve Bank of St. Louis, "How Has Stock Ownership Trended in the Past Few Decades?" (Apr. 9, 2018).
[25] U.S. SEC Office of the Investor Advocate, "Elder Financial Exploitation; Why it is a concern, what regulators are doing about it, and looking ahead" (June 2018).

a. Concerns with mandatory arbitration

i. Arbitration awards are not explained

Mandatory arbitration has many flaws which affect both investors and the industry. For example, arbitration awards do not contain reasoned opinions justifying the outcome. The awards often just state who won the arbitration and what amount was awarded, if any. While FINRA arbitration awards are publicly available, they are of limited use to investors. The opacity in awards may prevent investors from making informed decisions about which firms and brokers to trust with their money because they cannot tell what actually happened. It also allows brokerage firms and brokers to more easily hide details of any wrongdoing from their current clients.

ii. Arbitration has eliminated judicial interpretation of SEC and FINRA rules and regulations

Investors and the industry both need judicial interpretations to apply new factual situations to existing and new rules and regulations. Since mandatory arbitration has become the norm, case law interpreting relevant statues has nearly disappeared, as arbitrators are not required to issue written decisions, nor are arbitration decisions considered binding authority. The case law and resulting clarity needed by the industry and investors has simply been unable to develop. Allowing judges to decide many of these issues with written opinions and an appeals process would provide more clarity to the rights and expectations of the industry and investors.

iii. Investors perceive the FINRA forum to be biased

In 2005, amid concerns about the fairness of the arbitration process, the Securities Industry Conference on Arbitration ("SICA") conducted a study of perceived fairness in the arbitration process.[26] It consisted of a survey that was sent to over 30,000 participants with questions assessing perception of the arbitration process. Particular emphasis was placed on: fairness of the SRO arbitration process; competence of arbitrators to resolve investors' disputes with their broker-dealers; fairness of SRO arbitration as compared to their perceptions of fairness in securities litigation in similar disputes; and fairness of the outcome of arbitrations.[27] Not surprisingly, the SICA study found that the overall perception of the securities arbitration process was negative.[28]

[26] *See* Barbara Black & Jill Gross, *Perceptions of Fairness of Securities Arbitration: An Empirical Study*, Report to the Securities Industry Conference on Arbitration (2008), *available at* https://digitalcommons.pace.edu/cgi/viewcontent.cgi?article=1477&context=lawfaculty.
[27] *See id.* at 1.
[28] *See id.* at 3.

Over sixty percent of customers perceived the process as unfair,[29] with nearly half perceiving arbitral panels as being biased.[30] And, most significantly, three out of every four customers found securities arbitration to be "very unfair" or "somewhat unfair" when compared with the judicial system.[31] Moreover, over one-third of customers confronted with a pre-dispute arbitration clause in the brokerage agreement were not aware of its existence.[32]

Further, the lack of diversity in the FINRA pool of arbitrators further undermines investor confidence in the system. Based on its most recent survey, FINRA's arbitrator pool is 70% male; and 83% Caucasian.[33] Moreover, the advanced age of many of FINRA's arbitrators also raises serious concerns about not only the diversity of the pool, but also those arbitrators' ability to effectively and impartially participate in the arbitration proceeding. Thirty eight percent of the pool is aged 70 or older, and 26% is aged 61 to 69.[34] Many elderly arbitrators use the income from serving on arbitration panels to supplement their retirement; and therefore, presumably, would like to continue serving on panels. However, arbitrators with a record of making awards to investors are often struck during the arbitration selection process by brokerage firms, the repeat players in the system, who do not want to see investor sympathetic arbitrators on panels. This fear of being kept off of panels may bias, consciously or not, this large percentage of arbitrators against making awards in investors' favor.

b. Benefits of arbitration

Despite its shortcomings, FINRA arbitration should be maintained as an option for investors. Indeed, if investors are allowed to choose between court and arbitration, thereby encouraging FINRA to address the perceived inadequacies with the forum, FINRA arbitration has the potential to be the fair and neutral forum which is necessary to comply with due process and ensure investor protection.

[29] *See id.* at 45 (finding that approximately 63% of investors answered "Disagree/Strongly Disagree" when responding to the statement, "As a whole, I feel the arbitration process was fair").
[30] *See id.* at 50 (finding that 47% of responses disagreed with the statement that "arbitration is conducted by the arbitrators in a way that is fair to all parties" and 44% disagreed with the statement that arbitrators conduct the arbitration without bias).
[31] *See id.* at 47 (finding that 75.55% of customers found arbitration to be "very unfair" or "somewhat unfair" when compared to civil litigation).
[32] *See id.* at 19 (stating that 37% of customers responded that they were unaware that their customer agreement contained a pre-dispute arbitration clause).
[33] *See* FINRA, "Our Commitment to Achieving Arbitrator and Mediator Diversity at FINRA", available at http://www.finra.org/arbitration-and-mediation/diversity-and-finra-arbitrator-recruitment.
[34] *Id.*

i. Arbitration may be less costly than court

Arbitration has always been touted as an efficient, cost-effective way to resolve disputes. While the hearing fees, fees which would not attach in a court proceeding, can be fairly substantial for larger cases, arbitration allows the parties to avoid the time and expense associated with court discovery procedures. Interrogatories, a time-consuming endeavor in court, are not permitted in FINRA arbitration.[35] Absent a compelling reason, depositions are also not permitted.[36] An investor should be permitted to weigh the cost of court discovery against the benefits of substantially lower court fees and court supervision, once the dispute arises.

Similarly, motions are strictly limited in arbitration. Pre-hearing motions to dismiss are discouraged, and may be granted only for tightly circumscribed reasons; an improper motion to dismiss subjects the industry defendant to potential sanctions.[37] This makes sense, as the investor is not entitled to the same discovery rights and procedural safeguards as they would get in court.

In view of the streamlined nature of arbitration, an investor is able to retain an attorney for smaller cases, and pursue those claims in an efficient manner. In most cases (though not all), the firm has greater financial resources, and is able to base its decision whether or not to arbitrate on the size of its war chest. With two-way choice, industry defendants would be able to refuse arbitration in order to make it uneconomical for investors to pursue smaller claims. In short, the industry can flex its economic muscle to the detriment of its own clients. This would be an appalling result for the small public investor.

ii. Arbitration may be a speedier option

Generally, arbitration leads to a quicker result than court proceedings. According to FINRA's statistics, the average turnaround time for cases filed in its forum has been 14.5 months for the past two years.[38] Most courts are unable to match this record. Arbitration is not dependent on a judge having availability in the court calendar. In arbitration, the parties have the ability to set a schedule for their case that meets their needs. Where an elderly investor desperately needs to replace funds lost through broker

[35] A party may propound requests for information, but such requests are limited in scope. FINRA Customer Code section 12507(a)(1) provides, in pertinent part: "Requests for information are generally limited to identification of individuals, entities, and time periods related to the dispute; such requests should be reasonable in number and not require narrative answers or fact finding. Standard interrogatories are generally not permitted in arbitration."
[36] FINRA Code of Arbitration Procedure for Customer Disputes, Rule 12510.
[37] FINRA Code of Arbitration Procedure for Customer Disputes, Rule 12504.
[38] *See* FINRA Dispute Resolution Statistics, available at http://www.finra.org/arbitration-and-mediation/dispute-resolution-statistics.

misconduct, the ability to get a case heard and decided quickly may be of great significance. Additionally, in 2004, FINRA instituted procedures for expediting cases involving senior or seriously ill customers, ensuring that these cases are handled as efficiently as possible.[39]

iii. FINRA has unique enforcement powers

Article XIII, Section 1(c) of FINRA's Corporate Bylaws provides that a member or associated person may be disciplined for failure to pay an arbitration award or written settlement agreement. Article VI, Section 3 permits summary suspension upon 15 days' written notice of a member or associated person who fails to pay. FINRA limited the defenses a firm or associated person may raise to prevent the suspension: (1) that the firm or person paid the award in full; (2) the customer has agreed to installment payments or has otherwise settled the matter; (3) the firm or person has filed a timely motion to vacate or modify the arbitration award and such motion has not been denied; and (4) the firm or person has filed a petition in bankruptcy and the bankruptcy proceeding is pending, or the bankruptcy court has discharged the award.[40]

Notwithstanding these powers, many arbitration awards still go unpaid. In 2017, of the FINRA cases where an investor was awarded some recovery, 34% of the awards, a total of $21 million, went unpaid.[41]

Conclusion

For almost twenty years between the time FINRA first enacted its Code of Arbitration Procedure and the *McMahon* decision, investors had a choice between court and arbitration. Even following *McMahon*, until pre-dispute arbitration agreements became pervasive throughout the industry, investors retained choice in terms of forum selection.

Brokerage firms have the resources necessary to resolve disputes in both the judicial and arbitral settings and, thus, are more capable of adjusting their strategy than investors. Therefore, the brokerage firm, rather than the investor, should bear the burden of uncertainty in forum selection. Firms will not be unduly burdened if investors have the ability to choose between court or arbitration once a dispute arises.

[39] *See* FINRA, "Expedited Procedures for Seniors and Seriously Ill", available at http://www.finra.org/arbitration-and-mediation/expedited-proceedings-seniors-seriously-ill.
[40] *See* FINRA Regulatory Notice 10-31 "Change to Expedited Proceedings for Failure to Comply with an Arbitration Award or Related Settlement", *available at* http://www.finra.org/sites/default/files/NoticeDocument/p121647.pdf.
[41] See FINRA, "Statistics on Unpaid Customer Awards in FINRA Arbitration", available at https://www.finra.org/arbitration-and-mediation/statistics-unpaid-customer-awards-finra-arbitration.

Thank you for your attention to this issue. We appreciate the opportunity to provide a statement. Please do not hesitate to contact us if you have any questions or would like any additional information.

Respectfully submitted,

Christine Lazaro
President

cc: Chairwoman Waters; Ranking Member McHenry

Invested in America

Submitted Testimony

of the Securities Industry and Financial Markets Association

before the U.S. House of Representatives

House Financial Services Subcommittee on

Investor Protection, Entrepreneurship and Capital Markets

Hearing entitled "Putting Investors First: Reviewing Proposals to

Hold Executives Accountable"

April 3, 2019

The Securities Industry and Financial Markets Association (SIFMA)[1] and its member firms appreciate the opportunity to submit our perspectives on the legislative proposals that the Committee is evaluating this week. We are writing specifically to express our concerns regarding the Discussion Draft which is entitled the "Investor Choice Act of 2019." This legislation would prohibit arbitration clauses in all consumer contracts, including the retail contracts of investors who utilize the services of broker-dealers.

Brokers-dealers are subject to fairly extensive and regular regulatory oversight by the Securities and Exchange Commission (SEC) and the Financial Industry Regulatory Authority (FINRA), among others. Under FINRA Rule 12200 (Arbitration under an Arbitration Agreement or the Rules of FINRA), broker-dealers are generally required to arbitrate a retail customer's dispute if required by a written agreement, *or* requested by the customer and if the dispute is between a customer and FINRA member (or associated person of a member). This rule is based on the belief that some customers may want to arbitrate and will benefit from it, especially considering that securities arbitration is less expensive, faster, and closely supervised and regulated by the SEC and FINRA.

It is important to recognize that arbitration is not specific to the financial services industry. Many industries outside of financial services include arbitration clauses, often employing arbitration fora that do not necessarily compare favorably to FINRA's forum. FINRA's arbitration forum stands above because it incorporates substantive and procedural protections comparable to court-based litigation, and thereby ensures fair case outcomes for retail customers.

Broker-dealers include arbitration clauses in customer contracts so that firms can appropriately price their products and services, as the cost of resolving future disputes is simply part of the cost of running a business. Each company must have a clear understanding of the scope of these costs. Arbitration clauses also provide clear and certain information as to where disputes will be handled for the customers and help secure lower dispute resolution costs that would otherwise be significantly higher in court-based litigation.

SIFMA consistently advocates to enhance the quality, and substantive and procedural fairness, of securities arbitration as the exclusive dispute resolution forum for most disputes between securities firms and their customers. The securities arbitration system has worked effectively for decades because it is subject to public oversight, regulatory oversight by multiple independent regulators, and rules of procedure that are designed to benefit investors. Pre-dispute arbitration agreements

[1] SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry's nearly 1 million employees, we advocate for legislation, regulation and business policy, affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org.

are a vital component of this system. Such agreements help shape the public policy in favor of arbitration that has been recognized by both Congress and the U.S. Supreme Court. This policy is strengthened by the recognition that securities arbitration promotes fair, efficient, and economical dispute resolution for all parties.

In sum, SIFMA believes we should preserve the current enforceability of arbitration clauses in customer contracts and therefore strongly opposes the Discussion Draft which would ban them.

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