INSIDER TRADING AND STOCK OPTION GRANTS: AN EXAMINATION OF CORPORATE INTEGRITY IN THE COVID-19 PANDEMIC

HEARING

BEFORE THE

SUBCOMMITTEE ON INVESTOR PROTECTION, ENTREPRENEURSHIP, AND CAPITAL MARKETS

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED SIXTEENTH CONGRESS

SECOND SESSION

SEPTEMBER 17, 2020

Printed for the use of the Committee on Financial Services

Serial No. 116–110

U.S. GOVERNMENT PUBLISHING OFFICE

43–503 PDF WASHINGTON : 2021

HOUSE COMMITTEE ON FINANCIAL SERVICES

MAXINE WATERS, California, *Chairwoman*

CAROLYN B. MALONEY, New York
NYDIA M. VELÁZQUEZ, New York
BRAD SHERMAN, California
GREGORY W. MEEKS, New York
WM. LACY CLAY, Missouri
DAVID SCOTT, Georgia
AL GREEN, Texas
EMANUEL CLEAVER, Missouri
ED PERLMUTTER, Colorado
JIM A. HIMES, Connecticut
BILL FOSTER, Illinois
JOYCE BEATTY, Ohio
DENNY HECK, Washington
JUAN VARGAS, California
JOSH GOTTHEIMER, New Jersey
VICENTE GONZALEZ, Texas
AL LAWSON, Florida
MICHAEL SAN NICOLAS, Guam
RASHIDA TLAIB, Michigan
KATIE PORTER, California
CINDY AXNE, Iowa
SEAN CASTEN, Illinois
AYANNA PRESSLEY, Massachusetts
BEN MCADAMS, Utah
ALEXANDRIA OCASIO-CORTEZ, New York
JENNIFER WEXTON, Virginia
STEPHEN F. LYNCH, Massachusetts
TULSI GABBARD, Hawaii
ALMA ADAMS, North Carolina
MADELEINE DEAN, Pennsylvania
JESÚS "CHUY" GARCIA, Illinois
SYLVIA GARCIA, Texas
DEAN PHILLIPS, Minnesota

PATRICK MCHENRY, North Carolina, *Ranking Member*
ANN WAGNER, Missouri
FRANK D. LUCAS, Oklahoma
BILL POSEY, Florida
BLAINE LUETKEMEYER, Missouri
BILL HUIZENGA, Michigan
STEVE STIVERS, Ohio
ANDY BARR, Kentucky
SCOTT TIPTON, Colorado
ROGER WILLIAMS, Texas
FRENCH HILL, Arkansas
TOM EMMER, Minnesota
LEE M. ZELDIN, New York
BARRY LOUDERMILK, Georgia
ALEXANDER X. MOONEY, West Virginia
WARREN DAVIDSON, Ohio
TED BUDD, North Carolina
DAVID KUSTOFF, Tennessee
TREY HOLLINGSWORTH, Indiana
ANTHONY GONZALEZ, Ohio
JOHN ROSE, Tennessee
BRYAN STEIL, Wisconsin
LANCE GOODEN, Texas
DENVER RIGGLEMAN, Virginia
WILLIAM TIMMONS, South Carolina
VAN TAYLOR, Texas

CHARLA OUERTATANI, *Staff Director*

SUBCOMMITTEE ON INVESTOR PROTECTION, ENTREPRENEURSHIP, AND CAPITAL MARKETS

BRAD SHERMAN, California, *Chairman*

CAROLYN B. MALONEY, New York,
DAVID SCOTT, Georgia
JIM A. HIMES, Connecticut
BILL FOSTER, Illinois
GREGORY W. MEEKS, New York
JUAN VARGAS, California
JOSH GOTTHEIMER. New Jersey
VICENTE GONZALEZ, Texas
MICHAEL SAN NICOLAS, Guam
KATIE PORTER, California
CINDY AXNE, Iowa
SEAN CASTEN, Illinois
ALEXANDRIA OCASIO-CORTEZ, New York

BILL HUIZENGA, Michigan, *Ranking Member*
STEVE STIVERS, Ohio
ANN WAGNER, Missouri
FRENCH HILL, Arkansas
TOM EMMER, Minnesota
ALEXANDER X. MOONEY, West Virginia
WARREN DAVIDSON, Ohio
TREY HOLLINGSWORTH, Indiana, *Vice Ranking Member*
ANTHONY GONZALEZ, Ohio
BRYAN STEIL, Wisconsin

CONTENTS

WITNESSES

Thursday, September 17, 2020

APPENDIX

Additional Material Submitted for the Record

INSIDER TRADING AND STOCK OPTION GRANTS: AN EXAMINATION OF CORPORATE INTEGRITY IN THE COVID-19 PANDEMIC

Thursday, September 17, 2020

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 12:31 p.m., via Webex, Hon. Brad Sherman [chairman of the subcommittee] presiding.

Members present: Representatives Sherman, Maloney, Himes, Foster, Meeks, Vargas, Gottheimer, Porter, Axne, Casten, Ocasio-Cortez; Huizenga, Wagner, Hill, and Gonzalez of Ohio.

Ex officio present: Representative McHenry.

Chairman Sherman. 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.

Members are reminded to keep their video function open at all times, even when they are not being recognized by the Chair. Members are also reminded that they are responsible for muting and unmuting themselves, and to mute themselves after they are finished speaking.

Consistent with the regulations accompanying H. Res. 965, the staff will only mute Members and witnesses as appropriate, when not being recognized by the Chair, in order to avoid inadvertent background noise. Members are reminded that all House rules relating to order and decorum apply to this remote hearing.

Today's hearing is entitled, "Insider Trading and Stock Option Grants: An Examination of Corporate Integrity in the COVID-19 Pandemic."

We know that we have votes on the Floor, but we will not have any further delays of this hearing in order to allow Members to vote. Rather, Members should go vote and return, and while we all have our part of the alphabet to vote in, I am sure there can be some accommodation made, so that if it is your turn to ask questions, you can vote with others not of your same alphabetic characterization. And when I am voting, I believe Mr. Meeks has agreed to serve as Chair until my return.

I will now recognize myself for 5 minutes for an opening statement.

Our capital market system is unique in history. Up until about 150 years ago, every business enterprise was made up of people who knew each other, were family members, who had personal trust, and a business could only be as large as a group of people could finance and put together, and investment opportunities were limited to those that you happened to know.

You wouldn't trust your money with some enterprise of strangers and, of course, you didn't have liquidity since you could sell your investment pretty much only to somebody else who knew those who were in the syndicate.

And so at that point, people could rely on personal trust. Today, investors turn their money over to anonymous insiders, corporate boards, and executives whom they have never met, and they know that the insiders have far more information, attention, and power.

So, they don't have the bonds of personal trust. They rely on the law to make sure that the insiders are treating the investment fairly. [Inaudible] turn their money over [inaudible].

I will continue. We had a little technical problem there.

We now apply that system to the COVID pandemic in which nearly 200,000 Americans have lost their lives, and in which many firms affected by this pandemic are having sudden increases or decreases in their value.

For many pharmaceutical firms, for example, even the suggestion of involvement in a Federal program can cause shares to shoot up in value.

Following this sort of announcement, Kodak, Novavax, and Vaxart each saw their stock prices rise by over 400 percent. With this trend in mind, the SEC has reminded companies that in this pandemic, they should not only abide by the law, but practice, "good corporate hygiene."

SEC Chair Clayton has reiterated these views in a recent letter regarding today's hearing, which will I submit for the record, and it will be made a part of the record, without objection.

But admonishments are not laws and regulations. Admonishments will not deter the truly greedy, and so we have to design our laws and regulations to govern those who cannot be governed by mere admonishments.

For example, while taxpayers have invested $3.1 billion in Federal contracts with Novavax and Moderna to develop vaccines, since April, executives of these firms have sold over $60 million of their company stock. We need to know that they were not taking advantage of any inside information, that perhaps their stock had gone up too high, given the realistic possibilities.

Of greater concern is suspicious activity involving Kodak with the announcement of a $765 million government loan that raised insider trader concerns. In particular, we have a concern there on stock options and their grant dates when all equity compensation to insiders needs to be approved by shareholders.

When shareholders approve a plan which says that stock options will be granted with a stock option exercise price equal to fair market value on option grant date, they believe that executives who get these stock options will live by that.

If, instead, the "fair market value" doesn't reflect material information, insider information that is going to be announced the next day or the next week, then shareholders have been duped into approving equity compensation that does not reflect real fair market value.

I want to thank the insiders at Kodak who have added insult to injury. First, they granted stock options at what they knew to be an unfairly low price. Then, they spent a lot of shareholder money on a corporate law firm to tell them it was all legal.

That memo tells us we have to change the law, because if any major firm can say this is legal, it shouldn't be. And so, we have to deal with the issues of what is called, "spring-loading," where shareholders approve a compensation plan based on fair market value.

It has to be fair market value where the market has knowledge of the material transactions that the insiders know about.

I look forward to exploring this with our witnesses, I now recognize the ranking member of the subcommittee, Mr. Huizenga, for 4 minutes for his opening statement.

Mr. HUIZENGA. Thank you, Mr. Chairman.

It has famously been said that the definition of insanity is doing the same thing over and over again, and expecting different results. So, here we are once again holding a hearing on an issue on which we have already held a hearing.

Additionally, three of the bills attached to this hearing have not only had a hearing; they have been passed by the House of Representatives. So I ask the committee, why are we spending precious time and resources on bills that have already passed the House of Representatives 9 months ago? Just because we keep having hearings on bills that have already passed doesn't mean that the Senate is going to take them up.

Now, don't get me wrong. Insider trading is not only wrong, it is illegal, and not only does it hurt the integrity of our capital markets but it also hurts our Main Street investors as well as Mr. and Mrs. 401K.

And yes, we also agree that insider trading should be and must be punished to the fullest extent of the law.

However, this subcommittee should not be used as a name and shame game for companies for wrongdoing that has been perceived to have happened. And yes, the facts surrounding one company at first certainly appear to be suspicious and need to be fully investigated.

But that is not our job. The Securities and Exchange Commission is tasked with ensuring market integrity, and under the Securities Exchange Act of 1934, the SEC already has the power to bring enforcement actions in instances of insider trading.

In fact, during Fiscal Year 2019, the Commission brought 862 enforcement actions to hold individual issuers, financial institutions, and others accountable, sending a clear message to market participants.

Last year's results speak for themselves: 862 enforcement actions obtained judgments and orders totaling more than $4.3 billion in disgorgement and penalties, obtained nearly 600 bars or suspensions against market participants, suspended trading in the securities of 271 issuers, and returned nearly $1.2 billion to harmed investors.

So instead of playing judge, jury, and executioner in the court of public opinion, this committee should be focused on the bipartisan solutions that support job creators of all sizes, particularly our hard-hit small businesses.

These proposals would strengthen broader access to capital, reduce regulatory costs and burdens, and improve and expand access for investors to better put their money to work and create more investment opportunities for everyday Main Street investors.

But I am not just going to curse the political darkness. I am going to try to light a policy candle here, and here is a partial list of what we should be discussing and working on today.

H.R. 4860, the Crowdfunding Amendments Act, introduced by the ranking member. We have my legislation, H.R. 609, the Small Business Mergers, Acquisitions, Sales, and Brokers Simplification Act, something we have dealt with now for 4 Congresses in a row.

H.R. 1909, the Helping Angels Lead Our Startups (HALOS) Act, by Representative Chabot of the Small Business Committee. H.R. 2899, the Main Street Growth Act, introduced by Representative Emmer. Representative Loudermilk's H.R. 3987, the Alleviating Stress Test Burdens to Help Investors Act. H.R. 4076, the Modernizing Disclosures for Investors Act, introduced by the vice ranking member, Representative Wagner.

Another one of my bills, H.R. 2919, the Improving Investment Research for Small and Emerging Issuers Act. Representative Steil has one, H.R. 4918, the Helping Startups Continue to Grow Act. And H.R. 7834, the Regulation A+ Improvement Act, introduced by the subcommittee vice ranking member, Representative Hollingsworth.

I could go on and on. But the list is, as you can see, exhaustive, and we have much more to do. But instead of holding hearings on legislation that the House has already acted on, let us move forward on bipartisan solutions that deliver the results the American people deserve from the Financial Services Committee.

We know that there are problems. We need to address those problems. This isn't going to do it, unfortunately.

Chairman SHERMAN. I would point out that one part of this hearing is on my bill to deal with spring-loading, which has not been considered by this committee, let alone the full House, and which bans a practice that I think we will discover is both wrongful and, unfortunately, legal.

And so, we do have a strong purpose to have this subcommittee hearing.

I now recognize the ranking member of the full Financial Services Committee, the gentleman from North Carolina, Mr. McHenry, for one minute.

Mr. MCHENRY. Look, insider trading is wrong. We can all agree on that. The SEC, I think we can all agree, is doing a really good job in pursuing bad actors.

As my friend, Bill Huizenga, just said, we should be spending time on identifying solutions that strengthen our economy, strengthen our economic recovery, and help our workers come back safely to the workforce after the virus, after we get testing and treatment going.

And today, I introduce a bill to do just that, H.R. 8280, the Gig Worker Equity Compensation Act. Today, an increasing share of our workforce does not want to be bound by traditional constraints such as an office or set hours or traditional employer/employee relationships.

These gig workers are critical in our technology-driven world. My bill allows gig workers such as rideshare drivers or food delivery couriers to share in the same economic benefits, the upside potential of owning the businesses they are helping to improve.

So today's hearing should be focused on that type of solution, not just a rear-facing set of issues in an election year.

Thanks so much.

Chairman SHERMAN. I will point out that spring-loading is legal until this committee makes it illegal, and it is just as wrong as the—

Mr. MCHENRY. Regular order, Mr. Chairman. If you wish to debate, the Chair can debate. But you should not opine about everyone else's opinion. That is not in good form for the Chair.

Chairman SHERMAN. You were not recognized, but you did make your point clear. But when people question whether this is a legitimate hearing, it is appropriate to spend 10 or 20 seconds responding.

Today, we welcome the testimony of Mr. Rick Claypool, Dr. Jill Fisch, Mr. Jacob Frenkel, and Mr. Granville Martin.

First, Mr. Claypool is a research director for the Public Citizen's president's office, where he focuses on corporate crime and wrongdoing and the ways in which corporate power distorts our democracy.

Second, Dr. Fisch is the Saul A. Fox Distinguished Professor of Business Law, and co-director of the Institute of Law and Economics at the University of Pennsylvania Law School.

Third, Mr. Frenkel is Chair of the Government Investigations and Securities Enforcement Practice at Dickinson Wright. He also previously served as Senior Counsel for the SEC's Division of Enforcement.

And finally, Mr. Martin is senior vice president and general counsel for the Society for Corporate Governance, where he leads the Society's efforts related to corporate governance, securities laws, and regulations.

Witnesses are reminded that your oral testimony will be limited to 5 minutes. A chime will go off at the end of your time, and I would ask you to respect our rules here by wrapping up your oral testimony. And without objection, your written statements will be made a part of the record.

I now recognize our first witness, Mr. Claypool.

STATEMENT OF RICK CLAYPOOL, RESEARCH DIRECTOR, OFFICE OF THE PRESIDENT, PUBLIC CITIZEN

Mr. CLAYPOOL. Thank you.

Chairman Sherman, Ranking Member Huizenga, and members of the subcommittee, on behalf of more than 500,000 members and supporters of Public Citizen, many of whom are investors and who, like all Americans, are hopeful for the timely development of safe and affordable COVID-19 treatments, welcome this probe into insider trading during the pandemic.

The reported events are concerning. Chair Sherman described the Kodak concerns well. Additionally, Moderna Therapeutics announced that all 45 participants in the first phase of its COVID-19 trial, who received its vaccine, developed some antibodies.

This is good news, good news that pushed up the company's stock price 30 percent to an all-time high of $87. Prior to the announcement, several executives modified existing or adopted new 10b5-1 plans. In the days following the announcement, Moderna's CEO, other executives, and funds controlled by the board sold about $90 million worth of company shares.

Now, remember, it is taxpayer money funding 100 percent of this work to develop a COVID-19 vaccine, all of it.

A study published by a coalition that Public Citizen helps lead found that stock market value for the 8 biotech companies in the S&P 500 grew by $130 billion between January and August, and executives and insiders from just 3 of these companies—Moderna, Inovio, and Vaxart—sold at least $370 million in company stocks, inflated by news of government awards and trial results.

Meanwhile, NPR is reporting that the number of SEC insider trading enforcement actions has plummeted to its lowest point in decades. Public Citizen research has documented declines in corporate and white-collar crime enforcement at the SEC and across the Federal Government.

If the agency is following the Trump Administration's orders to stand down, as numerous government-wide policies such as a May Executive Order and subsequent August memo direct, then that alone deserves a hearing.

As to legislation, we look forward to a full House passage of Representative Cynthia Axne's bill requiring the SEC and the CFPB to provide monthly reports on consumer and investor protection activities.

Ideally, the SEC will want to report a significant enforcement increase against opportunistic insiders.

We applaud the House for approving the Public Citizen-endorsed insider trading reform bill authored by Representative Jim Himes, establishing a clear law against illegal trading, that will serve prosecutors well.

We also applaud passage of the 8-K Trading Gap bill authored by Representative Carolyn Maloney, and the 10b5-1 trading plan authored by Chairwoman Waters.

One particularly promising deterrent is compensation deferral mechanisms that requires recipients of Coronavirus Aid, Relief, and Economic Security (CARES) Act aid to place a significant percent of senior compensation in a collective pool.

Should a corporation later be found to misuse CARES Act aid or aid from a successor law, or engage in any other misconduct that results in fines, then the pool of senior managers' deferred pay would be used to fund the funds.

Such a concept already exists in separate bills sponsored by Representatives Tulsi Gabbard and Katie Porter.

I think it is crucial for Congress to condition the trillions in Federal aid, purportedly with the intention of helping workers, so that it is not diverted into the pockets of pandemic profiteers.

We applaud this committee's contributions to the Health and Economic Recovery Omnibus Emergency Solutions (HEROES) Act, and look forward to working with you as you fashion the next necessary round of recovery and stimulus legislation.

I welcome your questions, and you may draw on Public Citizen issue experts with written responses where relevant.

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

Chairman SHERMAN. The Chair is amazed. This may be the first time in decades that a witness has concluded in well less than 5 minutes. The witness did not choose to yield his remaining time to me and, accordingly, I will now recognize Dr. Fisch.

STATEMENT OF JILL E. FISCH, SAUL A. FOX DISTINGUISHED PROFESSOR OF BUSINESS LAW, AND CO-DIRECTOR, PENN INSTITUTE FOR LAW & ECONOMICS, UNIVERSITY OF PENNSYLVANIA LAW SCHOOL

Ms. FISCH. Chairman Sherman, Ranking Member Huizenga, and members of the subcommittee, it is an honor to participate in today's hearing.

Thank you to Chairman Sherman for the kind introduction. Just a point of clarification, I am just a lowly law professor, I am not a doctor, but thank you for the promotion.

[laughter]

But I want to take just a few minutes to put the reported events to which Chairman Sherman and Rick Claypool referred in a little bit of context.

In the past 6 months, as we all know, the capital markets have experienced unprecedented levels of volatility and trading activity.

I know SEC Chairman Jay Clayton has provided this subcommittee in earlier testimony with data on both the high levels of trades and the incredible price swings that we have seen, not just in pharmaceutical companies but across a range of industries that have been affected by the pandemic, and these fluctuations, obviously, create the opportunity for manipulation, for misconduct, and for self-dealing. They have also drawn considerable media attention.

I have written about securities fraud, SEC enforcement, and insider trading, and I want to focus in my opening remarks on a review of the regulatory structure and the challenges that the market environment imposes on that regulatory structure.

The activities that I understand the subcommittee to be interested in today involve three distinct sets of legal issues: disclosure integrity; the use of stock options; and insider trading.

I will address those issues in turn. I will briefly conclude by addressing potential areas of regulatory reform.

The first issue is disclosure integrity. Some news stories that we have heard say that the issuers have made distorted, inaccurate, or overly optimistic disclosures to drive up their stock prices, and this can be for various reasons ranging from enabling insiders to sell and make a lot of money, to increasing the value of stock options, or facilitating the issuer's access to the capital markets.

Now, let me be clear. Existing securities regulation requires disclosures to be accurate. False and misleading statements, particularly those that are made with an effort to distort stock prices or create opportunities for personal gain, constitutes securities fraud. An issuer or a corporate official that makes false claims, claims about a pharmaceutical product that is under development or misstates the results of a clinical trial could face both an SEC enforcement action and private civil litigation, and false statements that are made willfully can subject the issuer and individual corporate officials to criminal liability. This is not a gray area.

The existing market environment, however, creates a challenging disclosure environment. The scope of the pandemic, the lockdown, and the effect on the world's economy, are unprecedented.

Pandemic-related information has the potential to have an enormous impact on the economy and on stock prices. Everyone is watching to see what is happening with these companies. And the SEC itself has encouraged issuers to provide as much information as possible about pandemic-related risks on businesses.

But at the same time, we don't actually know what the truth is. The scientific community, and the public health community is still evaluating all of this.

So, it is hard for businesses to predict what is going to happen in the future, what is going to be the effect on their stock prices, and so forth.

Simply put, issuers are in a challenging environment. They are pressured to disclose as much information as possible. But premature disclosure of uncertain information may, in hindsight, prove inaccurate.

At the same time, stock prices are reacting dramatically. Chairman Sherman identified the possibility that stock prices may be too high at the time that executives receive stock options.

The concept that stock prices reflect fundamental value or that the fundamental value of these companies is even knowable at any given point right now is something that is very challenging from a market regulatory perspective.

Now, let me say—I see, my time is running short, and as a law professor, I am always long-winded, so I will cut to the chase and talk further, perhaps, in response to your questions about stock options and insider trading.

But let me just say a couple of words about potential regulatory reforms. As I said, the law doesn't prohibit accurate statements, even if those statements are forward-looking, even if those statements are not based on hard science about what a vaccine or what a product is going to do.

The law, however, doesn't permit executives to create trading opportunities through their public statements, and here, I think, the potential, if I—Chairman Sherman, if I could just take a minute to wrap up.

Chairman SHERMAN. Thirty seconds.

Ms. FISCH. Here, I think the potential rethinking of 10b5-1 plans, which I think the current market has exposed, is creating a potential regulatory gap, a potential opportunity for profitable manipulation of disclosures in order for the potential of self-gain is a really promising area and, I think, a scenario that legislation and regulation haven't fully recognized.

And I would be happy to talk about that more in response to questions.

Thank you.

[The prepared statement of Ms. Fisch can be found on page 59 of the appendix.]

Chairman SHERMAN. Thank you for your testimony.

I now recognize Mr. Frenkel.

STATEMENT OF JACOB S. FRENKEL, CHAIR, GOVERNMENT INVESTIGATIONS AND SECURITIES ENFORCEMENT PRACTICE, DICKINSON WRIGHT

Mr. FRENKEL. Thank you.

Good afternoon, Chairman Sherman, Ranking Member Huizenga, and distinguished members of this subcommittee.

Thank you for giving me the opportunity to testify on critical issues impacting our capital markets. My perspective comes from 32 years of professional experience in capital markets enforcement, investigations, governance, and integrity issues, including my work at the Securities and Exchange Commission's Division of Enforcement, as a Federal prosecutor of public corruption and securities violations, and as an actively practicing defense and governance lawyer for more than 21 years.

I believe that in 2020, unlike 20 or more years ago, pre-Enron, most corporate boards and management want to get it right.

Nevertheless, we still see capital markets activity that gives rise to questions about commitments to compliance and fundamental common law duties that are the responsibility of corporate custodians.

This committee has identified insider trading, Rule 10b5-1 plans, stock option grants, spring-loading, and bullet dodging as issues of heightened interest, warranting consideration of legislation.

Beyond these undeniable vital areas of concern, I suggest to the committee, respectfully, that COVID-19 solutions-related capital markets activities also should invite scrutiny of several other issues.

They include, first, regulation FD and its inapplicability to foreign private issuers. We saw the effect of the exemption 2 weeks ago when AstraZeneca's CEO disclosed, on a nonpublic call arranged by JPMorgan, about its suspension of vaccine clinical trials as a result of an unexplained illness in a trial participant.

If AstraZeneca had been a U.S. issuer, then there likely would have been an obligation for prompt public disclosure of what appeared to be an unintentional selective disclosure.

Second, is the SEC's 10-day trading suspension authority, which operates like a court-imposed temporary restraining order. However, it is not an enforcement action, but operates as an administrative arrow through the heart of legitimate small entrepreneurial public companies.

For trading suspensions that issuers contest, the SEC takes months if not longer to resolve the challenge. Legislation should dictate a precise and narrow timeframe for making the decision.

Third, is delegation of authority to authorize formal orders of investigation at the SEC. For decades, the Commission alone made the decision. Post-Madoff, the authority was delegated into the Enforcement Division, what I and others viewed as the out-of-control practice in the previous SEC administration.

Although SEC Chairman Clayton has reined in this delegation of authority, I believe the Congress intended for the Commissioners to decide whom to investigate and to make the solemn decision about authorizing subpoena power much like a Federal Judge reviews and approves search warrant applications.

And fourth, is trade clearance and conflict-of-interest disclosure policies and whether they should apply to NIH advisory panels.

The question for consideration is what level of transparency should exist to enable you on Capitol Hill, and the public, to assess possible conflicts of interest among scientific and technical peer review advisors who are not subject to the Federal Advisory Committee Act.

These are not instead of, but are in addition to, the important issues already identified by this subcommittee. I hope that we will be able to discuss each of these issues this afternoon.

Finally, you have asked that we address the importance of corporate integrity during the COVID-19 pandemic and the impact it has on investor protection and overall market integrity. I believe that is too narrow.

Corporate integrity, a commitment to best practices and proper governance, including a conscientious discharge of common law fiduciary duties and a constant focus on investor protection and market integrity was, is during the pandemic, and always will be and must be the guiding principles of corporate boardrooms and C-Suites for U.S. capital markets participants.

I compliment the committee for highlighting the importance of and addressing these issues with this hearing. I look forward to answering your questions this afternoon.

Thank you.

[The prepared statement of Mr. Frenkel can be found on page 64 of the appendix.]

Chairman SHERMAN. Thank you.

As described earlier, Mr. Meeks will be taking over while I vote. So, I am hoping to encourage Mr. Meeks to vote in the next few minutes, since I will be turning the gavel over to him in about 20 minutes.

Mr. MEEKS. Very well. I will run to vote now, and I will be back.

Chairman SHERMAN. Good. See you in 15 or 20 minutes.

With that, I now recognize Mr. Martin.

Mr. Martin?

STATEMENT OF GRANVILLE MARTIN, SENIOR VICE PRESIDENT AND GENERAL COUNSEL, SOCIETY FOR CORPORATE GOVERNANCE

Mr. MARTIN. I, of course, didn't unmute myself. You would think I would be used to this by now, 6 months into this. My apologies.

I am also wearing a tie for the first time in many months. So, thanks for the opportunity to do that.

Chairman Sherman, Ranking Member Huizenga, and members of the subcommittee, thanks for the opportunity to testify today.

I am Granville Martin, general counsel for the Society for Corporate Governance, the Society's professional association of approximately 3,500 corporate and assistant secretaries serving approximately 1,000 public companies.

Our members support the work of corporate boards and executive managements on corporate governance and disclosure matters.

We traditionally focus on securities and corporate law issues, and in the last several years have broadened our perspective to also include environmental and social issues.

Diversity, climate change, and human capital management are among the key issues which investors have sought greater disclosure on, and that public companies increasingly provide.

At the outset, let me state clearly that the Society's public company members support a rigorous framework of insider trading regulation and enforcement. Ensuring that America's markets retain a reputation for transparency and fairness is in the interest of all public companies.

A market where insiders can benefit from material nonpublic information at the expense of other investors is wrong, and we support the laws and enforcement necessary to prevent and punish such conduct.

Most public companies have adopted policies that prevent illegal insider trading. Common features of such policies include a prohibition of trading at any time while in possession of Material Nonpublic Information (MNPI), a preclearance procedure of transactions, imposition of trading blackout periods, and limitations on the adoption of 10b5-1 plans.

It is worth noting that the company-imposed blackout periods restricting executives from selling stock generally begin several weeks prior to the end of the fiscal quarter, and last until a day or two after the publication of quarterly earnings.

As a result, company officers and directors typically will have four open windows per year, with each window lasting just a few weeks.

Section 10b of the Securities Exchange Act and the associated Rule 10b5-1 prohibit stock sales made on the basis of MNPI that is obtained through a breach of duty of trust that is owed to the issuer of that security.

Rule 10b5-1 specifies that the sale of a security is made on the basis of MNPI, when the person making the sale was "aware" of that information when the sale was made.

Rule 10b5-1 also provides an affirmative defense to Section 10b insider trading allegations, when such trades are made pursuant to a preexisting written trading plan that complies with the rule.

The rule's affirmative defense is only available, however, if the plan was entered into in good faith.

Rule 10b5-1 does not operate in a vacuum. It does not alter the elements of a case under Section 10b. Scienter is still required.

Additionally, transactions pursuant to a 10b5-1 plan must still comply with the volume limitations of Rule 144 of the short-swing profit rule 16b.

In addition, executives are subject to the filing of ownership forms under Section 16a of the Exchange Act, including Form 4, which must be filed in connection with each transaction.

The filing of Schedules 13d and 13g are also required where appropriate.

The Section 10b and Rule 10b5-1 prohibition on insider trading when aware of MNPI, along with the related disclosure obligations and established company practices, provide, in our view, a comprehensive and effective legal framework. We do not believe that changes are warranted.

Like so many other aspects of our lives, COVID-19 presents new and abrupt challenges to public companies, including related to insider trading law compliance.

As companies grappled with the implications of the pandemic, the SEC issued guidance emphasizing market integrity and urging companies to provide detailed COVID-related disclosure.

Based on our review of Society members' disclosures, we believe public companies have responded robustly to this guidance. COVID-related disclosure has been widespread and has covered a wide range of topics.

In addition, many public companies reassessed their insider trading policy compliance programs, including whether their internal procedures were able to identify all of the executives who are now possibly in possession of COVID-related MNPI.

Pre-pandemic, such concerns for supply chain and operational executives were minimal.

Let me turn to some of the pending legislation. In general, the Society does not have a position on the appropriateness of the [inaudible] structure of executive compensation.

Having said that, we have observed that the use of stock options by startups and other early-stage companies is common and essential. Boards of directors and their compensation committees are best-positioned to decide on the appropriateness of such options grants.

Investors expressed their view on the appropriateness of compensation through required sale on payloads that incur in many cases annually. Transparent fairness exists under the current regulatory framework.

Similarly, we believe the 8-K Trading Gap bill is unnecessary, given that Section 10b and Rule 10b5 already prohibit trading by insiders if the undisclosed significant event is material.

We would note that the bill makes conduct that is already prohibited further illegal, if that is possible. We believe the regulation of insider trading is almost done.

We believe the regulation of insider trading has been subject to some confusion. Having said that, the SEC study mandated by H.R. 624 could contribute to a common and well-founded understanding of 10b5-1 plans and whether any changes are warranted, and we support the enactment of H.R. 624.

Thanks for the invitation for the invitation to testify, and I would be happy to answer any questions.

[The prepared statement of Mr. Martin can be found on page 87 of the appendix.]

Chairman SHERMAN. Thank you.

I now recognize myself for 5 minutes for questions. I want to commend the Chair and the ranking member for authoring legislation that has already passed the House dealing with instructing the SEC to focus on insider trading and certain aspects thereof, and one of the purposes of this hearing is to join forces with the ranking member and the Chair to make that statement very clear to the SEC.

It is the hope that these hearings will inspire the Senate to act on that bipartisan legislation or, just as good, get the SEC to do what the legislation directs them to do, whether the statute directs them to do it or not.

Insiders hold material information that is not known to the general public. We have insider trading rules that deal chiefly with transactions between the insider and outsiders through the market.

We have much weaker rules dealing—or no rules dealing with insider trading and options or stock between the insider and the corporation itself.

Now, I know that the Minority can be very popular in the boardrooms of this country by saying that it is illegitimate to have a hearing of this subcommittee except if the purpose of that hearing is to make it easier to market stock to the public, and there is a rule for us making it easier on business insiders to raise capital.

But it is, certainly, legitimate for this subcommittee to explore the loopholes that caused insiders to be able to take advantage of the general public and the general investing public.

We do have good laws on traditional false statements. The SEC has done many thousands of enforcement transactions dealing with traditional insider trading.

But when insiders make use of material undisclosed information in stock option transactions and other transactions with the company, according to Kodak's lawyers and, frankly, including—and even in our discussions with the SEC can, generally, be legal, although wrongful.

Ms. Fisch, as you know, the day before the Federal Government announced its plans to provide Kodak a $765 million loan, the company's CEO was granted 1.75 million stock options.

Now, stock option plans legally need to be approved by shareholders, and the shareholders approved a plan that said that the option exercise price for these employee stock options needs to be set at, "fair market value."

But here is where the shareholders may have gotten tricked, because that is defined as the latest closing price of the shares, and under normal circumstances, that is fair market value.

But in this case, Kodak, undisclosed to the market, had just landed $765 million. Considering Kodak's share price rose by over 500 percent within hours after these options were granted, this seems to be a situation where the shareholders were fooled by the term, "fair market value," which turned out to be a much lower—a value that didn't reflect the knowledge.

Would you agree that legislation is appropriate to close this loophole by prohibiting users who use fair market value to set employee stock option exercise prices from doing so based on a market price that doesn't reflect information the company is about to disclose prior to disclosure?

Ms. FISCH. Thank you, Chairman Sherman.

Stock options, obviously, are a form of executive compensation, and as compensation, they have a number of problems. One of the problems that we see right now is there is a huge amount of volatility in prices. Prices are reacting—as you yourself observed, prices may be overreacting to information as well.

So, I think a compensation structure that looks at market price as an indication of fair value is particularly problematic in this environment.

That being said, the whole regulatory structure is designed to put safeguards into place, not just the shareholder vote but also the role of the compensation committee.

Chairman SHERMAN. Thank you. My time has expired.

I now recognize the ranking member of the subcommittee, Mr. Huizenga.

Mr. HUIZENGA. Thank you, Mr. Chairman. I appreciate the opportunity, and I would ask unanimous consent to submit a letter for the record that is from Securities and Exchange Commission Chairman Clayton. It is addressed to you, and CC'd to me. I would like to put that into the record.

Chairman SHERMAN. Without objection, it is so ordered for the second time, since I had already put it in the record. Now, it is in there twice. That is good.

Mr. HUIZENGA. Double. Belt and suspenders.

I appreciate it. And maybe, I will just start with where Professor Fisch had left off, and in this letter the chairman is very clear about some of his concerns about the 10b5-1 plans and, in fact, a couple of the headings on this are: Insider Trading Policies for Senior Executives and Board Members; Terms and Administration of Rules; and 10b5-1 Plans.

He does say also in the letter that there is a joint explanatory statement accompanying the Fiscal Year 2020 Financial Services and General Government (FSGG) Appropriations Act on the growth share repurchases and are considering this and other issues relating to Rule 10b5-1 as plans as part of that report.

Under Issuing and pricing stock options, he very specifically says that a grant may also be inconsistent with existing accounting standards because, in short, the trading price of its stock is not a good indicator of fair market value, and he then goes on to ask to make sure that senior executives and board members keep that in mind, but also to have the Divisions of Corporation Finance and Enforcement look at it.

So, Professor Fisch, I don't know if you would care to address that, very briefly, any more than where you had started to go down that path?

Ms. FISCH. Thank you. I guess what I did want to say is you are absolutely right and, of course, SEC Chairman Clayton is absolutely right. Good corporate hygiene, I think, these days requires a corporation to think seriously about having explicit written policies in place with respect to its option grants, with respect to its executive trading in the company stock, and with respect to 10b5-1 plans. I think those are all important issues.

But I just want to distinguish between good corporate hygiene, matters of good corporate governance, and even matters of a director's fiduciary duties and insider trading, because they are two different concepts, and lots of companies can be overpaying their executives right now based on salary or bonuses that are tied to stock prices without using stock options.

The problem is the overpayment. The problem is using stock prices as a metric of value, and the problem is not necessarily in the option form itself.

Mr. HUIZENGA. And the chairman says that may be inconsistent with existing accounting standards. So, is that something that the Public Company Accounting Oversight Board (PCAOB) needs to tackle?

Ms. FISCH. That is an interesting question, and the problem is, I am not sure how you come up in this market environment with a concept of fair value and how a board or a compensation committee goes ahead and does that.

Now, Chairman Sherman is right. If the company knows tomorrow it is going to release material information, the company is, obviously, going to suspect the stock price is going to be affected.

But if you look at Kodak's trading price from the time before the first press reports until today, it is all over the place, and I don't know at which point of the trading price we could say with confidence, yes, that reflects fair market value.

Mr. HUIZENGA. I think that point has been made. It is more than just one company. But the SEC, clearly, is very concerned about it, and the Chairman is.

Quite honestly, when Mr. Claypool was, I would say, disparaging the SEC Chair, whether it is Mary Jo White or Jay Clayton, I don't think I have ever heard a SEC Chair even come close to thinking that insider trading or that enforcement is somehow not acceptable. So, that just was wrongheaded on that.

Mr. Martin, specifically, companies participating in government assistance programs through the CARES Act have some guidance that has been put up, correct? Do you believe it is clear enough?

Mr. MARTIN. Yes, I do. I think the company response to the SEC guidance, both the statements with respect to insider trading and subsequent statements by the Chairman and Director Bill Hinman, were well-received.

It was very clear to the corporate community, and what you saw was a big increase, a needed increase in COVID-related disclosure, which the Chairman was very focused on, along with the Director.

We can provide a few statistics about the increase of that disclosure and, appropriately—and I think Professor Fisch was alluding to this—companies were really struggling at the beginning and, to some degree still are, with understanding what the significance of particular events are to their own business operations and, indeed, their stock prices have been extremely volatile.

And so, companies have struggled with that and their response, significantly, has been to very dramatically increase the amount of disclosure on COVID.

For example, at the end of March, a National Association of Corporate Directors (NACD) study found that 50 percent of Russell 3,000 companies that filled out a Form 10K as of March 30th—

Chairman SHERMAN. I believe the—

Mr. MARTIN. —were qualifiers for COVID-19—

Chairman SHERMAN. —time of the gentleman has expired.

Mr. MARTIN. Excuse me. I'm sorry. One last point.

Chairman SHERMAN. Thank you. Mr. Himes, it is your turn. Have you already voted?

Mr. HIMES. No, I have not. But I think I have time. So, I will use my time now.

Chairman SHERMAN. Ms. Porter, have you already voted or are you voting by proxy?

Ms. PORTER. I have already voted, sir.

Chairman SHERMAN. Good. I am going to—since Mr. Meeks has not returned, and with your permission, I will make you temporary Chair as I go vote.

Mr. HUIZENGA. And, Mr. Chairman, I guess I am looking to see if there is a Republican who is on as well to take the helm—the challenges of having committee hearings continue while we are doing extended voting. But I would love to hear one of my Republican colleagues let me know that they can take over as ranking member while I go vote..

Chairman SHERMAN. Okay. I am going to call upon Ms. Porter to act as our temporary Chair and ask Mr. Himes to proceed for 5 minutes.

Mr. HIMES. Great. Thank you, Mr. Chairman, and thanks very much to our witnesses today. This is an area of intense interest for me.

My office has devoted a lot of time to crafting what was, as the ranking member pointed out, bipartisan legislation which passed the House in May 2019, with H.R. 2534, the Insider Trading Prohibition Act. I'm very, very interested in that. It was very steeped in the complexity of defining insider trading.

I do have a question, but since it was a bipartisan bill, I want to suggest to my Republican friends that this is far from a waste of time, and it may not be exactly the way you want to promote business investment but there is, arguably, nothing quite so important to business investment as confidence in the capital markets, the confidence on the part of shareholders and others that they are playing in a fair market, which is why I have been very, very devoted to crafting a specific statute on the topic of insider trading.

There is a need for this. My Republican friends know that only 14 percent of Americans directly own stocks, and so as the stock market has rocketed in these last couple of years, directly, a very small percentage of Americans have been able to participate in that upside.

It is true that roughly half of Americans, of course, indirectly own some stock through pension plans and retirement plans.

But we should all be looking to increase the number of Americans who feel like they have a stake in the equity of their economy, and critical to that, of course, is making sure that we can look people in the eye and say, this is a fair and level playing field.

I don't want to get into the complexities of all that occurred in Kodak, and I understand they are complicated.

Look, there is nothing wrong with stock prices going up, necessarily. There is nothing wrong with stock option plans, necessarily.

What is wrong is when corporate insiders take advantage of inside information. We spend a lot of time in the bill defining transactions, the purchase and sales of securities.

The fact that we are talking about spring-loading and bullet dodging, that pertains to, essentially, a transaction. But it is an indirect transaction. It is the conveyance of value, because a stock option is valuable.

And so my question is—I am not quite sure which of my witnesses, maybe I will start with Mr. Frenkel.

My question is, do you think we can alter insider trading law, broaden it to be about the conveyance of value, and would that capture what we are talking about here?

Or do we need an entirely separate statute for value that is conveyed via option plans and programs as opposed to the purchase or sale of securities?

[No response.]

Mr. HIMES. Mr. Frenkel, you are muted, I think.

Ms. PORTER. [presiding]. Mr. Frenkel, you are on mute.

Mr. FRENKEL. I'm sorry. Thank you, Congressman Himes, and I apologize for staying on mute.

I think in the context of the insider trading laws, the focus has always historically been on the purchase and sale and the conveyance of information.

To me, as Professor Fisch had indicated, the issues around spring-loading and bullet dodging are as much a part of executive compensation as they are the information.

Insiders are always going to have access to information that is in balance with respect to the rest of the market. But that really is more an issue of timing and broader disclosure obligations than insider trading itself.

Mr. HIMES. No, I understand that, and I guess the point I am making—and I understand that we are really talking more about compensation than a purchase or a sale of a security.

But at the end of the day, what is happening is that a decision about conveyance of value is being made possibly when there is an imbalance of information.

So it is not clear to me that there is a radical categorical difference between an executive who is going to approve a stock option plan 3 weeks from now, but knowing that they are about to receive a loan accelerates that decision—there is not a categorical difference between that and that executive going out and purchasing the stock.

There are differences of timing, et cetera. But it is, effectively, the same thing. It is conveying value wrongly because inside information is bad, right?

Mr. FRENKEL. I would agree, and really what—Congressman, you are correctly identifying the issue as being the use and application of that information as being subject to imbalance favoring that corporate executive.

I still believe it is an issue that really should fall beyond insider trading, because it really does not relate to a trade itself. It really goes to disclosure issues, in my view.

Mr. HIMES. Yes. My time has expired. But I would be grateful if in this hearing, we got down to, how can we address legislatively spring-loading and bullet dodging most appropriately?

But my time has expired, so I will yield back, and I thank the witnesses.

Ms. PORTER. The Chair now recognizes the gentleman from Ohio, Mr. Gonzalez.

Mr. GONZALEZ OF OHIO. Thank you, Madam Chairwoman. And thank you, everybody, for your testimony today.

I want to start with something that Mr. Claypool brought up that kind of perked my interest, and I am curious for everybody's take on it.

You highlighted the Moderna situation where, upon getting good news, the stock price went up significantly. It sold stock. There's nothing in and of itself wrong with that.

But it does sort of raise a question around specific COVID support. to me it does, anyway, specific COVID support and any additional disclosures we might want as a result of that.

I think these are unusual times, and when we have the Federal Government, basically, funding 100 percent of R&D on a product that is going to be incredibly important, God willing, maybe there should be additional scrutiny there.

I guess I would start first with Mr. Martin. Do you have any thoughts on how we could better inform investors with respect to these sorts of announcements or any changes you might make on a temporary basis? Not permanent, but on a temporary basis, as a result of COVID?

Mr. MARTIN. I think the existing framework that necessitates the disclosure of material information to investors through the filing of an 8-K is the appropriate mechanism.

To the extent that there is trading around or in advance of such disclosure, that is already illegal. So it is not immediately evident to me what an alternative framework can do beyond what the existing framework does, which is to mandate the disclosure of material information to investors.

And I am sorry, but I don't have any particularly intelligent ideas as an alternative to that.

Mr. GONZALEZ OF OHIO. Yes, that is a fine answer. I just wanted your perspective on it.

And now, another thing from Mr. Claypool's testimony I would take issue with, which is around sort of a normative judgment around repurchasing of stocks, in particular.

There is a quote in here: "When managers repurchase stock, they are confessing they have no new promising ideas on which to invest."

Mr. Martin, again, what do you think of that statement? I will just say, as a—I don't want to set you up to be overly combative, but as somebody who has been an investor for my entire adult life, when companies I have invested in repurchase stock, that means that I own more of the company now.

And so, that actually benefits all of the shareholders, is my personal belief. But I would be curious for your perspective on that as well.

Mr. MARTIN. I agree with that. Share repurchases are a legitimate tool for capital planning for companies. Of course, companies can raise or lower their dividend as needed and share repurchases are an entirely legitimate use of shareholder funds for the benefit of existing shareholders.

I know that there are conflicting feelings about that, particularly in the wake of some tax legislation a few years ago.

I just disagree with that perspective and would hope that Congress will maintain the discretion that companies have to make those kinds of capital planning decisions and that boards and senior management are left to make those kinds of determinations.

Mr. GONZALEZ OF OHIO. Thank you. I agree with everything you just said, and I yield back.

Ms. PORTER. Thank you. I am now going to turn over the chairing of this hearing to my colleague, the distinguished gentleman from New York, Mr. Meeks.

Mr. MEEKS. [presiding]. Thank you, Congresswoman Porter. Thank you for holding it down for us.

I now yield 5 minutes to the gentleman from Illinois, Mr. Foster, for questions.

Mr. FOSTER. Thank you. Professor Fisch, I would like to take you up on your offer to dig a little bit deeper on 10b5-1 plans. Some of the stories that we have seen regarding pharmaceutical companies developing COVID-related products apparently involved executives modifying these plans right before some big announcement, which caused the stock to skyrocket.

Some of these apparently have resulted in what might otherwise be considered suspiciously timed trades, but are given at least a partial safe harbor because they were done pursuant to 10b5-1 plans.

So, very quickly, could you briefly describe what 10b5-1 plans are and what they are intended to be and accomplish?

Ms. FISCH. Thank you.

Yes, 10b5-1 plans are designed primarily as a tool for executives to manage their stock trading over the long term. So today, executives increasingly are being paid in stocks, stock options, restricted stock.

Obviously, they have liquidity needs, and the idea behind a 10b5-1 plan is typically what this allows you to do is sell stock on a regular basis, right—they are usually used on the sales side—and not worry about the fact that before you sell the stock, you come into possession of material nonpublic information, and you would thereby be precluded from selling.

Once you put the plan in place, once you commit to sell, you are insulated from liability even if you have knowledge at the time the sale actually occurs.

Now, the loophole, Congressman, that you are referring to is the fact that these plans don't have to be disclosed, and practice among issuers varies dramatically in the type of disclosure that they make, or whether they disclose the existence of these plans at all. So, that is the first problem.

The second problem is that the law allows you to modify or to terminate your 10b5-1 plan, and it doesn't restrict that termination to situations in which you don't have material nonpublic information.

So, let us say I have a 10b5-1 plan. I am planning to sell my stock this week. I learn good news about my company or it is going to get a Federal grant or promising drug trials, and I say, okay, hang on, I am going to terminate my plan, I am not going to sell.

Obviously, I am making use of inside information, but I have not traded. I am declining to trade, and as a result, it is a loophole that is not covered by existing law.

Mr. FOSTER. Is there a downside in mandatory disclosure of these, either in real time or at quarterly intervals or some standardized time?

Ms. FISCH. Frankly, sir, I don't see a downside and, in fact, there have been a couple of empirical studies that have looked at issuer disclosure practices and found that the issuers who disclosed these plans voluntarily also have better general corporate governance. In other words, disclosure seems to be a signal of good corporate hygiene, so to speak.

Mr. FOSTER. And what about requirements that separate the decision time from the time of the actual purchases, so that you have to declare months or longer in advance that you are going to start or stop this program?

Ms. FISCH. That would absolutely be a useful refinement as well. We haven't yet talked in this hearing about 16b and short-swing trading liability. That is a provision in the original Securities Exchange Act of 1934 that is supposed to limit the ability of executives to benefit from sort of short-term trading by buying and selling within a short time period.

I think you could apply that same approach to 10b5-1 plans and say, look, given the intent behind these plans, you should have to put the plan into place for a period of time and, ideally, the plan should persist for a period of time so that there is less likelihood the executives will try to take advantage of short-term information asymmetries.

Mr. FOSTER. And do any of the other witnesses have any comments on this area of potential improvements or fixing loopholes or other risks?

[No response.]

Mr. FOSTER. Okay. Deafening silence.

Well, I appreciate all your help. As the son of a law professor, I just have a lot of sympathy for your life, and anyway, we will have that discussion offline.

And with that, I yield back.

Chairman SHERMAN. Thank you very much. I thank the gentleman for his questions, and commend to him and others the Waters-McHenry bill designed to focus on the problem he illustrates.

I want to thank Ms. Porter and Mr. Meeks for acting as temporary Chair in my absence, and I now recognize Mr. Hill for 5 minutes.

Mr. HILL. Thank you, Mr. Chairman, and what a good discussion this is. I want to, of course, commend and thank all of the members who worked on insider trading topics over the years but, particularly, my friend, Mr. Himes of Connecticut, who has been such a thoughtful leader on this subject as our committee has navigated what is a very challenging subject in order to balance the needs for information in the capital markets, the flexibility of use, and really identify criminal behavior.

So thanks, Jim Himes, for your work and for the bipartisan work that we have done together.

Mr. Martin, I want to talk a little bit about the Society's survey on the members regarding insider trading preclearance policies.

You say 90 percent of your members follow a preclearance policy. Could you highlight what your best practices would indicate that could have prevented or brought clarity to or remediated some of the challenges that we have read about in recent days and that we have talked about over the course of this hearing?

Mr. MARTIN. Sure. In general, I think there is a suite of policies that corporates implement to, as was said at the outset, that 20 years ago, I think it was Mr. Franklin noted, that the change in most corporate suites to take insider trading and avoiding it and regulating it—companies are taking it very seriously.

So, there is a suite of policies that they instituted to address that, including compliance training with executives that requires the executives to acknowledge the existence of the policies, that they understand what the limitations are including, obviously, that you can't trade while in possession of MNPI.

The designation of particular brokerage houses to handle all transactions in company stock that allows Section 16 executives and others who may have an MNPI to be flagged, and so those accounts can be monitored.

You mentioned the survey that the Society conducted about 2 years ago which indicated that approximately 90 percent of the companies surveyed require preclearance of trades by in-house legal.

I mentioned in my opening remarks that virtually every company imposes blackout periods in advance of quarterly earnings. But it is more stringent than just that.

Those windows will be closed in the event that new material information develops. It could be a leadership change, or it could be something with respect to a new product. And then, of course, some companies further regulate the adoption of 10b5-1 plans when they can be adopted and cooling off periods and things like that.

So, there is a suite of policies that companies have become much more conversant and frequent users of, because trying to avoid their executives becoming embroiled in an insider trading allegation or enforcement action is incredibly time-consuming and expensive for companies, and the incentives are really lined up for companies to try to avoid those kinds of outcomes.

Mr. HILL. Yes. My limited experience in this area is also at a very active company that is growing and doing mergers and acquisitions and having executive management changes and maybe having a very periodic 8-K filing process is that the number of days somebody can actually trade their stock is very limited per quarter, just fractionally.

Is there a better way? Now that we have seen the expansion of stock options over the past 30 years, is there a better way to provide long-term growth-based compensation to executives other than stock options? Have you all done any studies on that?

Mr. MARTIN. I don't think we have done any particular studies on that. Obviously, the question of how long vesting periods are is pertinent to your question, and I can speak from my own personal experience in a limited amount of time, that those vesting periods for some executives have been pushed out.

Mr. HILL. Thank you. I look forward to following up with you on that and I appreciate it.

Mr. Chairman, my best regards for our panel. It was an excellent discussion.

Chairman SHERMAN. Thank you.

I now recognize my fellow Californian, Mr. Vargas.

Mr. VARGAS. Thank you very much, Mr. Chairman, and I appreciate very much the words of my good friend, French Hill.

I was a little surprised when this hearing started, that I heard the ranking member and others say, basically, there is nothing here to see; why don't we just move along?

IT seems to me that there is a lot here to see, at least from my perspective. I appreciate the effort that the pharmaceutical companies are putting forward to develop a COVID-19 vaccine and the treatment supply and, of course, they should be compensated.

I believe that they should be. But I am also concerned about the large amounts of money that they are making when the rest of the country is having such a difficult time.

And I guess I am very concerned about the legal but wrongful aspects of this. It really does seem to me that while what Kodak did was lega,l it is certainly wrongful, and I do not have great confidence in the SEC at the moment. Their enforcement is way down.

So, I think that we have something here.

Professor Fisch, could you comment on that? Is there nothing to see here? Should we move along?

Ms. FISCH. No, I commend the subcommittee for raising what I think are very important topics, and I wouldn't say that you all should just move along.

But what I think a number of the comments have suggested, though, is that you are actually focusing on two related but separate ideas.

One is the conveyance or the wrongful misuse of information, and the other is sort of the compensation and whether companies that are facing speculation in their stock price and also companies that are the subject of government funding, whether they should be compensating their executives to the degree that they are.

Stock options and some of the recent stock option experiences involve a combination of the two, and I think members of the subcommittee, at least some members, might be equally upset if these executives were getting huge grants just in the form of salary.

Now, obviously, there is nothing wrong with a compensation committee deciding to pay an executive millions of dollars before the news of a government grant has been publicly released.

The compensation committee knows about the government grant. It is not a misuse of nonpublic information. But you might say, well, gee, it smells bad. This is taxpayer funding.

This isn't something the executives should profit from. That is a little bit different from the stock trading or the insider trading concept.

Mr. VARGAS. Well, Professor, I think it does smell pretty bad, to be frank.

Mr. Frenkel, if you could speak a little bit about the spring-loading and bullet dodging you were talking about earlier?

Mr. FRENKEL. I would agree with all of the comments that have been made so far with respect to spring-loading and bullet dodging.

I think the focus has been more on the spring-loading component, where the bullet dodging piece of it is about a company temporarily depressing the stock price by releasing information before a stock option grant date as opposed to holding back the release of the positive information until after the option date.

I think one of the courts in Delaware, if I am not mistaken, a number of years ago referred to spring-loading and, really, in particular, spring-loading as being a matter of a corporate disclosure conduct issue involving an unclean heart but not necessarily in violation of the law.

I think what we are really talking about here is moving the whole discussion into how to provide some form of disclosure and regulation around these concerns.

The one thing, respectfully, that I think I should also address is the issue of SEC enforcement in this area, because while the SEC's numbers may be down, I would submit, as somebody who defends these investigations, that the Commission is very aggressive.

There have been 40 trading suspensions that are specifically related to issuers in the COVID-19 solutions space. So, the Commission really has been very vigilant.

On the other hand, as it has been dealing with staff reductions, that also has impacted its ability to be as broad in its application of, or choice of cases.

But I think in terms of the gestation of investigations, we are still seeing a very active division, just sort of a reprioritization over the last 18 months.

Mr. VARGAS. My time is about up. Not to be confrontational or be difficult, but I would disagree with that, especially when you see what happened with Kodak.

I don't know how you explain that to the American public.

Thank you. My time has expired.

Chairman SHERMAN. I now recognize the former Chair of this subcommittee, the gentlelady from New York, Mrs. Maloney, who is also the Chair of the House Committee on Oversight and Reform..

Mrs. MALONEY. I thank the gentleman for yielding, and thank you for this important hearing.

Mr. Frenkel, I would like to address my question to you. Earlier this year, the House passed my legislation, the 8-K Trading Gap Act, with overwhelming bipartisan support.

This bill would close the loophole in our current law that allows corporate executives to trade on information before it is disclosed to the public.

And 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.

Of course, during this 4-day gap, executives at the company know about the event but their investors don't. My bill would address this problem by simply prohibiting executives from trading during this 4-day gap.

Given the recent controversial activities that my colleague, Congressman Vargas, just mentioned, the companies like Kodak, Novac, and Moderna, I believe it is important now more than ever to close this loophole.

Since the start of the pandemic in mid-March, there have been over 10,000 8-K filings with the SEC.

Mr. Frenkel, would you agree that during this crisis, when firms have increasingly made important public announcements, it is especially important that we close this loophole?

Mr. FRENKEL. I would agree. I would agree entirely, and I think your legislation is right on point, and I think it also goes to a point that Mr. Martin had made before regarding corporate blackout periods. And certainly, there is abuse.

But, using the example that Mr. Vargas had raised with respect to Kodak, I also refer to the committee statement from yesterday.

The fact is, the SEC has not yet begun, let alone completed, conducting its investigation, and the SEC certainly can come to entirely different conclusions than the findings of the internal investigation, because if you look at the report of the internal investigation, I believe the questions that were posed were extremely narrow, or at least that were addressed in the course of the internal investigation.

So yes, back to the guts of your question, I do think that your proposed legislation around 8-K disclosures is right on point and, essentially, legislates the blackout period, which is something that really does impose a level of control that the market really warrants.

Mrs. MALONEY. Also, as Chair of the House Committee on Oversight and Reform, I launched an investigation with Chairwoman Waters, and Representatives Engel and Clyburn, into the Administration's $765 million loan to Kodak.

As part of our investigation, the Oversight Committee continues to investigate the reasoning behind the U.S. International Development Finance Corporation decision to provide the loan, and whether they violated their own policies and procedures, and whether Kodak shared any material nonpublic information before the announcement was made public.

Now, this was the International Development Finance Corporation. They gave it to a domestic corporation—that is a violation there—and to a company that had no experience, zero, in vaccines.

Kodak itself has acknowledged that it is under investigation by the SEC, and this follows the unusual spike in the trading of its stock just one day prior to the July 28th announcement, on July 27th.

More than 1.6 million shares of Kodak were traded, more than 6 times the average daily volume of shares a day during the previous 30 days.

And while the increase in trading activity is reported as a result of Kodak inadvertently releasing the news of the loan to local news outlets—now, why did they do that—where it is headquartered, Kodak waited until the following day to publicly disclose the announcement.

Unless its stockholders were paying attention to social media, Kodak effectively kept millions of shareholders in the dark from the spike in trading activity.

So, Mr. Frenkel, do you see this as a potential violation of Regulation Fair Disclosure (FD), which states that when there is a, "nonintentional disclosure," the issuer must publicly disclose the information promptly and, if not, can this sort of trading activity still be harmful to shareholders and the market?

Mr. FRENKEL. The answer, Congresswoman, is yes, there is a potential for a violation of Regulation FD, which I believe the SEC would include within the scope of its investigation.

I would also point out that as we look at the price of the stock—I will be very brief on this—we are also dealing with issues such as potential stock manipulation but also tipping—were there other people who traded—and with the people who potentially were selling—were involved on the put option side.

I believe all of these things are something that the SEC will look at during the scope of its investigation.

Mrs. MALONEY. When do you expect the investigation to be completed?

Chairman SHERMAN. I believe the gentlelady's time has expired. If there could be a one-sentence answer, we will hear it, and then we will go on to Mr. Meeks.

Mr. FRENKEL. I think SEC investigations on allegations such as this easily could run 9 months to 12 to 15 months.

Chairman SHERMAN. Thank you.

Mrs. MALONEY. I yield back. Thank you, Mr. Chairman.

Chairman SHERMAN. I now recognize the gentleman from New York, Mr. Meeks.

Mr. MEEKS. Thank you, Mr. Chairman. And thank you for holding this important hearing.

I have been listening off and on to some of the witnesses and some of my colleagues' questioning, and I think that what we have here is, in the middle of this pandemic that just killed hundreds of thousands of Americans, and I know that it has devastated the economy and a number of other things, the question that presents itself to us, though, is credibility, and when we have a time of everybody questioning things, especially when you have the President of the United States questioning the scientists and doctors and when we are going to have a vaccine and when we are not, whether or not everything is on the up and up. We also deal with lies as we deal with these pharmaceutical companies in the search for a vaccine.

And I agree that we need one sooner rather than later, and I agree that individuals should be compensated for the appropriate amount of work that they do.

As we know, there is no magic bullet. But a vaccine is an effective and safe thing that we need, as well as wearing our masks on a continuous basis as the doctor said in testimony yesterday.

And so, I applaud all of the doctors, scientists, and companies working on this crucial project.

So what it is is the importance of a vaccine is why it is so unfortunate that we have—as I had indicated, the President just yesterday contradicted his own CDC Director about when a vaccine would be ready. So, I think we need to be building up the confidence of the American people.

That brings me to where we are now, because there is also a role, I think, for the capital markets and corporate governance to step up because they have to understand the credibility issue and have an important role to play here also.

I believe that we need leaders of these companies to have their incentives structured toward producing a safe and effective vaccine, but we also need laws that can foster some productive arrangements while protecting the integrity of our capital markets.

I will start with you, Ms. Fisch. What are some of the ways you think that we can use corporate governance and combine it with financial regulations to promote and encourage the development of a safe and effective vaccine while also protecting some of the market misbehavior that I hear a lot of my colleagues talking about?

Ms. FISCH. Congressman, I wish I had an answer for that question. I think the challenge that we all face is that yes, in this environment we really want to preserve capital market incentives.

We want to preserve compensation incentives. If some company or some executive comes up with a vaccine, the whole world is going to say yes, this is worth an awful lot of money to us.

But corporate governance only gets you so far. Right now, I think sort of the gap between corporate governance and science is really wide and that is part of the struggle.

A company is taking baby steps and I hear the debate about, well, companies should be precluded from awarding stock options until they file an 8-K. A company may not know if this baby step, the step with respect to testing progress, is going to pan out.

Am I going to mislead investors if I say we are making progress? Am I going to mislead investors if I don't talk about the progress?

So, that is why I talked about this disclosure environment being very challenging to manage, and I do think it comes down to good corporate governance practices. But a lot of those governance practices are internal.

How much is the board riding herd on all of this? How much is the board paying attention both to what the company is saying and to what its executives are doing? And so to a certain degree, that is not about insider trading with securities. It is not about fraud. But it is about best practices.

Mr. MEEKS. Thank you.

Mr. MARTIN. Can I just add something there?

Mr. MEEKS. Go ahead.

Mr. MARTIN. I'm sorry, Congressman.

Mr. MEEKS. Go ahead. I am out of time, but go ahead.

Mr. MARTIN. I would just add that a lot of our committees have been trying to figure out how to—and have revised how they use their procedures around their disclosure committees.

They add to those disclosure committees to try to add the right kinds of perspectives, to get at what Ms. Fisch is saying, how do you assess the materiality or particular developments that, pre-pandemic, would not have risen to that level?

Mr. MEEKS. Thank you.

Let me ask another quick question. What I am noticing—I had another one but I won't get to it—is that there has been a growing trend for companies to go public, not by using the traditional IPO process but, rather, through a reverse merger with a special purpose acquisition company (SPAC), and I have serious concerns about this new trend.

I wanted to know if you see any particular implications for insider trading or other issues with SPACs. I'm just curious, you can say yes or no, you have some concerns.

Mr. FRENKEL. This is Jacob Frenkel. I could certainly address that, very briefly.

Mr. MEEKS. Please, if the chairman will allow.

Mr. FRENKEL. The issue with reverse mergers is not just SPACs. It is also with reverse mergers with, essentially, dormant public companies. That is something that is a hot topic issue for the SEC, and has been for probably 30 years, if not longer. It is not an insider trading issue. It really is more of a market structure issue.

Chairman SHERMAN. Thank you very much. The time of the gentleman has expired. The next two questioners, I believe, are both voting, and at the suggestion of staff, we are going to take a 10-minute recess. We will reconvene in 10 minutes.

Thank you.

[brief recess]

Chairman SHERMAN. We will reconvene, and I believe Mr. Gottheimer is next to be recognized for 5 minutes.

Mr. GOTTHEIMER. Thank you, Chairman Sherman, and thank you to all of our panelists for being here today.

When the pandemic first hit, my district in northern New Jersey was in the eye of the COVID storm. New Jersey had the second-highest rate of cases in the country, and the supply of protective gear was uncertain.

Some health care providers estimated that supplies would run out in a matter of days. Health providers called on the Administration to use the Defense Protection Act (DPA) to leverage America's manufacturing capacity to make sure the necessary equipment was ready to keep fighting the pandemic.

Using the DPA is crucial in our fight against COVID. However, I was just as surprised as many of us when the International Development Finance Corporation (DFC) announced that they would issue their first DPA loan worth $765 million to Kodak to produce pharmaceutical components.

The DPA is finally being utilized, but to a company that has only just recently left bankruptcy, with no proven success record in pharmaceuticals being entrusted with such a important task. Frankly, it is a joke.

Still, we know who was not surprised. Kodak's CEO purchased 46,737 shares of the company leading up to the announcement and received 1.75 million stock options from the Kodak board the day before the announcement was made.

These stock options may have been worth as much as $50 million just a few days later. I helped lead a letter from this committee to the SEC urging an investigation surrounding these transactions and market movement, and I was pleased to hear the SEC has opened an investigation, that the DFC's inspector general is investigating the origin of the loan.

Mr. Frenkel, knowing the circumstances around the loan, the purchasing of the stocks by corporate insiders, the options granted, the early leak of the announcement, would you say there is a potential here for unlawful insider trading?

Mr. FRENKEL. I think I would go beyond that. I think in terms of potential violations, there is the potential that the SEC could find a range of violations including in a disclosure, in terms of trading, in terms of possibly even individuals involved in manipulation.

We don't know, and I think the fundamental issue from my perspective is we have to give deference to the SEC to allow it to conduct its investigation.

I also think that we have to be mindful of one other thing, which is that when we talk about the specific securities laws violations, if we go back to insider trading enforcement in the 1980s and 1990s, those cases primarily were brought by the Southern District of New York, charging it as wire fraud and mail fraud.

So, there is also a broad range of Federal criminal statutes that potentially can apply, even if there may not be a specific SEC law or regulation that could fall within the scope of a violation.

In terms of the potential scope of the investigation, I think it is real. I think that, as I mentioned earlier, if you look at the questions that were posed in the internal investigation by outside counsel, they are very narrowly framed.

I think to the committee's point, there still is plenty for the SEC to look at, and there is the potential for the Commission's Enforcement Division to find and recommend enforcement action. But only time will tell.

Mr. GOTTHEIMER. Thank you, sir. I appreciate that response.

Would you discuss a little more kind of the harm this causes shareholders and potential harm here to shareholders and capital markets and the taxpayers?

Mr. FRENKEL. The core issue, one, is credibility. Interestingly, I actually go back to the language of the Securities Act of 1933.

When you look at the preamble of the 1933 Act, it is full and fair disclosure of the character of securities sold to interstate and foreign commerce through the mails and to prevent frauds in the sale thereof.

I think everything that this committee is doing on a bipartisan level is very much directed towards, and I support it fully, enhancing disclosure to ensure that there is a level of—the ability for the public, for participants, to have confidence in our markets, and I think that continues to be, really, the core issues: credibility; transparency; and confidence.

Mr. GOTTHEIMER. Thank you. Our country is clearly on the cusp here of many questions that we need to get answers to, and where I live, we are home to so many life sciences companies that have decades of experience and success.

Now is not the time, clearly, to place bets, during a public health crisis, on unproven entities that are unprepared to help our nation through this pandemic, and I strongly agree that a corporate insider shouldn't profit from these misguided allocations of resources.

So, I look forward to our continued oversight. Thank you very much for being here, sir.

Chairman SHERMAN. Thank you.

I now recognize the gentleman who brings extensive security law experience to his service on this subcommittee, Mr. Casten.

[No response.]

Chairman SHERMAN. Mr. Casten, you are recognized for 5 minutes.

Mr. CASTEN. I apologize, Mr. Chairman. I didn't recognize that I had all that extensive securities law experience and didn't realize you were talking about me.

Thank you so much, Mr. Chairman, and thank you to our witnesses for being here.

I want to start by making three statements that I think are just factual and should be fairly nonobjectionable.

First, capital markets are not moral. Capital markets are not immoral. Capital markets are amoral. They amorally rationally allocate capital to places where we think there will be future cash flows.

Second, rushing a vaccine to market too early is massively dangerous to public health. If it is not tested on populations who are healthy prior to taking the vaccine, it not only risks our health from the vaccine but risks future certainty about the trustworthiness of all vaccines.

And the third statement of fact, Operation Warp Speed has distributed, I think, about $9 billion to developers of vaccines, and the President of the United States is openly touting that there will be a vaccine available by election day.

Those are facts. Given that amorality, a question for you, Mr. Claypool, is it rational to assume that a company receiving cash from Operation Warp Speed, when the President of the United States is saying there will be a vaccine by the election, is it rational for an amorally rational investor to assume that that company might have an increase in near-term cash flows?

Mr. CLAYPOOL. I think it is perfectly rational to think that, as a result of good news, the company's value is going to go up.

With that said, there is not a place for—in the greater context of this crisis and seeing the idea that—I guess, one could also argue that it is rational for an insider to exploit insider information if they believe they could get away with it.

Mr. CASTEN. I am not trying to ask you a "gotcha" question. I am glad you agree with the first part. Is it not also rational to assume that if a company did see a surge in cash flows from that good news, and a surge in their equity value, but that the vaccine was subsequently proven to be dangerous, that that company might face longer-term liabilities, legal or otherwise, from bringing that to market too soon?

Okay. So is it then not rational for an informed amoral insider, looking at that information, to say, it is in my amoral interest to participate in those markets? Buy now and cash out quickly before that future liability comes home to roost?

Mr. CLAYPOOL. I could see if there was a logic to that sort of hedge. It strikes me as, I guess, more cynical than we would hope the companies that we are relying on to develop vaccines for all of us will be acting in this crisis.

I think we expect good faith development from those who do the work. That is their core business purpose.

Mr. CASTEN. Yet, and I am in no way—I don't mean my comments in any way to question the morality of the companies. I am just making a comment about the nature of markets, that are not immoral. But they are not moral either. They are just making judgments. And I have concerns about the public health risks of rushing a vaccine to market.

When we have insiders trading on this information, and should the chickens come home to roost that we have rushed this out too soon, what concerns do you have about what that does to trust in our capital markets?

Mr. CLAYPOOL. I think it is very dangerous, and I also would add that to the concern of spring-loading and those kinds of issues, it is worth being concerned that good news could be withheld until after those stock options are issued in a way that executives are most able to exploit.

Mr. CASTEN. Thank you. I don't know what we do with this other than that back in the days when I was a CEO of a company, one of the—I had a professor in grad school who said the most dangerous type of leadership is leadership based on knowledge, because the preservation of power depends on limiting people around you's access to information.

And I used to find, when I raised money on Wall Street, as the chairman was praising me for, that Wall Street is a place where information is power. Sadly, it is actually true of the current job I have.

But I think we always need to keep our vigilance up in industries like that where withholding information from other people is a way to gain power.

Thank you, and I yield back.

Mr. CLAYPOOL. I agree.

Chairman SHERMAN. The gentlelady from New York, Ms. Ocasio-Cortez, is recognized for 5 minutes.

Ms. OCASIO-CORTEZ. Thank you, Mr. Chairman, and thank you for hosting this incredibly important hearing. I had a quick question. So much of what we are discussing today has to do with prospects of insider trading, and also tying CEO compensation to stock, and my question for Mr. Claypool is, when CEOs and corporate CEOs, pharmaceuticals and otherwise, are compensated with stock packages and packages where an enormous amount of money that they are being compensated in is in stock options, how does that potentially influence decision-making when it comes to the long-term health of a company or long-term decisions for pharmaceuticals?

Mr. CLAYPOOL. Thank you, Congresswoman.

That is an interesting question, because so often, the premise of issuing stock options as a way of paying executives is intended to align the interests of a company with the interests of shareholders.

And what we are seeing in instances such as we are observing here, is that this intense short-termism encourages ways for companies to look for ways to quickly raise the stock price or to take advantage of volatile circumstances and pursue a short-term gain.

There have been a variety of reforms that even companies have self-enacted. Most companies, in the aftermath of the scandal where companies were backdating their pay to—it was kind of the opposite where they were kind of—they knew the price of a stock would go up, so they would sort of shift the date of the award backwards in time, was that many companies sort of picked—in fact, I think most companies now pick a select date to award those stock options.

That was a positive development. However, what studies are now showing is that companies are trying to find ways to, say, time bad news for before before the announcements or saving the good news for after the set date they know the stock options are made.

Now, every individual instance of this may have a very plausible explanation for why they announced the news they did, when they did, and the timing of the options.

But the reasons that I have just shown, 1,200 companies that have this sort of V-shaped pattern in how they are paid, and the pattern is even greater for companies who pay above average amounts of stock options and for companies that are hard to value because, like these pharmaceutical companies whose—their real destinies are based on just the success or failure of, often, a single drug being developed is a circumstance that invites shenanigans, and I am happy that the committee is looking into that, and hopefully will find ways to thwart it.

Ms. OCASIO-CORTEZ. Absolutely.

Ms. FISCH. Congresswoman, could I just weigh in on that?

Ms. OCASIO-CORTEZ. Yes, absolutely.

Ms. FISCH. I'm sorry to interrupt. You identified concerns about short-termism in trading opportunities. But I think the academic literature reveals a bigger problem with option-based compensation, which is that it makes operational decisions too risky, and I think that relates to Congressman Casten's concern about scientific development and particularly vaccines.

If you have stock options, that is a really high-powered incentive to take risks so that your stock price balloons, and I think in this environment, that is an extra caution that we really have to worry about.

Ms. OCASIO-CORTEZ. Absolutely. So, would you say it is fair to say that having these kinds of stock options could incentivize riskier behavior when it comes to an industry like pharmaceuticals, that could carry an elevated risk with it?

Ms. FISCH. Absolutely, and I think where we see particular concern is in some of these companies that historically have not been profitable, where their stock price is very low to begin with and, therefore, the potential downside is very limited but the potential upside is enormous.

Ms. OCASIO-CORTEZ. Thank you. Thank you very much.

And I have one last question for Mr. Frenkel. You have been a prosecutor, and insider trading, and, perhaps, activities that mirror or appear like insider trading, are not exclusive to the private sector.

We have seen some questionable activity right here in Congress, and I am really interested in your thoughts on the 2012 Stock Act, how it may fall short, and what are some of the concerns that you think there are with respect to Congress and Members of Congress engaging in behavior that could be seen as or interpreted as insider trading?

Chairman SHERMAN. I will ask you to answer in just a couple of seconds, because the time of the gentlelady has expired.

Mr. FRENKEL. Thank you, Mr. Sherman.

I think the easiest way to answer that question succinctly is that we look to the SEC and the Department of Justice, through bringing their cases, to have a deterrent effect on certain behavior.

So, absent there being such cases, there is always going to be a perception that the law may not be sufficiently effective. I think at this point, we have to defer to the investigations and see if they result in enforcement actions that, in turn, will send a message about the level of commitment to enforcement of such laws.

Chairman SHERMAN. Thank you. Thank you very much.

I see no other members who have not been recognized. I am informed that all members of the subcommittee who wish to participate have been able to ask questions.

Mr. HUIZENGA. Mr. Chairman, I am trying to get your attention so that I can submit an article for the record.

Chairman SHERMAN. The gentleman is recognized.

Mr. HUIZENGA. Thank you, and it actually fits perfectly with what my colleague from New York was talking about, as well as Mr. Frenkel and others.

This is a November 2019 Reuter's article. The headline is, "U.S. SEC enforcement activity hits second-highest level ever in 2019," and the article goes on to explain what the SEC has been doing on enforcement.

So, I would like to submit that for the record.

Chairman SHERMAN. Without objection, it is so ordered.

Mr. HUIZENGA. Thank you.

Chairman SHERMAN. Again, seeing no Members who have not been recognized, I would like to thank our witnesses for their testimony. I think today, we have learned that, especially during an outbreak of COVID, we need to make sure that insiders don't deal unfairly with the investing public and don't profit from not-yet-disclosed material information.

I look forward to working with my colleagues to achieve those objectives and, hopefully, the SEC will not only continue the enforcement efforts that Mr. Huizenga pointed out, but will look at some of the issues brought up in this hearing in the areas that are perhaps wrongful but legal.

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.

This hearing is now adjourned. Thank you.

[Whereupon, at 2:29 p.m., the hearing was adjourned.]

A P P E N D I X

September 17, 2020

215 Pennsylvania Avenue, SE • Washington, D.C. 20003 • 202/546-4996 • www.citizen.org

Testimony

Rick Claypool

Research Director, Office of the President

Public Citizen

Virtual Hearing - Insider Trading and Stock Option Grants: An Examination of Corporate Integrity in the Covid-19 Pandemic

House Financial Services Subcommittee on Investor Protection, Entrepreneurship and Capital Markets

September 17, 2020

Chairman Sherman, Ranking Member Huizenga, members of the subcommittee. My name is Rick Claypool, and I am a research director in the office of the president for Public Citizen.

Public Citizen is a national non-profit organization with more than 500,000 members and supporters. We represent consumer interests through lobbying, litigation, administrative advocacy, research, and public education on a broad range of issues including consumer rights in the marketplace, product safety, financial regulation, worker safety, safe and affordable health care, campaign finance reform and government ethics, fair trade, climate change, and corporate and government accountability.

My research is focused on corporate and white-collar law enforcement. I was the lead author of Public Citizen's report about declining federal enforcement against corporate wrongdoers between Obama's last year in office and Trump's first; the report noted that SEC enforcement against corporate wrongdoers fell 44% first year and that penalties dropped 68%.[1] In another report, I documented the Justice Department's overreliance on leniency agreements with corporations that violate the law, including in securities fraud cases.[2] In a report focused on the enforcement implications of the 2018-2019 federal government shutdown, I highlighted that as a result of the shutdown, 94% of the SEC's staff was furloughed, inhibiting enforcement against insider trading and other violations.[3] Additionally, I have assisted Public Citizen's efforts against congressional insider trading, which culminated in the passage of the 2012 STOCK Act. This legislation significantly curtailed lawmakers and staffers trading on insider knowledge -- a major step forward in financial market fairness.[4]

This testimony was prepared in consultation with many experts both at Public Citizen and allied organizations, including Peter Maybarduk, director of Public Citizen's Access to Medicines Program; Bartlett Naylor, financial policy advocate at Congress Watch; Dr. Craig Holman, government affairs lobbyist, Congress Watch; and Remington Gregg, counsel for civil justice and consumer rights, Congress Watch.

We welcome the committee's concern with insider trading by executives at corporations associated with the pandemic, as firms receiving Title IV CARES; firms receiving contracts for medicine development; and others who may profiteer with funds Congress intended to help workers.

This hearing is important for a number of reasons. It is important because the development of a vaccine should not fall victim to manipulative pharmaceutical executives whose goal is not so much to produce efficiently a safe, effective vaccine, but to play the market for personal gain. It is important because the prodigious sums of taxpayer dollars heading to bolster companies struggling with the voluntary economic coma should not be diverted to the C-suite. It is important because the exposure of insider trading may be an indicator of even greater problems, notably a morally fractured corporate culture.

Nearly all Public Citizen's 500,000 members are exposed to the stock market through personal investments, retirement plans and other savings instruments and therefore dependent on the integrity of the market and of corporate managers ultimately accountable for it. Some of our members have recorded significant investment success, such as one generous member who guided his otherwise moderate income into an investment portfolio that allowed him to make a multi-million-dollar gift to Public Citizen a few years ago.

Public Citizen has addressed insider trading on several fronts. As mentioned, we helped to conceive and promote what Congress eventually approved as the STOCK Act, which clarifies that insider trading laws apply to members of Congress and established a disclosure system of transactions to

---

[1] Rick Claypool, Taylor Lincoln, Michael Tanglis and Alan Zibel, Corporate Impunity: "*Tough on Crime*" *Trump Is Weak on Corporate Crime and Wrongdoing*, PUBLIC CITIZEN (July 2018), https://www.citizen.org/wp-content/uploads/corporate-enforcement-public-citizen-report-july-2018.pdf

[2] Rick Claypool, *Soft on Corporate Crime: Justice Department Refuses to Prosecute Corporate Lawbreakers, Fails to Deter Repeat Offenders*, PUBLIC CITIZEN (Sept. 2019), https://www.citizen.org/wp-content/uploads/soft-on-corporate-crime-dpa-npa-repeat-offenders-report.pdf

[3] Rick Claypool, *As Shutdown Drags on, Agencies Devoted to Consumer and Worker Health and Safety Unfunded and Deprioritized*, PUBLIC CITIZEN (Jan. 2019), https://www.citizen.org/news/trump-shutdown-consumer-protection/

[4] Craig Holman, The Impact of the STOCK Act on Stock Trading Activity by U.S. Senators, 2009 – 2015, Public Citizen (June 2017), https://www.citizen.org/wp-content/uploads/migration/case_documents/2017_stock_act_report.pdf

monitor compliance. Before the STOCK Act, a 2004 study found that investment returns for senators were 12 percent higher than for average investors.[5] Financial disclosure statements for members of Congress before the STOCK Act showed an alarming trend of members investing in businesses and industries directly affected by Congress. A study by the Center for Responsive Politics found that nearly one in four members invested in health care companies in 2007 and 2008, such as Merck, Pfizer and United Health, whose business activities are the subject of intense congressional scrutiny and whose business futures depend on pending congressional actions.[6]

We enthusiastically promoted Rep. Jim Himes' (D-Conn.) efforts through HR 2534 to codify illegal insider trading,[7] which we will discuss later.

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. Much of the trading manipulation involves stock options. These are granted to senior executives that, on the surface, are meant to motivate. A stock option is granted with a so-called strike price, typically the price of the day it is granted. If the price of Acme is $2 on the day of the option grant, then the executive only makes money if the stock rises above $2. Stock option value follows the price of the stock, which increases with increased profits. Stock prices rise if the company increases profits. Stock prices can also rise if the company repurchases its own shares—a buyback-- leaving fewer shares to which profits are allocated.

And now, during the worst pandemic to plague America since 1918, executives of major pharmaceutical firms on whom Americans are depending to deliver vaccines seem to be gaming the market.

- In July 2020, Moderna Therapeutics announced that all 45 participants in the first phase of its COVID-19 vaccine trial who received one of three dose levels of the vaccine developed some antibodies. The firm trumpeted this success with appearances on prominent media broadcasts. [8] The news pushed up the company's stock price 30% to an all-time high of $87. In the days following the announcement, Moderna's CEO, other executives and funds controlled by the chairman of its board sold about $90 million worth of company shares. Critics have called for an SEC investigation.[9] Public Citizen is particularly

[5] Alan Ziobrowski, et al., *Abnormal Returns from the Common Stock Investments of the U.S. Senate*, JOURNAL OF FINANCIAL AND QUANTITATIVE ANALYSIS (Dec. 2004), https://projects.iq.harvard.edu/files/gov2126/files/ziobrowski_2004.pdf

[6] Lindsay Renick Mayer, "Congressional Lawmakers Invest in Their (Financial) Health," CENTER FOR RESPONSIVE POLITICS (July 9, 2009). https://www.opensecrets.org/news/2009/07/lawmakers-invest-in-their-fina/

[7] HR 2534, Insider Trading Prohibition Act, approved by House Dec. 5, 2019. https://www.congress.gov/bill/116th-congress/house-bill/2534

[8] Nicole Brown, "Moderna President Hopeful Company Is "On The Right Path" With Coronavirus Vaccine," CBS THIS MORNING (May 18, 2020), https://www.cbsnews.com/news/coronavirus-vaccine-moderna-covid-19-trial-antibodies-first-phase/

[9] Stephen Gandel, "Watchdog Urges SEC To Investigate Vaccine Maker Moderna," CBS NEWS (June 3, 2020) https://www.cbsnews.com/news/insider-trading-allegations-moderna-accountable-us-securities-exchange-commission/

concerned with profiteering at Moderna: Taxpayer money funds 100% of its work to bring a COVID-19 vaccine to licensure, yet it announced new, higher intended prices for the prospective vaccine. The so-called Moderna vaccine belongs in significant part to the people of the U.S. We paid for it. Federal scientists led the way. It ought to be the people's vaccine, not a new taxpayer burden.[10]

- In late July 2020, "the Eastman Kodak Company handed its chief executive 1.75 million stock options," noted the New York Times. "It was the type of compensation decision that generally wouldn't attract much notice, except for one thing: The day after the stock options were granted, the White House announced that the company would receive a $765 million federal loan to produce ingredients to make pharmaceuticals in the United States. The news of the deal caused Kodak's shares to soar more than 1,000 percent. Within 48 hours of the options grants, their value had ballooned, at least on paper, to about $50 million."[11] [12] According to Forbes, "It is the timing of these options which has become the focus of a Securities and Exchange Commission ("SEC") investigation for possible insider trading. Senator Elizabeth Warren (D-Mass.) asked the SEC in an open letter to examine these transactions citing "insider trading" and "unauthorized disclosure of material, nonpublic information." As a result, the Kodak loan has been placed on hold pending the results of the investigation."[13]

A coalition where Public Citizen serves on the steering committee just published "Pandemic Profiteering," a look at "How Pharma Insiders Are Using News of Government Awards and Trial Results to Boost Their Stock Prices and Profiteer Without a Vaccine."[14] The report finds:

> From January to August, the stock market value for the eight biotech companies on the S&P 500 grew by $130 billion. During the same period, executives and insiders from just three of these companies — Moderna, Inovio and Vaxart — made at least $370 million in sales of company stocks inflated by news of government awards and trial results. These

---

[10] Statement of Peter Maybarduk: Paying Twice for a Vaccine: Moderna is Taking Taxpayers For a Ride, Public Citizen press release (Aug. 5, 2020), https://www.citizen.org/news/paying-twice-for-a-vaccine-moderna-is-taking-taxpayers-for-a-ride/

[11] Jesse Drucker, Ellen Gabler, ***Kodak C.E.O. Got Stock Options Day Before News of Loan Sent Stock Soaring,*** NEW YORK TIMES (July 31, 2020) https://www.nytimes.com/2020/07/31/business/kodak-ceo-stock-options.html

[12] On Monday, July 27th, a day when Kodak stock "rocketed" up 25% to close the day at $2.62 per share, Kodak executives received stock options. James Continenza, CEO of Kodak, received roughly 1.75 million stock options with exercise prices of $3.03, $4,53, $6,03 and $12, according to an SEC filing. This is nearly triple the 650,000 shares he had already owned. Those shares were awarded to Continenza in five different tranches since August of 2019. From Forbes: Chris Carosa, "How A PR Error Might Absolve Kodak Of Insider Trading Charges," FORBES (August 16, 2020) https://www.forbes.com/sites/chriscarosa/2020/08/16/how-a-pr-error-might-absolve-kodak-of-insider-trading-charges/#b15970159196

[13] Chris Carosa, "How A PR Error Might Absolve Kodak Of Insider Trading Charges", FORBES (August 16, 2020) https://www.forbes.com/sites/chriscarosa/2020/08/16/how-a-pr-error-might-absolve-kodak-of-insider-trading-charges/#b15970159196

[14] *Pandemic Profiteering: How Pharma Insiders Are Using News of Government Awards and Trial Results to Boost Their Stock Prices and Profiteer Without a Vaccine,* LOWERDRUGPRICESNOW.ORG (August 2020) https://www.lowerdrugpricesnow.org/wp-content/uploads/LDPN_Pandemic_Profiteering_REPORT-FINAL.pdf

> findings show that company executives and insiders are profiteering from the pandemic, without any guarantee of a vaccine. [15]

The New York Times found that pharmaceutical firms "are making millions of dollars after announcing positive developments, including support from the government, in their efforts to fight Covid-19. After such announcements, insiders from at least 11 companies — most of them smaller firms whose fortunes often hinge on the success or failure of a single drug — have sold shares worth well over $1 billion since March."[16]

This subcommittee does not oversee the integrity of the health care industry. But this welcome, vital look at insider trading and abuse of stock options in this sector raises an important hypothesis: if senior executives are focused on gaming the market, can they be trusted with their basic mission of providing health care? We explore the intersection between C-suite profiteering and health care expense in an appendix to this testimony.

Stock buybacks expose another area that effectively enables and/or is motivated by opportunities for insider trading. Senior managers whose pay is linked to the stock price can line their pockets by arranging for the repurchase of their companies' shares. When stocks are bought back, the same earnings are allocated to a fewer number of shares, leading to the value and price of each of these shares increasing along with stock-based manager compensation. On the surface, a stock buyback represents a declaration of management indolence. Firms issue stock to raise capital for growth, for the expansion of existing production, or for the research and development of new products. When managers repurchase stock, they are confessing they have no new promising ideas in which to invest. Paradoxically, stock buybacks reward these lethargic executives since they raise the stock price for managers who are paid in stock options. In other words, even though the managers have not developed a better mousetrap, they secure the same bonus as if they had.

The 2017 Trump tax giveaway law[17] generated a windfall for all American corporations by cutting the corporate rate by 40 percent. Trump officials claimed corporations would trickle down profits by investing these new proceeds into more company assets, including higher worker pay. Trump claimed the bill would generate an annual average pay raise of $4,000.[18] Treasury Secretary Steven Mnuchin also claimed the increased economic vitality would generate enough new tax revenue that the tax cuts would pay for themselves. None of this proved true.[19] [20]

In the first quarter of 2018 alone, with the new tax law fully in force, American corporations bought back a record $178 billion in stock.[21] During this period, the market hit record highs. When a

---

[15] *Ibid.*

[16] David Gelles and Jesse Drucker, "Corporate Insiders Pocket $1 Billion in Rush for Coronavirus Vaccines," NEW YORK TIMES (JULY 25, 2020), HTTPS://WWW.NYTIMES.COM/2020/07/25/BUSINESS/CORONAVIRUS-VACCINE-PROFITS-VAXART.HTML

[17] The law is officially known as the 2017 Tax Cuts and Jobs Act.

[18] Joseph Zeballos-Roig, "These 7 charts show Trump's tax cuts still haven't been the economic 'rocket fuel' he promised, 2 years after the fact," MARKET INSIDER (Dec. 22, 2019), https://bit.ly/2KlWNsg.

[19] *Key Facts: How Corporations Are Spending Their Trump Tax Cuts,* AMERICANS FOR TAX FAIRNESS, https://bit.ly/2Vp5ZCg.

[20] Wage Growth Tracker, FEDERAL RESERVE BANK OF ATLANTA (April 15, 2019), https://bit.ly/3aqeFg4.

[21] Talib Visram, "Tax Cut Fuels Record $200 Billion Stock Buyback Bonanza," CNN.COM (June 5, 2018); *see also* William Lazonick, "Stock Buybacks: From Retain-and-Reinvest to Downsize-and-Distribute," Brookings Initiative on 21st Century Capitalism (April 2015), at 2 ("Over the decade 2004-2013, 454 companies in the

corporation buys stock, it should be governed by the maxim that applies to any investor: buy low, sell high. Yet because this frenzy of corporate stock buybacks happened when the market was at a record high level, it contradicts any claim that they were sound business decisions.

Still worse, Commissioner Robert Jackson of the SEC found that corporate insiders were inexplicably active sellers following a buyback announcement,[22] buttressing the concern about possible manipulation. Commissioner Jackson observed,

> "There is clear evidence that a substantial number of corporate executives today use buybacks as a chance to cash out the shares of the company they received as executive pay. We give stock to corporate managers to convince them to create the kind of long-term value that benefits American companies and the workers and communities they serve. Instead, what we are seeing is that executives are using buybacks as a chance to cash out their compensation at investor expense."[23]

In the CARES Act, Congress approved more than $500 billion in funds for corporate America in the hopes that they would retain employees through the shutdown. These funds were necessary, proponents explained, because these companies lacked the reserves to keep workers on the payroll. Had these same firms not engaged in a spree of buybacks just in the last three years, they might need taxpayer help. In the last three years, companies in the S&P 500 repurchased $2 trillion worth of their own stock.[24]

Another example is backdating. Backdating is the practice of awarding executives stock options at a lower price by making the award on paper appear to have been granted on a previous date, when the stock was trading at a lower price. The backdating scandals of the early 2000s resulted in 12 executive prosecutions and payments of nearly $1 billion in penalties[25] – not for the backdating itself, but for the illegal accounting of the activity.[26] The courts have decided that the fact of backdating alone is not sufficient to prove an illegal fraud has occurred.[27]

In the aftermath of the backdating scandals, most companies (more than 65% in 2010) have adopted the reform of scheduling option grants on the same dates every year. A 2018 study by Stanford University law professor Robert M. Daines, however, shows the market manipulation scheme appears to have mutated to adapt to the reforms – and may well have become more harmful.[28] In

---

S&P 500 Index in March 2014 that were publicly listed over the ten years did $3.4 trillion in stock buybacks, representing 51 percent of net income.").

[22] Comm. Robert Jackson, Speech at the Center for American Progress, SECURITIES AND EXCHANGE COMMISSION (June 11, 2018). https://bit.ly/3czxyi2.

[23] *Ibid.*

[24] Matt Phillips, "The Stock Buyback Binge May Be Over. For Now," NEW YORK TIMES (March 23, 2020) https://www.nytimes.com/2020/03/24/business/coronavirus-stock-buybacks.html

[25] Edmund Andrews, "How CEOs Reinvented the Dating Game Scandal in Stock Options," Stanford Business (Aug. 29, 2018), https://www.gsb.stanford.edu/insights/how-ceos-reinvented-dating-game-scandal-stock-options

[26] Peter Lattman, "Backdating Scandal Ends With a Whimper," The New York Times (Nov. 11, 2010), https://dealbook.nytimes.com/2010/11/11/backdating-scandal-ends-with-a-whimper/

[27] Stephen Taub and Dave Cook, "Backdating Not Sufficient to Prove Fraud," CFO (April 16, 2007), https://www.cfo.com/risk-compliance/2007/04/backdating-not-sufficient-to-prove-fraud/

[28] Daines, R., McQueen, G., & Schonlau, R. (2018). *Right on Schedule: CEO Option Grants and Opportunism.* JOURNAL OF FINANCIAL AND QUANTITATIVE ANALYSIS, *53*(3), 1025-1058. doi:10.1017/S0022109017001259, https://www.cambridge.org/core/journals/journal-of-financial-and-

this updated variant, instead of manipulating the date when stock options are granted, company statements that affect the price of the company's stocks are strategically timed around the fixed date options are granted in order to benefit stock option recipients. The study analyzed stock prices for 1,500 companies and found that, on average, prices dropped in the months before the grants and quickly rose afterward, giving executives the advantage of always being able to buy low and sell high. The pattern was more pronounced at companies where executives received above-average numbers of stock options and at companies that are hard to value, and so may have prices that are more sensitive to the company's own statements.

Another group of apparent opportunists are executives at Hertz, the bankrupt rental car company, who have positioned themselves to siphon tens of millions of dollars out of the corporation. Because of the pandemic, Hertz announced in April that it would lay off 10,000 workers – a third of its U.S. workforce.[29] In May, the company disclosed it paid $16.2 million in cash retention bonuses to executives right before the company declared bankruptcy.[30] Hertz isn't alone. Reuters found that at a third of the 40 large corporations that filed for bankruptcy during the pandemic paid out similar cash bonuses.[31] In 2005, Congress passed the Bankruptcy Abuse Prevention and Consumer Protection Act, forbidding corporations from doling out large payouts to retain executives during bankruptcy proceedings.[32] The payouts from Hertz and other companies, including J.C. Penney, Neiman Marcus, and Chesapeake Energy, show that instead of ceasing the abuse, corporations that want to shower executives of bankrupt companies with millions merely shifted it to before the bankruptcy. Nevertheless, what makes Hertz's executive handouts especially egregious is the company's intention to give away another round -- $14.6 million – which in court documents the company describes as "incentive" pay rather than retention pay,[33] a scheme the courts blessed in 2012.[34]

In the confusing and volatile COVID-19 market, many more stock prices are sensitive to company statements, and perhaps none more so than the pharmaceutical corporations racing to produce vaccines. Just as many in the public are wary of the potential for political incentives to supersede safety if an artificially accelerated timeline results in a vaccine being ready for distribution by Election Day, so too should the public be wary of potential the financial incentive of pharmaceutical

---

quantitative-analysis/article/right-on-schedule-ceo-option-grants-and-opportunism/DA0C243E4AE7E58B78D2E20E78520A9A/share/f9663ff7226e5992e78e2f25ad6301d6f6105b2a

[29] "U.S. car rental company Hertz to lay off 10,000 staff on coronavirus hit," Reuters (April 20, 2020), https://www.reuters.com/article/us-hertz-layoffs/u-s-car-rental-company-hertz-to-lay-off-10000-staff-idUSKBN2222XD

[30] "Hertz awards over $16 million in retention bonus to key executives," Reuters (May 26, 2020), https://www.reuters.com/article/us-hertz-glo-hldg-bankruptcy-retentionbo/hertz-awards-over-16-million-in-retention-bonus-to-key-executives-idUSKBN2322AS

[31] Mike Spector and Jessica DiNapoli, "On eve of bankruptcy, U.S. firms shower execs with bonuses," Reuters (May 26, 2020), https://www.reuters.com/article/us-health-coronavirus-bankruptcy-bonuses/on-eve-of-bankruptcy-u-s-firms-shower-execs-with-bonuses-idUSKCN24I1EE

[32] Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Congressional Record Volume 151, Number 26 (March 8, 2005), https://www.govinfo.gov/content/pkg/CREC-2005-03-08/html/CREC-2005-03-08-pt1-PgS2200-2.htm

[33] Peg Brickley, "Bankrupt Hertz Sets Up Another Round of Executive Bonuses," The Wall Street Journal (Aug. 28, 2020), https://www.wsj.com/articles/bankrupt-hertz-sets-up-another-round-of-executive-bonuses-11598645731

[34] Mike Spector And Tom McGinty, "The CEO Bankruptcy Bonus," The Wall Street Journal (Jan. 27, 2012), https://www.wsj.com/articles/SB10001424053111903703604576584480750545602

executives to withhold a vaccine until the instant they are strategically poised to earn the greatest returns.

The harms are no less insidious than outright illegal insider trading – it is the subordination of companies' core business to producing massive executive payouts, and the potential for victimization – if it interferes with the release of treatments and vaccines for COVID-19 – is spread far beyond direct market participants.

This sub-pandemic of insider trading invites reflection on the nature of stock-based compensation. On paper, compensating senior executives (and even line employees) with stock was intended to align the interest of employees and owners; if the manager works harder, the company prospers, the stock rises, benefitting both the employee and the shareholder. But stock price manipulation renders the executive an antagonist to the shareholder. Without reforms, this alignment of interests won't be realized.

Insider trading is but one indicator of how average Americans can be abused by corporate executives. The Covid-19 pandemic has laid bare the extreme economic and racial inequalities that have held back our country for years and made us much more vulnerable to the ravages of the current crisis. The lack of responsible policies to rein in CEO pay has been a key driver of inequality.

Since the 1980s, the fruits from rising economic output from workers at American corporations have meant concentrated earnings in the C-suite. Average worker wages have stagnated, while those of senior managers soared. This follows a precipitous decline in the top marginal tax rate along with deterioration in the power of collective bargaining owing to declining unionization rates.

Meeting certain performance benchmarks, often pegged to a firm's stock price, determines that senior pay. A survey of misconduct and other catastrophes of the American workplace shows the abiding presence of extraordinary pay packages.

- Because of badly constructed pay incentives, thousands of bankers engaged in widespread fraud, inflating a housing bubble whose rupture cost millions their jobs, savings and homes.
- Badly constructed pay incentives prompted the decades long Wells Fargo fake account scandal, where compensation for senior executives to grow accounts led line agents to add more unwitting customer interfaces, resulting in mass firings.
- The worst mine disaster in recent history followed years of compensation tied to cutting safety expenses.
- Similarly, corners cut at Boeing led to the crash of two airliners, while the CEO's pay turned, in part, on cost cutting.
- Perverse corporate pay incentives reflected and exacerbated racism. Among Fortune 500 CEOs, just 4 are African American. And people of color remain disproportionately represented in low-wage occupations.

Strangling worker wages for decades to bloat the pay in the C-suite has led to massive income and wealth inequality. The induced coma of the pandemic has ripped the scar off this economic wound, requiring massive aid to newly displaced workers who have no savings to fund more than a few weeks of basic expenses, such as groceries, rent, or medicine.

Public Citizen explores these problems in depth in a July report titled "White Collar Crime Still Pays." [35]

Washington must repair this dynamic. Leaders should reform executive compensation, force board directors to exercise responsible diligence over management. And the nation's securities law enforcers must do their job.

The lessons from the Dodd-Frank Wall Street Reform and Consumer Protection Act contain a cautionary tale relevant to how this committee and Congress addresses pandemic aid and the need for executive compensation conditions.

On July 21, 2010, 10 years ago, President Barack Obama signed the Dodd-Frank law. This groundbreaking legislation was a response to the worst financial crash since 1929, brought about by greedy malefactors who committed widespread fraud, largely in mortgage-making and mortgage securities trading, in the pursuit of lucre.[36] In response to this greed, Dodd-Frank directed bank regulatory agencies to adopt stricter rules in mortgage-making; tighter controls on the gambling known as derivatives trading; restrictions on banks wagering with federally insured deposits; and critically, guardrails on how bankers could profit personally. It also created a new consumer financial protection agency, the Consumer Financial Protection Bureau. In all, Dodd-Frank mandated the agencies to adopt some 400 rules. While many rules were simple, such as the mandate that companies post the CEO's pay as a multiple of the median-paid worker at the firm to demonstrate the level of pay inequity, the agencies still labored for years to finalize them. They were besieged by bank lobbyists who considered passage of t0he reform measure simply the "first quarter" in football game and counted on an inevitable fading of citizen demands for reform. Perhaps one of the five most important of these 400 rules called for prohibiting incentive-based payment arrangements for senior bank officials that would encourage taking "inappropriate risks," such as by offering "excessive compensation." Lawmakers recognized that this reform was crucial, and because of that (unlike the vast majority of the 400 rules), they set a deadline for regulators to implement it: May 2011. Yet today, evincing the vast power of the bank lobby in Washington, this rule remains unimplemented.

Along with Dodd-Frank, Congress also approved vast sums of money to bail out the bank creditors, as the banks lacked the capital to make good on their own debts. With this debt relief, bailout proponents promised that the banks could forebear on delinquent mortgage holders and keep people who'd lost their jobs in their homes. But as the bailout proceeded, it became clear that many banks simply sat on the money and proceeded with evictions and foreclosures. In the end, more than 10 million people lost their homes, their jobs, and their savings, while bankers effectively pocketed some of the bailout, returning to the salad days of high bonuses. In the year that JP Morgan paid record fines for mortgage fraud during the years leading to the crisis, its board gave CEO Jaime Dimon a raise.[37] Had regulators completed the job of banker pay reform, and the ability to make a personal fortune even at the expense of others' misfortune been eliminated, this could not have happened.

---

[35] Bartlett Naylor, *White Collar Crime Still Pays*, PUBLIC CITIZEN, (July 21, 2020), https://www.citizen.org/news/white-collar-crime-still-pays-10-years-after-dodd-frank/
[36] Bartlett Naylor, *TOO Big*, PUBLIC CITIZEN (July 2016) https://www.citizen.org/wp-content/uploads/toobig.pdf
[37] Bartlett Naylor, *TOO Big*, PUBLIC CITIZEN (July 2016) https://www.citizen.org/wp-content/uploads/toobig.pdf

Now, as the world struggles with a pandemic, governments across the planet have placed their economies in voluntary comas. Millions of Americans have lost their jobs. While many low-paid workers have been deemed essential, such as those in health care, grocery sales, delivery, trash-pick up, and remain on the job, some 40 percent of Americans who were paid less than $40,000 before the shut-down are unemployed.[38] Janitors in now dark office buildings cannot telework, nor can restaurant or hotel workers. To soften the blow, Congress approved massive aid packages, which include direct payments to citizens. It also includes a massive aid package to corporations of $500 billion. With loans from the Federal Reserve, this corporate aid package approaches $5 trillion, with a goal of helping corporations retain their workforce, even as they lack the business that requires this labor.

However, the lessons of the 2008 bank bailout have left us with legitimate fears that corporate profiteers may siphon some of this aid into their own pockets, leaving less for workers.

No corporation caused the pandemic. Yet in many ways, the necessity of the CARES Act, the $2.3 trillion relief package during the pandemic, an unprecedently large measure conceived and approved in 11 days with inevitable shortcomings, and the direct $1,200 individual payments[39] stem from corruptions in high pay. The need for the government to offer trillions of dollars in relief to businesses and regular Americans was, indirectly, related to the problems excessive pay has created. Corporations spent well more than the $2.3 trillion in the CARES Act on buy backs of their own stock in recent years. Those buybacks sparked increases in the stock price to which senior pay is pegged. Corporations failed to reward workers for productivity gains with real wage growth for decades, instead bloating the paychecks of senior executives. Hence, almost half of Americans lack even $400 in savings to buy groceries beyond a few weeks during the lockdown.[40]

So, with the failures of leaving reforms incomplete from the 2010 Dodd-Frank law standing as a stark object lesson in the bank bailout, Congress must not repeat that error, and must be diligent to ensure that the trillions in aid goes not to corporate profiteers but to workers. That means strong complete transparency of where the money goes and on what terms, oversight to ensure that recipients are worthy, and vigilant police and prosecutors to hold wrongdoers accountable.

Needed Reforms

Enforcement

Of course, laws and regulations prohibiting insider trading and other forms of market manipulation are only as good as the that enforcement efforts investigating suspicious activity and holding violators accountable. Recent years have seen marked declines in many aspects of corporate and white-collar enforcement. Corporate prosecutions have reached historic lows, with U.S. Sentencing Commission data showing fiscal year 2019 to have been the second-lowest year on record since the commission began reporting this information in 1996; the lowest year on record was fiscal year

---

[38] J. Edward Moreno, "40 percent of households earning less than $40K lost jobs in March: Fed chairman." THE HILL (May 13, 2020) https://thehill.com/policy/finance/497527-40-percent-households-earning-less-than-40k-lost-jobs

[39] Updated Information on Individual Payments in the CARES Act, Congressman Albio Sires (April 16, 2020), https://sires.house.gov/media-center/press-releases/information-on-individual-payments-in-the-cares-act

[40] *Report on the Economic Well-Being of U.S. Households in 2018*, FEDERAL RESERVE (May 2019) https://www.federalreserve.gov/publications/files/2018-report-economic-well-being-us-households-201905.pdf

2018.[41] Similarly, prosecutions of individual white collar offenders also has plummeted to an all-time low, according to a report from Syracuse University's Transactional Records Access Clearinghouse (TRAC) based on DOJ records.[42] On point, a National Public Radio investigation found that the SEC brought fewer insider trading cases in 2019 than in any year since 1996.[43]

The reason for these enforcement declines is not that corporations and executives have abruptly become angels. My research finds that plummeting corporate prosecutions is explained by the Justice Department's overreliance on deferred- and non-prosecution agreements – even for corporate repeat offenders.[44] Across the government, the Trump administration appointees enacted policies that signaled light touch enforcement for corporate and white collar violators even as the administration pursued "zero tolerance" enforcement against first-time border crossers and low level offenders.[45] The most recent example of such a policy is the Aug. 31 White House Office of Administration and Regulatory Affairs memo emphasizing that in matters of regulatory enforcement, the burden is placed on federal agencies to prove a violation, not on the accused violator to prove their compliance, and that career staff should seek the approval of political appointees before bringing cases.[46]

Such policies make it harder for enforcement agencies to bring cases and prevent wrongdoing. The consequence is impunity for rampant wrongdoing. It should go without saying that allowing bad actors to run amok in the markets, siphoning money away from worthwhile investments and honest investors, corrupts the system feeds the growing sense among Americans across the political spectrum that the markets are rigged. In the face of such unfairness – especially now as the pandemic increasingly widens the gulf of inequality between the haves and have nots – Americans want accountability. What a shame it will be if what they see instead is impunity.

To address insider trading, the Securities and Exchange can and should police this sector with greater zeal. Bad actors abound on Wall Street. Yet the SEC which is the primary guardian of the integrity of how savers are sold investments, how corporations report results to these investors, and of whether bad actors are arrested, has reduced enforcement. Public Citizen has published reports documenting this decline.[47] Between President Obama's last year and President Trump's first year, corporate penalties dropped 68 percent and never fully rebounded. The Trump SEC has placed

---

[41] United States Sentencing Commission, *Fiscal Year 2019: Overview of Federal Criminal Cases* (April 2020), https://www.ussc.gov/sites/default/files/pdf/research-and-publications/research-publications/2020/FY19_Overview_Federal_Criminal_Cases.pdf

[42] TRAC Reports, "Corporate and White-Collar Prosecutions At All-Time Lows" (March 3, 2020), https://trac.syr.edu/tracreports/crim/597/

[43] Tom Dreisbach, "Under Trump, SEC Enforcement Of Insider Trading Dropped To Lowest Point In Decades," NPR (Aug. 14, 2020), https://wamu.org/story/20/08/14/under-trump-sec-enforcement-of-insider-trading-dropped-to-lowest-point-in-decades/

[44] Rick Claypool, Soft on Corporate Crime: Justice Department Refuses to Prosecute Corporate Lawbreakers, Fails to Deter Repeat Offenders, Public Citizen (Sept. 2019), https://www.citizen.org/wp-content/uploads/soft-on-corporate-crime-dpa-npa-repeat-offenders-report.pdf

[45] Rick Claypool, Taylor Lincoln, Michael Tanglis and Alan Zibel, Corporate Impunity: "Tough on Crime" Trump Is Weak on Corporate Crime and Wrongdoing, Public Citizen (July 2018), https://www.citizen.org/wp-content/uploads/corporate-enforcement-public-citizen-report-july-2018.pdf

[46] Paul J. Ray, Memorandum for the Deputy Secretaries of Executive Departments and Agencies, Subject: Implementation of Section 6 of Executive Order 13924 (Aug. 31, 2020), https://www.whitehouse.gov/wp-content/uploads/2020/08/M-20-31.pdf

[47] Rick Claypool, *Wall Street Impunity*, PUBLIC CITIZEN (Sept. 6, 2018) https://www.citizen.org/wpcontent/uploads/migration/wall_street_crash_enforcement_v13.pdf

Wall Street ahead of Main Street. The investigation by National Public Radio found that amidst volatile stock markets leading to "more opportunities for insider trading, using inside information to profit in the stock market, which is illegal . . . NPR has found the Trump administration has brought the fewest number of insider trading cases in decades."[48] [49]

The subcommittee can ask the SEC chair why this is so. One answer may be that he is carrying out the White House's wishes. According to the Los Angeles times, "A memo produced by the White House and sent to agency heads last week instructs them to make significant changes to how and when they bring enforcement cases, telling them not to open multiple investigations into the same company and urging them to seek political appointees' approval before proceeding with an inquiry."[50]

This alone deserves congressional inquiry. At a time when trillions in taxpayer dollars are exiting Washington to address our economic problems, we need more, not less vigilant policing.

Legislation

We support many legislative efforts to combat stock market manipulation and insider trading.

We support H.R. 624, Promoting Transparent Standards for Corporate Insiders Act, authored by Chair Maxine Waters (D-Calif). This bill directs the Securities and Exchange Commission (SEC)

---

[48] Tom Dreisbach, "Under Trump, SEC Enforcement Of Insider Trading Dropped To Lowest Point In Decades," NPR (August 14, 2020) https://www.npr.org/2020/08/14/901862355/under-trump-sec-enforcement-of-insider-trading-dropped-to-lowest-point-in-decade

[49] We wish to emphasize the importance of maintaining market integrity and following corporate controls and procedures. For example, in these dynamic circumstances, corporate insiders are regularly learning new material nonpublic information that may hold an even greater value than under normal circumstances. This may particularly be the case if earnings reports or required SEC disclosure filings are delayed due to COVID-19. Given these unique circumstances, a greater number of people may have access to material nonpublic information than in less challenging times. Those with such access – including, for example, directors, officers, employees, and consultants and other outside professionals – should be mindful of their obligations to keep this information confidential and to comply with the prohibitions on illegal securities trading. Trading in a company's securities based on inside information may violate the antifraud provisions of the federal securities laws.

We similarly urge public companies to be mindful of their established disclosure controls and procedures, insider trading prohibitions, codes of ethics, and Regulation FD and selective disclosure prohibitions to ensure to the greatest extent possible that they protect against the improper dissemination and use of material nonpublic information. Likewise, broker-dealers, investment advisers, and other registrants must comply with policies and procedures that are designed to prevent the misuse of material nonpublic information.

More generally, the Enforcement Division is committing substantial resources to ensuring that our Main Street investors are not victims of fraud or illegal practices in these unprecedented market and economic conditions. The Enforcement Division is committed to protecting investors and maintaining confidence in the fairness and integrity of our markets. From, Release, Securities and Exchange Commission, (March 23, 2020) https://www.sec.gov/news/public-statement/statement-enforcement-co-directors-market-integrity

[50] Anna Phillips, White House Directs Agencies To Relax Enforcement, Los Angeles Times (Sept. 9, 2020) https://www.latimes.com/politics/story/2020-09-09/white-house-directs-agencies-to-relax-enforcement, Also, Memorandum, Office of Information and Regulatory Affairs, (August 31, 2020) https://www.whitehouse.gov/wp-content/uploads/2020/08/M-20-31.pdf

to study and report on possible revisions to regulations regarding Rule 10b5-1 trading plans. These are plans that establish certain pre-determined times that an executive will exercise (cash) his or her stock options. It is a way for the executive to avoid falling afoul of prohibitions against illegal insider trading. Unfortunately, executives have found ways to game these plans.

Machinations around 10b5-1 plans are yet another example of strategies executives may be using to gain unfair advantage in the marketplace. Adopted by the SEC in 2000 to provide executives and insiders with protocols for trading company stocks without exposing them to the risk of insider trading accusations,[51] 10b5-1 plans have long drawn criticism for giving corporate chiefs legal cover to engage in illegal insider trading. The rule forbids executives from trading company stocks when they have material nonpublic information and instead establishes preset formulas for brokers trade on their behalf. Nevertheless, a 2012 investigation in the Wall Street Journal found evidence insiders are able to exploit the rule's timing requirements and routinely outperform the market.[52] There is no preset amount of time required to pass between when a plan is set up and when trading can begin, and a plan holder may cancel it at any time. As the Wall Street Journal put it, "There is little in the system to prevent an executive who foresees good news about the company from canceling a scheduled share sale, or an executive who foresees bad news from canceling a scheduled share purchase." Modifying plans before announcements is precisely what NPR found that Moderna did.[53] This is why an SEC insider trading investigation is urgent. It is also why the bipartisan Promoting Transparent Standards for Corporate Insiders Act (H.R. 624),[54] which cleared the House 413-3,[55] is such a vital and timely reform, and why the Senate should include the bill in the next COVID-19 relief package.

Public Citizen also supports H.R.4335, The 8-K Trading Gap of 2019, authored by Rep. Carolyn Maloney, (D-N.Y.). The bill directs 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. This would have arrested some of the pandemic profiteering we've been witnessing. This cleared the House 384-7.

Currently, public companies must disclose significant corporate events, such a successful clinical trial for a vaccine to investors and the public on Form 8–K. But there is a timing gap: they can wait four business days after the event occurs to make this disclosure. As a result, corporate executives have the benefit of knowing material, nonpublic information for four days before investors and the rest of the public. This is a problem because there is no rule prohibiting these executives from buying or selling the company's securities during this four-day gap. A 2015 study found that during a six-year period, insiders who traded during this four-day gap successfully earned $105 million in

---

[51] Final Rule: Selective Disclosure and Insider Trading, SECURITIES AND EXCHANGE COMMISSION, 17 CFR Parts 240, 243, and 249, Release Nos. 33-7881, 34-43154, IC-24599, File No. S7-31-99, RIN 3235-AH82 (Oct. 23, 2000), https://www.sec.gov/rules/final/33-7881.htm

[52] Susan Pulliam and Rob Barry, "Executives' Good Luck in Trading Own Stock," The Wall Street Journal (Nov. 27, 2012), https://www.wsj.com/articles/SB10000872396390444100404577641463717344178

[53] Susan Pulliam and Rob Barry, "'Bad Optics' Or Something More? Moderna Executives' Stock Sales Raise Concerns," NPR (Sept. 4, 2020), https://www.npr.org/2020/09/04/908305074/bad-optics-or-something-more-moderna-executives-stock-sales-raise-concerns

[54] H.R.624 - Promoting Transparent Standards for Corporate Insiders Act, 116th Congress (2019-2020) https://www.congress.gov/bill/116th-congress/house-bill/624

[55] Ibid.

above-market returns on these trades.[56] H.R. 4335, the 8–K Trading Gap Act, fixes this loophole by 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.

Public Citizen also supports an as yet unnumbered bill that would amend the Securities Exchange Act of 1934 to prohibit issuers from granting stock options if the grantor or recipient are in possession of certain nonpublic information, and for other purposes: this bill would impose certain restrictions on issuers from granting stock options to any officer, employee, or director if the issuer is in possession of material nonpublic information. We believe this blanket prohibition should clarify that insider information cannot be abused.

We welcome Rep. Cynthia Axne's (D-Iowa) bill, HR 6735, which would establish the Consumer and Investor Fraud Working Group to help protect consumers and investors from fraud during the COVID–19 pandemic.[57] This requires the SEC (along with the Consumer Financial Protection Bureau) to report monthly on how they're helping consumers and investors during the pandemic, including any enforcement efforts. Given the axiom that what's measured is what's managed, the SEC might feel some pressure to show more than zero effort on a monthly basis.

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."[58] 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,[59] that is, where the tipper or tippee receives financial or other gain.

---

[56] Cited in Congressional Record, January 13, 2020, p. H188, CONGRESSIONAL RECORD (January 13, 2020) https://www.congress.gov/116/crec/2020/01/13/CREC-2020-01-13-pt1-PgH188.pdf

[57] Rep. Cindy Axne HR 6735,Consumer and Investor Fraud Working Group,(website accessed Sept. 10, 2020) https://www.congress.gov/bill/116th-congress/house-bill/6735

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

[59] 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

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. HR 2534, the Insider Trading Prohibition Act, advanced by this committee, approved by the House 400-15. and authored chiefly by Rep. Himes, referenced above, achieves these goals. Public Citizen strongly supports this bill. It 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." [60]

On options, back dating is not currently illegal. Provided shareholders are informed, companies may and do set a strike price well below the level that prevails currently—a date back in the past. Shareholders apparently permit this because of an unholy alliance between firms and their institution investors, who may also be managers of a company's pension plans. (And even where they do not manage the specific company's plan, a history of contesting management is bad marketing when attempting to win other pension management contracts. This frustrates a prohibition on such conflicts.) Congress should consider basic reforms on back-dating, such as permitting the strike price to be established only at certain arbitrary times, such as the first of the year, or at pre-set intervals during the year. [61]

---

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 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.

[60] Office of Rep. Jim Himes, *Himes Bipartisan Insider Trading Bill Passes Financial Services Committee,* U.S. CONGRESS (May 10, 2019) https://himes.house.gov/media-center/press-releases/himes-bipartisan-insider-trading-bill-passes-financial-services

[61] Robert Daines, et al, *Right on Schedule: CEO Option Grants and Opportunism*, JOURNAL OF FINANCIAL AND QUANTITATIVE ANALYSIS (June 2018) https://www.cambridge.org/core/journals/journal-of-financial-and-

Stock buybacks should be banned until all forms of aid are repaid — without exception. The CARES Act does include restrictions on stock buybacks, but these conditions — as well as the executive compensation limits — may be waived by the Treasury Secretary if he deems it necessary "to protect the interests of the Federal Government." Aided firms must quit quarterly capitalism and wasteful stock buybacks engineered to spark a short-lived stock price jump to inflate stock-based executive compensation. Had firms not engaged in buybacks at even half the rate of the last two decades, major American corporations would not need any aid right now at all. Buybacks drain capital that could be used for better employee pay or other investments in physical assets. Before an SEC rule change in the 1980s, buybacks were rare, but now they are an engine of escalating CEO pay.[62] Sen. Tammy Baldwin (D-Wisc) promotes the Reward Work Act which bans buybacks altogether. It also requires that a third of board members be elected by a firm's employees.[63] A bill authored by Sen. Bernie Sanders (I-Vt.) and Rep. Ro Khanna (D-Calif.) would prohibit buybacks where CEO pay exceeds 150 times that of the company's median pay. Senators Cory Booker (D-N.J.) and Bob Casey (D-Pa.) have introduced the Worker Dividend Act that requires companies that buy back stocks to also pay out a commensurate sum to all of its employees.[64] The SEC should require that shareholders approve buybacks, rather than directors.[65] Finally, Congress should simply ban executive stock sales during buybacks altogether.

Equity-based pay should include provisions that prevent executives from reaping crisis windfalls. To prevent executives from receiving preferential protection from the economic crisis, corporations should be banned from repricing executive stock options or resetting the value of stock grants that may now be underwater. Any equity awards should include conditions reflecting best practices on both clawbacks and equity holding requirements.

A sizeable portion of pay for aided companies should be deferred and used to pay corporate penalties. Following the 2008 financial crash, the Justice Department found widespread fraud. However, prosecutors brought no charges against any senior individuals. Some officials cited the complication of identifying culpable individuals but that left shareholders to shoulder the fines. To improve compliance we call for the system advocated for by Willian Dudley, then president of the New York Federal Reserve, which says that senior bankers (such as the 2,000 most senior at JP Morgan) must defer a substantial portion of pay.[66] If the bank must pay a penalty, this pool is used to pay the fine instead of shareholder funds. This will motivate managers to police one another. Rep. Katie Porter (D-Calif.) sponsors a bill that calls on all corporations to sequester a portion of compensation for their top five officers (or explain to shareholders why they do not).

Rep. Ben McAdams (D-Utah) proposes a measure that allows the SEC to grant restitution to investors and disgorgement from ill-gotten gains, regardless of a statute of limitations. This bill repairs the damage done in the Supreme Court's decision in Kokesh v. SEC. The bill establishes

---

quantitative-analysis/article/right-on-schedule-ceo-option-grants-and-opportunism/DA0C243E4AE7E58B78D2E20E78520A9A/share/f9663ff7226e5992e78e2f25ad6301d6f6105b2a

62 Comm. Robert Jackson, Speech at the Center for American Progress, Securities and Exchange Commission (June 11, 2018), https://bit.ly/3czxyi2.

63 Reward Work Act, S.2605 (2018), https://bit.ly/34RgRMt.

64 Press Release, Office of Senator Cory Booker, "Booker, Casey Introduce Bill Aimed at Corporate Short-termism, Stock Buybacks," (March 7, 2018), https://bit.ly/3aCEXvA.

65 Lenore Palladino, *Stock Buybacks: Driving a High-Profit, Low-Wage Economy*, ROOSEVELT INSTITUTE (March 2018), https://bit.ly/3axJn73.

66 Bartlett Naylor, *Decimate Wall Street*, HUFFINGTON POST (December 22, 2014), https://bit.ly/2xWbI9W.

restitution and forfeiture of ill-gotten gains as statutory responses separate from a penalty. We support this measure as a vehicle to make victims whole and remove any ability that bad actors could calculate that their scams could be more lucrative than a subsequent penalty. We also support Rep. Vincente Gonzalez' (D-Texas) bill the expands the statute of limitations from five years to ten years for recovering civil monetary penalties. We also support Rep. Porter's bill to increase the size of penalties from the current per-violation cap of $181,000 to $1 million for individuals, and from $905,000 to $10 million for corporations.

Public Citizen also supports a measure to require the SEC to study stock buybacks under rule 10b-18. This measure takes a welcome step to address the glut of stock buybacks that have accelerated since the SEC relaxed anti-manipulation rules in 1982. On the surface, a stock buyback represents a declaration of management indolence. Stock buybacks raise stock prices, and when senior executive pay is paid in stock options, this can generate an unjustified bonus.

When Congress approved the $2.3 trillion CARES Act, it contained essentially no conditions on senior executive pay. It required only that certain airline and other executives limit their compensation to $3 million and half of the amount above this $3 million they received in 2019. [67] There are no limits on pay for executives at other aided firms.

Nearly 60 organizations have petitioned Congress for limits. CEOs of aided firms should receive no more than 50 times the median of their employees' pay. Senior executives should have a sizeable portion of their pay sequestered for a "penalty pot." If the firm is found to have abused the aid or engaged in misconduct that requires it to pay a penalty, taxpayers should not subsidize that penalty; the penalty pot from deferred executive compensation would be used. This deputizes all senior executives to police one another, since misconduct by any will impact them all. Further, buybacks should be banned, corporation deductions for pay to any individual of more than $1 million should be prohibited, and re-pricing options should be prohibited. Re-pricing is where the original price where a bonus kicks in is lowered, such as in a major stock dip.[68] More than 100 House Democrats have called for similar reforms.[69]

Conclusion

The American public supports pay reform. Polls affirm that Americans believe CEOs are overpaid relative to their line workers.[70] Over time, polls have shown shifting but always strong support for limiting CEO pay.[71] [72] Polls show widespread support for higher income taxes and a wealth tax. One October 2019 poll shows that Americans' top priority regarding tax policy is making sure the

---

[67] See Title IV, CARES Act

[68] *Petition to Limit Executive Compensation During Covid-19 Crisis,* PUBLIC CITIZEN (April30, 2020 https://www.citizen.org/article/petition-to-limit-executive-compensation-during-covid-19-crisis/

[69] Sarah Anderson, *100 House Democrats Call for Cap on CEO-Worker Pay Gaps at Bailed-Out Firms,* Institute for Policy Studies, (March 21, 2020) https://ips-dc.org/100-house-democrats-call-for-cap-on-ceo-worker-pay-gaps-at-bailed-out-firms/

[70] The CEO-Worker Pay Gap, INSTITUTE FOR POLICY STUDIES (February 2019), https://bit.ly/2VoSyCI.

[71] Frank Newport, *Americans Split on Government Action to Limit Executive Pay,* GALLUP (April 5, 2018), https://bit.ly/34Rpiau.

[72] From Gabriel Zucman, *Triumph of Influence*, Oct 2019.

wealthy pay their fair share. Another poll shows strong support for an additional 10-percentage point tax on income above $2 million.[73]

Those engrossed in the pandemic must not repeat this neglect from the unfulfilled rulemaking from the 2010 Dodd-Frank Act. Now that trillions in taxpayer dollars are leaving Washington, lawmakers must not let it fatten the bank accounts of executives at those firms being aided. Limits must be placed, conditions established. This is basic. Ideally, corporate America will learn that real pay reform will be good for the entire economy, will lead to less misconduct, and honest drug-making.

[73] Millionaires Surtax: A Winning Issue in 2020, MILLIONAIRES SURTAX, https://bit.ly/2VBdl68.

APPENDIX:

The Intersection of Executive Compensation and Health Care Expense

The U.S. health system costs four times as much to run as the system in Canada.[74] There is little debate that profiteering drives this expense. Part of that profiteering is the extraordinary CEO and senior manager pay in the health care industry. For example, the CEO of Regeneron Pharmaceuticals pocketed $118 million in 2018. The CEO of HCA Healthcare took in $109 million, the Pfizer CEO made $47 million, and the Humana CEO took in $27 million.[75] Just these singular annual payments are enough not only to secure a luxurious future for these CEOs, but also their offspring, with no need ever to work again. Yet these CEOs will undoubtedly receive similar windfalls in future years, as well. Below these CEOs are countless other senior executives who also receive millions of dollars annually. These are the routine paychecks financed by the high prices that average Americans pay for health insurance, co-pays and for care services.

In 2016, the U.S. spent 17.8 percent of its gross domestic product (GDP) on healthcare. Other countries' spending ranged from a low of 9.6 percent of GDP in Australia to a high of 12.4 percent of GDP in Switzerland.[76] A sizeable amount of this difference in spending finds itself in the bank accounts of health provider business. Drug pricing, surprise billing and the opioid crisis demonstrate the problem of misplaced pay incentives in the health care industry.

The high cost of prescription medicines in the U.S. demonstrates how profiteering subordinates health care results. Since 1996, pharmaceutical corporations have increased the list price of a vial of insulin from $21 to over $275.[77] For example, patients with serious diabetes can pay $3,000 a month for insulin in the United States. In Canada, the comparable bottle of insulin costs $21.[78] Drug price gouging is all too common. Corporations abuse their monopolies to jack-up prices. As a Public Citizen commentary noted, "Pharma CEOs get rich, patients die rationing insulin."[79] These high drug prices raise stock prices which raises stock-based compensation of their executives.

Consider Allergan. A Public Citizen report noted that "[A] closer examination of the corporation's record reveals a catalogue of abuses, showing just how deeply the pharmaceutical industry business

---

[74] Melissa Healey, *U.S. health system costs four times more to run than Canada's single-payer system*, LOS ANGELES TIMES (January 7, 2020), https://lat.ms/2RJjMBw. https://www.latimes.com/science/story/2020-01-07/u-s-health-system-costs-four-times-more-than-canadas-single-payer-system

[75] Bob Herman, *Health care CEOs took home $2.6 billion in 2018*, AXIOS (May 16, 2019), https://bit.ly/3evPCvq.

[76] Lisa Rapaport, *U.S. health spending twice other countries with worse results*, REUTERS (March 13, 2018), https://reut.rs/2xAUnmE.

[77] Carolyn Johnson, *Why Treating Diabetes Keeps Getting More Expensive*, WASHINGTON POST (Oct. 31, 2016) https://www.washingtonpost.com/news/wonk/wp/2016/10/31/why-insulin-prices-have-kept-rising-for-95-years/

[78] Emily Miller, *U.S Drug Prices vs. The World*, DRUG WATCH (January 25, 2018), https://bit.ly/3acyMy9.

[79] Pharma CEOs Get Rich, Patients Die Rationing Insulin, Public Citizen (website viewed July 17, 2020) https://www.citizen.org/article/pharma-ceos-get-rich-patients-die-rationing-insulin/

model is broken" Allergan "has repeatedly used dubious tactics to boost profits — from paying off its competitors, to gaming the patent system, to hiking the prices of old medicines." Recently, "Allergan has entered settlements for a billion dollars over its anticompetitive conduct and remains enmeshed in several other lawsuits, with possible legal exposure for billions more. Between 2006 to 2012, its former subsidiary sold 26 billion opioid pills, more than 80 for every American."[80]

Critics, including the firm's own shareholders, lambasted compensation plans for leading to these legal costs. One institutional investor highlighted the "stunningly excessive level of management compensation."[81] One Allergan CEO was "lined up to receive $38.7 million in compensation" as a golden parachute, according to a media account. [82] In 2019, the CEO received $9.2 million in compensation. This included more than $6 million worth of stock options.[83] The board of directors, which approves executive compensation, is also paid, in part, in stock options. Approximately half of the more than $300,000 that each receives comes from stock-based compensation.[84]

Congress has investigated the connection between raising drug prices and winning greater executive compensation. For example, a Senate committee reviewed the connection between the pay of AbbVie Chairman and CEO Richard Gonzalez and the sales of its arthritis treatment Humira. Since 2014, AbbVie has nearly doubled the price of Humira. The drug now carries a list price of more than $60,000 per year. AbbVie has aggressively kept low-cost biosimilar competition off the U.S. market."[85] In 2017, Humira generated $18.3 billion in sales, a 14.6 percent increase from the previous year. Humira sales accounted for about 65 percent of the company's $28.1 billion in revenue. In turn, this increase factored in "the compensation for AbbVie's top executives," according to one account.[86] [87]

CEO Gonzalez received a total of $22.6 million for his performance in 2017, $4.3 million of which was his cash bonus. The rest of his compensation was base salary and a mix of stock, restricted shares and options. "This strikes me as problematic," Sen. Ron Wyden, (D-Ore.), noted. "Would

---

[80] ZAIN RIZVI, PUBLIC CITIZEN, BY ANY MEANS NECESSARY: HOW ALLERGAN GAMED THE SYSTEM TO RAISE DRUG PRICES AND FLOOD THE COUNTRY WITH PILLS (January 2020), https://bit.ly/2KfEgxA.

[81] David Tepper on behalf of APPALOOSA LP, Letter to Allergan (Feb. 19, 2019), https://tinyurl.com/qwnvrmd.

[82] Carly Helfan, *Pharma Allergan CEO Saunders lines up for $39M parachute after AbbVie buy*, FIERCEPHARMA (Aug. 14 2019), https://tinyurl.com/uym6u4h.

[83] *Allergan, Proxy Statement*, SECURITIES AND EXCHANGE COMMISSION (2020) https://www.sec.gov/Archives/edgar/data/1631650/000156459019011278/aimt-def14a_20190523.htm

[84] *Allergan, Proxy Statement*, SECURITIES AND EXCHANGE COMMISSION (2020) https://www.sec.gov/Archives/edgar/data/1631650/000156459019011278/aimt-def14a_20190523.htm

[85] Berkely Lovelace Jr., *Senate panel grills pharma CEO over executive bonuses and sales of AbbVie blockbuster drug Humira*, CNBC (February 27, 2019), https://cnb.cx/3esCnvr.

[86] Berkely Lovelace Jr., *Senate panel grills pharma CEO over executive bonuses and sales of AbbVie blockbuster drug Humira*, CNBC (February 27, 2019), https://cnb.cx/3esCnvr.

[87] According to this account, "Humira sales are one of the company's four main financial targets — along with net revenues, operating margin and return on assets — that accounted for 60 percent of Gonzalez's short-term incentive plan. The plan pays out a cash award for each of the top five executives equal to up to 200 percent of their base salary, depending on if they meet the targets and other performance measures." Berkely Lovelace Jr., *Senate panel grills pharma CEO over executive bonuses and sales of AbbVie blockbuster drug Humira*, CNBC (February 27, 2019), https://cnb.cx/34SluWE.

you make a smaller bonus if you dropped the price of Humira?" In response, Gonzalez acknowledged, "It is clear it would be a part of the evaluation."[88]

The opioid crisis emerged from similar profiteering by senior managers. Opioids are a class of strong, highly addictive painkillers. Before the 1980s, many doctors refrained from prescribing such sustained pain killers following surgeries, deciding that the patient would be better suffering some discomfort over the short-term rather than risk long-term addition to pain killers. Then the opioid industry began to promote so-called scientific studies claiming that the painkillers were not addictive.[89] [90] [91] It took decades before this industry link was identified and disinterested research debunked the finding.[92] As the Centers for Disease Control and Prevention (CDC) summarized, "In the late 1990s, pharmaceutical companies reassured the medical community that patients would not become addicted to prescription opioid pain relievers, and healthcare providers began to prescribe them at greater rates. This subsequently led to widespread diversion and misuse of these medications before it became clear that these medications could indeed be highly addictive."[93]

But the faux findings were convenient to otherwise well intended caregivers. Private insurance favored opioid treatments over more expensive therapies. Explained one expert, "Most insurance, especially for poor people, won't pay for anything but a pill."[94] In addition to opioids distributed through doctor prescriptions, an illegal market developed.

In fact, opioids are addictive and are readily abused. In 2000, the CDC counted approximately 8,000 fatalities from opioid abuse. By 2010, this grew to nearly 20,000 annually. In 2017, the figure surpassed 45,000.[95]

Subsequent litigation laid bare the financial motivations behind the promotion of opioid sales by leading opioid manufacturers and distributors. The Sackler family, which owned Purdue Pharma, reaped generous rewards from the opioid crisis, notably its flagship brand OxyContin, which it introduced in 1996.

---

[88] Berkely Lovelace Jr., *Senate panel grills pharma CEO over executive bonuses and sales of AbbVie blockbuster drug Humira*, CNBC (February 27, 2019), https://cnb.cx/34SluWE.
[89] Subsequently, it was found that this research was unsound, and, moreover, funded secretly by the opioid industry. Danny Hakim, Roni Caryn Rabin, and William Rashbaum, *Lawsuits Lay Bare Sackler Family's Role in Opioid Crisis*, NEW YORK TIMES, https://nyti.ms/2xJfGCI.
[90] Richard D. DeShazo, Mckenzie Johnson, and Kathryn Rodenmyer, *Backstories on the US Opioid Epidemic: Intentions Gone Bad, and Industry Gone Rogue, and Watch Dogs Gone to Sleep,* AMERICAN JOURNAL OF MEDICINE, https://bit.ly/2wXvsJU.
[91] For example, in 1980, a letter to the editor the New England Journal of Medicine reported that of 11,882 hospitalized patients treated with narcotics, less than 1 percent of them became addicted. The letter was subsequently "uncritically cited" in 439 articles published in scientific journals. Richard D. DeShazo, Mckenzie Johnson, and Kathryn Rodenmver, *Backstories on the US Opioid Epidemic: Intentions Gone Bad, and Industry Gone Rogue, and Watch Dogs Gone to Sleep,* AMERICAN JOURNAL OF MEDICINE, https://bit.ly/2wXvsJU.
[92] Richard D. DeShazo, Mckenzie Johnson, and Kathryn Rodenmyer, *Backstories on the US Opioid Epidemic: Intentions Gone Bad, and Industry Gone Rogue, and Watch Dogs Gone to Sleep,* AMERICAN JOURNAL OF MEDICINE, https://bit.ly/2wXvsJU.
[93] *Opioid Overdose Crisis*, NATIONAL INSTITUTE ON DRUG ABUSE (February 2020), https://bit.ly/2RTn9WK.
[94] Owen Amos, *Why Opioids are Such an American Problem,* BBC NEWS (October 25, 2017), https://bbc.in/3ezwaOl.
[95] Linked from Overdose Death Rates. By National Institute on Drug Abuse (NIDA). Data source is CDC's searchable database, called CDC Wonder. 2002-2015 chart. 2002-2017 chart

Even as the opioid crisis became widespread and well publicized, Sackler family members looked to capitalize further. For example, in 2011 Sackler "family members peppered the sales staff with questions about how to expand the market for the drugs." One asked "if they could sell a generic version . . . in order to 'capture more cost sensitive patients." [96]

Explained one observer, "The pill is stronger than morphine and sparked the opioid crisis that's now killing[97] more than 100 people a day in America and has spawned millions of addicts."[98] The family had helped fund the faux science, and marketed the additive drug aggressively.[99] Said attorney Michael Moore, who led litigation against Purdue, "Greed is the main thing. The market for OxyContin should have been much, much smaller, but they wanted to have a $10bn drug and they didn't tell the truth about their product."[100] A group of senators concluded that Purdue's opioid marketing campaign, which accelerated the epidemic, that has claimed an estimated 400,000 lives, grew from a "significant incentive bonus compensation for [the CEO] for achieving ambitious opioid sales targets." The senators expressed concern that Purdue is using profits from selling more prescription opioids to reward high-level employees with massive bonuses. [101]

Eventually, litigation concerning the company's role in the opioid crisis led the firm to declare bankruptcy. Even after that, high compensation did not abate. Even now, the congressional critics say this bonus culture persists. For example, the CEO of Purdue received a $1.3 million incentive bonus payment even though he "is a named defendant in multiple lawsuits, which allege he personally designed Purdue's intentionally deceptive opioid marketing campaign." The senators noted that "the payment is based on aggressive performance incentives similar to those used to encourage opioid sales." In conclusion, senators investigating the company argued, "By maintaining the aggressive incentive plan *for* [the CEO], the Board is showing that it does not recognize the role the incentive program played in accelerating the opioid crisis into a national tragedy"[102]

Purdue is not the only company where pay fueled pill pushing. McKesson has been one of the largest distributors of opioids. Here, too, the CEO's pay linked to hitting targets related to distribution metrics. Even in a year when McKesson faced litigation stemming from its role in the opioid crisis, the CEO received a $4 million bonus for hitting financial targets tied to distribution,[103]

---

[96] Danny Hakim, Roni Caryn Rabin and William K Rashbaum, *Lawsuits Lay Bare Sackler Family's Role in Opioid Crisis*, NEW YORK TIMES (April 1, 2019), https://nyti.ms/2VkUfRn.
[97] *Opioid Overdose Statistics*, CENTER FOR DISEASE CONTROL, https://bit.ly/2XPDU91.
[98] Joanna Walters, *Meet the Sacklers: feuding over blame for the opioid crisis*, THE GUARDIAN (February 13, 2018), https://bit.ly/2VDkh1e.
[99] Barry Meier, *In Guilty Plea, OxyContin Maker to Pay $600 Million*, NEW YORK TIMES (May 10, 2007), https://nyti.ms/3akJByh.
[100] Joanna Walters, *Meet the Sacklers: feuding over blame for the opioid crisis*, THE GUARDIAN (February 13, 2018), https://bit.ly/2VDkh1e.
[101] Press Release, Office of Senator Tammy Baldwin, *Baldwin, Colleagues Call on Purdue Pharma to Cancel $1.3 Million Bonus For CEO* (December 17, 2019), https://bit.ly/3eBeWjw.
[102] Press Release, Office of Senator Tammy Baldwin, *Baldwin, Colleagues Call on Purdue Pharma to Cancel $1.3 Million Bonus For CEO* (December 17, 2019), https://bit.ly/3eBeWjw.
[103] Bob Herman, *More Lawsuits roll in against opioid makers, distributors*, AXIOS (January 5, 2018), https://bit.ly/2VtxoTZ.

in addition to a retirement package of $159 million.[104] [105] Eventually, McKesson settled with the Department of Justice for $150 million on charges that it "failed to report suspiciously large orders of prescription opioids from its pharmacy customers," according one account..[106] The firm "is also contending with more than 1,000 civil suits across the U.S. related to its distribution of controlled substances."[107]

---

104 Joseph Walker, *Longtime McKeeson CEO to Step Down*, WALL STREET JOURNAL (Nov. 1, 2018), https://on.wsj.com/3brzvNE.

105 The CEO also reduced compensation for its Teamster truck drivers. Erika Fry, *Big McKesson Shareholder, Governance Experts Say the Crisis Should Have Cost the CEO Some Bonus Pay*, FORTUNE (June 10, 2017), https://bit.ly/2Vo6IUl.

106 Joseph Walker, *Longtime McKeeson CEO to Step Down*, WALL STREET JOURNAL (Nov. 1, 2018), https://on.wsj.com/2zdZVE91541112805.

107Joseph Walker, *Longtime McKeeson CEO to Step Down*, WALL STREET JOURNAL (Nov. 1, 2018), https://on.wsj.com/2zdZVE91541112805.

Testimony before the
Investor Protection, Entrepreneurship, and Capital Markets Subcommittee
U.S. House Committee on Financial Services
"Insider Trading and Stock Option Grants:
An Examination of Corporate Integrity in the Covid-19 Pandemic"

Jill E. Fisch
Saul A. Fox Distinguished Professor of Business Law
University of Pennsylvania Law School

September 17, 2020

Chairman Sherman, Ranking Member Huizenga and Members of the Subcommittee, it is an honor to participate in today's hearing on Insider Trading and Stock Option Grants: An Examination of Corporate Integrity in the Covid-19 Pandemic. My name is Jill Fisch, and I am a professor at the University of Pennsylvania Law School where I teach and write in the areas of corporate law, corporate governance, and securities regulation. I also serve as the co-director of the Penn Institute for Law & Economics. Prior to joining the faculty at Penn, I taught at Fordham Law School for almost twenty years. Before that I worked as a corporate litigator in New York and in the criminal division of the U.S. Department of Justice.

In the past six months, the capital markets have experienced unprecedented levels of trading activity and price volatility.[1] The stock prices of many companies, particularly those in industries affected directly by the pandemic, including pharmaceutical companies, but also those involving the production of testing kits, personal protective equipment, internet-based services and even household supplies, have fluctuated dramatically. These fluctuations create the opportunity for manipulation and misconduct and have drawn considerable media attention.

I have written extensively about securities fraud, SEC enforcement and insider trading,[2] and I am happy to address the Subcommittee's questions with respect to recent market events. At the outset, I want to be clear that I have not conducted any investigation or empirical analysis of the events at specific companies. Instead, I am here today to provide you with an overview of the existing regulatory structure and the challenges posed by the current market environment.

---

[1] SEC Chairman Jay Clayton has provided this Subcommittee with data on the high level of trading volume and volatility that the market has experienced in recent months. See Jay Clayton, Capital Markets and Emergency Lending in the COVID-19 Era, Testimony before the Investor Protection, Entrepreneurship, and Capital Markets Subcommittee U.S. House Committee on Financial Services, June 25, 2020 n. 2, available at https://www.sec.gov/news/testimony/clayton-2020-06-25.

[2] See, e.g., Jill E. Fisch, *Constructive Ambiguity and Judicial Development of Insider Trading*, 71 SMU L. Rev. 749 (2018); Jill E. Fisch, *Family Ties:* Salman *and the Scope of Insider Trading*, 69 Stan. L. Rev. Online 46 (2016); Jill E. Fisch, *Federal Securities Fraud Litigation as a Lawmaking Partnership*, 93 Wash. U. L. Rev. 453 (2016); Jill E. Fisch, *Start Making Sense: An Analysis and Proposal for Insider Trading Regulation*, 26 Ga. L. Rev. 179 (1991).

The activities in which I understand the Subcommittee to be interested involve three distinct sets of legal issues: disclosure integrity, the use of stock options and insider trading. I will address those issues in turn. I will briefly conclude by addressing the potential need for regulatory responses.

I. Disclosure Integrity

The first issue implicated by recent events is disclosure integrity. Some news stories have reported that issuers have made distorted, inaccurate or overly-optimistic disclosures in order to drive up their stock price for various reasons. Those reasons range from enabling insiders to sell their stock at a profit, increasing the value of executive stock options or facilitating the issuer's access to additional capital.

Existing securities regulation requires issuer disclosures to be accurate. False and misleading disclosures, particularly those that are made with the effort to manipulate stock prices or create opportunities for personal gain, constitute securities fraud.[3] Accordingly, an issuer or corporate official that makes false claims about a pharmaceutical product that is under development or misstates the results of a clinical trial, has violated existing law and may face both an SEC enforcement action and private civil litigation. In addition, willful misstatements may subject the issuer and individual officials to criminal liability.[4] Importantly, securities fraud liability attaches to all public statements, whether or not those statements are contained in a securities filing or addressed directly to the capital markets.

The existing market environment, however, creates a challenging disclosure environment for issuers. The scope of the pandemic, the global lockdown, and the effect on the world economy, are unprecedented. Any pandemic-related information has the potential to have an enormous impact. As a result, investors, capital markets, and the general public, are making tremendous demands on issuers to predict the future – to explain the potential effect of pandemic-related issues on their business operations. The SEC has encouraged issuers to provide as much information as possible about pandemic-related risks.[5] At the same time, there are many unknowns. The medical and scientific communities are still in the process of developing information on how the virus spreads, how to treat it effectively and the potential time frame for existing research efforts. It is difficult for businesses to predict when they will be able to reopen, and the extent of consumer demand for services ranging from airline flights to face masks. It is equally hard to predict the cost of constantly-evolving regulatory restrictions, including measures designed to protect the health and safety of customers and employees. Simply put, issuers are under great pressure to disclose as much information as possible, in a constantly-changing environment, but premature disclosure may of uncertain forward-looking information may, in hindsight, prove inaccurate.

---

[3] See 15 U.S.C. § 78j; 17 C.F.R. § 240.10b-5.
[4] 15 U.S.C. § 78ff(a).
[5] See, e.g., Coronavirus (COVID-19), Division of Corporation Finance, Securities and Exchange Commission, CF Disclosure Guidance: Topic No. 9, March 25, 2020, available at https://www.sec.gov/corpfin/coronavirus-covid-19 ("The Division encourages timely reporting while recognizing that it may be difficult to assess or predict with precision the broad effects of COVID-19 on industries or individual companies.").

At the same time, because the whole world is watching the effort to fight the pandemic, every disclosure, particularly in critical industries such as pharmaceuticals, has a dramatic effect on stock prices. Even an announcement that a company has made a small research advance is promising news, not just for investors, but for the world. Although some commentators have portrayed this price response as problematic, it is exactly the opposite. Investors evaluate issuers based on their future potential. In fact, it is socially desirable for capital to flow to issuers that offer the prospect of developing successful products – we call this allocational efficiency. An announcement that an issuer's product has had success in an early stage trial, or that the issuer has demonstrated sufficient potential to obtain government funding are indications of the issuer's potential future value and, as such, these announcements should cause stock prices to rise.

That is not to say that false announcements about research into treatments or vaccines are acceptable. As I said earlier, knowing, intentional and even reckless false statements are illegal and actionable. But particularly in this market environment, a significant stock price reaction to good news does not demonstrate fraudulent behavior, whether or not the company is ultimately successful in developing an effective product.

II. Stock Options

A few key points about the use of stock options. Stock options are a form of executive compensation. The grant of an option allows an executive to purchase stock at a future point in time at a pre-determined price, typically the current market price of the stock. The value of the option grant to the executive then is the difference between the grant price and the price at the time that the option is exercised. When the option is exercised, the executive purchases the stock from the corporation, not from public investors. As a result, the cost to the corporation from an option grant is no different than if the executive were paid the same amount in the form of a salary or bonus.[6] The primary rationale for using options is that they are performance-based; the executive only makes money if the stock price increases.[7]

As executive compensation, stock options are also subject to certain structural requirements. Contrary to some suggestions by the media, corporate executives cannot simply award themselves stock options. For a publicly-traded corporation, the compensation committee of the Board of Directors, a committee consisting of independent directors, must approve both the amount and structure of executive compensation. In some cases, option grants are also subject to shareholder approval. Existing securities laws require extensive disclosure of the compensation of an issuer's top executives, and the Dodd-Frank Act implemented "Say on Pay," a requirement that the shareholders be given an opportunity to cast a non-binding vote approving the issuer's compensation plan.[8]

---

[6] At one point, issuers could obtain more favorable accounting treatment by compensating executives with options rather than other forms of compensation. That possibility was eliminated by the adoption of a requirement that issuers expense stock option grants. See David I. Walker, *Reconsidering Realization-Based Accounting for Equity Compensation*, 13 N.Y.U. J.L. & Bus. 535 (2017).

[7] Regulators and investors have increased encouraged issuers to incorporate performance-based metrics into their executive compensation structures.

[8] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 951, 124 Stat. 1376 (2010) (codified at 15 U.S.C. § 78n-1).

Because of this structure, an executive who is granted a stock option is not engaging in insider trading. The situation is no different than if, in expectation of receiving government funding or FDA approval, a pharmaceutical company awarded its executives salary increases or bonuses. There is no requirement that, in making compensation decisions, the Board disclose material non-public information, nor is there any rationale for such a requirement, as there is no need to protect the interests of an uninformed market counterparty. State corporate law imposes fiduciary duties on the directors who approve a stock option grant, however, and federal law requires accurate disclosure of the terms of the options and the date upon which they are granted.[9]

The use of option-based compensation does create a degree of moral hazard. The schedule on which options are granted, vest, and can be exercised may create strong financial incentives for executives to control the timing of the issuer's disclosures in order to generate profitable trading opportunities. Federal securities law attempts to limit this type of opportunistic behavior both by requiring disclosure when executives trade their company's stock[10] and by providing that short-swing trading profits – profits based on a purchase and sale within a six month period, must be forfeited to the corporation.[11] These provisions do not require proof that the executive was privy to or misused material non-public information.

III. Insider Trading

The final concern is the possibility of insider trading. Congress has never defined insider trading by statute, although there have been many bills introduced with proposed definitions. Of those bills, H.R.2534 does an excellent job of synthesizing the existing case law, establishing clear standards for what constitutes the wrongful acquisition or use of material nonpublic information, and increasing predictability. There are, however, advantages and disadvantages to promulgating a statutory definition in that it may inhibit the law's ability to adapt to future practices and market conditions. There is also little reason to believe that the conduct that has been the focus of the media attention falls within a grey area of existing law. If corporate executives purchased or sold securities ahead of material public disclosures, their actions were illegal. Indeed, it appears that a fair amount of the media attention has focused on corporate executives who sold their existing holdings **following** a public disclosure, a disclosure that resulted in a substantial increase in stock price. This does not constitute insider trading.

There is, however, a component of discretionary executive trading behavior that is potentially problematic, and that is the use of 10b5-1 plans.[12] The purpose of such plans is to enable an executive to establish a plan to buy or sell stock in advance of acquiring any material nonpublic information. Once a plan is in place, the trades can occur even if, at the time of the trade, the executive is in possession of inside information. 10b5-1 plans allow executives to obtain liquidity by selling stock that they have received as compensation on a regular basis without triggering insider trading liability in connection with those sales.

[9] These disclosure requirements were at the heart of the options back-dating scandals.
[10] 15 U.S.C. § 78p(a).
[11] 15 U.S.C. § 78p(b).
[12] 17 C.F.R. § 240.10b5-1.

A shortcoming of the existing regulatory structure is that current law does not require corporate executives to disclose the existence of their 10b5-1 trading plans. Nor are executives required to disclose if they modify or terminate an existing plan. In addition, current law allows executives, in some cases, to modify existing trading plans on the basis of inside information without facing liability for insider trading. Specifically, an executive who learns about positive news can terminate his or her previously established decision to sell, based on that news. Because the termination does not constitute the purchase or sale of a security, but rather refraining from trading, technically it is not insider trading. It appears that some executives, in light of market developments may have decided not to trade in accordance with their existing 10b5-1 plans. Although individual issuers may establish procedures governing when or how executives are permitted to do so, such procedures are not required by existing law.

IV. Potential regulatory responses

Finally, a few words about potential regulatory reforms. As I indicated, existing law clearly prohibits corporations and corporate executives from making false statements to manipulate stock prices, whether or not they do so with the intention of creating profitable trading opportunities. The law does not, however, prohibit corporate executives from profiting when stock prices rise in response to accurate positive information, even if that information is speculative and even if the market is over-reacting to the news.

The use of stock options and the use of stock price as a metric for executive performance increase the probability that corporate executives will enjoy substantial gains if the price of their company's stock increases – and there have been many recent examples of such gains in both the pharmaceutical industry and elsewhere. It may be bad corporate policy to pay executives too much or to structure their compensation to be so heavily depend on stock price movements, and the practice may be problematic from a governance perspective, but that does not make it insider trading or securities fraud.

The potential for corporate executives to behave opportunistically through their use of 10b5-1 trading plans is another matter. The capital markets would benefit from greater disclosure requirements surrounding the use of 10b5-1 plans so that they do not serve as a cover for the misuse of information. Similarly, it is a matter of good corporate hygiene for corporate boards to set policies to monitor the circumstances under which executives establish, modify and terminate such plans.

Thank you, Chairman Sherman and Ranking Member Huizenga, for inviting me to participate in today's hearing, and I look forward to your questions.

DICKINSON WRIGHT

Opening Statement by

Jacob S. Frenkel

Member Partner and Chair of Government Investigations and Securities Enforcement Practice

before the

United States House of Representatives
Committee on Financial Services
Subcommittee on Investor Protection, Entrepreneurship and Capital Markets

on

"Insider Trading and Stock Option Grants: An Examination of Corporate Integrity in the Covid-19 Pandemic"

September 17, 2020

WWW.DICKINSONWRIGHT.COM

Opening Statement of Jacob S. Frenkel for the Committee on Financial Services, Subcommittee on Investor Protection, Entrepreneurship and Capital Markets, Hearing on "Insider Trading and Stock Option Grants: An Examination of Corporate Integrity in the Covid-19 Pandemic," September 17, 2020

Good afternoon, Chairman Sherman, Ranking Member Huizenga, and distinguished members of this Subcommittee.

Thank you for giving me the opportunity to testify on critical issues impacting our capital markets. My perspective comes from 32 years of professional experience in capital markets enforcement, investigations, governance and integrity issues, including my work at the Securities and Exchange Commission's Division of Enforcement, as a federal prosecutor of public corruption and securities violations, and as an actively practicing defense and governance lawyer for more than 21 years.

I believe that in 2020, unlike 20 or more years ago pre-Enron, most corporate boards and management want to get it right. Nevertheless, we still see capital markets activity that gives rise to questions about commitments to compliance and fundamental common law duties that are the responsibility of corporate custodians. This Committee has identified insider trading, Rule 105-1 plans and stock options grants – spring-loading and bullet-dodging – as issues of heightened interest and warranting consideration of legislation.

Beyond these undeniable vital areas of concern, I suggest to the Committee, respectfully, that Covid-19 solutions-related capital markets activities also should invite scrutiny of several other issues. They include:

- First -- Regulation FD and its inapplicability to foreign private issuers. We saw the effect of the exemption two weeks ago when Astrazeneca's CEO disclosed on a non-public call arranged by JP Morgan about its suspension of vaccine clinical trials as a result of an unexplained illness in a trial participant. If Astrazeneca had been a US issuer, then there likely would have been an obligation for prompt public disclosure of what appeared to be an unintentional selective disclosure.

- Second is the SEC's 10-day trading suspension authority, which operates like a court-imposed temporary restraining order; however, it is not an enforcement action but operates as an administrative arrow through the heart of legitimate small entrepreneurial public companies. For trading suspensions that issuers contest, the SEC takes months if not longer to resolve the challenge. Legislation should dictate a precise and narrow time frame for making the decision.

- Third is delegation of authority to authorize formal orders of investigation at the SEC. For decades, the Commission alone made the decision. Post-Madoff, the authority was delegated into the Enforcement Division, what I and others viewed as an out-of-control practice in the previous SEC administration. Although SEC Chairman Clayton has reigned in this delegation of authority, I believe that Congress intended for the Commissioners to decide whom to investigate and to make the solemn decision about authorizing subpoena power, much like a federal judge reviews and approves search warrant applications.

• And, fourth is trade clearance and conflict of interest disclosure policies, and whether they should apply to NIH Advisory panels. The question for consideration is what level of transparency should exist to enable you on Capitol Hill and the public to assess possible conflicts of interest among scientific and technical peer review advisers who are not subject to the Federal Advisory Committee Act.

These are not instead of but are in addition to the important issues already identified by this Subcommittee. I hope that we will be able to discuss each of these issues this afternoon.

Finally, you have asked that we address the importance of corporate integrity during the COVID-19 pandemic and the impact it has on investor protection and overall market integrity. I believe that is too narrow. Corporate integrity -- a commitment to best practices and proper governance, including a conscientious discharge of common law fiduciary duties, and a constant focus on investor protection and market integrity -- was, is during the pandemic, and always will be and must be guiding principles in corporate boardrooms and c-suites for US capital markets participants.

I complement the Committee for highlighting the importance of and addressing these issues with this hearing. I look forward to answering your questions this afternoon.

Thank you.

Vaxart, Inc.

(NASDAQ: VXRT)

Congressional Testimony of Jacob Frenkel

Member, Chair of Government Investigations & Securities Enforcement Practice

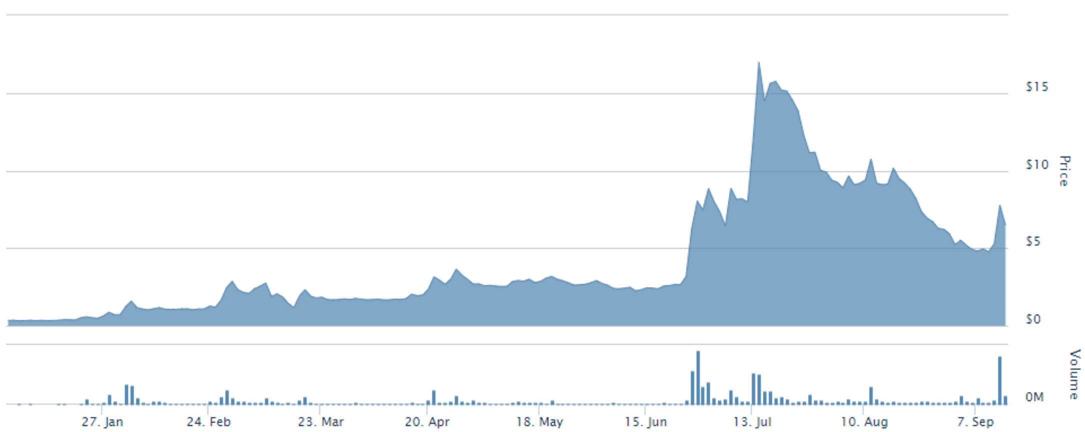
Dickinson Wright PLLC • Sept. 17, 2020

Financial Data Provided By

INVESTOR BRAND NETWORK IBN

JACOB FRENKEL TESTIMONY – EXHIBIT VXRT

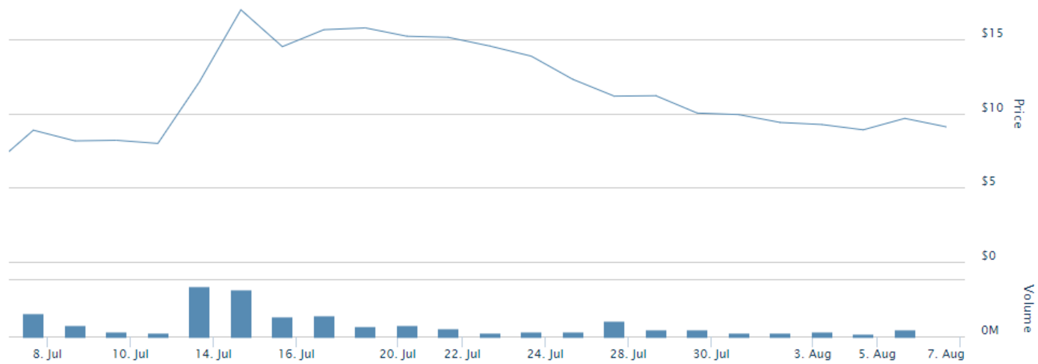
2020 YTD Chart for Vaxart, Inc. (NASDAQ: VXRT)



Financial Data Provided By INVESTOR BRAND NETWORK IBN

JACOB FRENKEL TESTIMONY – EXHIBIT VXRT

July 9-Aug. 5, 2020, Historical Data for Vaxart, Inc. (NASDAQ: VXRT)



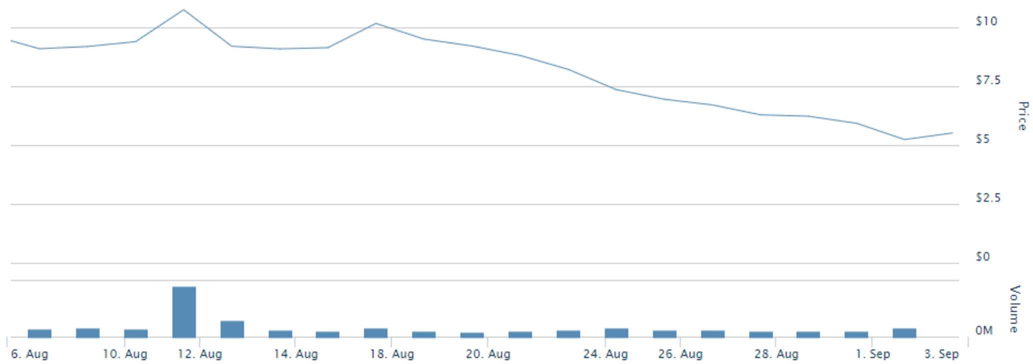
Date	Open	High	Low	Close	Volume	% Chg	$ Chg	Trade Val	# Trades
2020-08-05	9.75	10.99	9.62	9.665	20.52m	8.66%	0.77	207,711,871.00	76,259
2020-08-04	8.95	9.23	8.81	8.895	8.74m	-3.84%	-0.355	78,915,621.10	43,333
2020-08-03	9.17	9.74	8.45	9.25	13.96m	-1.49%	-0.14	126,558,876.00	56,556
2020-07-31	9.97	10.15	9.34	9.39	9.30m	-5.34%	-0.53	89,868,302.20	39,460
2020-07-30	9.54	10.40	9.53	9.92	9.95m	-1.00%	-0.10	99,531,650.50	37,760
2020-07-29	10.92	11.46	9.811	10.02	17.89m	-10.46%	-1.17	184,468,495.00	65,607
2020-07-28	11.30	12.25	10.511	11.19	18.55m	0.27%	0.03	217,429,483.00	68,345
2020-07-27	10.34	11.99	9.16	11.16	42.45m	-9.19%	-1.13	443,242,496.00	147,762
2020-07-24	13.01	13.12	12.00	12.29	14.63m	-11.26%	-1.56	183,156,180.00	59,987
2020-07-23	14.07	14.70	13.22	13.85	14.77m	-4.68%	-0.68	206,544,767.00	64,335
2020-07-22	14.65	14.75	14.13	14.53	9.48m	-3.87%	-0.585	137,166,579.00	47,831
2020-07-21	14.58	15.97	13.61	15.115	21.54m	-0.49%	-0.075	318,747,132.00	89,869
2020-07-20	16.567	16.878	14.77	15.19	31.42m	-3.56%	-0.56	493,012,006.00	121,030
2020-07-17	15.95	16.65	15.40	15.75	27.92m	0.77%	0.12	446,435,159.00	105,702
2020-07-16	14.09	17.15	14.00	15.63	56.50m	7.87%	1.14	903,933,548.00	204,523
2020-07-15	15.53	15.98	13.50	14.49	55.42m	-14.61%	-2.48	813,589,521.00	219,465
2020-07-14	13.17	17.49	13.03	16.97	127.59m	40.02%	4.85	1,947,859,900.00	469,969
2020-07-13	9.02	13.53	8.56	12.12	134.33m	51.88%	4.14	1,455,349,680.00	377,774
2020-07-10	8.05	8.15	7.61	7.98	10.35m	-2.56%	-0.21	81,721,775.10	36,410
2020-07-09	7.98	8.50	7.891	8.19	12.83m	0.49%	0.04	105,102,991.00	42,876

Financial Data Provided By

INVESTOR BRAND NETWORK IBN

JACOB FRENKEL TESTIMONY – EXHIBIT VXRT

Aug. 6-Aug. 31, 2020, Historical Data for Vaxart, Inc. (NASDAQ: VXRT)



Date	Open	High	Low	Close	Volume	% Chg	$ Chg	Trade Val	# Trades
2020-08-31	6.30	6.60	5.90	5.93	9.38m	-4.82%	-0.30	57,705,997.00	39,494
2020-08-28	6.30	6.41	5.882	6.23	8.54m	-0.95%	-0.06	52,370,190.80	34,784
2020-08-27	6.60	6.60	6.21	6.29	8.65m	-6.26%	-0.42	55,115,588.90	36,672
2020-08-26	6.9166	7.16	6.545	6.71	9.49m	-3.45%	-0.24	64,788,500.80	39,332
2020-08-25	6.93	7.55	6.6502	6.95	10.72m	-5.57%	-0.41	75,677,285.50	43,511
2020-08-24	7.89	7.98	6.85	7.36	13.32m	-10.46%	-0.86	97,506,866.80	50,049
2020-08-21	8.76	8.84	8.10	8.22	9.66m	-6.70%	-0.59	80,256,732.50	37,590
2020-08-20	9.10	9.20	8.77	8.81	8.92m	-4.34%	-0.40	79,914,325.00	39,970
2020-08-19	9.2835	9.52	9.08	9.21	6.98m	-3.10%	-0.295	64,252,218.20	29,811
2020-08-18	10.00	10.31	9.41	9.505	8.39m	-6.54%	-0.665	81,453,635.80	32,662
2020-08-17	9.155	10.49	9.155	10.17	13.76m	11.27%	1.03	136,314,607.00	48,498
2020-08-14	9.15	9.54	9.04	9.14	9.08m	0.55%	0.05	83,987,120.90	33,110
2020-08-13	8.99	9.59	8.93	9.09	10.43m	-1.20%	-0.11	95,688,274.40	43,061
2020-08-12	10.56	10.70	8.91	9.20	24.33m	-14.42%	-1.55	228,627,781.00	96,480
2020-08-11	9.38	12.49	8.8399	10.75	74.25m	14.42%	1.355	823,055,664.00	229,627
2020-08-10	9.61	9.86	9.27	9.395	12.35m	2.23%	0.205	118,182,142.00	47,553
2020-08-07	9.89	10.20	9.19	9.19	13.78m	1.05%	0.095	131,567,049.00	49,288
2020-08-06	9.86	10.04	9.04	9.095	11.93m	-5.90%	-0.57	113,571,246.00	50,891

Financial Data Provided By

INVESTOR BRAND NETWORK IBN

SG Blocks, Inc.

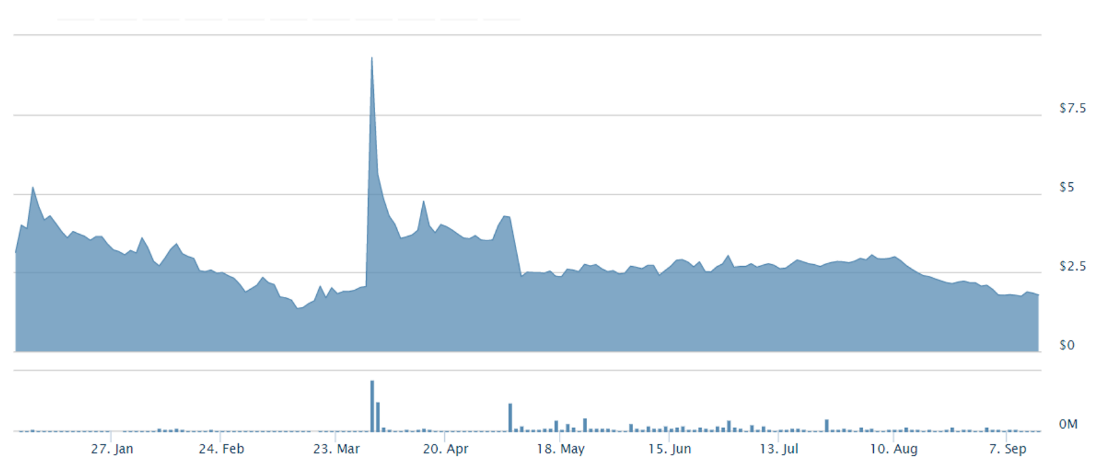
(NASDAQ: SGBX)

Congressional Testimony of Jacob Frenkel

Member, Chair of Government Investigations & Securities Enforcement Practice
Dickinson Wright PLLC • Sept. 17, 2020

JACOB FRENKEL TESTIMONY – EXHIBIT SGBX

2020 YTD Chart for SG Blocks, Inc. (NASDAQ: SGBX)



Financial Data Provided By INVESTOR BRAND NETWORK IBN

JACOB FRENKEL TESTIMONY – EXHIBIT SGBX

March 30-April 6, 2020, Historical Data for SG Blocks, Inc. (NASDAQ: SGBX)

Date	Open	High	Low	Close	Volume	% Chg	$ Chg	Trade Val	# Trades
2020-04-06	4.29	4.6782	3.90	4.03	474.27k	-6.06%	-0.26	1,974,240.05	2,679
2020-04-03	4.65	5.44	4.12	4.29	814.88k	-11.55%	-0.56	3,749,949.88	4,613
2020-04-02	5.00	5.98	4.41	4.85	1.67m	-13.70%	-0.77	8,488,714.65	9,216
2020-04-01	6.39	9.74	4.84	5.62	12.22m	-39.57%	-3.68	87,894,845.90	68,624
2020-03-31	3.80	9.74	3.26	9.30	21.43m	351.46%	7.24	138,564,640.00	122,763
2020-03-30	2.10	2.165	1.90	2.06	50.78k	1.48%	0.03	97,872.73	321
2020-03-27	1.96	2.30	1.8118	2.03	94.73k	4.64%	0.09	194,815.20	414
2020-03-26	1.90	2.10	1.7788	1.94	89.11k	2.11%	0.04	169,568.63	420
2020-03-25	1.95	2.11	1.76	1.90	74.35k	-0.03%	-0.0005	146,784.81	368
2020-03-24	1.95	2.00	1.805	1.9005	49.06k	3.85%	0.0705	94,526.34	280

Financial Data Provided By INVESTOR BRAND NETWORK IBN

Moderna, Inc.

(NASDAQ: MRNA)

Congressional Testimony of Jacob Frenkel
Member, Chair of Government Investigations & Securities Enforcement Practice
Dickinson Wright PLLC • Sept. 17, 2020

Financial Data Provided By INVESTOR BRAND NETWORK IBN

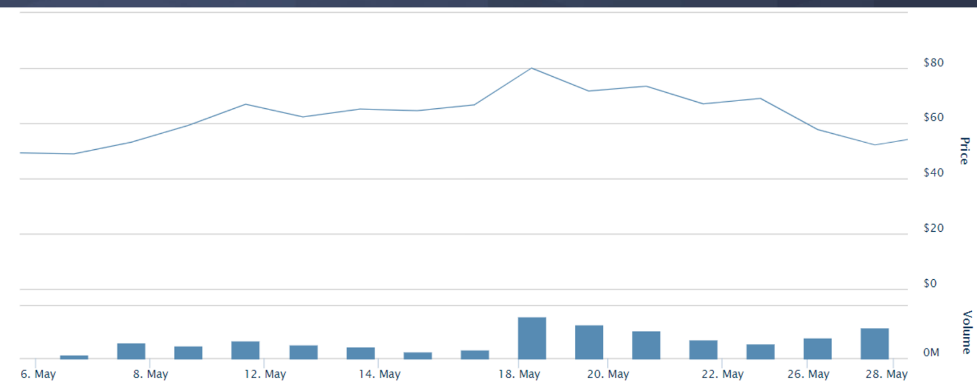
JACOB FRENKEL TESTIMONY – EXHIBIT MRNA

2020 YTD Chart for Moderna, Inc. (NASDAQ: MRNA)

Financial Data Provided By INVESTOR BRAND NETWORK IBN

JACOB FRENKEL TESTIMONY – EXHIBIT MRNA

May 7-May 27, 2020, Historical Data for Moderna, Inc. (NASDAQ: MRNA)

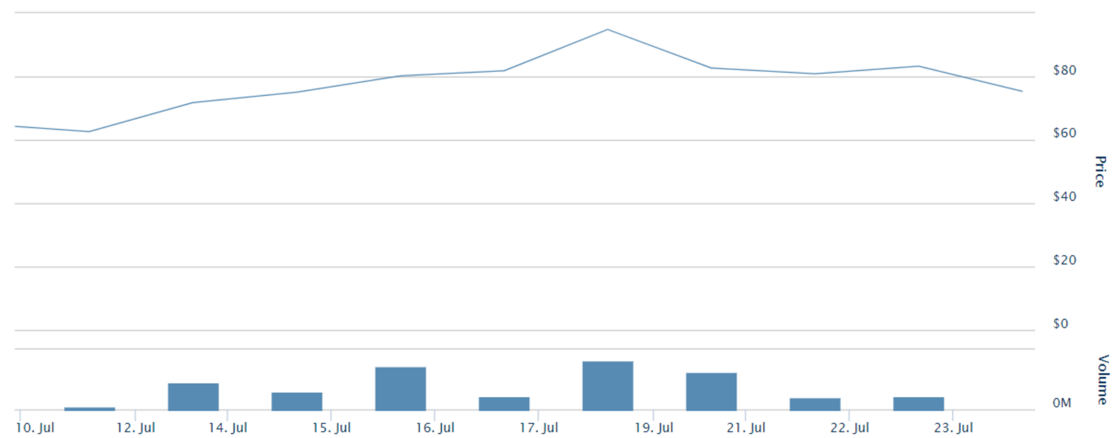


Date	Open	High	Low	Close	Volume	% Chg	$ Chg	Trade Val	# Trades
2020-05-27	51.20	53.34	46.13	52.18	59.51m	-9.58%	-5.53	3,022,479,030.00	423,354
2020-05-26	66.40	66.59	57.05	57.71	40.33m	-16.36%	-11.29	2,475,840,760.00	360,926
2020-05-22	69.93	70.60	67.14	69.00	28.91m	2.91%	1.95	1,994,931,890.00	227,958
2020-05-21	73.05	73.16	65.31	67.05	35.32m	-8.74%	-6.42	2,385,991,030.00	304,662
2020-05-20	70.01	74.48	67.41	73.47	53.66m	2.51%	1.80	3,839,844,970.00	389,698
2020-05-19	78.07	79.75	70.32	71.67	64.93m	-10.41%	-8.33	4,853,354,060.00	547,748
2020-05-18	86.14	87.00	75.66	80.00	81.21m	19.96%	13.31	6,681,005,970.00	702,665
2020-05-15	63.79	67.67	63.01	66.69	16.34m	3.30%	2.13	1,073,680,270.00	116,766
2020-05-14	64.79	65.39	61.44	64.56	12.20m	-0.95%	-0.62	774,944,809.00	96,713
2020-05-13	63.80	66.97	60.29	65.18	22.13m	4.54%	2.83	1,427,442,820.00	159,251
2020-05-12	65.99	68.49	62.02	62.35	25.93m	-6.80%	-4.55	1,677,606,950.00	214,499
2020-05-11	59.60	67.67	59.14	66.90	34.85m	12.91%	7.65	2,255,030,290.00	257,257
2020-05-08	53.06	59.88	52.15	59.25	24.14m	11.39%	6.06	1,382,168,510.00	184,526
2020-05-07	55.78	55.99	51.06	53.19	30.94m	8.66%	4.24	1,657,212,390.00	217,836

Financial Data Provided By INVESTOR BRAND NETWORK IBN

JACOB FRENKEL TESTIMONY – EXHIBIT MRNA

July 10-July 23, 2020, Historical Data for Moderna, Inc. (NASDAQ: MRNA)

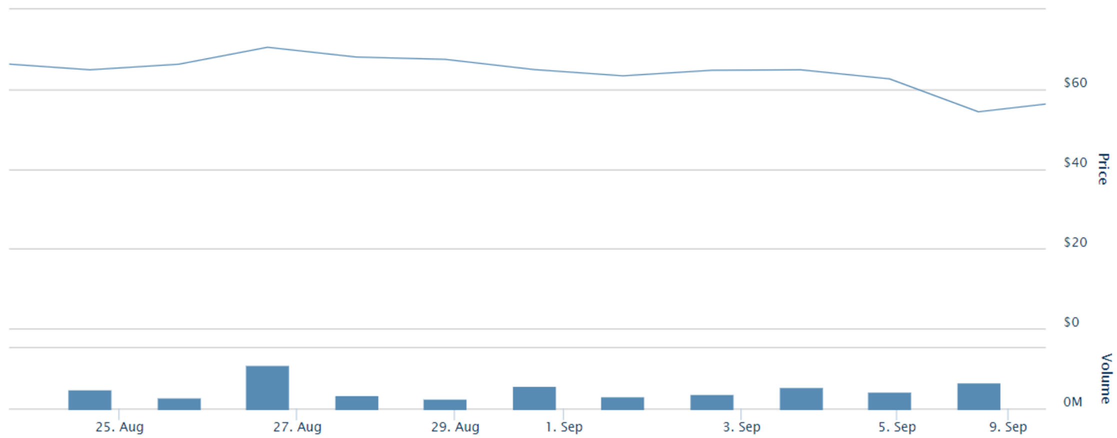


Date	Open	High	Low	Close	Volume	% Chg	$ Chg	Trade Val	# Trades
2020-07-23	82.05	82.68	72.20	75.33	29.29m	-9.49%	-7.895	2,279,546,620.00	280,298
2020-07-22	79.61	84.12	79.11	83.225	27.27m	2.93%	2.365	2,229,446,060.00	217,910
2020-07-21	80.91	82.43	79.07	80.86	26.19m	-2.20%	-1.82	2,115,266,980.00	232,983
2020-07-20	87.86	90.85	78.05	82.68	78.39m	-12.83%	-12.17	6,570,373,770.00	686,438
2020-07-17	83.35	95.21	82.61	94.85	103.51m	15.94%	13.04	9,441,572,480.00	717,456
2020-07-16	80.16	84.29	79.60	81.81	27.28m	1.98%	1.59	2,236,544,550.00	246,927
2020-07-15	87.65	88.37	78.01	80.22	90.77m	6.90%	5.18	7,490,582,770.00	795,582
2020-07-14	74.00	76.949	70.62	75.04	38.71m	4.54%	3.26	2,979,442,300.00	334,696
2020-07-13	63.89	77.75	63.80	71.78	56.62m	14.65%	9.17	4,086,098,230.00	436,373
2020-07-10	64.65	64.93	62.32	62.61	7.41m	-3.63%	-2.36	467,773,991.00	68,315

Financial Data Provided By INVESTOR BRAND NETWORK IBN

JACOB FRENKEL TESTIMONY – EXHIBIT MRNA

Aug. 24-Sept. 8, 2020, Historical Data for Moderna, Inc. (NASDAQ: MRNA)



Date	Open	High	Low	Close	Volume	% Chg	$ Chg	Trade Val	# Trades
2020-09-08	57.75	58.60	54.21	54.34	17.71m	-13.20%	-8.26	990,692,994.00	176,745
2020-09-04	64.99	65.00	59.01	62.60	11.65m	-3.46%	-2.24	718,741,559.00	131,943
2020-09-03	65.65	69.35	64.30	64.84	14.31m	0.19%	0.12	952,662,298.00	142,191
2020-09-02	62.84	64.89	61.381	64.72	9.87m	2.21%	1.40	623,133,575.00	103,658
2020-09-01	63.54	64.50	62.50	63.32	8.20m	-2.42%	-1.57	519,887,160.00	94,411
2020-08-31	67.14	67.20	62.54	64.89	15.27m	-3.85%	-2.60	977,404,216.00	167,247
2020-08-28	68.04	68.95	67.15	67.49	6.38m	-0.79%	-0.54	432,455,042.00	74,029
2020-08-27	69.98	70.32	67.01	68.03	9.26m	-3.50%	-2.47	629,359,767.00	101,384
2020-08-26	67.62	71.64	66.03	70.50	28.77m	6.42%	4.25	1,994,963,870.00	241,138
2020-08-25	64.32	66.696	63.55	66.25	7.80m	2.11%	1.37	512,559,432.00	75,091
2020-08-24	67.15	67.85	62.88	64.88	13.14m	-2.36%	-1.57	853,448,216.00	143,534

Financial Data Provided By INVESTOR BRAND NETWORK IBN

Eastman Kodak Company

(NYSE: KODK)

Congressional Testimony of Jacob Frenkel

Member, Chair of Government Investigations & Securities Enforcement Practice

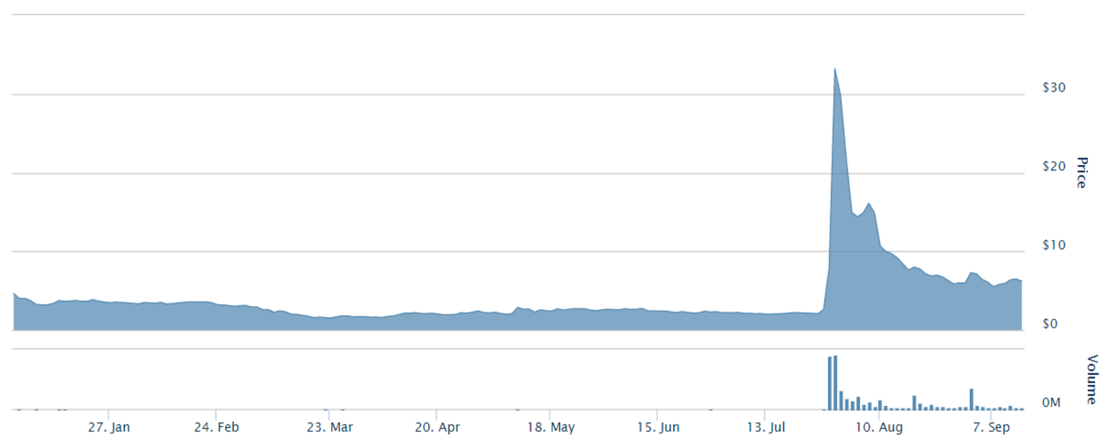
Dickinson Wright PLLC • Sept. 17, 2020

Financial Data Provided By

INVESTOR BRAND NETWORK IBN

JACOB FRENKEL TESTIMONY – EXHIBIT KODK

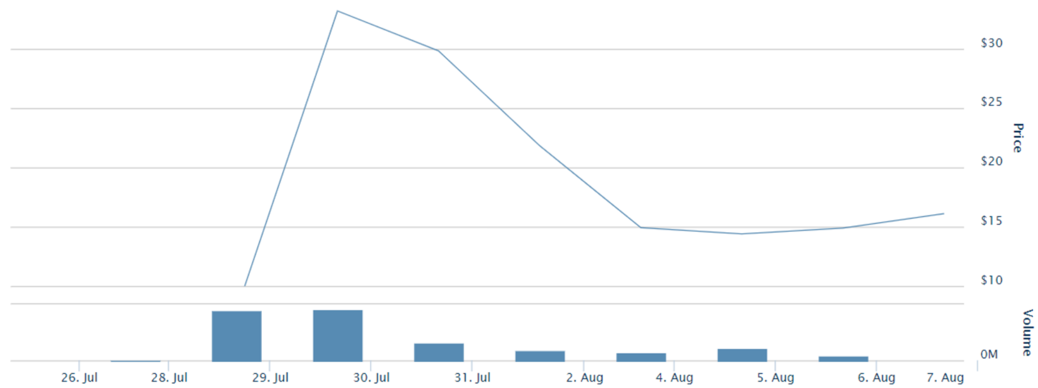
2020 YTD Chart for Eastman Kodak Company (NYSE: KODK)



Financial Data Provided By INVESTOR BRAND NETWORK IBN

JACOB FRENKEL TESTIMONY – EXHIBIT KODK

July 27-Aug. 4, 2020, Historical Data for Eastman Kodak Company (NYSE: KODK)

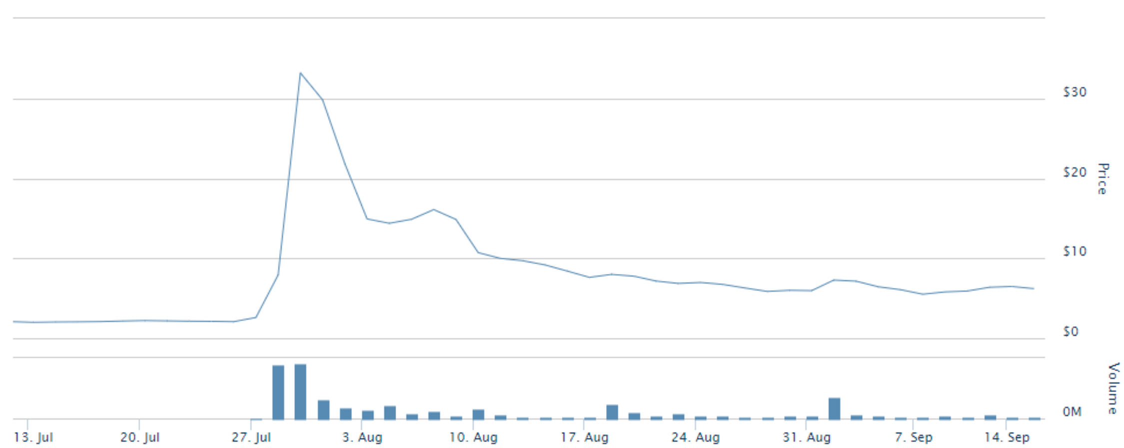


Date	Open	High	Low	Close	Volume	% Chg	$ Chg	Trade Val	# Trades
2020-08-04	15.08	17.88	12.86	14.40	65.70m	-3.61%	-0.54	1,009,301,930.00	301,090
2020-08-03	21.13	21.16	14.74	14.94	46.70m	-31.63%	-6.91	812,287,676.00	266,124
2020-07-31	25.02	25.70	20.27	21.85	57.45m	-26.75%	-7.98	1,310,222,540.00	397,450
2020-07-30	43.58	44.44	27.50	29.83	98.35m	-10.15%	-3.37	3,568,137,650.00	717,903
2020-07-29	18.50	60.00	17.50	33.20	275.05m	318.14%	25.26	8,372,570,010.00	1,657,142
2020-07-28	9.63	11.80	6.00	7.94	273.63m	203.05%	5.32	2,521,959,630.00	1,344,124
2020-07-27	2.13	2.65	2.13	2.62	1.62m	24.76%	0.52	3,863,325.22	4,520

Financial Data Provided By

INVESTOR BRAND NETWORK IBN

July 17-Sept. 14, 2020, Historical Data for Eastman Kodak Company (NYSE: KODK)



(continued on following page)

Financial Data Provided By INVESTOR BRAND NETWORK IBN

JACOB FRENKEL TESTIMONY – EXHIBIT KODK

KODK July 17-Sept. 14, 2020, Historical Data, Continued

Date	Open	High	Low	Close	Volume	% Chg	$ Chg	Trade Val	# Trades
2020-09-14	6.23	6.73	6.11	6.50	8.85m	1.56%	0.10	57,117,905.60	33,080
2020-09-11	6.26	6.60	6.02	6.40	20.41m	7.93%	0.47	128,902,924.00	60,364
2020-09-10	5.82	6.25	5.73	5.93	11.68m	1.89%	0.11	73,218,254.60	38,355
2020-09-09	5.6399	6.53	5.55	5.82	15.52m	5.24%	0.29	93,621,160.90	52,905
2020-09-08	5.90	5.93	5.51	5.53	9.64m	-9.34%	-0.57	54,780,646.00	36,975
2020-09-04	6.40	6.50	5.95	6.10	8.76m	-5.57%	-0.36	53,772,081.30	33,661
2020-09-03	7.00	7.08	6.41	6.46	13.21m	-9.78%	-0.70	88,302,149.90	47,390
2020-09-02	7.32	7.50	6.77	7.16	19.29m	-1.92%	-0.14	138,421,665.00	62,758
2020-09-01	9.48	9.87	7.21	7.30	106.24m	22.07%	1.32	874,037,926.00	407,380
2020-08-31	5.90	6.37	5.85	5.98	17.45m	-0.66%	-0.04	119,337,527.00	70,928
2020-08-28	5.86	6.40	5.66	6.02	13.99m	2.38%	0.14	84,404,044.50	51,467
2020-08-27	6.17	6.24	5.72	5.88	11.43m	-6.82%	-0.43	67,738,956.30	53,023
2020-08-26	6.75	6.75	6.085	6.31	11.77m	-6.66%	-0.45	75,128,664.00	50,427
2020-08-25	6.98	7.44	6.57	6.76	13.93m	-3.43%	-0.24	96,187,169.80	60,070
2020-08-24	6.83	7.50	6.70	7.00	13.82m	1.74%	0.12	97,060,618.80	52,814
2020-08-21	7.00	8.02	6.52	6.88	26.17m	-4.18%	-0.30	185,990,527.00	98,410
2020-08-20	7.78	8.00	7.09	7.18	13.59m	-7.83%	-0.61	101,141,406.00	50,927
2020-08-19	8.20	9.09	7.73	7.79	32.14m	-2.75%	-0.22	263,257,655.00	118,549
2020-08-18	7.34	13.69	6.68	8.01	72.55m	4.84%	0.37	647,004,355.00	257,240
2020-08-17	8.34	8.37	7.55	7.64	9.25m	-9.37%	-0.79	72,358,709.60	45,774
2020-08-14	9.07	9.18	8.22	8.43	10.49m	-8.37%	-0.77	89,415,207.20	51,096
2020-08-13	9.50	9.67	9.01	9.20	8.75m	-5.35%	-0.52	80,563,895.20	43,788
2020-08-12	10.40	10.47	9.54	9.72	9.50m	-2.90%	-0.29	93,656,257.10	55,165
2020-08-11	11.26	11.35	9.95	10.01	19.24m	-6.71%	-0.72	205,939,365.00	91,884
2020-08-10	8.90	11.60	8.50	10.73	47.30m	-27.89%	-4.15	486,229,938.00	221,027
2020-08-07	15.79	16.75	14.57	14.88	16.09m	-7.64%	-1.23	244,323,654.00	87,637
2020-08-06	15.11	17.50	14.80	16.11	39.43m	8.12%	1.21	644,870,227.00	203,270
2020-08-05	15.51	16.00	13.72	14.90	25.55m	3.47%	0.50	382,309,489.00	123,148
2020-08-04	15.08	17.88	12.86	14.40	65.70m	-3.61%	-0.54	1,009,301,930.00	301,090
2020-08-03	21.13	21.16	14.74	14.94	46.70m	-31.63%	-6.91	812,287,676.00	266,124
2020-07-31	25.02	25.70	20.27	21.85	57.45m	-26.75%	-7.98	1,310,222,540.00	397,450
2020-07-30	43.58	44.44	27.50	29.83	98.35m	-10.15%	-3.37	3,568,137,650.00	717,903
2020-07-29	18.50	60.00	17.50	33.20	275.05m	318.14%	25.26	8,372,570,010.00	1,657,142
2020-07-28	9.63	11.80	6.00	7.94	273.63m	203.05%	5.32	2,521,959,630.00	1,344,124
2020-07-27	2.13	2.65	2.13	2.62	1.62m	24.76%	0.52	3,863,325.22	4,520
2020-07-24	2.11	2.16	2.09	2.10	74.89k	-1.87%	-0.04	158,000.86	456
2020-07-23	2.14	2.20	2.09	2.14	80.84k	-0.93%	-0.02	174,063.14	430
2020-07-22	2.20	2.20	2.1403	2.16	52.42k	-1.82%	-0.04	113,882.35	372
2020-07-21	2.23	2.26	2.16	2.20	107.21k	-1.79%	-0.04	235,087.40	546
2020-07-20	2.26	2.28	2.21	2.24	117.17k	2.75%	0.06	263,730.19	571
2020-07-17	2.08	2.2699	2.08	2.18	214.99k	3.32%	0.07	471,416.27	1,240

Financial Data Provided By

INVESTOR BRAND NETWORK IBN

AstraZeneca

(LSE/STO/NYSE: AZN)

Congressional Testimony of Jacob Frenkel

Member, Chair of Government Investigations & Securities Enforcement Practice

Dickinson Wright PLLC • Sept. 17, 2020

Financial Data Provided By

INVESTOR BRAND NETWORK IBN

JACOB FRENKEL TESTIMONY – EXHIBIT AZN

2020 YTD U.S. Chart for AstraZeneca (LSE/STO/NYSE: AZN)

Financial Data Provided By INVESTOR BRAND NETWORK IBN

JACOB FRENKEL TESTIMONY – EXHIBIT AZN

2020 YTD London Stock Exchange Chart for AstraZeneca (LSE/STO/NYSE: AZN)

Financial Data Provided By INVESTOR BRAND NETWORK IBN

Statement by Granville Martin, General Counsel, Society for Corporate Governance

before

the U.S. House of Representatives Committee on Financial Services

on

Insider Trading and Stock Option Grants: An Examination of Corporate Integrity in the Covid-19 Pandemic

Chairman Sherman, Ranking Member Huizenga and Members of the Committee, thank you for the opportunity to testify today. I am Granville Martin, General Counsel of the Society for Corporate Governance. Prior to my tenure at the Society, I was a Managing Director in Sustainable Finance at JPMorgan Chase where I worked to manage environmental and social risk on behalf of the bank and assisted clients in improving the governance of those same risks.

Founded in 1946, the Society is a professional membership association of approximately 3,500 corporate and assistant secretaries, in-house counsel, outside counsel, and other governance professionals who serve approximately 1,700 entities, including approximately 1,000 public companies of almost every size and industry. Society members are responsible for supporting the work of corporate boards of directors and the executive managements of their companies on corporate governance and disclosure matters.

The Society's mission is to educate corporate governance practitioners on core and emerging governance issues. We have traditionally focused on securities and state corporate law compliance and disclosure and in the last several years have broadened our perspective of governance to also include environmental and social issues, risks and disclosures (i.e. ESG). Diversity, climate change and human capital management are among the ESG issues upon which investors have sought greater disclosure and that public companies increasingly provide. ESG is just one example of how the relevance and importance of corporate governance has increased in the last decade.

The topic of today's hearing—the regulation of insider trading—is a longstanding issue confronting the Society's public company members. At the outset, let me state clearly that the Society and its public company members support a rigorous framework of insider trading regulation, compliance training, and effective enforcement. Ensuring America's capital markets retain their reputation for transparency and fairness that undergirds investor confidence is in the interests of all public companies. A market where insiders can benefit from material non-public information (MNPI) at the expense of other investors is wrong, and the Society supports the laws, regulations and enforcement mechanisms intended to prevent and punish such conduct.

It's also relevant that the legal framework governing insider trading for public companies encourages them to adopt policies and procedures intended to prevent their executives from becoming embroiled in allegations of insider trading. Most public companies have adopted insider trading policies that govern trading of their Company's securities as well as securities of other publicly-traded companies. Common features of such policies include a prohibition of trading at any time while in possession of MNPI, a dedicated brokerage firm that administers the accounts where company equity grants and stock are held, a pre-clearance procedure of transactions by in-house legal departments, imposition of trading blackout periods in advance of earnings releases or in the event of significant corporate events--such as an acquisition or leadership change--and limitations on the adoption of 10b5-1 plans.

It is worth noting that company-imposed blackout periods restricting executives from buying or selling stock generally begin several weeks prior to the end of the fiscal quarter and last until one or two days after the publication of the company's applicable quarterly earnings materials. As a result, company officers and directors typically will have up to four open windows per year with each window lasting just a few weeks. In addition, a trading window may be closed early upon the development of new material information such as an acquisition or leadership change. As a result, the time that buying and selling may actually occur is quite limited.

Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act) and the associated Rule 10b-5 prohibit the employment of manipulative and deceptive devices in the trading of securities. Rule 10b5-1 states that the manipulative and deceptive devices prohibited under Section 10(b) and Rule 10b-5 include purchases and sales of securities made “on the basis of” MNPI about a security or issuer in breach of a duty of trust or confidence that is owed to the issuer of that security or the shareholders of that issuer, or to any other person who is the source of the MNPI. Furthermore, Rule 10b5-1 specifies that a purchase or sale of a security is made on the basis of MNPI when the person making the purchase or sale was “aware” of MNPI at the time the purchase or sale was made. Rule 10b5-1 also provides an affirmative defense to Section 10(b) insider trading allegations when such trades are made pursuant to a preexisting, written trading plan that complies with the rule.

Rule 10b5-1 allows corporate executives to adopt a plan, at a time when they are not in possession of MNPI, to make prearranged trades at specified prices or dates in the future. As noted above, a properly adopted 10b5-1 plan provides an executive "a safe harbor" to proceed with prearranged trades without facing charges of insider trading. The rule is intended to give executives an opportunity to transact in company stock —to pay their kids' college tuition, for example—in a structured manner consistent with the insider trading legal framework. The rule's affirmative defense or "safe harbor" is available only if a 10b5-1 plan was entered into in good faith and not as part of a scheme to evade Section 10(b)'s and Rule 10b-5's insider-trading prohibition.

To be effective, 10b5-1 plans must satisfy certain requirements. Among other things, a 10b5-1 plan must:

- Be established in good faith when the participant was not aware of inside information;
- Specify the number of securities to be traded and the price at which the securities are to be traded, or include a formula for making such determination; and
- Prohibit the participant from later exercising any influence over any person who exercises discretion as to how, when, or whether to effect the trades.

Rule 10b5-1 provides specific guidance in the insider trading realm, but it does not operate in a vacuum and co-exists with other securities laws, which remain applicable. For example, Rule 10b5-1 does not alter the elements of a case under Rule 10b-5/Section 10(b) (e.g., scienter is still required). Additionally, transactions pursuant to a Rule 10b5-1 plan must still comply with (1) the volume limitations of Rule 144 (if shares are not otherwise freely tradable and Rule 144 applies), (2) short swing profit rules and filings of ownership forms under Section 16(a) of the Exchange Act (i.e., filing a Form 4 in connection with each transaction), and (3) filing Schedules 13D or 13G where appropriate.

In addition, many companies impose additional restrictions on the adoption and use of 10b5-1 plans by their executives, if the company allows these plans at all. For example, a 2015 survey conducted by the Society of its public company members showed that most surveyed companies only permit a 10b5-1 plan to be adopted when their insider trading window is open. That is, these companies do not allow plans to be entered into during blackout periods, even if the insider is not in possession of MNPI. Similarly, 85% of 235 companies surveyed responded that they formally review and approve all of their company's 10b5-1 plans.

The Section 10(b) and Rule 10b5-1 prohibition on insiders' trading when aware of MNPI, along with the related disclosure obligations and established company practices noted above, deter and punish illegal conduct yet allow executives to transparently trade their companies' securities for the purposes of diversification or paying for significant life events (i.e. home purchase/college tuition) . To be sure—as with any area of the law—transgressions may occur. And when they do, the SEC—and the U.S. Department of Justice, if appropriate—should vigorously and fairly investigate and prosecute wrongdoing. Having said that, the Society believes that existing laws, regulations and the enforcement regime provide a comprehensive legal framework.

Like so many other aspects of our lives, COVID-19 presented new and abrupt challenges to public companies, including related to insider trading law compliance. As companies grappled with the implications of the pandemic in their disclosures and their internal policies and procedures, SEC Division of Enforcement issued a statement emphasizing the "importance of maintaining market integrity and following corporate controls and procedures."[1] In addition, SEC Chairman Jay Clayton and Division of Corporation Finance Director Bill Hinman issued a statement[2] urging companies to "provide as much information as is practicable regarding their current financial and operating status, as well as their future operational and financial planning" and noting that "[d]isclosure...is fundamental to furthering each aspect of our mission."

Based on our review of Society members' disclosures, we believe public companies responded robustly. COVID-related disclosure has been widespread and has covered a wide range of topics. In addition, many public companies re-assessed their insider trading policy compliance program, including whether their internal procedures were able to identify all of the executives who were now possibly in possession of COVID-related MNPI, whereas pre-pandemic such concerns regarding procurement, supply chain and operational executives were minimal. The Society provided educational resources to public company members to assist members in their compliance initiatives, and they responded accordingly.

[1] https://www.sec.gov/news/public-statement/statement-enforcement-co-directors-market-integrity

[2] https://www.sec.gov/news/public-statement/statement-clayton-hinman

In general, the Society does not have a position on the appropriateness of the amount or structure of executive compensation. Having said that, we would observe that the use of stock options by start-ups and other early stage companies is common and, from the perspective of the management of such companies, essential. These companies' use of stock options for compensation is a key driver in their ability to attract and retain the talent necessary to foster innovation and commercialization of new products and services. Ownership of stock by employees also more closely aligns their interests with the interests of company shareholders, which is rightly a high priority for the investor community.

While the Society supports required disclosure of executive compensation arrangements, we note that boards of directors and their compensation committees are best positioned to decide on the appropriateness of such option grants and that investors express their view of the appropriateness of compensation through required "say on pay" votes that occur in many cases annually. When significant numbers of investors express concern with a particular pay package, boards and management regularly take action to assuage those concerns even though such "say on pay" votes are precatory. Further regulation in this area is unnecessary. Transparency and fairness exist under the existing regulatory framework.

Similarly, H.R. 4335, the 8-K Trading Gap of 2019, which "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" is unnecessary, in our view, given that Section 10(b) and Rule 10b-5 already prohibit trading by officers and directors if the undisclosed "significant event" is material. While we are heartened by the bipartisan comity engendered by this bill, we would note that H.R. 4335 makes conduct that is already prohibited illegal.

We believe the regulation of insider trading has been subject to some confusion. I would argue that the 8-K Trading Gap bill is an example. Having said that, the SEC study mandated by H.R. 624 could contribute to a common and well-founded understanding of 10b5-1 plans, their structure and effect, and whether any regulatory changes are warranted. The Society supports the enactment of H.R. 624.

Thanks to the Committee for inviting me to testify, and I'd be happy to respond to any questions.

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

OFFICE OF
THE CHAIRMAN

September 14, 2020

The Honorable Brad Sherman
U.S. House of Representatives
2181 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Sherman:

I appreciated our discussion last month on a number of policy issues related to good corporate hygiene, including issues related to executive compensation and trading when in possession of material non-public information. I believe you and I agree generally on the importance of a robust control environment for senior executives and on a number of specific, related points, and wanted to provide you with more detail regarding my views.

Importance of a Strong Control Environment.

As I have emphasized to market participants on many occasions, the importance of good corporate hygiene cannot be overstated, nor can the importance of related controls designed to prevent not only insider trading but also, ideally, the appearance of impropriety or misalignment of interests. This perspective and related controls are especially important in times of heightened market volatility and uncertainty. In such circumstances, the potential for executives to possess material non-public information increases as we have witnessed during this time of COVID-19-induced economic and market stress.

My view is that, during this time of stress and acute uncertainty, our public companies as a general matter have discharged their responsibilities in the related areas of public disclosure and corporate controls well. That said, these are areas where market confidence, integrity and fairness require a universal commitment to compliance and regulatory vigilance. The Commission's Divisions and Offices have emphasized this perspective since the onset of the COVID-19 pandemic.

I will now turn to some of the specific measures we discussed that I believe would improve compliance, market integrity and investor confidence, including through a demonstrated commitment to good corporate hygiene.

Insider Trading Policies for Senior Executives and Board Members

In my view, a well-designed insider trading policy has controls in place to prevent senior executives and members of the board of directors from trading once a company is in possession of material non-public information, even if an individual officer or director did not personally have knowledge of the information. This includes the time period between the occurrence of an event and the required disclosure of the event to the public under Commission rules. In my view such a policy is not difficult to adopt or administer. As we discussed, the integrity bang for the compliance buck is large. You and I have previously discussed the legislation that Congress is considering in this area, and my staff looks forward to providing further technical assistance.

Terms and Administration of Rule 10b5-1 Plans

First, I want to reiterate my view on the importance of good corporate hygiene in the area of Rule 10b5-1 plans. When designed and administered appropriately, including with an eye toward eliminating any suggestion of impropriety or unfairness, these plans can facilitate long-term interest alignment and other principles of good corporate governance. However, there are practices that, while they may be consistent with law and regulation, raise questions of interest alignment and fairness, including, in particular, issues that arise when plans are implemented, amended or terminated and trading occurs (or does not occur) around those events.

I believe that companies should strongly consider requiring all Rule 10b5-1 plans for senior executives and board members to include mandatory seasoning, or waiting periods after adoption, amendment or termination before trading under the plan may begin or recommence. In my view, these required seasoning periods are appropriate between the establishment of a plan and the date of the initial trade, as well as between any modification, suspension or termination of a plan and the resumption of trading or entry into a new plan. Such seasoning periods not only help demonstrate that a plan was executed in good faith, but they also can bolster investor confidence in management teams and in markets generally.

Currently, SEC staff are working on a report in response to a directive in the Joint Explanatory Statement accompanying the FY 2020 FSGG appropriations act on the growth share repurchases, and are considering this and other issues relating to Rule 10b5-1 plans as part of that report. I look forward to reviewing the staff report as I expect it to provide additional information for us to consider with respect to the use of Rule 10b5-1 plans, particularly where trading under (or changes to) those plans overlap with company share repurchases. Here, I note that, in addition to fostering an environment of compliance with law and regulation around trading by senior executives and board members, boards of directors, and their compensation committees, should consider the interplay between company share repurchase plans and such trading, including when approving Rule 10b5-1 plans.

Issuing and Pricing Stock Options

Finally, I believe that companies should consider carefully the wisdom of issuing stock options to its executives while in possession of material non-public information. Many equity compensation plans require stock options to be granted with strike prices that are no less than fair market value. Implicit in this structure is the premise that equity awards are intended to incent performance that will result in future increases in company value. When a company grants an award based on the trading price of the stock while the company is in possession of materially positive non-public information, this premise is diluted to the extent future increases in company stock value are attributable to the release of positive information rather than future performance.

In addition, such a grant may not be consistent with the terms of the incentive plan approved by its shareholders. Similarly, such a grant may also be inconsistent with existing accounting standards because, in short, the trading price of its stock is not a good indicator of fair market value.

More generally, I believe boards and their compensation committees should be thoughtful about grants, particularly to senior executives and board members, in circumstances where the market is not fully informed of positive developments and have policies in place that ensure that plan requirements are satisfied and the awards are priced and accounted for properly. I have asked our staff in the Division of Corporation Finance to keep this potentially material dynamic in mind when reviewing compensation disclosures in Exchange Act reports filed with the Commission.

In closing, I have asked our staff, including the Director of our Division of Corporation Finance William Hinman, to discuss the points above in upcoming speaking engagements and to remind market participants of these views. Please do not hesitate to contact me at (202) 551-2100, or have a member of your staff contact Holli Heiles Pandol, Director of the Office of Legislative and Intergovernmental Affairs, at (202) 551-2010 if you would like to discuss further.

Sincerely,

Jay Clayton
Chairman

Cc: The Honorable Bill Huizenga

U.S. SEC enforcement activity hits second-highest level ever in 2019

By Pete Schroeder, Chris Prentice
3 MIN READ

WASHINGTON/NEW YORK (Reuters) - Enforcement activity by the U.S. Securities and Exchange Commission in fiscal 2019 resulted in $4.3 billion in fines and disgorgements, up from $3.9 billion a year earlier, the regulator said on Wednesday.

Those fines and disgorgements - or the return of ill-gotten gains - came through 862 enforcement actions, up from 821 in 2018. That is the second-highest level ever, after a record 868 actions taken in 2016, and the highest number of cases and largest amount collected under SEC Chairman Jay Clayton, who took the reins in 2017.

The SEC returned $1.2 billion to harmed investors, barred or suspended nearly 600 people from securities markets, and suspended trading in 271 companies, it said in an annual enforcement report.

“The results show broadly that we haven’t taken our foot off the gas,” Steven Peikin, co-director of the SEC’s enforcement division, told reporters along the sidelines of an event in New York.

The tally got a boost from a new initiative through which the SEC allowed investment advisory firms to self-report violations of conflict-of-interest rules to avoid a fine. Through it, 95 firms that came forward returned $135 million to affected investors.

The initiative is wrapping up, with just “a couple left in the pipeline,” SEC Enforcement Co-Director Stephanie Avakian said at the event.

The volume of cases involving fraud by small firms or investment advisers shows the agency is “sticking to its focus on protecting Main

Street investors," said Kurt Wolfe, an enforcement attorney at Troutman Sanders LLP.

Retail investors have been a priority for Clayton since he took the helm at the SEC.

"The results depicted in this report reflect the division's focus on rooting out misconduct that can do significant harm to investors and our markets," Clayton said in a statement.

A significant portion of the total amount assessed came from a single action related to a massive Ponzi scheme affecting over 8,400 retail investors.

Woodbridge Group of Companies LLC and its former owner and chief were ordered to pay over $1 billion in combined penalties and disgorgement. The SEC said it expects investors will be able to recoup at least 50% of their investments.

The year's activity also included settlements with Facebook Inc, Mylan NV, Fiat Chrysler Automobiles N.V., Nissan, and KPMG.

The uptick in activity was notable given a 35-day government shutdown in 2018 and 2019 and a hiring freeze that ended earlier this year, SEC officials said.

A 2017 Supreme Court decision continued to curtail the SEC's ability to reclaim funds from bad actors, the agency said in the report. The ruling in the case of Kokesh v. SEC found the agency faced a five-year statute of limitations for pursuing disgorgement claims.

The SEC said it had to forgo $1.1 billion of disgorgements in filed cases as a result.

"The real tally is probably a fair amount higher because we've made decisions with Kokesh in mind regarding resources," Avakian said on Wednesday.

Reporting by Pete Schroeder in Washington and Chris Prentice in New York; Additional reporting by Suzanne Barlyn in New York; editing by Bernadette Baum and Jonathan Oatis