

PROMOTING TRANSPARENT STANDARDS FOR CORPORATE  
INSIDERS ACT

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AUGUST 3, 2018.—Committed to the Committee of the Whole House on the State  
of the Union and ordered to be printed

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Mr. HENSARLING, from the Committee on Financial Services,  
submitted the following

R E P O R T

[To accompany H.R. 6320]

[Including cost estimate of the Congressional Budget Office]

The Committee on Financial Services, to whom was referred the bill (H.R. 6320) to require the Securities and Exchange Commission to carry out a study of Rule 10b5-1 trading plans, and for other purposes, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

PURPOSE AND SUMMARY

On July 10, 2018, Representative Maxine Waters introduced H.R. 6320, the “Promoting Transparent Standards for Corporate Insiders Act.” The bill requires the U.S. Securities and Exchange Commission (SEC) to conduct a study as to whether SEC Rule 10b5-1 should be amended, as further described below, and, if so, to amend Rule 10b5-1, subject to notice and comment, in a manner consistent with the results of such study.

Under Rule 10b5-1, directors and other major insiders of issuers registered under the Securities Exchange Act of 1934 who have access to material nonpublic information are able to establish a written plan that details when they will be able to buy or sell shares at a predetermined time on a scheduled basis. The bill requires the SEC to consider whether certain types of amendments to Rule 10b5-1 would enhance the rule and directs the SEC to consider certain factors, including how any such amendments to Rule 10b5-1 would clarify and enhance existing prohibitions against insider trading, the impact of any such amendments on attracting candidates for insider positions, the impact on capital formation, and

the effects on a company's willingness to operate as a public company.

#### BACKGROUND AND NEED FOR LEGISLATION

In 2000, the SEC promulgated Rule 10b5-1 ("Rule"). Rule 10b5-1 addresses the issue of when insider trading liability arises in connection with a trader's "use" or "knowing possession" of material nonpublic information. This rule provides that a person trades "on the basis of" material nonpublic information when the person purchases or sells securities while aware of the information. However, the rule also sets forth several affirmative defenses, to permit persons to trade in certain circumstances where it is clear that the information was not a factor in the decision to trade.

"Insider trading" is a term subject to many definitions and connotations and it encompasses both legal and prohibited activity. Illegal insider trading refers generally to buying or selling a security, in breach of a fiduciary duty or other relationship of trust and confidence, while in possession of material, nonpublic information about the security. The Rule adopted by the SEC in 2000 gives corporate employees a means to buy and sell without fearing potential securities fraud charges. Under the rule, an insider can put in place a plan to trade company shares when the person does not have inside information. That allows a corporate employee to "carry out those pre-planned transactions at a later time, even if they later become aware of material nonpublic information."

Some critics of the Rule as currently written argue insiders can maneuver around the Rule and trade on material, nonpublic information. Further, some observers have highlighted in the press notable trades by insiders that critics claim raise concerns regarding the efficacy of Rule 10b5-1 plans, and others have found that insiders may outperform other shareholders despite utilizing Rule 10b5-1 plans, which presumably operate in a manner to ensure that insiders are trading in a manner more consistent with shareholders who do not possess material nonpublic information. Nonetheless, as a general matter, Rule 10b5-1 serves an important function by providing greater clarity regarding what trades are presumed to have been made on the basis of material nonpublic information, while providing insiders with an affirmative defense where trades are executed pursuant to an established Rule 10b5-1 plan. The SEC's adopting release for Rule 10b5-1 noted that "the revised defense is designed to cover situations in which a person can demonstrate that the material nonpublic information was not a factor in the trading decision." Providing clarity regarding insider trading is important to our capital markets because equity compensation is the preferred way to reward executives and encourage performance, which means those rewarded with such shares must be able to sell them at appropriate times.

Because Rule 10b5-1 became effective 2000, this bill directs the SEC to study whether amendments to Rule 10b5-1 are necessary. In particular, the SEC shall consider whether the Rule should be amended to, among other things: limit the ability of insiders to adopt a Rule 10b5-1 plan during the issuer's trading windows; limit the ability of insiders to adopt multiple, overlapping trading plans; establish a mandatory delay between adoption of the trading plan and execution of the first trade, and if so, whether such delay

should be the same for trading plans adopted during the issuer's trading window as opposed to outside such window and whether any exceptions to such a delay are appropriate; limit the frequency of modifications or cancellations to trading plans; require insiders to file with the SEC trading plan adoptions, amendments, terminations, and transactions; and require boards of issuers who have adopted trading plans to adopt certain policies, periodically monitor trading plan transactions, and ensure that the issuer's policies discuss use of the plans in the context of equity hedging, holding, and ownership.

At the time of the Rule's adoption in 2000, the SEC noted the following benefits, ". . . the rule should increase investor confidence in the integrity and fairness of the market because it clarifies and strengthens existing insider trading law. Second, the rule will benefit corporate insiders by providing greater clarity and certainty on how they can plan and structure securities transactions." Some eighteen years later, it is appropriate to review the results of the Rule and to consider if amendments may be appropriate to consider how any amendments to Rule 10b5-1 clarify and enhance existing prohibitions against insider trading, the impacts of such amendments with regards to attracting candidates for insider positions, the impacts on capital formation, the effects on a company's willingness to operate as a public company, and any other considerations necessary and appropriate for the protection of investors. The bill directs the SEC to report to the House Financial Services Committee and Senate Banking Committee the findings of the study within one year of enactment. Additionally, if the SEC finds that amendments are necessary, the bill directs the SEC to revise Rule 10b5-1 consistent with the results of the study, subject to public notice and comment.

#### HEARINGS

The Committee on Financial Services held no hearings examining matters relating to H.R. 6320.

#### COMMITTEE CONSIDERATION

The Committee on Financial Services met in open session on July 11, 2018, and ordered H.R. 6321 to be reported favorably to the House by voice vote.

#### COMMITTEE VOTES

Clause 3(b) of rule XIII of the Rules of the House of Representatives requires the Committee to list the record votes on the motion to report legislation and amendments thereto. The sole vote was on a motion by Chairman Hensarling to report the bill favorably to the House without amendment. The motion was agreed to by voice vote, a quorum being present.

#### COMMITTEE OVERSIGHT FINDINGS

Pursuant to clause 3(c)(1) of rule XIII of the Rules of the House of Representatives, the findings and recommendations of the Committee based on oversight activities under clause 2(b)(1) of rule X of the Rules of the House of Representatives, are incorporated in the descriptive portions of this report.

## PERFORMANCE GOALS AND OBJECTIVES

Pursuant to clause 3(c)(4) of rule XIII of the Rules of the House of Representatives, the Committee states that H.R. 6320 will mandate the SEC to conduct a study on SEC rule 10b5-1 in order to determine if the rule needs to be amended in order to better prevent insider trading.

## NEW BUDGET AUTHORITY, ENTITLEMENT AUTHORITY, AND TAX EXPENDITURES

In compliance with clause 3(c)(2) of rule XIII of the Rules of the House of Representatives, the Committee adopts as its own the estimate of new budget authority, entitlement authority, or tax expenditures or revenues contained in the cost estimate prepared by the Director of the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974.

## CONGRESSIONAL BUDGET OFFICE ESTIMATES

Pursuant to clause 3(c)(3) of rule XIII of the Rules of the House of Representatives, the following is the cost estimate provided by the Congressional Budget Office pursuant to section 402 of the Congressional Budget Act of 1974:

U.S. CONGRESS,  
CONGRESSIONAL BUDGET OFFICE,  
*Washington, DC, July 17, 2018.*

Hon. JEB HENSARLING,  
*Chairman, Committee on Financial Services,  
House of Representatives, Washington, DC.*

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the enclosed cost estimate for H.R. 3555, H.R. 6177, H.R. 6319, H.R. 6320, H.R. 6321, H.R. 6322, H.R. 6323, and H.R. 6324.

If you wish further details on these estimates, we will be pleased to provide them. The CBO staff contact is Stephen Rabent.

Sincerely,

MARK P. HADLEY  
(For Keith Hall, Director).

Enclosure.

*Securities and Exchange Commission Legislation*

On July 11, the House Committee on Financial Services ordered eight bills to be reported related to the rules, regulations, and operations of the Securities and Exchange Commission (SEC). The bills are:

- H.R. 3555, the Exchange Regulatory Improvement Act, would require the Securities and Exchange Commission (SEC) to issue regulations regarding its definition of what constitutes a facility used by a national securities exchange;
- H.R. 6177, the Developing and Empowering our Aspiring Leaders Act of 2018, would direct the SEC to conduct a rule-making to expand what types of asset acquisitions are considered qualifying investments for a venture capital fund;
- H.R. 6319, the Expanding Investment in Small Business Act, would require the SEC to conduct a study on the limitation on the amount of outstanding securities a closed-end fund

may hold from a single issuer and still be classified as diversified;

- H.R. 6320, the Promoting Transparent Standards for Corporate Insiders Act, would require the SEC to conduct a study of various proposals to change agency rules regarding the use of written trading plans by certain securities traders;
- H.R. 6321, the Investment Adviser Regulatory Flexibility Improvement Act, would require the SEC to revise the definitions of a small business and small organization applicable for assessing the effect of the agency's rulemakings under the Investment Advisers Act of 1940 on those entities;
- H.R. 6322, the Enhancing Multi-Class Share Disclosures Act, would direct the SEC to issue a rule requiring securities issuers with multi-class stock structures to make disclosures regarding the voting power of certain individuals;
- H.R. 6323, the National Senior Investor Initiative Act of 2018, would direct the SEC to establish a taskforce to identify challenges that senior investors face and to report on its findings every two years; and
- H.R. 6324, the Middle Market IPO Underwriting Cost Act, would direct the SEC to study the costs associated with small and medium-sized companies undertaking an initial public offering and to report on its findings.

Using information from the SEC regarding the costs of similar activities, CBO estimates that implementing seven of those bills—H.R. 3555, H.R. 6177, H.R. 6319, H.R. 6320, H.R. 6321, H.R. 6322, and H.R. 6324—would each have a gross cost of about \$1 million for the agency to conduct the required studies and rulemakings and to issue reports. CBO estimates that implementing the eighth bill—H.R. 6323—would have a gross cost of \$7 million over the 2019–2023 period for the SEC to establish and carry out the functions of the taskforce established under the bill.

However, the SEC is authorized to collect fees sufficient to offset its annual appropriation; therefore, CBO estimates that the net effect on discretionary spending of implementing each of those bills would be negligible, assuming appropriation actions consistent with that authority. H.R. 6323 also would require the Government Accountability Office (GAO) to conduct a study on the economic costs of the financial exploitation of senior citizens and CBO estimates that implementing that section would cost GAO less than \$500,000; such spending would be subject to the availability of appropriated funds.

None of the bills would affect direct spending or revenues; therefore, pay-as-you-go procedures do not apply for any of the eight bills.

None of the bills would increase net direct spending or on-budget deficits in any of the four consecutive 10-year periods beginning in 2029, CBO estimates.

None of the bills contain intergovernmental mandates as defined in the Unfunded Mandate Reform Act (UMRA) and would not affect the budgets of state, local, or tribal governments. All of them would require the SEC to take actions that could raise the agency's administrative costs and the fees it collects to offset those costs. If the SEC increased fees, it would increase the cost of an existing mandate on private entities required to pay those fees. CBO esti-

mates that none of the bills would increase fees in an amount that would exceed the annual threshold for private-sector mandates established in UMRA (\$160 million in 2018, adjusted annually for inflation).

The CBO staff contacts for this estimate are Stephen Rabent (for federal costs) and Rachel Austin (for mandates). The estimate was reviewed by H. Samuel Papenfuss, Deputy Assistant Director for Budget Analysis.

#### FEDERAL MANDATES STATEMENT

This information is provided in accordance with section 423 of the Unfunded Mandates Reform Act of 1995.

The Committee has determined that the bill does not contain Federal mandates on the private sector. The Committee has determined that the bill does not impose a Federal intergovernmental mandate on State, local, or tribal governments.

#### ADVISORY COMMITTEE STATEMENT

No advisory committees within the meaning of section 5(b) of the Federal Advisory Committee Act were created by this legislation.

#### APPLICABILITY TO LEGISLATIVE BRANCH

The Committee finds that the legislation does not relate to the terms and conditions of employment or access to public services or accommodations within the meaning of the section 102(b)(3) of the Congressional Accountability Act.

#### EARMARK IDENTIFICATION

With respect to clause 9 of rule XXI of the Rules of the House of Representatives, the Committee has carefully reviewed the provisions of the bill and states that the provisions of the bill do not contain any congressional earmarks, limited tax benefits, or limited tariff benefits within the meaning of the rule.

#### DUPLICATION OF FEDERAL PROGRAMS

In compliance with clause 3(c)(5) of rule XIII of the Rules of the House of Representatives, the Committee states that no provision of the bill establishes or reauthorizes: (1) a program of the Federal Government known to be duplicative of another Federal program; (2) a program included in any report from the Government Accountability Office to Congress pursuant to section 21 of Public Law 111–139; or (3) a program related to a program identified in the most recent Catalog of Federal Domestic Assistance, published pursuant to the Federal Program Information Act (Pub. L. No. 95–220, as amended by Pub. L. No. 98–169).

#### DISCLOSURE OF DIRECTED RULEMAKING

Pursuant to section 3(i) of H. Res. 5, (115th Congress), the following statement is made concerning directed rule makings: The Committee estimates that the bill requires no directed rulemakings within the meaning of such section.

## SECTION-BY-SECTION ANALYSIS OF THE LEGISLATION

*Section 1. Short title*

This section cites H.R. 6320 as the “Promoting Transparent Standards for Corporate Insiders Act.”

*Section 2. SEC study*

This section cites that the SEC shall conduct a study of whether Rule 10b5–1 should be amended to more effectively regulate insider trading. It also requires the SEC to prepare a report to the Committee on Financial Services of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the Senate and to revise the rule, subject to public notice and comment, consistent with the results of the study. If the SEC finds that no amendments are necessary, the Commission would not be expected to revise Rule 10b5–1.

## CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with clause 3(e) of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows: H.R. 6320 does not repeal or amend any section of a statute. Therefore, the Office of Legislative Counsel did not prepare the report contemplated by Clause 3(e)(1)(B) of rule XIII of the Rules of the House of Representatives.