

Via Hand Delivery

December 2, 2019

The Honorable Nancy Pelosi  
Speaker  
United States House of Representatives  
Washington, DC 20515

The Honorable Kevin McCarthy  
Republican Leader  
United States House of Representatives  
Washington, DC 20515

*Re: H.R. 2534, the "Insider Trading Prohibition Act"*<sup>1</sup>

Dear Madam Speaker and Republican Leader McCarthy:

I am writing on behalf of the Council of Institutional Investors (CII) to express our general support for H.R. 2534, the "Insider Trading Prohibition Act", in connection with its expected consideration on the floor of United States House of Representatives (House).<sup>2</sup>

CII is a nonprofit, nonpartisan association of U.S. public, corporate and union employee benefit funds, other employee benefit plans, state and local entities charged with investing public assets, and foundations and endowments with combined assets under management of approximately \$4 trillion. Our member funds include major long-term shareowners with a duty to protect the retirement savings of millions of workers and their families. Our associate members include non-U.S. asset owners with about \$4 trillion in assets, and a range of asset managers with more than \$35 trillion in assets under management.<sup>3</sup>

## **Insider Trading**

Long-term investors like CII members can be harmed by practices that undermine confidence in the markets. That loss of confidence can occur when corporate executives are able to sell their company stock—often a significant component of their compensation—before their companies

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<sup>1</sup> Insider Trading Prohibition Act, H.R. 2534, 116 Cong. (as reported by House, Sept. 29, 2019), <https://www.congress.gov/bill/116th-congress/house-bill/2534/text>.

<sup>2</sup> Committee on Rules, Amendment Process Announcement for H.R. 2534—Insider Trading Prohibition Act (Nov. 22, 2019), <https://rules.house.gov/news/announcement/amendment-process-announcement-hr-2534-insider-trading-prohibition-act> (“The Committee on Rules is likely to meet the week of December 2 to grant a rule that may provide a structured amendment process for floor consideration of H.R. 2534 – Insider Trading Prohibition Act.”).

<sup>3</sup> For more information about the Council of Institutional Investors (“CII”), including its board and members, please visit CII’s website at <http://www.cii.org>.

report bad news to the public. CII, therefore, generally supports proposed legislation that is reasonably designed to limit corporate executives from trading company stock while possessing insider information.

For example, CII has publicly supported H.R. 624,<sup>4</sup> the “Promoting Transparent Standards for Corporate Insiders Act.”<sup>5</sup> That bill, generally consistent with CII membership-approved policies,<sup>6</sup> would require the Securities and Exchange Commission (SEC) to study and report on possible revisions to regulations regarding Rule 10b5-1 trading plans.<sup>7</sup> Those regulations permit corporate executives to establish a defense to insider trading for transactions executed pursuant to a plan.<sup>8</sup> Particularly in light of a history of suspiciously fortuitous trading practices by corporate insiders,<sup>9</sup> we were very pleased that H.R. 624 was approved by the House last January by a strong bipartisan vote of 413 to 3.<sup>10</sup>

We are also pleased that in February Ranking Member of the Securities Subcommittee of the Committee on Banking, Housing, and Urban Affairs Chris Van Hollen and Senator Deb Fischer introduced S. 573, a companion bill to H.R. 624.<sup>11</sup> We support passage of S. 573 in the United States Senate.

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<sup>4</sup> See, e.g., Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to Vanessa Countryman, Secretary, Securities and Exchange Commission 8 (July 18, 2019), [https://www.cii.org/files/issues\\_and\\_advocacy/correspondence/2019/July%2018%202019%20SEC%20Reg%20FLEX%20Letter%20Final\(1\).pdf](https://www.cii.org/files/issues_and_advocacy/correspondence/2019/July%2018%202019%20SEC%20Reg%20FLEX%20Letter%20Final(1).pdf) (“CII’s recommended improvements to Rule 10b5-1 have been incorporated into the SEC study of Rule 10b5-1 that would be mandated by H.R. 624”).

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

<sup>6</sup> CII, Corporate Governance Policies § 5.15b Stock Sales (updated Oct. 24, 2018), [https://www.cii.org/files/10\\_24\\_18\\_corp\\_gov\\_policies.pdf](https://www.cii.org/files/10_24_18_corp_gov_policies.pdf) (“10b5-1 program adoptions, amendments, terminations and transactions should be disclosed immediately, and boards of companies using 10b5-1 plans should: (1) adopt policies covering plan practices, (2) periodically monitor plan transactions and (3) ensure that company policies discuss plan use in the context of guidelines or requirements on equity hedging, holding and ownership.”).

<sup>7</sup> Promoting Transparent Standards for Corporate Insiders Act, H.R. 624, 116<sup>th</sup> Cong. § 2(a), (b).

<sup>8</sup> See, e.g., Nicole Vanatko, Reexamining the Rule 10b5-1 Trading Plans Defense to Insider Trading, CRS 2 (Jan. 31, 2019), <https://fas.org/sgp/crs/misc/LSB10249.pdf> (“the rule [10b5-1] establishes a defense to insider trading for transactions executed pursuant to a prearranged plan”).

<sup>9</sup> See *id.* (“The SEC and others have questioned the plans’ potential for abuse and possible weaknesses over at least the past decade, citing certain well-publicized reports and studies indicating that many executives achieve above-average returns when trading . . . pursuant to Rule 10b5-1 trading plans.”); Cydney Posner, Blog: New House Bill to Curb Potential Abuse of 10b5-1 Plans, PubCo@Cooley (Jan. 24, 2019), <https://www.jdsupra.com/legalnews/blog-new-house-bill-to-curb-potential-19688/> (commenting on “a number of problems with 10b5-1 plans, including the absence of public disclosure about the plan or changes to it and the absence of rules about how long the plans must be in place before trading under the plans can begin”); Craig M. Scheer, Rule 10b5-1 Trading Plans in the Current Environment: The Importance of Doing it Right, Bus. Law Today (Sept. 19, 2018), <http://apps.americanbar.org/buslaw/blt/content/2013/02/article-06-scheer.shtml> (“Critics have long viewed the rule as creating an opportunity for abuse, claiming that some insiders may in fact be aware of material non-public information at the time plans are established and that the rule can be used to provide cover for improper trades.”).

<sup>10</sup> See Promoting Transparent Standards for Corporate Insiders Act, H.R. 624, Final Vote Results for Roll Call 52, 116<sup>th</sup> Cong. (Jan. 28, 2019), <http://clerk.house.gov/evs/2019/roll052.xml>.

<sup>11</sup> Promoting Transparent Standards for Corporate Insiders Act, S. 573, 116<sup>th</sup> Cong. (2019), <https://www.congress.gov/bill/116th-congress/senate-bill/573/text>.

### Insider Trading Prohibition Act

Provisions of the Insider Trading Prohibition Act largely would codify existing case law on insider trading.<sup>12</sup> However, H.R. 2534 would change existing case law by not requiring “that defendants *actually know* how the information was obtained . . . .”<sup>13</sup> While this change could lead to an increase in insider trading prosecutions, we believe the change is appropriate because insider trading prosecutions should be pursued even if the trader did not pay for the tip or lacked specific awareness of how the information was obtained.<sup>14</sup>

More specifically, H.R. 2534 provides that it is not necessary that the person trading while in possession of insider information (or making a communication as proscribed by the bill) knows the specific means by which the information was obtained or communicated, or whether any personal benefit was paid or promised, “so long as the person trading while in possession of such information or making the communication, as the case may be, was aware, consciously avoided being aware, or recklessly disregarded that such information was wrongfully obtained or communicated.”<sup>15</sup> H.R. 2534 would also improve the ability to prohibit insider trading based on information acquired through, for example, theft, bribery, misrepresentation, misappropriation, or through breach of fiduciary duty or confidentiality agreement.<sup>16</sup>

Finally, CII observes that all four witnesses at the April hearing of the Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets of the Committee on Financial Services at

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<sup>12</sup> See Rahul Mukhi, Cleary Gottlieb Steen & Hamilton LLP, et al., A Look Inside H.R. 2534: The Insider Trading Prohibition Act, Harv. L. Sch. F. on Corp. Governance & Fin. Reg. (July 25, 2019), <https://corpgov.law.harvard.edu/2019/025347/25/a-look-inside-h-r-2534-insider-trading-prohibition-act/> (“In some aspects, the bill memorializes current insider trading law.”); Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to The Honorable Maxine Waters, Chair, Committee on Financial Services, United States House of Representatives et al. 3 (May 7, 2019), [https://www.cii.org/files/issues\\_and\\_advocacy/correspondence/2019/May%207%202019%20%20Letter%20to%20Committee%20on%20Financial%20Services%20KB.docx%20\(finalF\).pdf](https://www.cii.org/files/issues_and_advocacy/correspondence/2019/May%207%202019%20%20Letter%20to%20Committee%20on%20Financial%20Services%20KB.docx%20(finalF).pdf) (“The bill takes a narrow approach in overturning [existing case law] requirement, which we think is wise [and][f]or the most part, existing precedents on insider trading are appropriate.”).

<sup>13</sup> Kyle DeYoung et al., INSIGHT: The ‘Tipping’ Point—Possible Shakeup to Insider Trading Rules, Bloomberg Gov’t (Oct. 25, 2019) (on file with CII) (“Importantly, the Act eliminates the personal benefit test articulated in over 30 years of case law[,] because the Act does not require that defendants actually know how the information was obtained, it could lead to an increase in insider trading prosecutions.”).

<sup>14</sup> See Insider Trading Research with Professors Salman Arif, Joseph Schroeder, and Daniel Taylor (Apr. 19, 2019), <https://www.cii.org/podcasts> (Professor Taylor explaining his support for the Insider Trading Prohibition Act noting “this bill is necessary to clarify that we can go after and prosecute the trader regardless of whether the trader was aware of or paid for the tip”).

<sup>15</sup> H.R. 2534, Insider Trading Prohibition Act § 2(a)(16)(A)(c)(2).

<sup>16</sup> See *id.* § 2(a)(16)(A)(c)(1); see also Sarah Aberg, Sheppard Mullin Richter & Hampton LLP, et al., New Bill Seeks to Bring Clarity to Insider Trading Law, Gov’t Cont., Investigations & Int’l Trade Blog (Aug. 1, 2019), <https://www.jdsupra.com/legalnews/new-bill-seeks-to-bring-clarity-to-10349/> (“There are several gaps as a result of the current insider trading framework [including]. . . . the coupling of material nonpublic information (or ‘MNPI’) to a fiduciary duty preclude the use of the Act to prosecute those who trade on stolen MNPI (e.g., through hacking, corporate espionage, or outright theft), as opposed to MNPI voluntarily passed on by a corporate insider.”).

which the Insider Trading Prohibition Act was discussed expressed general support for the bill.<sup>17</sup> Of note, the witnesses included Professor John C. Coffee, Jr., who serves as a member of the Task Force on Insider Trading, assembled by Preet Bharara, the former S.D.N.Y. U.S. Attorney.<sup>18</sup> That task force includes ex-U.S. Attorneys and SEC enforcement specialists.<sup>19</sup>

In sum, the Insider Trading Prohibition Act would generally provide investors, other market participants and the courts a clearer standard on insider trading, without upsetting many standing precedents.<sup>20</sup> We think this is the correct approach.<sup>21</sup>

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If we can answer any questions or provide additional information that would be helpful to you or your staff, please do not hesitate to contact me at 202.822.0800 or [jeff@cii.org](mailto:jeff@cii.org).

Sincerely,



Jeffrey P. Mahoney  
General Counsel

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<sup>17</sup> See U.S. House of Representative Committee Repository, Putting Investors First: Reviewing Proposals to Hold Executives Accountable: Hearing Before the H. Subcomm. on Investor Protection, Entrepreneurship, and Capital Mkts. of the FSC, 116 Cong. (Apr. 3, 2019), <https://docs.house.gov/Committee/Calendar/ByEvent.aspx?EventID=109256>.

<sup>18</sup> U.S. House of Representative Committee Repository, Putting Investors First: Reviewing Proposals to Hold Executives Accountable: Hearing Before the H. Subcomm. on Investor Protection, Entrepreneurship, and Capital Mkts. of the FSC, 116 Cong. (Apr. 3, 2019) (Statement of Professor John C. Coffee, Jr., Adolf A. Berle Professor of Law, Columbia University Law School at 1), <https://financialservices.house.gov/uploadedfiles/hhrg-116-ba16-wstate-coffeej-20190403.pdf>.

<sup>19</sup> *Id.* at 2.

<sup>20</sup> See Kyle DeYoung et al. (“the proposed Insider Trading Prohibition Act (H.R. 2534) (Act) could clarify the legal haziness that financial institutions, corporate executives, and casual investors regularly wrestle”).

<sup>21</sup> Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to The Honorable Maxine Waters, Chair, Committee on Financial Services, United States House of Representatives et al. 3; see Letter from Jeffrey P. Mahoney, General Counsel, Council of Institutional Investors to The Honorable Carolyn B. Maloney, Chair, Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets, Committee on Financial Services, United States House of Representatives et al. 3 (Apr. 9, 2019), [https://www.cii.org/files/April%209%202019%20Letter%20to%20Subcommittee%20on%20Investor%20Protection%20and%20Capital%20Markets%20\(finalV\)%20KB.pdf](https://www.cii.org/files/April%209%202019%20Letter%20to%20Subcommittee%20on%20Investor%20Protection%20and%20Capital%20Markets%20(finalV)%20KB.pdf) (“CII generally supports the bill because it provides investors and other market participants with a clearer, simpler standard of the current law of insider trading.”).