

Via Hand Delivery

May 7, 2019

The Honorable Maxine Waters
Chair
Committee on Financial Services
United States House of Representatives
Washington, DC 20515

The Honorable Patrick T. McHenry
Ranking Member
Committee on Financial Services
United States House of Representatives
Washington, DC 20515

Re: May 8, 2019, Markup of H.R. 1988; H.R. 2409; H.R. 2513; H.R. 2514; H.R. 2515; and H.R. _____ - "Insider Trading Prohibition Act of 2019"¹

Dear Madam Chair and Ranking Member McHenry:

I am writing on behalf of the Council of Institutional Investors (CII) to express our appreciation to you for holding the above referenced markup and to provide you with our views on H.R. _____ - "Insider Trading Prohibition Act of 2019." We would respectfully request that this letter be made a part of the markup public record.

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

¹ U.S. House Committee on Financial Services, Markups, H.R. 1988; H.R. 2409; H.R. 2513; H.R. 2514; H.R. 2515; and H.R. _____ - "Insider Trading Prohibition Act of 2019" (May 8, 2019), <https://financialservices.house.gov/calendar/eventsingle.aspx?EventID=403650>.

² For more information about the Council of Institutional Investors ("CII"), including its board and members, please visit CII's website at <http://www.cii.org>.

Insider Trading

*CII generally supports H.R. ____, the Insider Trading Prohibition Act*³

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 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, earlier this year, CII publicly supported H.R. 624.⁴ That bill, generally consistent with CII membership-approved policies,⁵ would require the Securities and Exchange Commission (SEC) to study and report on possible revisions to regulations regarding Rule 10b5-1 trading plans.⁶ Those regulations permit corporate executives to establish a defense to insider trading for transactions executed pursuant to a plan.⁷ Particularly in light of a history of suspiciously fortuitous trading practices by corporate insiders,⁸ we were pleased to see H.R. 624 be approved by the U.S. House of Representatives on January 28, 2019, by a strong bi-partisan vote of 413 to 3.⁹

³ H.R. ____, Insider Trading Prohibition Act, 116th Cong. (2019) (Discussion Draft), <https://financialservices.house.gov/uploadedfiles/bills-116pih-insidertrading.pdf>.

⁴ See Promoting Transparent Standards for Corporate Insiders Act, H.R. 624, 116th Cong. (2019), <https://www.congress.gov/bill/116th-congress/house-bill/624/text>.

⁵ CII, Corporate Governance Policies § 5.15b Stock Sales (updated Oct. 24, 2018), https://www.cii.org/files/10_24_18_corp_gov_policies.pdf (“10b5-1 program adoptions, amendments, terminations and transactions should be disclosed immediately, and boards of companies using 10b5-1 plans should: (1) adopt policies covering plan practices, (2) periodically monitor plan transactions and (3) ensure that company policies discuss plan use in the context of guidelines or requirements on equity hedging, holding and ownership.”).

⁶ Promoting Transparent Standards for Corporate Insiders Act, H.R. 624, 116th Cong. § 2(a), (c).

⁷ 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”).

⁸ See *id.* at 2 (“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.”).

⁹ Promoting Transparent Standards for Corporate Insiders Act, H.R. 624, Final Vote Results for Roll Call 52, 116th Cong. (Jan. 28, 2019), <http://clerk.house.gov/evs/2019/roll052.xml>.

Insider Trading Prohibition Act

For the most part, provisions of the Insider Trading Prohibition Act largely would codify existing case law on insider trading. However, the bill also would overturn the controversial requirement affirmed in 2016 by the 2nd Circuit decision in *United States v. Newman*¹⁰ requiring that prosecutors show that a person receiving insider information provided a benefit to the tipster.¹¹ The bill takes a narrow approach in overturning the *Newman* requirement, which we think is wise. For the most part, existing precedents on insider trading are appropriate.

The bill 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.”¹² The bill would 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.

In sum, the Insider Trading Prohibition Act would provide investors, other market participants and the courts a clearer, simpler, and more consistent standard on insider trading, without upsetting most standing precedents. We think this is the correct approach.¹³

CII observes that all four witnesses at the April 3 hearing of the Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets (April Hearing) expressed support for the bill.¹⁴ Those witnesses included Professor John C. Coffee, Jr. who “serves as a member of the

¹⁰ *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014), available at <https://www.scotusblog.com/wp-content/uploads/2015/08/15-137-op-below.pdf> (“In sum, we hold that to sustain an insider trading conviction against a tippee, the Government must prove each of the following elements beyond a reasonable doubt: . . . the tippee knew of the tipper’s breach, that is, he knew the information was confidential and divulged for personal benefit”).

¹¹ See, e.g., Memorandum from FSC Majority Staff to Members, Committee on Financial Services 2 (Mar. 29, 2019), https://financialservices.house.gov/uploadedfiles/hrg-116-ba16-20190403-sd002-u1_-_memo.pdf (“Newman [has] . . . made it significantly more difficult for the government to successfully prosecute insider trading cases.”).

¹² H.R. ____, Insider Trading Prohibition Act § 2(a).

¹³ 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%202019%20Letter%20to%20Subcommittee%20on%20Investor%20Protection%20Entrepreneurship%20and%20Capital%20Markets%20\(finalV\)%20KB.pdf](https://www.cii.org/files/April%202019%20Letter%20to%20Subcommittee%20on%20Investor%20Protection%20Entrepreneurship%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.”).

¹⁴ 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>.

Task Force on Insider Trading, assembled by Preet Bharara, the former S.D.N.Y. U.S. Attorney . . . which includes ex-U.S. Attorneys and SEC enforcement specialists”¹⁵

Finally, we have reviewed the amendment in the nature of a substitute to the Insider Trading Prohibition Act to be offered by Representative Jim Himes at the markup.¹⁶ We believe the revisions contained therein are appropriate and generally responsive to suggested improvements identified at the April Hearing.¹⁷

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

Sincerely,



Jeffrey P. Mahoney
General Counsel

¹⁵ 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 1-2), <https://financialservices.house.gov/uploadedfiles/hrg-116-ba16-wstate-coffeej-20190403.pdf>.

¹⁶ H.R. ____, Insider Trading Prohibition Act, 116th Cong. (2019) (Amendment in the Nature of a Substitute to H.R. ____ offered by Mr. Himes of Connecticut), <https://financialservices.house.gov/uploadedfiles/bills-116-hr-h001047-amdt-5.pdf>.

¹⁷ See *id.* (deleting § 2(c) of the Discussion Draft appears responsive to suggestion by Professor John C. Coffee, Jr. regarding the benefits of the authority granted under Section 14(e) of the Securities and Exchange Act of 1934).