



BETTER MARKETS

April 1, 2022

Vanessa A. Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: Rule 10b5-1 and Insider Trading (File No. S7-20-21, RIN 3235-AM86)

Dear Ms. Countryman:

Better Markets¹ appreciates the opportunity to comment on the above-captioned Proposed Rule (“Proposal” or “Release”).² The Proposal would amend a safe harbor contained in SEC Rule 10b5-1 from insider trading liability,³ subject to certain conditions, for trades made pursuant to pre-established trading plans. The SEC adopted this safe harbor in 2000 to address speculative concerns that its otherwise common sense rule, which imposes liability for trades made when an insider is in knowing possession of material non-public information (“MNPI”), might result in insider trading liability in the narrow, seemingly entirely avoidable scenario where an insider “decides” to trade, but for some reason fails to consummate the trade, comes into possession of MNPI, and then decides to go through with the trade anyway. Since the adoption of the safe harbor, evidence has mounted that it has been subject to rampant abuse.

Accordingly, the Securities and Exchange Commission (“SEC” or “Commission”) is proposing to impose more meaningful restrictions on the availability of the safe harbor to reduce its abuse, including a mandatory cooling-off period following the establishment of a trading plan before an insider or issuer may rely on the safe harbor; restrictions on use of multiple and overlapping plans; and limits on the use of single stock plans. The SEC is also proposing to increase transparency by instituting disclosure requirements surrounding use of 10b5-1 plans and insider trading policies. In combination, the enhancements as proposed will make it less likely that insiders can successfully abuse Rule 10b5-1 trading plans to profit at the expense of the

¹ Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street, and make our financial system work for all Americans again. Better Markets works with allies—including many in finance—to promote pro-market, pro-business, and pro-growth policies that help build a stronger, safer financial system that protects and promotes Americans’ jobs, savings, retirements, and more.

² 87 Fed. Reg. 6652 (Feb. 4, 2022).

³ 17 C.F.R. 240.10b5-1.

shareholders whose welfare they are supposed to maximize. In particular, the SEC must not weaken or eliminate any aspect of the Proposal in response to what are often overstated industry concerns about the supposed “burden” of complying with the requirements of an entirely voluntary safe harbor. Moreover, the SEC should consider whether the safe harbor serves any function at all, and it should consider eliminating it entirely. Finally, the SEC’s additional proposal to require disclosure of option grants in close proximity to disclosure of material non-public information will appropriately increase the transparency of executive compensation.

BACKGROUND

Section 10(b) of the Exchange Act prohibits any person from using, in connection with the purchase or sale of any security, “any manipulative or deceptive device or contrivance” in violation of the SEC’s rules.⁴ SEC Rule 10b-5, in turn, makes it unlawful to “employ any device, scheme, or artifice to defraud...make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or...engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.”⁵ The SEC and courts have long recognized that trading on the basis of material, non-public information (“MNPI”) in violation of a pre-existing duty violates Exchange Act Section 10(b) and SEC Rule 10b-5.⁶

As the Supreme Court noted back in 1980, the particular form of prohibited insider trading most relevant to the Proposal—that of corporate insiders trading in their own company’s stock while armed with information relating to the value of the company’s stock known only to insiders—was even then “not a novel twist of the law,” but a recognition that such trading, among other harms, violates the “relationship of trust and confidence between the shareholders of a corporation and those insiders who have obtained confidential information by reason of their position with that corporation.”⁷ In other words, it has long been clear that corporate insiders cannot trade on the basis of MNPI without running afoul of the anti-fraud provisions of the securities laws and the SEC’s rules. Nevertheless, because the source of liability for insider trading are general anti-fraud provisions, rather than any specific prohibition, the contours have necessarily been “developed in the courts as a common law of federal securities fraud” meaning, at any given time, there may be uncertainty about whether a particular transaction violates the prohibition on trading on the basis of MNPI.⁸

In 1993, the Second Circuit provided some gloss on the scope of insider trading liability, addressing whether insider trading attaches anytime an insider trades while in “knowing possession” of MNPI, or whether there must be evidence that an insider actually used the MNPI in their trading decision. Explaining the superiority of a clear, bright line rule, the Second Circuit explained that only “knowing possession” of MNPI should be required to impose liability for

⁴ Release at 8687.

⁵ 17 C.F.R. § 240.10b-5.

⁶ *Chiarella v. United States*, 445 U.S. 222, 227 (1980) (citing a 1961 SEC case imposing liability on a corporate insider who sold shares on the basis of nonpublic information as an “important step in the development of § 10b-5”).

⁷ *Id.* at 227-28.

⁸ § 12:160. Insider Trading and Rule 10b-5—Overview, 4 Law Sec. Reg. § 12:160.

insider trading.⁹ As the Second Circuit pointed out, a “knowing possession” standard has the benefit of clarity. Beyond that, it also recognizes that it strains credulity to argue that a person can have MNPI and not use it in a trading decision:

“It recognizes that one who trades while knowingly possessing material inside information has an informational advantage over other traders. Because the advantage is in the form of information, it exists in the mind of the trader. Unlike a loaded weapon which may stand ready but unused, material information can not lay idle in the human brain. The individual with such information may decide to trade upon that information, to alter a previously decided-upon transaction, to continue with a previously planned transaction even though publicly available information would now suggest otherwise, or simply to do nothing. In our increasingly sophisticated securities markets, where subtle shifts in strategy can produce dramatic results, it would be a mistake to think of such decisions as merely binary choices—to buy or to sell.”¹⁰

To be sure, other courts would disagree to some extent, with both the Ninth and Eleventh Circuits opting to require some proof that the MNPI was “used” to impose liability. However, even those courts implicitly acknowledged that knowing possession of MNPI while trading was itself significant evidence of use, at least in certain situations. The Eleventh Circuit, addressing civil liability, held that “when an insider trades while in possession of material nonpublic information, a strong inference arises that such information was used by the insider in trading.”¹¹ The Ninth Circuit, addressing criminal liability, recognized that it could not impose an unfavorable inference on a criminal defendant, but nevertheless pointed out that it is “not necessary that the government present a smoking gun in every insider trading prosecution” and that “[a]ny number of types of circumstantial evidence might be relevant to the causation issue.”¹²

Nevertheless, the SEC sought to address the developing circuit split through rulemaking, proposing Rule 10b5-1, which attempted to split the difference. It broadly adopted the Second Circuit’s standard imposing liability where an insider trades while “aware” of MNPI.¹³ Unlike the Second Circuit, which would have left no wiggle room whatsoever for a person to demonstrate they had not used MNPI they were aware of, the SEC also proposed to establish a safe harbor. It was based on the premise that “where a trade resulted from a pre-existing plan, contract, or instruction made in good faith, it will be clear that the trader did not use the information he or she was aware of.”¹⁴ The SEC was concerned that an awareness standard “could be overbroad in some respects,” and specifically that “a person may reach a decision to make a particular trade without any awareness of material nonpublic information, but then come into possession of such information before the trade actually takes place.”¹⁵ In that situation, according to the SEC, a “rigid ‘knowing possession’ standard would lead to liability,” although seemingly that person

⁹ *United States v. Teicher*, 987 F.2d 112, 120 (2d Cir. 1993)

¹⁰ *United States v. Teicher*, 987 F.2d 112, 120–21 (2d Cir. 1993).

¹¹ *S.E.C. v. Adler*, 137 F.3d 1325, 1337 (11th Cir. 1998)

¹² *United States v. Smith*, 155 F.3d 1051, 1069 (9th Cir. 1998).

¹³ Selective Disclosure and Insider Trading, 64 Fed. Reg. 72,590, 72,591 (Dec. 28, 1999).

¹⁴ Selective Disclosure and Insider Trading, 64 Fed. Reg. 72,590, 72,591 (Dec. 28, 1999).

¹⁵ Selective Disclosure and Insider Trading, 64 Fed. Reg. 72,590, 72,600 (Dec. 28, 1999).

could have avoided liability even under that broad standard by either making the trade prior to coming into possession of MNPI, or abstaining from the trade once in possession of MNPI.¹⁶ It was also clear that the proposed safe harbor was intended to benefit issuers and corporate insiders, not investors, the markets, or the economy more broadly. The only benefit identified by the SEC for its proposed safe harbor was to give “corporate insiders....greater clarity and certainty on how they can plan and structure securities transactions.”¹⁷ This concern with making life easier for corporate insiders carried over into the final rule, which largely adopted Rule 10b5-1 as proposed but with some further accommodations. In response to industry concerns that the proposed voluntary safe harbor was not permissive enough, the SEC made the final safe harbor easier for corporate insiders to take advantage of, in part by allowing plans to qualify for the safe harbor even where the plan does not specify amounts, prices, or dates for trading.¹⁸ The SEC did not address any potential harm (or benefits) to the investors or markets it is charged with protecting from its adoption of a safe harbor for the benefit of facilitating trading by corporate insiders.

As it turns out, this overriding concern with providing flexibility and ease to issuers and their corporate insiders has come at a cost to investors and markets. Over time, it has become clear that the safe harbor established in Rule 10b5-1 has been widely abused, allowing corporate insiders to engage in insider trading and hide behind secretive Rule 10b5-1 plans that can be created, changed, and canceled at will and with no transparency.¹⁹ Multiple studies have shown that insiders trading pursuant to these plans, which are supposed to ensure insiders are not trading on the basis of inside information, have experienced abnormally high returns that are difficult to explain if the trading is truly pursuant to pre-established parameters rather than by use of inside information.²⁰ And driving the point home, the Wall Street Journal reported on several specific suspiciously-timed transactions by corporate insiders, made pursuant to Rule 10b5-1 plans, that were fortuitously timed to be just ahead of price-moving company announcements, helping those insiders make significant profits or avoid significant losses.²¹ This facilitation of insider trading harms investors and the markets in several ways, as the SEC explains in the Release:

- The profits corporate insiders make from trading on the basis of MNPI comes directly, and unfairly, at the expense of other investors who do not have access to inside information, ripping off those investors;
- The ability of corporate insiders to guarantee themselves profits through the use of secret, inside information, distorts incentives by “protecting the insider from the

¹⁶ Selective Disclosure and Insider Trading, 64 Fed. Reg. 72,590, 72,600 (Dec. 28, 1999).

¹⁷ Selective Disclosure and Insider Trading, 64 Fed. Reg. 72,590, 72,607 (Dec. 28, 1999).

¹⁸ Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,728 (Aug. 24, 2000).

¹⁹ Better Markets Press Release, The SEC Moves to Abusive De Facto Insider Trading By Corporate Executives Via So-Called Trading Plans (Jun. 7, 2021), <https://bettermarkets.org/newsroom/sec-moves-end-abusive-de-facto-insider-trading-corporate-executives-so-called-trading-plans/>.

²⁰ Alan D. Jagolinzer, *SEC Rule 10b5-1 and Insiders' Strategic Trade*, 55 Mgmt. Sci. 224 (2009); M. Todd Henderson, Alan Jagolinzer & Karl Muller, *Hiding in Plain Sight: Can Disclosure Enhance Insiders' Trade Returns?* at 2-3 (Coase-Sandor Working Paper Series in Law & Econ. No. 411, 2012); Daniel J. Morrissey, *Taming Rule 10b-5-1: The Unfinished Business of Texas Gulf Sulphur*, 71 SMU L. REV. 883, 887 (2018).

²¹ Susan Pulliam & Rob Barry, *Executives' Good Luck in Trading Own Stock*, WALL ST. J. (Nov. 27, 2012), <https://www.wsj.com/articles/SB10000872396390444100404577641463717344178>.

full effects of the poor corporate performance on the value of the insider’s equity position”;

- It allows corporate insiders “to adjust the timing or content of corporate disclosures,” a manipulative practice that leads to less informed trading, distorting markets, and possibly undermining investor confidence in the markets.²²

OVERVIEW OF PROPOSAL

The SEC is proposing to enhance Rule 10b5-1 by making the following changes to the availability of its safe harbor from insider trading liability:

- Provide that the safe harbor is not available for a Rule 10b5-1 plan of officers, directors, and issuers unless it provides a cooling-off period of at least 120 days for officers and directors, and at least 30 days for issuers, following the adoption or modification of a Rule 10b5-1 trading plan before trades can commence under the plans, in order to reduce the incentive to improperly enter into plans while in possession of MNPI;
- Provide that the safe harbor is not available for multiple overlapping plans for open market trades in the same class of securities, in order to prevent attempts to game the proposed cooling-off periods;
- Provide that the safe harbor is only available for one single-trade plan within any 12-month period, to address concerns that such single-trade plans have been particularly prone to abuse;
- Provide that the safe harbor is only available for officers and directors if they personally certify they are not aware of MNPI at the time a plan is adopted, to ensure that officers and directors actually consider whether they have MNPI before adopting a 10b5-1 plan; and
- Provide that the safe harbor is not available if a plan is operated in bad faith, to ensure that the safe harbor does not shield from liability situations where corporate insiders manipulate the timing of price moving corporate announcements or other events to benefit from trades under a Rule 10b5-1 plan, or other actions undertaken in bad faith with regard to a Rule 10b5-1 plan.²³

The SEC also proposes to require that issuers provide additional disclosure regarding Rule 10b5-1 plans and other trading arrangements, including quarterly reporting of relevant trading arrangements on Forms 10-Q and 10-K, as appropriate, disclosure of insider trading policies and procedures through the addition of new Item 408(b) in Regulation S-K.²⁴ In addition to these

²² Release at 8701.

²³ Release at 8689-94.

²⁴ Release at 8694-8696.

disclosures, the SEC proposes to require more granular disclosure of stock option grants made in close proximity to certain significant, potentially price moving announcements, in order to enhance transparency surrounding these so-called “spring-loaded” and “bullet-dodging” options.²⁵

COMMENTS

I. THERE IS NO CREDIBLE BASIS FOR THE SEC TO WEAKEN ANY ASPECT OF THE PROPOSAL

Overall, the SEC has crafted a proposal that should make it more difficult for corporate insiders to abuse the safe harbor provided by Rule 10b5-1. However, to the extent that the Proposal will reduce the likelihood of abuse, it will only do so meaningfully if the SEC resists industry pressure to weaken or eliminate any elements of the Proposal. As the SEC’s experience with the current safe harbor demonstrates, issuers, their powerful and wealthy corporate insiders, and their creative lawyers have the means and ability to find ways to bring their actions within the technical ambit of the safe harbor, while still engaging in bad faith, abusive insider trading. Accordingly, weakening or eliminating any element of the Proposal will likely serve to provide issuers and corporate insiders an ability to skirt, if not outright flout, the ban on trading on the basis of MNPI. In addition, weakening or eliminating any element of the Proposal would be inappropriate because the safe harbor does not itself impose any mandatory obligations on issuers, corporate insiders, or other shareholders, directly or indirectly. Rather, any burdens it imposes on issuers or corporate insiders are solely those voluntarily undertaken in order to receive the enormous benefits of a shield from liability for transactions that could constitute serious violations of law.

A. Each Element of the Proposal is Necessary to Reduce Abuses of 10b5-1 Plans

Each proposed amendment to the safe harbor in Rule 10b5-1 is designed to address the specific ways in which the current safe harbor facilitates abusive insider trading. The cooling-off periods before an insider or issuer may make transactions pursuant to the plan and still fall within the safe harbor is designed to prevent insiders from gaming the use of 10b5-1 plans by entering into them, and then canceling or modifying them in secret.²⁶ Similarly, the cooling-off periods will mean that, even if an insider improperly enters a 10b5-1 plan with MNPI, the value of that MNPI will likely be significantly diminished by the time the cooling-off period has ended, which will deter such improper actions in the first place. The restriction on overlapping plans will support the cooling-off period by preventing insiders from using multiple different plans to get around the dictates of the cooling-off period.²⁷ The requirement that plans be “operated” in good faith, in addition to being entered into in good faith, will ensure there is liability where modifications or cancellations are made with intent to evade the requirements of the safe harbor, or where persons attempt to manipulate the timing of corporate announcements to benefit trades made pursuant to a

²⁵ Release at 8698-99.

²⁶ See Release at 8690.

²⁷ Release at 8692.

Rule 10b5-1 plan.²⁸ The disclosure requirements will enhance the ability of the SEC and the public to monitor the use of Rule 10b5-1 plans for potential abuse. In addition, they will assist investors concerned with corporate governance in monitoring whether a particular company has effective policies, procedures, and practices for deterring abusive trading practices by corporate insiders.

In other words, there are myriad avenues available under the current safe harbor that unscrupulous insiders can take to shield improper and abusive insider trades from liability, and the elements of the Proposal are intended to foreclose these avenues. Accordingly, weakening or eliminating any element of the Proposal will keep open one or more avenues for continued abuse of the safe harbor, undermining its effectiveness in protecting investors and the markets. For example, eliminating or weakening the transparency elements of the Proposal would effectively weaken the substantive elements of the Proposal, because it would make effective oversight to ensure compliance with those substantive elements difficult, if not impossible. By the same token, weakening the substantive elements of the Proposal would render the transparency elements largely meaningless: while investors and the SEC would be able to better monitor potential abuse of 10b5-1 plans, that would be of little use if there can be no liability for apparently abusive transactions because they manage to fall within the ambit of a still-too-permissive safe harbor. In other words, the SEC should consider each element of the Proposal as a “load-bearing” element of its policy objective of reducing abuse of the safe harbor, where weakening or eliminating any element threatens to cause the collapse of the entire policy structure.

This is a critical consideration for the SEC to keep in mind, because comments from the industry and its allies will almost surely express some measure of support for the *goal* of eliminating abuse of 10b5-1 plans, but they will insist that some elements are unnecessary, superfluous, or particularly burdensome and can be jettisoned or weakened without undermining the overall goals of the Proposal. However, what such exhortations will not mention is that many issuers, their powerful corporate insiders, and their army of creative lawyers, will surely exploit any weakness in the rule to continue to abuse the safe harbor, just as they have abused the myriad weaknesses in the current safe harbor to profit, with little danger of liability, at the expense of investors and the integrity of the markets. The SEC must ensure that this does not happen by resisting this industry pressure and, at the very least, adopting each element of the Proposal as proposed.

B. Because the SEC is Not Imposing a Mandatory Obligation on Issuers, it Must Not Let Disingenuous Concerns About “Burden” on Issuers or Corporate Insiders Shape any Aspect of the Proposal to Amend the 10b5-1 Safe Harbor

We often caution the SEC and other financial regulators not to undertake an unnecessary, burdensome, and misleading quantitative “cost-benefit analysis.”²⁹ This is because, while “cost-

²⁸ Release at 8693.

²⁹ See Better Markets, White Paper: Cost-Benefit Analysis in Consumer and Investor Protection Regulation: An Overview and Update 4-7 (Dec. 8, 2020), https://bettermarkets.org/sites/default/files/Better_Markets_WhitePaper_CBA_Consumer_Investor_Investor_Protection_Dec-2020.pdf.

benefit analysis” creates the impression that it provides precise assessments and definitive answers about the utility of a particular rule, in reality, such analyses have proven inherently unreliable, particularly with regard to financial regulation. In particular, cost-benefit analysis is frequently biased—particularly when it comes to financial regulation, the benefits, while real, are often difficult to quantify, whereas the costs to the regulated industry are often easier to quantify (yet harder to confirm, as the supporting data are often in the sole possession of the industry itself).³⁰ In turn, this inherent bias means that a quantitative cost-benefit analysis will often understate the benefits of the rule to the public while overstating the costs of the rule to industry. That in turn leads to rules that, implicitly or explicitly, are designed to reduce burdens on industry and therefore do not sufficiently protect the public from fraud, abuse, excessive-risk taking, and other activities that can have enormous, but uncertain, consequences on investors and the economy.³¹ Thus, the SEC, charged with protecting the public interest, must not allow industry claims of excessive burdens or costs from a proposed rule to undermine the rule’s ability to sufficiently protect the public.

This concern is especially relevant here because the amendments to the Rule 10b5-1 safe harbor **do not impose any affirmative obligations on any person or company**. In other words, to the extent the Proposal may make it more costly for a trading plan to qualify for the safe harbor, taking on those costs is **entirely voluntary and easily avoidable**. For example, the SEC identifies as a potential cost of some aspects of the Proposal that the “proposed conditions that would impose additional barriers to sales of company stock under Rule 10b5-1(c)(1) could result in decreased liquidity of the insider’s holdings, including reduced ability to meet unanticipated liquidity needs (such as emergency or unplanned expenses) as well as potential constraints on portfolio rebalancing and achieving optimal portfolio diversification and tax treatment.”³²

However, it is not really the so-called “additional barriers” the SEC proposes that would have those effects. Whether the safe harbor continues in its current form, is amended as proposed to be more restrictive, or is eliminated entirely, it does not, by itself, decrease the liquidity of anyone’s holdings or otherwise have any impact on their ability to construct a portfolio that meets their financial needs. Rather, it is at least two independent and voluntary decisions by the corporate insider that lead to these results. The first is the decision to trade in the company’s stock in the first place, and the second is the decision to attempt to take advantage of the enormous benefit of the safe harbor. A corporate insider can have a fully liquid portfolio that they are free to rebalance or otherwise, adjust according to their current financial situation if they choose not to trade in the securities of their company. Or, if a corporate insider does want to trade in their own company’s

³⁰ See Better Markets, White Paper: Cost-Benefit Analysis in Consumer and Investor Protection Regulation: An Overview and Update 4-5 (Dec. 8, 2020), https://bettermarkets.org/sites/default/files/Better_Markets_WhitePaper_CBA_Consumer_Investor_Investor_Protection_Dec-2020.pdf.

³¹ Better Markets, White Paper: Cost-Benefit Analysis in Consumer and Investor Protection Regulation: An Overview and Update 4-5 (Dec. 8, 2020), https://bettermarkets.org/sites/default/files/Better_Markets_WhitePaper_CBA_Consumer_Investor_Investor_Protection_Dec-2020.pdf.

³² Release at 8708.

stock, they are free to do so as long as they are not in possession of MNPI that has any bearing on the decision to trade or its timing—failing to bring trades within the ambit of the safe harbor does not automatically result in insider trading liability. Ultimately, while it will be somewhat (and appropriately) more difficult for issuers and insiders, and particularly officers and directors, to meet the conditions of the safe harbor, the SEC is not mandating that any insider meet the conditions of the safe harbor, **even where an insider wants to trade in the company’s stock**. Accordingly, the SEC must not let concerns about the “burden” of complying with the safe harbor result in a weaker rule.

Relatedly, while it is not necessarily inappropriate to explain how it will be more costly to comply with the safe harbor (so long as it recognizes these costs as voluntary), the SEC must still have a credible basis for identifying these as potential costs. Several aspects of the SEC’s economic discussion raise the concern that the SEC is overstating the potential costs of the Proposal, particularly where those costs are entirely speculative. For example, the SEC speculates that the proposed amendments to the safe harbor would “tend to reduce incentive alignment between insiders and shareholders” by reducing insider equity ownership. However, even to the extent that the Proposal would result in a reduction in insider equity ownership, it does not necessarily follow that “incentive alignment” between insiders and shareholders would be reduced. Insiders do not need to be shareholders of their companies for their interests to align with shareholders. In addition to the weighty legal obligations that require officers and directors to act in the best interest of the company and its shareholders, there are myriad executive compensation structures that can mitigate or eliminate the principal-agent problem identified by the SEC (for example, tying bonuses and future compensation to financial performance).³³

The Release also contains unfounded speculation that the Proposal might somehow result in a cost to shareholders, because “insiders facing illiquidity risk may seek high total pay to compensate for the restrictions,” and that this increased cost “would be borne by existing shareholders.”³⁴ However, the two studies cited by the SEC in support of this supposed “cost,” taken together, make clear that this increased compensation cost would almost certainly be the result of the inability of corporate insiders to **illegally profit from trades made on the basis of MNPI**. The first study does not attempt to distinguish between legitimate trades by insiders that are not made on the basis of MNPI and illegitimate trades that are. Instead, it focuses more broadly on “restrictions on insider trading,” leaving open the possibility that the reason the lack of “insider trading restrictions” allowed some firms to lower compensation costs is because the lack of restrictions allow executives to profit from illegal activity.³⁵ The second study, which analyzes

³³ Cf. Darren T. Roulstone, *The Relation Between Insider-Trading Restrictions and Executive Compensation*, 41 J. OF ACCT. RES. 525 (2003) (explaining that firms with greater restrictions on insider trading incentivize executives through use of “more incentive-based compensation”).

³⁴ Release at 8708.

³⁵ See Darren T. Roulstone, *The Relation Between Insider-Trading Restrictions and Executive Compensation*, 41 J. OF ACCT. RES. 525, 549 (2003) (explaining that it is likely that the increase in compensation costs from insider trading restrictions is likely offset by gains in “cost of capital, investor relation, or legal liability benefits.”).

the usage of Rule 10b5-1 plans, made an explicit finding that companies that allow insiders to trade pursuant to Rule 10b5-1 pay less compensation because of an expectation that **insiders will be able to earn outsize profits by illegally trading on the basis of MNPI.**³⁶ In other words, this study confirms that the potential “cost” identified by the SEC will only accrue inasmuch as it prevents corporate insiders from gaining illegal profits as a result of abusive conduct that harms investors and the markets. This is a bit like saying a “cost” of the Foreign Corrupt Practices Act is the increased compensation foreign officials will demand because they will no longer be able to command as much in bribes. If the SEC overstates this and other “costs,” it not only risks crafting a weak rule but also opens itself up to increased litigation risk, as a court may take seriously the SEC’s overstatement of costs.³⁷

II. THE SEC SHOULD CONSIDER FURTHER RESTRICTING OR ELIMINATING THE RULE 10B5-1 SAFE HARBOR

There is ample justification for the SEC’s proposed amendments to the Rule 10b5-1 safe harbor considering the significant evidence that corporate insiders have abused the safe harbor to engage in illegal, abusive, and harmful insider trading. Moreover, as explained above, the voluntary nature of the safe harbor means that any supposed “burdens” on issuers and corporate insiders can be avoided entirely. Accordingly, the SEC should seriously consider adopting each of the reasonable alternatives it has identified that would further restrict the availability of the safe harbor, including broadening the application of the cooling-off periods to all natural persons, rather than just officers and directors; lengthening the cooling-off periods; and providing that the safe harbor is not available at all for single-stock plans, which have been uniquely subject to abuse.³⁸ Adding these restrictions to the safe harbor will make it less subject to abuse while imposing no additional mandatory obligations on issuers, corporate insiders, or other shareholders.

However, another reasonable alternative the SEC should consider is to simply eliminate the safe harbor. Nothing requires that Rule 10b5-1 contain a safe harbor. It is not a statutory requirement. When the Second Circuit correctly indicated that “knowing possession” was the correct standard for insider trading liability, it did not indicate that anything similar to the SEC’s safe harbor would also be required.³⁹ Thus it cannot fairly be argued that the only reasonable interpretation of Section 10(b) of the Exchange Act (or any other applicable statute) requires the

³⁶ M. Todd Henderson, *Insider Trading and CEO Pay*, 64 VAND. L. REV. 505, 551 (2011) (“The problem arises because the board is arguably complicit in the executives’ illegal activity.”).

³⁷ Cf. Better Markets, White Paper: Cost-Benefit Analysis in Consumer and Investor Protection Regulation: An Overview and Update 14 (Dec. 8, 2020) (explaining that when an agency undertakes a cost-benefit analysis, courts will analyze the propriety of the analysis actually performed even if the cost-benefit analysis is more robust than legally required, https://bettermarkets.org/sites/default/files/Better_Markets_WhitePaper_CBA_Consumer_Investor_Investor_Protection_Dec-2020.pdf).

³⁸ Release at 8711-12.

³⁹ *United States v. Teicher*, 987 F.2d 112, 120 (2d Cir. 1993) (explaining the advantages of a “knowing possession” standard, including “the attribute of simplicity,” without indicating any sort of safe harbor would be necessary).

inclusion of a safe harbor in Rule 10b5-1.⁴⁰ The SEC's adoption of the safe harbor was a policy choice, not a legal requirement. And that policy choice rested on extraordinarily thin grounds. The entire justification the SEC gave for proposing the safe harbor in 1999 was its concern that

“an absolute standard based on knowing possession, or awareness, could be overbroad in some respects. Sometimes a person may reach a decision to make a particular trade without any awareness of material nonpublic information, but then come into possession of such information before the trade actually takes place. A rigid ‘knowing possession’ standard would lead to liability in that case. We believe, however, that for many cases of this type, a reasonable standard would not make such trading automatically illegal.”⁴¹

But, in fact, liability in this hypothetical scenario is easily avoided; this is not a trap for the unwary. This hypothetical insider could complete their trade sooner, to avoid the possibility that they would come into possession of MNPI before the trade takes place. Or, the insider could simply abstain from making the trade until the MNPI is no longer MNPI. In most cases, this would seem to be an inconvenience, at worst; even if in some narrow circumstances taking these simple actions to avoid liability could fairly be said to be a hardship, it is difficult to see how this would be unfair to the insider or why helping insiders in such scenarios is of concern to the SEC.⁴² To that end, the SEC's identification of the benefits was similarly scant. In total, the SEC expected the safe harbor to

benefit corporate insiders by providing greater clarity and certainty on how they can plan and structure securities transactions. The rule provides specific guidance on how a person can plan future transactions at a time when he or she is not aware of material nonpublic information without fear of incurring liability. We believe that this guidance will make it easier for corporate insiders to conduct themselves in accordance with the laws against insider trading.⁴³

Suffice it to say, the inclusion of such an expansive and permissive safe harbor from insider trading liability should have rested on something more than speculation that it might make it easier for corporate insiders to avoid insider trading liability in a seemingly narrow scenario where insider trading liability would already be easily avoidable. The SEC should at least consider as a reasonable alternative eliminating the safe harbor altogether and, if it does not eliminate the safe

⁴⁰ Cf. *S.E.C. v. Adler*, 137 F.3d 1325, 1337 (11th Cir. 1998) (“We view the choice between the SEC's knowing possession test and the use test advocated by Pegram as **a difficult and close question of first impression.**”) (emphasis added); *United States v. Smith*, 155 F.3d 1051, 1067 (9th Cir. 1998) (“Despite the **Second Circuit's thoughtful analysis**, we believe that the weight of authority supports a “use” requirement.”).

⁴¹ Selective Disclosure and Insider Trading, 64 Fed. Reg. 72,590, 72,600 (Dec. 28, 1999).

⁴² In proposing the safe harbor, the SEC did not give any indication that issuers or corporate insiders were suffering any hardship from any lack of certainty following the Second Circuit's opinion in *Treicher*, nor did it specifically seek comment on whether its hypothetical scenario reflected the experiences of insiders, or whether insiders were otherwise suffering hardship as a result the *Treicher* opinion. Selective Disclosure and Insider Trading, 64 Fed. Reg. 72,590, 72,600 (Dec. 28, 1999).

⁴³ Selective Disclosure and Insider Trading, 65 Fed. Reg. 51,716, 51,733 (Aug. 24, 2000).

harbor, providing at least a stronger justification for its existence, including how maintaining the safe harbor benefits (or at least, with the proposed amendments, does not harm) investors and the markets.

III. THE PROPOSAL TO REQUIRE GREATER DISCLOSURE OF SPRING-LOADED OR BULLET-DODGING OPTIONS WILL RESULT IN GREATER TRANSPARENCY IN EXECUTIVE COMPENSATION

The SEC is also proposing to require additional disclosure surrounding options that are awarded within 14 days of “the filing of a periodic report, an issuer share repurchase, or the filing or furnishing of a current report on Form 8-K that contains material nonpublic information.”⁴⁴ This is intended to ensure that investors have fulsome information surrounding the granting of so-called “spring-loaded” or “bullet-dodging” grants of stock options. These are grants of stock options timed close to likely price-moving disclosures, for the benefit of the executives who receive them. Spring-loaded options are awarded close in time to an announcement likely to increase the share price, such as a positive earnings report so that they will likely be in-the-money when the announcement is made.⁴⁵ Conversely, bullet-dodging options are granted after the release of MNPI likely to decrease the stock price, to avoid the negative impact of the announcement.⁴⁶

As the SEC explains in the Release, stock option awards are typically designed to incentivize employees by making it advantageous to work to increase company value.⁴⁷ But spring-loaded or bullet-dodging options do not serve this function, because an advantageous price movement (or price avoidance) is all but assured thanks to the proximity of the option award to a price-moving event.⁴⁸ Therefore, even putting aside other potential issues with spring-loaded or bullet-dodging options, absent clear information about the timing of option grants, investors will not have anything resembling an adequate understanding of the nature of issuers’ compensation practices and how those practices incentivize (or do not incentivize) executives.⁴⁹ The proposed enhancements to Item 402 of Regulation S-K, to specifically enumerate the details of option grants within 14 days of potentially price moving events, will provide investors with this information, ensuring they are able to fully evaluate issuers’ compensation practices, particularly important “as they consider their say-on-pay votes, and when approving executive compensation and electing directors.”⁵⁰

CONCLUSION

We hope these comments are helpful as the Commission finalizes the Proposal.

⁴⁴ Release at 8697-98.

⁴⁵ Release at 8697.

⁴⁶ Release at 8697.

⁴⁷ Release at 8697.

⁴⁸ *See* Release at 8697.

⁴⁹ Release at 8697-98.

⁵⁰ Release at 8698.

Sincerely,



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