OFFICE OF
THE CHAIRMAN

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

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

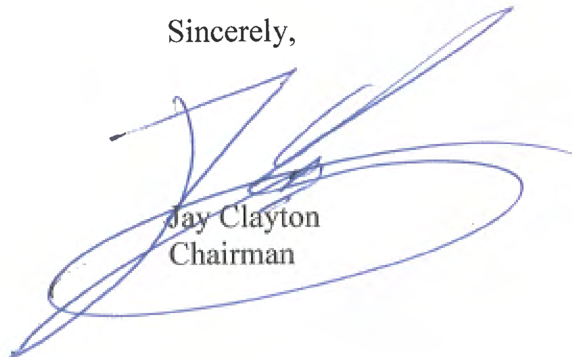
Finally, I believe that companies should consider carefully the wisdom of issuing stock options to its executives while in possession of material non-public information. Many equity compensation plans require stock options to be granted with strike prices that are no less than fair market value. Implicit 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