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Chairman Crapo, Ranking Member Brown, and Members of the Committee, my name is Darla Stuckey, and I am the President and CEO of the Society for Corporate Governance. The Society appreciates the opportunity to present its views on corporate governance legislation before the Committee.

Founded in 1946, the Society is a professional membership association of more than 3,600 corporate secretaries, in-house counsel, and other governance professionals and service providers to the industry who serve approximately 1,200 entities, including about 1,000 public companies of almost every size and industry across the United States.

Society members are responsible for supporting the work of corporate boards of directors, their committees, and the executive managements of their companies on corporate governance and disclosure. Our members generally are responsible for their companies' compliance with the securities laws and regulations, corporate law, and stock exchange listing requirements.

The Decline of Public Company Ownership

A fundamental mission of the Society is to advocate for legislative and regulatory changes that will relieve some of the burdens that discourage companies from becoming and remaining public companies. There are a wide range of forces that discourage investors and the companies they own from going and remaining public. In 1997, there were approximately 7,100 public companies in the United States. Now there are fewer than 3,600.

The decline in public ownership should concern every American. Growing wealth inequality has many drivers, but fewer public companies means fewer investment opportunities for average American investors. This is particularly troubling when one considers that a significant amount of wealth is generated by a company shortly after that company goes public. Think of the opportunities that ordinary American savers have missed out in just the last few years. In fact, companies are staying private longer. In a study published on August 8, 2017, by Jay R. Ritter, Cordell Professor of Finance at the University of Florida, a company's median age for an IPO in 1999-2000 was 5 years, while from 2001-2016 it was 11 years.[1] In 2016, 74 companies became public at a median age of 10 years.[2]

As I said, there are a range of factors discouraging public ownership of companies. But the Committee has before it two bills that can directly and concretely improve the climate for public ownership, H.R. 4015, the Corporate Governance Reform and Transparency Act; and S. 1744, the Brokaw Act. I will discuss each individually.

H.R. 4015, "Corporate Governance Reform and Transparency Act"

H.R. 4015, which has passed the U.S. House of Representatives, addresses the role and activities of the private firms providing proxy advisory services to institutional investors. These entities—called proxy advisory firms—operate with very little

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[1] Jay R. Ritter, "Initial Public Offerings: Updated Statistics," University of Florida, at 11, August 8, 2017, *available at* https://site.warrington.ufl.edu/ritter/files/2017/08/IPOs2016Statistics.pdf.
[2] *Id*. This was the lowest number of IPOs since 2009.

regulation or oversight. H.R. 4015 would provide badly needed improvements to the accuracy and processes of these firms.

Background on Proxy Advisory Firms

The proxy advisory market is dominated by two firms—Institutional Shareholder Services, or ISS, and Glass Lewis. For the uninitiated, proxy advisory firms play an important role in the capital markets by advising investors how they should vote their proxies. This involves preparing recommendations to institutional investors who hold shares in companies—sometimes very large amounts—whether they should (or should not) vote for a particular director, approve the CEO's compensation, and/or how the investor should vote on shareholder proposals. These shareholder proposals can range from an amendment to a company's by-laws to a new climate change policy.

While simply recommending how an investor should vote may sound somewhat unimportant, the reality is far different. ISS and Glass Lewis recommendations are the single most influential pronouncement on the composition of a public company's board, its executive compensation policies, and an increasingly diverse range of shareholder proposals. In fact, anecdotal evidence from some of our member companies consistently shows that as much as 30% of the total shareholder votes are cast within 24 hours of the ISS and Glass Lewis recommendations being released to their clients.

In our view, proxy advisory firms exert outsized influence in the proxy voting process. These firms own and control the software platforms that send investor votes to the tabulator for a shareholder meeting, so they can be counted. The combination of generating proxy voting recommendations and controlling the physical infrastructure through which the votes are cast (sometimes with voting decisions made by the institutional investors and sometimes by default if no client voting decisions are made) are what give proxy advisory firms their importance and give rise to the imperative that these firms "get it right."

Accuracy and Accountability Problems with Proxy Advisory Firms

Proxy advisory firms make proxy recommendations on literally every public company in the U.S. and thousands of public companies in Europe and Asia. This is a large and labor-intensive task. The scale and complexity of making proxy voting recommendations for thousands and thousands of companies during "proxy season" effectively requires proxy advisors to do all their analysis from February to June. With almost all of the recommendations coming out in a 6-8 week period.

Reading and accurately digesting thousands of proxy statements, annual reports, and—increasingly—corporate social responsibility statements in a condensed period makes errors inevitable. Compounding this problem is the fact that many companies are not able to see the proxy advisors' reports about themselves until after each report has been issued. For any company not in the S&P 500, the only way it can see the report is to subscribe to the proxy advisor's service.[3]

It is true that ISS and Glass Lewis will send the underlying data for their reports to some companies for their review. But the analysis and final recommendations are not known, and errors occur during this process. S&P 500 companies are given their reports in advance by ISS, but companies only have one or two days (frequently over a weekend) to review before the recommendations are released publicly. There is often not enough

[3] ISS permits companies in the S&P 500 to have 24-48 hours to review their reports before they are issued, with no subscription required. Smaller companies must pay to receive them. Glass Lewis uses a factual database that companies can access, but does not provide draft reports to any company of any size for review before issuance.

time for companies to review what is arguably the most important corporate governance recommendation about that company each year.

<u>One Small Cap Company's Multi-Year Battle with Factual Errors</u>

An inability to review draft reports from proxy advisory firms means that companies who want factual errors corrected are often unable to get a response from proxy advisory firms until it is too late, <u>i.e.</u>, after investors have voted on the basis of a recommendation relying on inaccurate information.

A very real example of this problem comes from a Society member that works for a small cap company in the transportation industry. The company's story highlights a multitude of problems that the provisions of H.R. 4015 would fix:

> In May 2016, we received an ISS report with an 'against' recommendation regarding Say-on-Pay that was based on a material factual error. The ISS personnel incorrectly concluded that under our annual bonus plan, we set the financial metric goal for the 2015 fiscal year lower than the actual results we had obtained in 2014. This was simply untrue—this was not a matter of methodology or interpretation, but a clear mathematical mistake.
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> As a small-cap company, unlike larger companies, we are not given a 'preview' of our report from ISS, so we received this report just 2 weeks prior to our May 2016 annual meeting. We quickly utilized all of the methods available to us to try to get the error corrected and the recommendation reversed. Although ISS acknowledged the error, they declined to issue either a correction or a revised report.
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> We engaged in robust shareholder outreach as we have for many years, and while the shareholders who were able to speak with us quickly understood the mistake and supported our Say-on-Pay [proposal], we were not able to have meetings with all the shareholders we reached out to due to the extremely busy proxy 'in-season' and a large portion of our shareholders being quantitative or passive firms who outsource their voting to proxy advisory firms. The result was that our 2016 Say-on-Pay [proposal] narrowly failed with a 49.8% favorable vote outcome.

We engaged in extensive ‘offseason‘ shareholder outreach during the fall of 2016, reaching out to shareholders representing over 75% of our outstanding shares, and, while shareholders offered small governance-related suggestions such as proxy access, none expressed any wish to see specific changes in our executive pay program; some instructed us to ‘fix‘ our ISS recommendation and then they would be sure to vote in support. We promptly added proxy access, and disclosed our outreach efforts and feedback in our April 2017 proxy statement fully and accurately.

In May 2017, ISS issued their report, *again recommending against our Say-on-Pay,* alleging that due to our prior year’s low vote outcome, our shareholders must have demanded extensive pay program changes that our compensation committee ignored. This was simply factually untrue.

Due to ISS’ programmatic rules, a second consecutive year meant ISS not only recommended against Say-on-Pay but against the re-election of our four-member compensation committee, including a new committee member who was not even on the board at the time compensation decisions were being made. This meant that four members of our ten-member board who had been key drivers of an extraordinary 2016 business year that saw a transformative transaction with a global e-commerce company and a 26% shareholder return were at risk of non-re-election due to proxy advisory errors and formulaic inflexibility. Moreover, the board members being recommended against included at the time the sole female member of our board and one of our two racially diverse board members.

Thanks to above-and-beyond shareholder outreach efforts we were able to get the compensation committee members re-elected but received only 32% in favor of our Say-on-Pay vote in May 2017.

Through a combination of extensive pro-active compensation program changes and at-length engagement with ISS and Glass Lewis in the fall of 2017, this May we received ‘for‘ recommendations from both firms in reports which were fortunately finally absent material factual errors (ISS’ report still has an error regarding our perquisite program which we are attempting to fix). This recommendation resulted in a 94% favorable Say-on-Pay vote this year, demonstrating the outsize influence of proxy advisory firms and the crucial need for regulation that ensures shareholders who rely on proxy firms’ recommendations are relying on accurate data. (emphasis added).

Other Problems with Proxy Advisory Firm Practices

In addition to the problems discussed above, proxy advisory firms use a "one-size-fits-all" approach that imposes the same standards on all public companies, instead of evaluating the specific facts and circumstances of each company they evaluate. This has the effect of homogenizing corporate governance practices for the benefit of the proxy advisory firms themselves and not for other stakeholders in the proxy process. In fact, one proxy advisory firm, ISS, told a large-cap Society member its proxy access bylaw that was the subject of a shareholder proposal did not comport with "best practices" and that it would recommend against management, even though over 90% of such bylaws have the same provisions as the one on the ballot. When pressed about how ISS could *not* identify this bylaw amendment as a best practice, the ISS corporate sales team member said that "for ISS best practice is the preferred practice by ISS." In short, ISS sets the standard.

Proxy advisory firms also operate without providing adequate transparency into their internal standards, procedures, and methodologies. These firms are basically "black boxes," operating with little accountability or input into their internal processes.

Conflicts of interest within these firms also need to be addressed. One of the firms—ISS—provides corporate governance and executive compensation consulting services to public companies, in addition to providing voting recommendations to its institutional clients on the *same* companies. A common practice is for a company to get a call from the ISS corporate consulting sales force with a pitch that—for a price—they can miraculously fix any problems that company has had with a previous vote. Indeed, for an even higher price, a company can get even more service, including language explaining elements of an annual bonus plan in a company's Compensation Discussion and Analysis section. And, even more recently, ISS now has an environmental scorecard it pitches to companies showing negative results, and, when asked what forms the basis of the score, companies are told they can learn about it if they pay $35,000 to ISS.

Another conflict that exists is proxy advisory firms providing voting recommendations on shareholder proposals submitted to companies by their institutional investor clients. These conflicts need to be specifically and prominently disclosed to clients of proxy advisory firms so that they may evaluate this information in the context of the firms' voting recommendations. Not only do the firms recommend on their own clients' proposals, one of the firms, ISS, has a service for investors to help them craft proposals that will pass muster under SEC rules.

<u>The Fiduciary Responsibilities of Institutional Investors</u>

One of the reasons that proxy advisory firms have become so powerful is the belief that every vote is an asset and that asset managers must vote every item on a ballot in order to satisfy their fiduciary duty to their clients, and their clients' beneficiaries. SEC and Department of Labor rules and guidance confirm that a proxy vote is an asset and that institutional investors owe fiduciary duties to their clients, investors, and beneficiaries with respect to the voting process.

While some have interpreted these rules and guidance to mean they must vote each and every item on a proxy card, this is not the case. Rather, institutions should weigh the cost of voting certain items against the benefits of voting on those items. Clearly, not every item on a ballot must be voted if the manager in his or her judgment believes it costs more to understand and vote on an item that the vote is worth.

Practically speaking, however, no investment manager will say to his or her clients that they didn't exercise their right to vote. So they hire proxy advisory firms at the lowest cost possible and then report that they voted each of their positions (although not the number of shares)—even if they have little interest or expertise in executive compensation or environmental issues, for example. This would be the case typically with smaller passive investors, or quantitative fund managers, or those who simply own one stock as a hedge against another position.

Again, the outsize influence of proxy advisory firms is due to the many institutional investors and their third-party managers who choose to reduce costs by not having in-house proxy staffs to analyze and vote at shareholder meetings.

This is *not* the group of asset managers that public companies typically engage with and it is not the group of asset managers and owners who lobby and advocate against legislative proposals like H.R. 4015. That group—consisting of large asset managers like BlackRock, Vanguard, T. Rowe Price, State Street Global Advisors, TIAA-CREF, BNY Mellon, Capital Group, and other household names—manage their voting process by using proxy advisory firms as one of many data points, typically as a screen or filter, and they conduct a deeper analysis on particular companies that fall outside parameters that they have set. These firms also have "custom guidelines" that they instruct the proxy advisory firms to use when voting their shares. In addition, these institutions engage with companies directly and make their own voting policies transparent and available to issuers.

However, there are smaller institutional investors and managers that do typically "outsource" their voting decisions to proxy advisory firms that provide automated voting services. This is a way to fulfill what they believe to be their compliance obligations with respect to proxy voting at the lowest cost. Together, these small managers add up.

A number of these small managers adopt ISS and Glass Lewis "default" voting guidelines and policies and then let the proxy firms apply these policies by generating electronic ballots that reflect these default positions for each shareholder meeting. As a technical matter, the client has the right to override a particular ISS or Glass Lewis voting recommendation. *However, most of these ballots are left untouched and submitted automatically without any client input or decision*. This "robo-voting" process results in as much as 20% of votes that are cast automatically within 24-48 hours of the issuance of ISS and Glass Lewis reports on a company in advance of a shareholder meeting.

In all these cases, the result is an outsourcing of voting responsibilities to a non-fiduciary.

SEC Actions to Address Proxy Advisory Firm Issues

The SEC has taken a few steps to address the role and activities of proxy advisory firms. The agency evaluated the proxy system in 2009 and issued a wide-ranging Concept Release in 2010. In December 2013, the SEC held a Roundtable on Proxy Advisory Services to discuss many of these issues. The Society testified at that Roundtable.

The SEC followed up its Roundtable by issuing Staff Legal Bulletin 20 in June 2014, which provided guidance to institutional investors about their obligations under the Investment Advisers Act and established several standards for proxy advisory firms to adhere to, under the Securities Exchange Act of 1934. Institutions can and do use proxy advisory firms, so long as they insure the voting is done in accordance with their own fiduciary duties.

While these were excellent first steps in addressing these problems, more needs to be done.

<u>The Need for Legislation to Establish a Regulatory Framework Applicable to Proxy Advisory Firms</u>

Proxy advisory firms exist because of well-intentioned regulatory action that nevertheless has resulted in many different unintended consequences. One consequence is that the proxy advisory industry is subject to an incomplete and harmful regulatory framework. As an example, the largest proxy firm, ISS has chosen to register under the Investment Advisers Act of 1940. However, the SEC's rules for investment advisers do not reflect the unique role that proxy advisory firms perform in the proxy voting process. Proxy advisory firms do not select securities for their clients or provide investment advice in the way a typical asset manager does. Instead, these firms recommend how to vote at shareholder meetings and, as described above, automate the voting process for their clients.

The second biggest proxy advisory firm, Glass Lewis, is not registered as an investment adviser (or under any other securities statute). As a non-registered entity, Glass Lewis is not subject to the provisions of the Investment Advisers Act, or any other SEC regulation.

Additionally, the SEC has created an exemption from its proxy rules for proxy advisory firms, so they are not required to abide by solicitation and disclosure rules that apply to other proxy participants. Thus, their recommendation reports, in contrast to company proxy materials, are not always available to issuers unless they pay for them, and they are not subject to any outside review or oversight, even after annual meetings.

This unworkable regulatory system should not be permitted to continue, and these firms should be subject to more robust oversight by the SEC and the institutional investors that rely on them. This can be accomplished by developing a targeted regulatory framework that reflects the unique role that proxy advisory firms perform in the proxy voting process.

Along with considering greater regulatory oversight of proxy advisory firms, the SEC and Department of Labor should review the existing framework applicable to the use of proxy advisory firms by institutional investors. This review should include the Egan Jones and ISS no-action letters that were issued by the SEC staff in 2004.[4] The SEC and Department of Labor should ensure that institutional investors are exercising sufficient oversight over their use of proxy advisory services, in a manner consistent with their fiduciary duties.

H.R. 4015 addresses many of the concerns raised by public companies and other participants in the U.S. proxy system. It requires the proxy advisory firms to register with the SEC. It requires these firms to be more transparent about their internal standards, procedures, and methodologies. It provides companies with a mechanism to review draft reports before they are issued. It also provides companies with a process to correct mistakes. And, finally, the bill authorizes the SEC to regulate and/or prohibit the conflicts of interest that exist in proxy advisory firms.

[4] *See* Egan Jones Proxy Services, May 27, 2004; and Institutional Shareholder Services, Inc., September 15, 2004.

For these reasons, the Society strongly supports H.R. 4015 and urges its passage through the Committee on Banking, Housing, and Urban Affairs.

We do understand that several institutional investors and the proxy advisory firms themselves have opposed H.R. 4015 because of concerns about the increased costs that the requirements of the bill may impose on these firms and their institutional clients. The Society understands the need that institutional investors and their proxy voters have for summaries and analyses of proxy materials, particularly those who hold every U.S. equity and are required to vote thousands of meetings each year. The Society is mindful of these concerns and is more than willing to work with the Committee to improve the legislation in a manner that accomplishes its goals, while also reducing its compliance costs.

H.R. 1744, "Brokaw Act"

Another disincentive to public ownership of companies is the burden of being subject to attacks by activist investors, a number of whom have short-term agendas.

There is no doubt that some activists create longer-term shareholder value and the Society is not seeking to stifle activist investing. The Society does not believe, however, that there is a level playing field between activists and companies. Companies are required by securities laws to publicly disclose material information within 4 days. Activist investors, on the other hand, have 10 days to file a Schedule 13D, disclosing the material fact that they have acquired 5% of a particular company's stock.

This 10-day window has been the subject of criticism for allowing too much time for activist investors to accumulate large positions in public companies—sometimes through undisclosed derivative positions—before being required to disclose anything publicly. As an example, former SEC Chair Mary Schapiro noted in 2011 that many feel that the 10-day reporting deadline "[r]esults in secret accumulation of securities; [r]esults in material information being reported to the marketplace in an untimely fashion; and [a]llows 13D filers to trade ahead of market-moving information and maximize profit, perhaps at the expense of uninformed security holders and derivative counterparties."[5]

S. 1744 would equalize these reporting time frames and make other necessary modernizations.

The SEC has not updated its 13D disclosure requirements in several decades and, in fact, this year is the 50th anniversary of the enactment of the Williams Act, which established this regulatory framework. S. 1744 would update these SEC requirements by closing certain loopholes and ensuring that securities positions taken by activist investors are more transparent to companies and to the capital markets.

The Brokaw Act—named for a village in Wisconsin that went bankrupt in part due to the actions of a group of hedge funds that pressured the Wausau Paper Company in 2011—would make three changes to the SEC's 13(d) disclosure rules. First, it would direct the SEC to shorten the deadline for disclosing an ownership interest from 10 days to 4 days, which is the current deadline for companies filing an 8-K report. The original 10-day deadline was developed when snail mail was the primary form of written communication, and this deadline has been eclipsed by the rise of electronic communication and the rapid speed in which securities are currently traded.

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[5] Chairman Mary L. Schapiro, "Remarks at the Transatlantic Corporate Governance Dialogue, U.S. Securities and Exchange Commission, December 15, 2011, *available at* https://www.sec.gov/news/speech/2011/spch121511mls.htm.

Some have argued that the 10 days was a careful balance drawn at the time to give investors an advantage over potentially entrenched management. A lot has changed on that front in 50 years and the argument that the legislative history of the Williams Act requires the 10 days for activists to have an advantage is longer relevant. Shareholder rights and shareholder engagement have come of age. In fact, so much so that we see a decrease in the number of private companies willing to take advantage of the public markets, and we see those who do go public institute stock classes to alleviate the burdens of activism and other shareholder empowerment mechanisms.

Second, the bill would require disclosure of any short or derivative positions that cross the 5% threshold, something that does not occur today. This closes a significant loophole that otherwise permits investors to accumulate large short and/or derivative positions in a security without any public disclosure.

And third, the bill would expand the 13(d) reporting requirement to include hedge funds and other activist investors that are coordinating activities for the purpose of seeking control or influence over a public company.

The Society has been working with the original sponsor of the Brokaw Act, Senator Tammy Baldwin of Wisconsin. This Act is now co-sponsored by Senator Perdue of Georgia and it represents good public policy for both public companies and their investors. We urge the Committee to pass this legislation to update and modernize the 13(d) disclosure regime.

Let me now turn to two bills before the Committee that could further discourage companies from going or remaining public, and that the Society opposes in their current form, S. 536, the Cybersecurity Disclosure Act, and the 8-K Trading Gap Act.

S. 536, "Cybersecurity Disclosure Act"

S. 536 requires public companies to disclose if they have a board member with expertise or experience in cybersecurity and to describe in detail the nature of that expertise or experience. If there isn't a cybersecurity expert on a board, a company will have to disclose "what other cybersecurity steps taken by the reporting company were taken into account by such persons responsible for identifying and evaluating nominees" for such board positions.

The Society generally believes that having special interest directors is not a good practice. First, there are not enough cyber "experts" around to serve on every board. Even if there were, it is unlikely they would agree to serve as an expert because a board member is only an overseer and not in control of all corporate affairs. He or she can only determine if management has organized and spent the resources to protect the company from cyber breaches given the type of data it has, the costs required to be expended, and the likelihood of success.

In addition, this bill is not necessary because director qualifications in the proxy already describe a person's experience and background. Anyone reading a proxy would be able to tell if a board has someone with cyber expertise as a member. A bill like this could lead to requirements that boards appoint other special interest directors.

This bill also creates a false presumption that a cyber expert director is required to effect appropriate board oversight. Concerns expressed by a Society member about encouraging a single-issue director are illustrative:

> Of course, we want our public companies' boards to have the requisite skills to deal with all sorts of issues. However, specifying the types of skills that a company's board must have strikes me as the ultimate one-size-fits-all approach and has no logical limits.

> Should every public company have an expert on revenue recognition? Related-party transactions? Has anyone thought through the consequences of having a board comprised of one-issue experts who may not have any other applicable skill sets? And would a cyber-expert want to be on a board, given that he or she would likely be blamed (and possibly sued) if the company had a breach or other cyber problem?[6]

Further, in its 2016 guidance for investors to assess the adequacy of their portfolio company boards' cybersecurity oversight, even the Council of Institutional Investors doesn't subscribe to the view that all boards need a resident cyber expert:

> Cybersecurity is an integral component of a board's role in risk oversight. Directors have the authority, capacity and responsibility to make pivotal contributions in this area by ensuring adequate resources and management expertise are allocated to robust cyber risk management policies and practices, and ensuring disclosure fairly and accurately portrays material cyber risks and incidents.
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> *To achieve these objectives, directors need not develop advanced technical expertise*. Nor do directors need to support unrestrained capital spending on any project with a 'cyber' prefix.[7] (emphasis added)

S. , "8-K Trading Gap Act"

The 8-K Trading Gap Act requires the SEC to issue new rules prohibiting insider trading during a "covered period." The term "covered period" is defined as the period between: (1) the date when material non-public information is known to officers and directors of a company; and (2) the date when the information is disclosed to the public through an 8-K or other SEC filing.

[6] Robert B. Lamm, "Beware when the legislature is in session," *The Securities Edge*, March 19, 2017, *available at* https://www.thesecuritiesedge.com/2017/03/beware-when-the-legislature-is-in-session/.
[7] Council of Institutional Investors, "Prioritizing Cybersecurity," at 1, April 2016, *available at* https://www.cii.org/files/publications/misc/4-27-16%20Prioritizing%20Cybersecurity.pdf.

The Society believes this bill is unnecessary and could lead to unintended consequences. It is already illegal to trade on material non-public information, and recent SEC guidance has confirmed existing law for circumstances involving cybersecurity. In addition, public companies uniformly have insider trading policies that require pre-clearance and strictly regulate trading in a company's securities by employees, including executive officers and directors of a company. These are conservative risk management policies that apply broadly, and they typically have two levels of protection: (1) a trading window that is closed (a.k.a. "blackout period) when the company is in possession of material non-public information; and (2) a pre-clearance procedure for more senior executives whereby no trading is allowed unless cleared by the senior legal officer of the company.

In order to determine whether the company has material non-public information, companies have internal processes for information to be communicated up the chain of command so that appropriate decisions can be made. This reporting up the chain is a common practice in public companies and it runs through several internal mechanisms within companies, including preparation of SEC reports, financial statements, etc.

A practical difficulty with this bill is how best to make the judgment call about whether a particular piece of cybersecurity information (or a situation) involves material non-public information, especially in an evolving situation where a company is trying to determine the difference between an intrusion and a breach.

First, a company must determine if the information is non-public. This sounds easier than it is, as the information must be analyzed in light of the company's current public disclosures (e.g., its risk factors and MD&A).

Second, a judgment must be made as to whether the information is material. This is typically the most difficult judgment to be made; in these situations, an expected value analysis needs to be conducted, i.e., would the event be material if it occurred and what is the likelihood that the event will occur? This analysis is made more difficult when, as in the case of a cyber-attack, it is often not clear for some time what the event itself is. It could be a meaningless intrusion, or a significant one.

For example, is the event when an issuer's computer system detects an intrusion; is it when the first employee learns about the intrusions; is it when the company makes a determination that the intrusion could be material; or is it when the company makes a determination that the intrusion is actually material?

These difficult judgment calls also apply to other evolving circumstances, such as an internal investigation, a negotiation over the continued employment of a senior executive, or a merger and acquisition transaction.

Trying to fix the problem of trading when there is the *potential* for material non-public information within a company would be fixing the problem by killing an ant with a bazooka. Companies are in a difficult position here as there is always *potential* material non-public information inside a company. In the case of cyber intrusions, a company would have to keep the trading window closed permanently. The net effect could be, at worst, that insiders could never sell their stock, or, at best, they would be severely limited in doing so. This would be a strong disincentive for those making a decision to take a company public, or to remain public. Moreover, because many companies compensate their employees with some form of equity, to align their interests with those of all shareholders, a reduction in the ability for employees to sell their company equity would be problematic and could lead to a de-equitization of America's workforce.

For all these reasons, the Society believes that current laws and conservative risk management policies by companies are adequately preventing executive insider trading between the time that material non-public information is determined and the time when a public filing is made.

Conclusion

Thank you for the opportunity to present the views of the Society on these important legislative proposals affecting corporate governance. I am happy to answer any questions you may have about these proposals.