

Submitted online at <https://www.sec.gov/cgi-bin/ruling-comments>

April 1, 2022

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

RE: Affirmative defense provisions of Rule 10b5-1; Proposed Rule (File Number S7-20-21)

Dear Ms. Countryman:

Thank you for the opportunity to comment on the Securities and Exchange Commission's proposed amendments to Rule 10b5-1 under the Securities Exchange Act of 1934, published in the Federal Register on February 15th, 2022 (87 Fed. Reg. 8686).

I am a lawyer by training and in my over three decades of legal practice have been the general counsel of multiple public companies. In my current role as Chief Legal Officer for a public company, I oversee the framework for equity awards and sales by all employees and directors, including the adoption of 10b5-1 plans by senior leadership. I have always had a deep interest in the legal and tax framework surrounding equity-based compensation and related aspects of public policy. These comments are my own and do not necessarily represent the views of my current employer or any previous employer. Therefore, I am submitting them anonymously.

My comments will focus on the provisions of the proposed amendments as they apply to single trade plans. I am concerned that the evidentiary basis for these restrictions is deeply flawed. My concerns are in three main areas: sample bias in the underlying data set, failure to account for regression to the mean, and a falsely negative characterization of a legitimate diversification strategy.

The proposed amendments cite academic literature calling single trade plans a "red flag" associated with "opportunistic use of 10b5-1 plans." See, for example, Larker et al., "Gaming the System: Three Red Flags of Potential 10b5-1 Abuse" (Stanford Closer Look Series 2021). However, the only data available to these academic authors comes from review of Form 144 and Form 4/5 filings, and therefore is based only on trades that actually occurred under 10b5-1 plans. This clear sample bias undermines the entire analysis of the supposed "red flag" nature of single trade plans. Because these plans are no more than limit orders, all the available data can ever show is that a pre-defined limit was reached and the stock was traded. Missing are all the cases where a pre-defined limit was not reached, and no trade occurred. In my experience overseeing 10b5-1 plans over many years, most senior executives are optimistic about the future of their company and so set a relatively high trigger price in their 10b5-1 plans, particularly for plans involving options, where the strike price must be met before the option is worth anything. Again, in my experience, many of these plans are adopted and end after their defined term (usually around a year) with no trades executed. This pattern may repeat itself for years, with the employee ever hopeful but in the end disappointed. In the year when the hope is delivered, and a trade under a single trade 10b5-1 plan results at a three or four year high for the stock price, it is all too easy to accuse the senior executive of having special access to information compared to other investors. This misperception confuses association with causation, and it fails to credit the executive with their own

efforts to raise the share price and benefit all investors. The post-hoc theorizing of academic writers who lack access to the full data set is not a sufficient evidentiary basis on which to impose new limitations on single trade 10b5-1 plans.

The preamble to the proposed regulation also points out as evidence of a “red flag” for single trade 10b-51 plans the observed relative performance of stock traded under such plans versus comparative industry averages over time, particularly when the plans have shorter cooling off periods. The authors of the academic papers on which this assertion is based fail to consider the effect of regression to the mean in their analysis. Employees seeking to diversify will be aware when the stock of their company is trading up relative to historical prices, and even more so when this performance is better than average in their industry. An employee following standard investment advice in this situation would seek to sell some of their position to lock in those gains, and the sooner the better. If they do so under a 10b5-1 plan with a short cooling off period, then it is likely the stock will still be at a relatively high price compared to the industry average. With a longer cooling off period, regression to the mean will occur and the relative price of their company’s stock will return to more typical levels – resulting, of course, in exactly the poor relative performance between the two time points (high plan trade and return to mean) academics cite in criticizing single trade plans.

Finally, the preamble cites general criticisms of single trade plans as inherently suspect because they seem to deliver better-than-expected results. This critique is misplaced. In fact, single trade plans are not only a legitimate strategy but the best possible strategy for equity price optimization by employees, particularly when it comes to option grants. Any investor could adopt this strategy because it is nothing more than a long-term limit order. In thinking about the fundamentals behind the operation of long-term 10b5-1 plans and similarly-structured limit orders, I created Monte Carlo simulations based on both synthetic prospective data and historical real-world stock price data. These models clearly show that in volatile sectors, picking a relatively high price for a limit order (or 10b5-1 plan) that lasts for a reasonably long time (a year in my models) outperforms any other common trading strategy in terms of price optimization. This effect is even more pronounced if the same plan is maintained for a period of several years, or the assumption is made that the equity is in the form of an option grant (and therefore has a floor price below which it is worthless, incentivizing the employee to set a significantly higher trigger price for the plan). These models are helpful but not needed to make the basic point, as the observed outcome is just the other side of regression to the mean. If you imagine rolling a pair of dice repeatedly, but only writing down the results when they are higher than nine, of course that list of results taken alone will make it seem that the dice are loaded. In the context of single trade 10b5-1 plans or limit orders, if an individual sets them up at a relatively high price and waits for a long period of time, the resulting trades will of course occur at a price much higher than more frequent trades based on traditional “feathering” approaches to diversifying away from concentrated positions, which by their very design tend to approximate the mean. And if the stock crashes and never recovers, under the current disclosure framework no trades will be reported – only the “good trades” show up. By seeking to block the best price optimization strategy for employees, the proposed limitation on single trade plan denies those employees the full potential benefit of their equity compensation. Indeed, it seems that the intent is specifically to avoid good outcomes for those employees because of some vague moral indignation that they might do too well out of all their work for their company. Not only is this unfair to those employees, but it also ignores the fact that non-employees can use the exact same strategy by setting up a simple long-term limit order. As a side note, to the extent the limitation on single trades is

designed primarily to cap or limit executive compensation, it would also likely be beyond the statutory authority of the Commission.

Although this comment focuses on single trade plans, the academic literature cited in the preamble to the proposed regulation contains many other analytical flaws. For example, criticisms of timing of trades under 10b5-1 plans relative to earnings announcements fail to account for the fact that many equity grants are made, and vest, on annual cycles, often in the first quarter of the year or around proxy season. For example, see Exhibit 10 from Larker et al. (Stanford Closer Look Series 2021), showing an obvious association between trades and common vesting dates for employee equity awards. Of course, one would expect employees and directors to set up 10b5-1 plans to trigger a trade on the occurrence of both a good price and a vesting event, but the literature fails to analyze or correct for this fact.

In conclusion, while the Commission's effort to address perceived abusive use of single trade 10b5-1 plans is no doubt motivated by good intentions, the data and analyses on which the Commission relies is fundamentally flawed and dramatically overstated. There is no reliable evidence cited by the Commission on which to base the assertion that a single trade plan, absent any other misconduct, is inherently suspect. Association is not causation. Regression to the mean is real. I respectfully suggest that the proposed amendment be revised to require that 10b5-1 plans for corporate insiders be subject a mandatory cooling off period of 60 days, which would be sufficient to eliminate public perceptions of gaming of the system by insiders. The Commission should also include the reporting requirements in the proposed rule, which would allow the Commission and other interested parties to study the behavior of single trade 10b5-1 plans over time and conduct analyses of that behavior that are based on a valid data set. If it becomes clear through such analyses that abuse of the system is occurring, the Commission would then be in a far better place to amend the rule in an appropriate and tailored fashion. Thank you for your consideration of my comments.