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Testimony

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*Virtual Hearing - Insider Trading and Stock Option Grants: An Examination
of Corporate Integrity in the Covid-19 Pandemic*

House Financial Services Subcommittee on Investor Protection, Entrepreneurship and
Capital Markets

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Chairman Sherman, Ranking Member Huizenga, members of the subcommittee. My name is Rick Claypool, and I am a research director in the office of the president for Public Citizen.

Public Citizen is a national non-profit organization with more than 500,000 members and supporters. We represent consumer interests through lobbying, litigation, administrative advocacy, research, and public education on a broad range of issues including consumer rights in the marketplace, product safety, financial regulation, worker safety, safe and affordable health care, campaign finance reform and government ethics, fair trade, climate change, and corporate and government accountability.

My research is focused on corporate and white-collar law enforcement. I was the lead author of Public Citizen's report about declining federal enforcement against corporate wrongdoers between Obama's last year in office and Trump's first; the report noted that SEC enforcement against

corporate wrongdoers fell 44% first year and that penalties dropped 68%.¹ In another report, I documented the Justice Department's overreliance on leniency agreements with corporations that violate the law, including in securities fraud cases.² In a report focused on the enforcement implications of the 2018-2019 federal government shutdown, I highlighted that as a result of the shutdown, 94% of the SEC's staff was furloughed, inhibiting enforcement against insider trading and other violations.³ Additionally, I have assisted Public Citizen's efforts against congressional insider trading, which culminated in the passage of the 2012 STOCK Act. This legislation significantly curtailed lawmakers and staffers trading on insider knowledge -- a major step forward in financial market fairness.⁴

This testimony was prepared in consultation with many experts both at Public Citizen and allied organizations, including Peter Maybarduk, director of Public Citizen's Access to Medicines Program; Bartlett Naylor, financial policy advocate at Congress Watch; Dr. Craig Holman, government affairs lobbyist, Congress Watch; and Remington Gregg, counsel for civil justice and consumer rights, Congress Watch.

We welcome the committee's concern with insider trading by executives at corporations associated with the pandemic, as firms receiving Title IV CARES; firms receiving contracts for medicine development; and others who may profiteer with funds Congress intended to help workers.

This hearing is important for a number of reasons. It is important because the development of a vaccine should not fall victim to manipulative pharmaceutical executives whose goal is not so much to produce efficiently a safe, effective vaccine, but to play the market for personal gain. It is important because the prodigious sums of taxpayer dollars heading to bolster companies struggling with the voluntary economic coma should not be diverted to the C-suite. It is important because the exposure of insider trading may be an indicator of even greater problems, notably a morally fractured corporate culture.

Nearly all Public Citizen's 500,000 members are exposed to the stock market through personal investments, retirement plans and other savings instruments and therefore dependent on the integrity of the market and of corporate managers ultimately accountable for it. Some of our members have recorded significant investment success, such as one generous member who guided his otherwise moderate income into an investment portfolio that allowed him to make a multi-million-dollar gift to Public Citizen a few years ago.

Public Citizen has addressed insider trading on several fronts. As mentioned, we helped to conceive and promote what Congress eventually approved as the STOCK Act, which clarifies that insider trading laws apply to members of Congress and established a disclosure system of transactions to

¹ Rick Claypool, Taylor Lincoln, Michael Tanglis and Alan Zibel, *Corporate Impunity: "Tough on Crime" Trump Is Weak on Corporate Crime and Wrongdoing*, PUBLIC CITIZEN (July 2018), <https://www.citizen.org/wp-content/uploads/corporate-enforcement-public-citizen-report-july-2018.pdf>

² Rick Claypool, *Soft on Corporate Crime: Justice Department Refuses to Prosecute Corporate Lawbreakers, Fails to Deter Repeat Offenders*, PUBLIC CITIZEN (Sept. 2019), <https://www.citizen.org/wp-content/uploads/soft-on-corporate-crime-dpa-mpa-repeat-offenders-report.pdf>

³ Rick Claypool, *As Shutdown Drags on, Agencies Devoted to Consumer and Worker Health and Safety Unfunded and Deprioritized*, PUBLIC CITIZEN (Jan. 2019), <https://www.citizen.org/news/trump-shutdown-consumer-protection/>

⁴ Craig Holman, *The Impact of the STOCK Act on Stock Trading Activity by U.S. Senators, 2009 – 2015*, Public Citizen (June 2017), https://www.citizen.org/wp-content/uploads/migration/case_documents/2017_stock_act_report.pdf

monitor compliance. Before the STOCK Act, a 2004 study found that investment returns for senators were 12 percent higher than for average investors.⁵ Financial disclosure statements for members of Congress before the STOCK Act showed an alarming trend of members investing in businesses and industries directly affected by Congress. A study by the Center for Responsive Politics found that nearly one in four members invested in health care companies in 2007 and 2008, such as Merck, Pfizer and United Health, whose business activities are the subject of intense congressional scrutiny and whose business futures depend on pending congressional actions.⁶

We enthusiastically promoted Rep. Jim Himes' (D-Conn.) efforts through HR 2534 to codify illegal insider trading,⁷ which we will discuss later.

Illegal insider trading undermines the integrity of financial markets. When corporate insiders and others who wrongfully obtain inside information trade on it, they engage in theft. Insider trading is akin to an owner selling a car that the person knows is defective for an inflated price. More broadly, illegal insider trading contributes to income inequality because senior management profits at the expense of everyday investors outside of elite circles. Much of the trading manipulation involves stock options. These are granted to senior executives that, on the surface, are meant to motivate. A stock option is granted with a so-called strike price, typically the price of the day it is granted. If the price of Acme is \$2 on the day of the option grant, then the executive only makes money if the stock rises above \$2. Stock option value follows the price of the stock, which increases with increased profits. Stock prices rise if the company increases profits. Stock prices can also rise if the company repurchases its own shares—a buyback-- leaving fewer shares to which profits are allocated.

And now, during the worst pandemic to plague America since 1918, executives of major pharmaceutical firms on whom Americans are depending to deliver vaccines seem to be gaming the market.

- In July 2020, Moderna Therapeutics announced that all 45 participants in the first phase of its COVID-19 vaccine trial who received one of three dose levels of the vaccine developed some antibodies. The firm trumpeted this success with appearances on prominent media broadcasts.⁸ The news pushed up the company's stock price 30% to an all-time high of \$87. In the days following the announcement, Moderna's CEO, other executives and funds controlled by the chairman of its board sold about \$90 million worth of company shares. Critics have called for an SEC investigation.⁹ Public Citizen is particularly

⁵ Alan Ziobrowski, et al., *Abnormal Returns from the Common Stock Investments of the U.S. Senate*, JOURNAL OF FINANCIAL AND QUANTITATIVE ANALYSIS (Dec. 2004),

https://projects.iq.harvard.edu/files/gov2126/files/ziobrowski_2004.pdf

⁶ Lindsay Renick Mayer, "Congressional Lawmakers Invest in Their (Financial) Health," CENTER FOR RESPONSIVE POLITICS (July 9, 2009). <https://www.opensecrets.org/news/2009/07/lawmakers-invest-in-their-fina/>

⁷ HR 2534, Insider Trading Prohibition Act, approved by House Dec. 5, 2019.

<https://www.congress.gov/bill/116th-congress/house-bill/2534>

⁸ Nicole Brown, "Moderna President Hopeful Company Is "On The Right Path" With Coronavirus Vaccine," CBS THIS MORNING (May 18, 2020), <https://www.cbsnews.com/news/coronavirus-vaccine-moderna-covid-19-trial-antibodies-first-phase/>

⁹ Stephen Gandel, "Watchdog Urges SEC To Investigate Vaccine Maker Moderna," CBS NEWS (June 3, 2020) <https://www.cbsnews.com/news/insider-trading-allegations-moderna-accountable-us-securities-exchange-commission/>

concerned with profiteering at Moderna: Taxpayer money funds 100% of its work to bring a COVID-19 vaccine to licensure, yet it announced new, higher intended prices for the prospective vaccine. The so-called Moderna vaccine belongs in significant part to the people of the U.S. We paid for it. Federal scientists led the way. It ought to be the people's vaccine, not a new taxpayer burden.¹⁰

- In late July 2020, “the Eastman Kodak Company handed its chief executive 1.75 million stock options,” noted the New York Times. “It was the type of compensation decision that generally wouldn’t attract much notice, except for one thing: The day after the stock options were granted, the White House announced that the company would receive a \$765 million federal loan to produce ingredients to make pharmaceuticals in the United States. The news of the deal caused Kodak’s shares to soar more than 1,000 percent. Within 48 hours of the options grants, their value had ballooned, at least on paper, to about \$50 million.”¹¹ ¹² According to Forbes, “It is the timing of these options which has become the focus of a Securities and Exchange Commission (“SEC”) investigation for possible insider trading. Senator Elizabeth Warren (D-Mass.) asked the SEC in an open letter to examine these transactions citing “insider trading” and “unauthorized disclosure of material, nonpublic information.” As a result, the Kodak loan has been placed on hold pending the results of the investigation.”¹³

A coalition where Public Citizen serves on the steering committee just published “Pandemic Profiteering,” a look at “How Pharma Insiders Are Using News of Government Awards and Trial Results to Boost Their Stock Prices and Profiteer Without a Vaccine.”¹⁴ The report finds:

From January to August, the stock market value for the eight biotech companies on the S&P 500 grew by \$130 billion. During the same period, executives and insiders from just three of these companies — Moderna, Inovio and Vaxart — made at least \$370 million in sales of company stocks inflated by news of government awards and trial results. These

¹⁰ Statement of Peter Maybarduk: Paying Twice for a Vaccine: Moderna is Taking Taxpayers For a Ride, Public Citizen press release (Aug. 5, 2020), <https://www.citizen.org/news/paying-twice-for-a-vaccine-moderna-is-taking-taxpayers-for-a-ride/>

¹¹ Jesse Drucker, Ellen Gabler, *Kodak C.E.O. Got Stock Options Day Before News of Loan Sent Stock Soaring*, NEW YORK TIMES (July 31, 2020) <https://www.nytimes.com/2020/07/31/business/kodak-ceo-stock-options.html>

¹² On Monday, July 27th, a day when Kodak stock “rocketed” up 25% to close the day at \$2.62 per share, Kodak executives received stock options. James Continenza, CEO of Kodak, received roughly 1.75 million stock options with exercise prices of \$3.03, \$4.53, \$6.03 and \$12, according to [an SEC filing](#). This is nearly triple the 650,000 shares he had already owned. Those shares were awarded to Continenza in five different tranches since August of 2019. From Forbes: Chris Carosa, “How A PR Error Might Absolve Kodak Of Insider Trading Charges,” FORBES (August 16, 2020) <https://www.forbes.com/sites/chriscarosa/2020/08/16/how-a-pr-error-might-absolve-kodak-of-insider-trading-charges/#b15970159196>

¹³ Chris Carosa, “How A PR Error Might Absolve Kodak Of Insider Trading Charges”, FORBES (August 16, 2020) <https://www.forbes.com/sites/chriscarosa/2020/08/16/how-a-pr-error-might-absolve-kodak-of-insider-trading-charges/#b15970159196>

¹⁴ *Pandemic Profiteering: How Pharma Insiders Are Using News of Government Awards and Trial Results to Boost Their Stock Prices and Profiteer Without a Vaccine*, LOWERDRUGPRICESNOW.ORG (August 2020) https://www.lowerdrugpricesnow.org/wp-content/uploads/LDPN_Pandemic_Profiteering_REPORT-FINAL.pdf

findings show that company executives and insiders are profiteering from the pandemic, without any guarantee of a vaccine.¹⁵

The New York Times found that pharmaceutical firms “are making millions of dollars after announcing positive developments, including support from the government, in their efforts to fight Covid-19. After such announcements, insiders from at least 11 companies — most of them smaller firms whose fortunes often hinge on the success or failure of a single drug — have sold shares worth well over \$1 billion since March.”¹⁶

This subcommittee does not oversee the integrity of the health care industry. But this welcome, vital look at insider trading and abuse of stock options in this sector raises an important hypothesis: if senior executives are focused on gaming the market, can they be trusted with their basic mission of providing health care? We explore the intersection between C-suite profiteering and health care expense in an appendix to this testimony.

Stock buybacks expose another area that effectively enables and/or is motivated by opportunities for insider trading. Senior managers whose pay is linked to the stock price can line their pockets by arranging for the repurchase of their companies’ shares. When stocks are bought back, the same earnings are allocated to a fewer number of shares, leading to the value and price of each of these shares increasing along with stock-based manager compensation. On the surface, a stock buyback represents a declaration of management indolence. Firms issue stock to raise capital for growth, for the expansion of existing production, or for the research and development of new products. When managers repurchase stock, they are confessing they have no new promising ideas in which to invest. Paradoxically, stock buybacks reward these lethargic executives since they raise the stock price for managers who are paid in stock options. In other words, even though the managers have not developed a better mousetrap, they secure the same bonus as if they had.

The 2017 Trump tax giveaway law¹⁷ generated a windfall for all American corporations by cutting the corporate rate by 40 percent. Trump officials claimed corporations would trickle down profits by investing these new proceeds into more company assets, including higher worker pay. Trump claimed the bill would generate an annual average pay raise of \$4,000.¹⁸ Treasury Secretary Steven Mnuchin also claimed the increased economic vitality would generate enough new tax revenue that the tax cuts would pay for themselves. None of this proved true.^{19 20}

In the first quarter of 2018 alone, with the new tax law fully in force, American corporations bought back a record \$178 billion in stock.²¹ During this period, the market hit record highs. When a

¹⁵ *Ibid.*

¹⁶ David Gelles and Jesse Drucker, “Corporate Insiders Pocket \$1 Billion in Rush for Coronavirus Vaccines,” *NEW YORK TIMES* (JULY 25, 2020), [HTTPS://WWW.NYTIMES.COM/2020/07/25/BUSINESS/CORONAVIRUS-VACCINE-PROFITS-VAXART.HTML](https://www.nytimes.com/2020/07/25/business/coronavirus-vaccine-profits-vaxart.html)

¹⁷ The law is officially known as the 2017 Tax Cuts and Jobs Act.

¹⁸ Joseph Zeballos-Roig, “These 7 charts show Trump’s tax cuts still haven’t been the economic ‘rocket fuel’ he promised, 2 years after the fact,” *MARKET INSIDER* (Dec. 22, 2019), <https://bit.ly/2KIWNsg>.

¹⁹ *Key Facts: How Corporations Are Spending Their Trump Tax Cuts*, AMERICANS FOR TAX FAIRNESS, <https://bit.ly/2Vp5ZCg>.

²⁰ Wage Growth Tracker, FEDERAL RESERVE BANK OF ATLANTA (April 15, 2019), <https://bit.ly/3aqeFg4>.

²¹ Talib Visram, “Tax Cut Fuels Record \$200 Billion Stock Buyback Bonanza,” *CNN.COM* (June 5, 2018); *see also* William Lazonick, “Stock Buybacks: From Retain-and-Reinvest to Downsize-and-Distribute,” *Brookings Initiative on 21st Century Capitalism* (April 2015), at 2 (“Over the decade 2004-2013, 454 companies in the

corporation buys stock, it should be governed by the maxim that applies to any investor: buy low, sell high. Yet because this frenzy of corporate stock buybacks happened when the market was at a record high level, it contradicts any claim that they were sound business decisions.

Still worse, Commissioner Robert Jackson of the SEC found that corporate insiders were inexplicably active sellers following a buyback announcement,²² buttressing the concern about possible manipulation. Commissioner Jackson observed,

“There is clear evidence that a substantial number of corporate executives today use buybacks as a chance to cash out the shares of the company they received as executive pay. We give stock to corporate managers to convince them to create the kind of long-term value that benefits American companies and the workers and communities they serve. Instead, what we are seeing is that executives are using buybacks as a chance to cash out their compensation at investor expense.”²³

In the CARES Act, Congress approved more than \$500 billion in funds for corporate America in the hopes that they would retain employees through the shutdown. These funds were necessary, proponents explained, because these companies lacked the reserves to keep workers on the payroll. Had these same firms not engaged in a spree of buybacks just in the last three years, they might need taxpayer help. In the last three years, companies in the S&P 500 repurchased \$2 trillion worth of their own stock.²⁴

Another example is backdating. Backdating is the practice of awarding executives stock options at a lower price by making the award on paper appear to have been granted on a previous date, when the stock was trading at a lower price. The backdating scandals of the early 2000s resulted in 12 executive prosecutions and payments of nearly \$1 billion in penalties²⁵ – not for the backdating itself, but for the illegal accounting of the activity.²⁶ The courts have decided that the fact of backdating alone is not sufficient to prove an illegal fraud has occurred.²⁷

In the aftermath of the backdating scandals, most companies (more than 65% in 2010) have adopted the reform of scheduling option grants on the same dates every year. A 2018 study by Stanford University law professor Robert M. Daines, however, shows the market manipulation scheme appears to have mutated to adapt to the reforms – and may well have become more harmful.²⁸ In

S&P 500 Index in March 2014 that were publicly listed over the ten years did \$3.4 trillion in stock buybacks, representing 51 percent of net income.”)

²² Comm. Robert Jackson, Speech at the Center for American Progress, SECURITIES AND EXCHANGE COMMISSION (June 11, 2018). <https://bit.ly/3czxyi2>.

²³ *Ibid.*

²⁴ Matt Phillips, “The Stock Buyback Binge May Be Over. For Now,” NEW YORK TIMES (March 23, 2020) <https://www.nytimes.com/2020/03/24/business/coronavirus-stock-buybacks.html>

²⁵ Edmund Andrews, “How CEOs Reinvented the Dating Game Scandal in Stock Options,” Stanford Business (Aug. 29, 2018), <https://www.gsb.stanford.edu/insights/how-ceos-reinvented-dating-game-scandal-stock-options>

²⁶ Peter Lattman, “Backdating Scandal Ends With a Whimper,” The New York Times (Nov. 11, 2010), <https://dealbook.nytimes.com/2010/11/11/backdating-scandal-ends-with-a-whimper/>

²⁷ Stephen Taub and Dave Cook, “Backdating Not Sufficient to Prove Fraud,” CFO (April 16, 2007), <https://www.cfo.com/risk-compliance/2007/04/backdating-not-sufficient-to-prove-fraud/>

²⁸ Daines, R., McQueen, G., & Schonlau, R. (2018). *Right on Schedule: CEO Option Grants and Opportunism*. JOURNAL OF FINANCIAL AND QUANTITATIVE ANALYSIS, 53(3), 1025-1058. doi:10.1017/S0022109017001259, <https://www.cambridge.org/core/journals/journal-of-financial-and->

this updated variant, instead of manipulating the date when stock options are granted, company statements that affect the price of the company's stocks are strategically timed around the fixed date options are granted in order to benefit stock option recipients. The study analyzed stock prices for 1,500 companies and found that, on average, prices dropped in the months before the grants and quickly rose afterward, giving executives the advantage of always being able to buy low and sell high. The pattern was more pronounced at companies where executives received above-average numbers of stock options and at companies that are hard to value, and so may have prices that are more sensitive to the company's own statements.

Another group of apparent opportunists are executives at Hertz, the bankrupt rental car company, who have positioned themselves to siphon tens of millions of dollars out of the corporation. Because of the pandemic, Hertz announced in April that it would lay off 10,000 workers – a third of its U.S. workforce.²⁹ In May, the company disclosed it paid \$16.2 million in cash retention bonuses to executives right before the company declared bankruptcy.³⁰ Hertz isn't alone. Reuters found that at a third of the 40 large corporations that filed for bankruptcy during the pandemic paid out similar cash bonuses.³¹ In 2005, Congress passed the Bankruptcy Abuse Prevention and Consumer Protection Act, forbidding corporations from doling out large payouts to retain executives during bankruptcy proceedings.³² The payouts from Hertz and other companies, including J.C. Penney, Neiman Marcus, and Chesapeake Energy, show that instead of ceasing the abuse, corporations that want to shower executives of bankrupt companies with millions merely shifted it to before the bankruptcy. Nevertheless, what makes Hertz's executive handouts especially egregious is the company's intention to give away another round -- \$14.6 million – which in court documents the company describes as “incentive” pay rather than retention pay,³³ a scheme the courts blessed in 2012.³⁴

In the confusing and volatile COVID-19 market, many more stock prices are sensitive to company statements, and perhaps none more so than the pharmaceutical corporations racing to produce vaccines. Just as many in the public are wary of the potential for political incentives to supersede safety if an artificially accelerated timeline results in a vaccine being ready for distribution by Election Day, so too should the public be wary of potential the financial incentive of pharmaceutical

[quantitative-analysis/article/right-on-schedule-ceo-option-grants-and-opportunism/DA0C243E4AE7E58B78D2E20E78520A9A/share/f9663ff7226e5992e78e2f25ad6301d6f6105b2a](https://www.reuters.com/quantitative-analysis/article/right-on-schedule-ceo-option-grants-and-opportunism/DA0C243E4AE7E58B78D2E20E78520A9A/share/f9663ff7226e5992e78e2f25ad6301d6f6105b2a)

²⁹ "U.S. car rental company Hertz to lay off 10,000 staff on coronavirus hit," Reuters (April 20, 2020), <https://www.reuters.com/article/us-hertz-layoffs/u-s-car-rental-company-hertz-to-lay-off-10000-staff-idUSKBN222XD>

³⁰ "Hertz awards over \$16 million in retention bonus to key executives," Reuters (May 26, 2020), <https://www.reuters.com/article/us-hertz-glo-hldg-bankruptcy-retentionbo/hertz-awards-over-16-million-in-retention-bonus-to-key-executives-idUSKBN2322AS>

³¹ Mike Spector and Jessica DiNapoli, "On eve of bankruptcy, U.S. firms shower execs with bonuses," Reuters (May 26, 2020), <https://www.reuters.com/article/us-health-coronavirus-bankruptcy-bonuses/on-eve-of-bankruptcy-u-s-firms-shower-execs-with-bonuses-idUSKCN241EE>

³² Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Congressional Record Volume 151, Number 26 (March 8, 2005), <https://www.govinfo.gov/content/pkg/CREC-2005-03-08/html/CREC-2005-03-08-pt1-PgS2200-2.htm>

³³ Peg Brickley, "Bankrupt Hertz Sets Up Another Round of Executive Bonuses," The Wall Street Journal (Aug. 28, 2020), <https://www.wsj.com/articles/bankrupt-hertz-sets-up-another-round-of-executive-bonuses-11598645731>

³⁴ Mike Spector And Tom McGinty, "The CEO Bankruptcy Bonus," The Wall Street Journal (Jan. 27, 2012), <https://www.wsj.com/articles/SB10001424053111903703604576584480750545602>

executives to withhold a vaccine until the instant they are strategically poised to earn the greatest returns.

The harms are no less insidious than outright illegal insider trading – it is the subordination of companies’ core business to producing massive executive payouts, and the potential for victimization – if it interferes with the release of treatments and vaccines for COVID-19 – is spread far beyond direct market participants.

This sub-pandemic of insider trading invites reflection on the nature of stock-based compensation. On paper, compensating senior executives (and even line employees) with stock was intended to align the interest of employees and owners; if the manager works harder, the company prospers, the stock rises, benefitting both the employee and the shareholder. But stock price manipulation renders the executive an antagonist to the shareholder. Without reforms, this alignment of interests won’t be realized.

Insider trading is but one indicator of how average Americans can be abused by corporate executives. The Covid-19 pandemic has laid bare the extreme economic and racial inequalities that have held back our country for years and made us much more vulnerable to the ravages of the current crisis. The lack of responsible policies to rein in CEO pay has been a key driver of inequality.

Since the 1980s, the fruits from rising economic output from workers at American corporations have meant concentrated earnings in the C-suite. Average worker wages have stagnated, while those of senior managers soared. This follows a precipitous decline in the top marginal tax rate along with deterioration in the power of collective bargaining owing to declining unionization rates.

Meeting certain performance benchmarks, often pegged to a firm’s stock price, determines that senior pay. A survey of misconduct and other catastrophes of the American workplace shows the abiding presence of extraordinary pay packages.

- Because of badly constructed pay incentives, thousands of bankers engaged in widespread fraud, inflating a housing bubble whose rupture cost millions their jobs, savings and homes.
- Badly constructed pay incentives prompted the decades long Wells Fargo fake account scandal, where compensation for senior executives to grow accounts led line agents to add more unwitting customer interfaces, resulting in mass firings.
- The worst mine disaster in recent history followed years of compensation tied to cutting safety expenses.
- Similarly, corners cut at Boeing led to the crash of two airliners, while the CEO’s pay turned, in part, on cost cutting.
- Perverse corporate pay incentives reflected and exacerbated racism. Among Fortune 500 CEOs, just 4 are African American. And people of color remain disproportionately represented in low-wage occupations.

Strangling worker wages for decades to bloat the pay in the C-suite has led to massive income and wealth inequality. The induced coma of the pandemic has ripped the scar off this economic wound, requiring massive aid to newly displaced workers who have no savings to fund more than a few weeks of basic expenses, such as groceries, rent, or medicine.

Public Citizen explores these problems in depth in a July report titled “White Collar Crime Still Pays.”³⁵

Washington must repair this dynamic. Leaders should reform executive compensation, force board directors to exercise responsible diligence over management. And the nation’s securities law enforcers must do their job.

The lessons from the Dodd-Frank Wall Street Reform and Consumer Protection Act contain a cautionary tale relevant to how this committee and Congress addresses pandemic aid and the need for executive compensation conditions.

On July 21, 2010, 10 years ago, President Barack Obama signed the Dodd-Frank law. This groundbreaking legislation was a response to the worst financial crash since 1929, brought about by greedy malefactors who committed widespread fraud, largely in mortgage-making and mortgage securities trading, in the pursuit of lucre.³⁶ In response to this greed, Dodd-Frank directed bank regulatory agencies to adopt stricter rules in mortgage-making; tighter controls on the gambling known as derivatives trading; restrictions on banks wagering with federally insured deposits; and critically, guardrails on how bankers could profit personally. It also created a new consumer financial protection agency, the Consumer Financial Protection Bureau. In all, Dodd-Frank mandated the agencies to adopt some 400 rules. While many rules were simple, such as the mandate that companies post the CEO’s pay as a multiple of the median-paid worker at the firm to demonstrate the level of pay inequity, the agencies still labored for years to finalize them. They were besieged by bank lobbyists who considered passage of the reform measure simply the “first quarter” in football game and counted on an inevitable fading of citizen demands for reform. Perhaps one of the five most important of these 400 rules called for prohibiting incentive-based payment arrangements for senior bank officials that would encourage taking “inappropriate risks,” such as by offering “excessive compensation.” Lawmakers recognized that this reform was crucial, and because of that (unlike the vast majority of the 400 rules), they set a deadline for regulators to implement it: May 2011. Yet today, evincing the vast power of the bank lobby in Washington, this rule remains unimplemented.

Along with Dodd-Frank, Congress also approved vast sums of money to bail out the bank creditors, as the banks lacked the capital to make good on their own debts. With this debt relief, bailout proponents promised that the banks could forebear on delinquent mortgage holders and keep people who’d lost their jobs in their homes. But as the bailout proceeded, it became clear that many banks simply sat on the money and proceeded with evictions and foreclosures. In the end, more than 10 million people lost their homes, their jobs, and their savings, while bankers effectively pocketed some of the bailout, returning to the salad days of high bonuses. In the year that JP Morgan paid record fines for mortgage fraud during the years leading to the crisis, its board gave CEO Jaime Dimon a raise.³⁷ Had regulators completed the job of banker pay reform, and the ability to make a personal fortune even at the expense of others’ misfortune been eliminated, this could not have happened.

³⁵ Bartlett Naylor, *White Collar Crime Still Pays*, PUBLIC CITIZEN, (July 21, 2020), <https://www.citizen.org/news/white-collar-crime-still-pays-10-years-after-dodd-frank/>

³⁶ Bartlett Naylor, *TOO Big*, PUBLIC CITIZEN (July 2016) <https://www.citizen.org/wp-content/uploads/toobig.pdf>

³⁷ Bartlett Naylor, *TOO Big*, PUBLIC CITIZEN (July 2016) <https://www.citizen.org/wp-content/uploads/toobig.pdf>

Now, as the world struggles with a pandemic, governments across the planet have placed their economies in voluntary comas. Millions of Americans have lost their jobs. While many low-paid workers have been deemed essential, such as those in health care, grocery sales, delivery, trash-pick up, and remain on the job, some 40 percent of Americans who were paid less than \$40,000 before the shut-down are unemployed.³⁸ Janitors in now dark office buildings cannot telework, nor can restaurant or hotel workers. To soften the blow, Congress approved massive aid packages, which include direct payments to citizens. It also includes a massive aid package to corporations of \$500 billion. With loans from the Federal Reserve, this corporate aid package approaches \$5 trillion, with a goal of helping corporations retain their workforce, even as they lack the business that requires this labor.

However, the lessons of the 2008 bank bailout have left us with legitimate fears that corporate profiteers may siphon some of this aid into their own pockets, leaving less for workers.

No corporation caused the pandemic. Yet in many ways, the necessity of the CARES Act, the \$2.3 trillion relief package during the pandemic, an unprecedentedly large measure conceived and approved in 11 days with inevitable shortcomings, and the direct \$1,200 individual payments³⁹ stem from corruptions in high pay. The need for the government to offer trillions of dollars in relief to businesses and regular Americans was, indirectly, related to the problems excessive pay has created. Corporations spent well more than the \$2.3 trillion in the CARES Act on buy backs of their own stock in recent years. Those buybacks sparked increases in the stock price to which senior pay is pegged. Corporations failed to reward workers for productivity gains with real wage growth for decades, instead bloating the paychecks of senior executives. Hence, almost half of Americans lack even \$400 in savings to buy groceries beyond a few weeks during the lockdown.⁴⁰

So, with the failures of leaving reforms incomplete from the 2010 Dodd-Frank law standing as a stark object lesson in the bank bailout, Congress must not repeat that error, and must be diligent to ensure that the trillions in aid goes not to corporate profiteers but to workers. That means strong complete transparency of where the money goes and on what terms, oversight to ensure that recipients are worthy, and vigilant police and prosecutors to hold wrongdoers accountable.

Needed Reforms

Enforcement

Of course, laws and regulations prohibiting insider trading and other forms of market manipulation are only as good as the that enforcement efforts investigating suspicious activity and holding violators accountable. Recent years have seen marked declines in many aspects of corporate and white-collar enforcement. Corporate prosecutions have reached historic lows, with U.S. Sentencing Commission data showing fiscal year 2019 to have been the second-lowest year on record since the commission began reporting this information in 1996; the lowest year on record was fiscal year

³⁸ J. Edward Moreno, "40 percent of households earning less than \$40K lost jobs in March: Fed chairman." THE HILL (May 13, 2020)

<https://thehill.com/policy/finance/497527-40-percent-households-earning-less-than-40k-lost-jobs>

³⁹ Updated Information on Individual Payments in the CARES Act, Congressman Albio Sires (April 16, 2020), <https://sires.house.gov/media-center/press-releases/information-on-individual-payments-in-the-cares-act>

⁴⁰ *Report on the Economic Well-Being of U.S. Households in 2018*, FEDERAL RESERVE (May 2019)

<https://www.federalreserve.gov/publications/files/2018-report-economic-well-being-us-households-201905.pdf>

2018.⁴¹ Similarly, prosecutions of individual white collar offenders also has plummeted to an all-time low, according to a report from Syracuse University's Transactional Records Access Clearinghouse (TRAC) based on DOJ records.⁴² On point, a National Public Radio investigation found that the SEC brought fewer insider trading cases in 2019 than in any year since 1996.⁴³

The reason for these enforcement declines is not that corporations and executives have abruptly become angels. My research finds that plummeting corporate prosecutions is explained by the Justice Department's overreliance on deferred- and non-prosecution agreements – even for corporate repeat offenders.⁴⁴ Across the government, the Trump administration appointees enacted policies that signaled light touch enforcement for corporate and white collar violators even as the administration pursued “zero tolerance” enforcement against first-time border crossers and low level offenders.⁴⁵ The most recent example of such a policy is the Aug. 31 White House Office of Administration and Regulatory Affairs memo emphasizing that in matters of regulatory enforcement, the burden is placed on federal agencies to prove a violation, not on the accused violator to prove their compliance, and that career staff should seek the approval of political appointees before bringing cases.⁴⁶

Such policies make it harder for enforcement agencies to bring cases and prevent wrongdoing. The consequence is impunity for rampant wrongdoing. It should go without saying that allowing bad actors to run amok in the markets, siphoning money away from worthwhile investments and honest investors, corrupts the system feeds the growing sense among Americans across the political spectrum that the markets are rigged. In the face of such unfairness – especially now as the pandemic increasingly widens the gulf of inequality between the haves and have nots – Americans want accountability. What a shame it will be if what they see instead is impunity.

To address insider trading, the Securities and Exchange can and should police this sector with greater zeal. Bad actors abound on Wall Street. Yet the SEC which is the primary guardian of the integrity of how savers are sold investments, how corporations report results to these investors, and of whether bad actors are arrested, has reduced enforcement. Public Citizen has published reports documenting this decline.⁴⁷ Between President Obama's last year and President Trump's first year, corporate penalties dropped 68 percent and never fully rebounded. The Trump SEC has placed

⁴¹ United States Sentencing Commission, *Fiscal Year 2019: Overview of Federal Criminal Cases* (April 2020), https://www.ussc.gov/sites/default/files/pdf/research-and-publications/research-publications/2020/FY19_Overview_Federal_Criminal_Cases.pdf

⁴² TRAC Reports, "Corporate and White-Collar Prosecutions At All-Time Lows" (March 3, 2020), <https://trac.syr.edu/tracreports/crim/597/>

⁴³ Tom Dreisbach, "Under Trump, SEC Enforcement Of Insider Trading Dropped To Lowest Point In Decades," NPR (Aug. 14, 2020), <https://wamu.org/story/20/08/14/under-trump-sec-enforcement-of-insider-trading-dropped-to-lowest-point-in-decades/>

⁴⁴ Rick Claypool, Soft on Corporate Crime: Justice Department Refuses to Prosecute Corporate Lawbreakers, Fails to Deter Repeat Offenders, Public Citizen (Sept. 2019), <https://www.citizen.org/wp-content/uploads/soft-on-corporate-crime-dpa-mpa-repeat-offenders-report.pdf>

⁴⁵ Rick Claypool, Taylor Lincoln, Michael Tanglis and Alan Zibel, Corporate Impunity: "Tough on Crime" Trump Is Weak on Corporate Crime and Wrongdoing, Public Citizen (July 2018), <https://www.citizen.org/wp-content/uploads/corporate-enforcement-public-citizen-report-july-2018.pdf>

⁴⁶ Paul J. Ray, Memorandum for the Deputy Secretaries of Executive Departments and Agencies, Subject: Implementation of Section 6 of Executive Order 13924 (Aug. 31, 2020), <https://www.whitehouse.gov/wp-content/uploads/2020/08/M-20-31.pdf>

⁴⁷ Rick Claypool, *Wall Street Impunity*, PUBLIC CITIZEN (Sept. 6, 2018) https://www.citizen.org/wpcontent/uploads/migration/wall_street_crash_enforcement_v13.pdf

Wall Street ahead of Main Street. The investigation by National Public Radio found that amidst volatile stock markets leading to “more opportunities for insider trading, using inside information to profit in the stock market, which is illegal . . . NPR has found the Trump administration has brought the fewest number of insider trading cases in decades.”^{48 49}

The subcommittee can ask the SEC chair why this is so. One answer may be that he is carrying out the White House’s wishes. According to the Los Angeles times, “A memo produced by the White House and sent to agency heads last week instructs them to make significant changes to how and when they bring enforcement cases, telling them not to open multiple investigations into the same company and urging them to seek political appointees’ approval before proceeding with an inquiry.”⁵⁰

This alone deserves congressional inquiry. At a time when trillions in taxpayer dollars are exiting Washington to address our economic problems, we need more, not less vigilant policing.

Legislation

We support many legislative efforts to combat stock market manipulation and insider trading.

We support H.R. 624, Promoting Transparent Standards for Corporate Insiders Act, authored by Chair Maxine Waters (D-Calif). This bill directs the Securities and Exchange Commission (SEC)

⁴⁸ Tom Dreisbach, “Under Trump, SEC Enforcement Of Insider Trading Dropped To Lowest Point In Decades,” NPR (August 14, 2020) <https://www.npr.org/2020/08/14/901862355/under-trump-sec-enforcement-of-insider-trading-dropped-to-lowest-point-in-decade>

⁴⁹ We wish to emphasize the importance of maintaining market integrity and following corporate controls and procedures. For example, in these dynamic circumstances, corporate insiders are regularly learning new material nonpublic information that may hold an even greater value than under normal circumstances. This may particularly be the case if earnings reports or required SEC disclosure filings are delayed due to COVID-19. Given these unique circumstances, a greater number of people may have access to material nonpublic information than in less challenging times. Those with such access – including, for example, directors, officers, employees, and consultants and other outside professionals – should be mindful of their obligations to keep this information confidential and to comply with the prohibitions on illegal securities trading. Trading in a company’s securities based on inside information may violate the antifraud provisions of the federal securities laws.

We similarly urge public companies to be mindful of their established disclosure controls and procedures, insider trading prohibitions, codes of ethics, and Regulation FD and selective disclosure prohibitions to ensure to the greatest extent possible that they protect against the improper dissemination and use of material nonpublic information. Likewise, broker-dealers, investment advisers, and other registrants must comply with policies and procedures that are designed to prevent the misuse of material nonpublic information.

More generally, the Enforcement Division is committing substantial resources to ensuring that our Main Street investors are not victims of fraud or illegal practices in these unprecedented market and economic conditions. The Enforcement Division is committed to protecting investors and maintaining confidence in the fairness and integrity of our markets. From, Release, Securities and Exchange Commission, (March 23, 2020) <https://www.sec.gov/news/public-statement/statement-enforcement-co-directors-market-integrity>

⁵⁰ Anna Phillips, White House Directs Agencies To Relax Enforcement, Los Angeles Times (Sept. 9, 2020) <https://www.latimes.com/politics/story/2020-09-09/white-house-directs-agencies-to-relax-enforcement>, Also, Memorandum, Office of Information and Regulatory Affairs, (August 31, 2020) <https://www.whitehouse.gov/wp-content/uploads/2020/08/M-20-31.pdf>

to study and report on possible revisions to regulations regarding Rule 10b5-1 trading plans. These are plans that establish certain pre-determined times that an executive will exercise (cash) his or her stock options. It is a way for the executive to avoid falling afoul of prohibitions against illegal insider trading. Unfortunately, executives have found ways to game these plans.

Machinations around 10b5-1 plans are yet another example of strategies executives may be using to gain unfair advantage in the marketplace. Adopted by the SEC in 2000 to provide executives and insiders with protocols for trading company stocks without exposing them to the risk of insider trading accusations,⁵¹ 10b5-1 plans have long drawn criticism for giving corporate chiefs legal cover to engage in illegal insider trading. The rule forbids executives from trading company stocks when they have material nonpublic information and instead establishes preset formulas for brokers trade on their behalf. Nevertheless, a 2012 investigation in the Wall Street Journal found evidence insiders are able to exploit the rule's timing requirements and routinely outperform the market.⁵² There is no preset amount of time required to pass between when a plan is set up and when trading can begin, and a plan holder may cancel it at any time. As the Wall Street Journal put it, "There is little in the system to prevent an executive who foresees good news about the company from canceling a scheduled share sale, or an executive who foresees bad news from canceling a scheduled share purchase." Modifying plans before announcements is precisely what NPR found that Moderna did.⁵³ This is why an SEC insider trading investigation is urgent. It is also why the bipartisan Promoting Transparent Standards for Corporate Insiders Act (H.R. 624),⁵⁴ which cleared the House 413-3,⁵⁵ is such a vital and timely reform, and why the Senate should include the bill in the next COVID-19 relief package.

Public Citizen also supports H.R.4335, The 8-K Trading Gap of 2019, authored by Rep. Carolyn Maloney, (D-N.Y.). The bill directs the SEC to issue a rule requiring public companies to put in place policies and procedures that are reasonably designed to prohibit officers and directors from trading company stock after the company has determined that a significant corporate event has occurred, and before the company has filed a Form 8-K disclosing such event. This would have arrested some of the pandemic profiteering we've been witnessing. This cleared the House 384-7.

Currently, public companies must disclose significant corporate events, such a successful clinical trial for a vaccine to investors and the public on Form 8-K. But there is a timing gap: they can wait four business days after the event occurs to make this disclosure. As a result, corporate executives have the benefit of knowing material, nonpublic information for four days before investors and the rest of the public. This is a problem because there is no rule prohibiting these executives from buying or selling the company's securities during this four-day gap. A 2015 study found that during a six-year period, insiders who traded during this four-day gap successfully earned \$105 million in

⁵¹ Final Rule: Selective Disclosure and Insider Trading, SECURITIES AND EXCHANGE COMMISSION, 17 CFR Parts 240, 243, and 249, Release Nos. 33-7881, 34-43154, IC-24599, File No. S7-31-99, RIN 3235-AH82 (Oct. 23, 2000), <https://www.sec.gov/rules/final/33-7881.htm>

⁵² Susan Pulliam and Rob Barry, "Executives' Good Luck in Trading Own Stock," The Wall Street Journal (Nov. 27, 2012), <https://www.wsj.com/articles/SB10000872396390444100404577641463717344178>

⁵³ Susan Pulliam and Rob Barry, "'Bad Optics' Or Something More? Moderna Executives' Stock Sales Raise Concerns," NPR (Sept. 4, 2020), <https://www.npr.org/2020/09/04/908305074/bad-optics-or-something-more-moderna-executives-stock-sales-raise-concerns>

⁵⁴ H.R.624 - Promoting Transparent Standards for Corporate Insiders Act, 116th Congress (2019-2020) <https://www.congress.gov/bill/116th-congress/house-bill/624>

⁵⁵ Ibid.

above-market returns on these trades.⁵⁶ H.R. 4335, the 8-K Trading Gap Act, fixes this loophole by requiring public companies to put in place policies and procedures that are reasonably designed to prohibit officers and directors from trading company stock after the company has determined that a significant corporate event has occurred and before the company has filed a Form 8-K disclosing such event.

Public Citizen also supports an as yet unnumbered bill that would amend the Securities Exchange Act of 1934 to prohibit issuers from granting stock options if the grantor or recipient are in possession of certain nonpublic information, and for other purposes: this bill would impose certain restrictions on issuers from granting stock options to any officer, employee, or director if the issuer is in possession of material nonpublic information. We believe this blanket prohibition should clarify that insider information cannot be abused.

We welcome Rep. Cynthia Axne's (D-Iowa) bill, HR 6735, which would establish the Consumer and Investor Fraud Working Group to help protect consumers and investors from fraud during the COVID-19 pandemic.⁵⁷ This requires the SEC (along with the Consumer Financial Protection Bureau) to report monthly on how they're helping consumers and investors during the pandemic, including any enforcement efforts. Given the axiom that what's measured is what's managed, the SEC might feel some pressure to show more than zero effort on a monthly basis.

Currently, the law governing illegal insider trading lacks definition. This has forced the SEC and the Department of Justice (DOJ) to rely on general anti-fraud statutes and decades of case law subject to interpretation by judges. Under current SEC interpretations, illegal insider trading is "buying or selling a security, in breach of a fiduciary duty or other relationship of trust and confidence, on the basis of material, nonpublic information about the security."⁵⁸ For nearly fifty years, federal prosecutors who have brought criminal insider trading charges under Section 10(b) of the Exchange Act and the SEC's implementing rule governing the law, Rule 10b-5, and more recently, litigation has focused on a personal benefit test,⁵⁹ that is, where the tipper or tippee receives financial or other gain.

⁵⁶ Cited in Congressional Record, January 13, 2020, p. H188, CONGRESSIONAL RECORD (January 13, 2020) <https://www.congress.gov/116/crec/2020/01/13/CREC-2020-01-13-pt1-PgH188.pdf>

⁵⁷ Rep. Cindy Axne HR 6735, Consumer and Investor Fraud Working Group, (website accessed Sept. 10, 2020) <https://www.congress.gov/bill/116th-congress/house-bill/6735>

⁵⁸ Fast Answers: Insider Trading, SECURITIES AND EXCHANGE COMMISSION, <https://www.investor.gov/additionalresources/general-resources/glossary/insider-trading> (last visited Mar. 27, 2019).

⁵⁹ In *Dirks v. S.E.C.*, 463 U.S. 646, 662 (1983), the Supreme Court held that a breach of duty occurs when, based on objective criteria, "the insider personally will benefit, directly or indirectly, from his disclosure." The Court explained that the relationship between the insider and the tippee involves a quid pro quo. This could either be in the form of money, or friendship. In 2014, the Second Circuit narrowed the definition of a personal benefit. In *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014), the government charged Todd Newman and Anthony Chiasson with insider trading after material, nonpublic information had been shared with acquaintances, rather than good friends or relatives. These acquaintances later passed the tips along to others who ultimately told Newman and Chiasson. For Newman, the insider initially gave the information to a colleague and fellow alumnus of the same school while receiving casual career advice. In Chiasson's case, the initial tip was given from one acquaintance to another through a church relationship. Each tip eventually reached the defendants, who traded on it and were convicted in December 2012. The Second Circuit voided the convictions. The court argued that the initial exchange of information did not turn on a personal benefit. The court explained that the career advice given between colleagues and a conversation between

We believe the personal benefit test unjustly limits the boundaries of what should be illegal insider trading. Insiders should not divulge inside information. When a person receives inside information, they should not trade with this knowledge, and each person engaged in such action should be prosecuted. HR 2534, the Insider Trading Prohibition Act, advanced by this committee, approved by the House 400-15, and authored chiefly by Rep. Himes, referenced above, achieves these goals. Public Citizen strongly supports this bill. It makes it unlawful for a person to trade on material, nonpublic information when the information was wrongfully obtained, or when the use of such information to make a trade would be deemed wrongful; makes it unlawful for a person who wrongfully obtains material, nonpublic information to communicate that “tip” to another person when it is reasonably foreseeable that the person is likely to trade on that information. The bill defines “wrongful” as information that has been obtained through “theft, bribery, misrepresentation or espionage, a violation of any federal law protecting computer data or the intellectual property or privacy of computer users, conversion, misappropriation or other unauthorized and deceptive taking of such information, or a breach of any fiduciary duty or any other personal or other relationship of trust and confidence.”⁶⁰

On options, back dating is not currently illegal. Provided shareholders are informed, companies may and do set a strike price well below the level that prevails currently—a date back in the past. Shareholders apparently permit this because of an unholy alliance between firms and their institution investors, who may also be managers of a company’s pension plans. (And even where they do not manage the specific company’s plan, a history of contesting management is bad marketing when attempting to win other pension management contracts. This frustrates a prohibition on such conflicts.) Congress should consider basic reforms on back-dating, such as permitting the strike price to be established only at certain arbitrary times, such as the first of the year, or at pre-set intervals during the year.⁶¹

acquaintances at church acquaintances did not qualify as a personal benefit. While the Supreme Court declined to review Newman directly, it did address the general issue in a case from the Ninth Circuit, *Salman v. United States*, 137 S. Ct. 420 (2016). The insider-tipper in *Salman* was an investment banker who gave information to his brother. The investment banker testified that he gave the information to his brother to “fulfill whatever needs he had,” along with the knowledge that his brother would trade on it. The brother also passed the information along to another person related to the banker. This person traded on that information and was convicted in the Northern District of California in 2013. The Ninth Circuit affirmed the conviction in an opinion that rejected the Second Circuit’s formulation of Newman. The Supreme Court then decided to resolve the circuit split in favor of the Ninth Circuit. The Second Circuit’s next opportunity to revisit Newman came in *United States v. Martoma*, 894 F.3d 64 (2d Cir. 2018). This year, on January 24, former SAC Capital Advisors portfolio manager Mathew Martoma petitioned the Supreme Court to review his 2014 conviction for insider trading. This conviction stemmed from 2008 activity when Martoma paid a doctor from the University of Michigan for inside information about clinical trial results for an experimental Alzheimer’s medication. *United States v. Martoma*, 894 F.3d 64 (2d Cir. 2018), petition for cert. filed, (U.S. Jan. 24, 2019) (No. 18-972). Before the trial results were published, Martoma directed SAC Capital investments in instruments that led to \$275 million in gains and losses avoided. The Second Circuit upheld the conviction, holding that the personal benefit requirement was satisfied by Martoma’s payments to the doctor. The court attempted to reconcile the *Salman* and *Newman* cases with a further discussion of the personal benefit test.

⁶⁰ Office of Rep. Jim Himes, *Himes Bipartisan Insider Trading Bill Passes Financial Services Committee*, U.S. CONGRESS (May 10, 2019) <https://himes.house.gov/media-center/press-releases/himes-bipartisan-insider-trading-bill-passes-financial-services>

⁶¹ Robert Daines, et al, *Right on Schedule: CEO Option Grants and Opportunism*, JOURNAL OF FINANCIAL AND QUANTITATIVE ANALYSIS (June 2018) <https://www.cambridge.org/core/journals/journal-of-financial-and-quantitative-analysis>

Stock buybacks should be banned until all forms of aid are repaid — without exception. The CARES Act does include restrictions on stock buybacks, but these conditions — as well as the executive compensation limits — may be waived by the Treasury Secretary if he deems it necessary “to protect the interests of the Federal Government.” Aided firms must quit quarterly capitalism and wasteful stock buybacks engineered to spark a short-lived stock price jump to inflate stock-based executive compensation. Had firms not engaged in buybacks at even half the rate of the last two decades, major American corporations would not need any aid right now at all. Buybacks drain capital that could be used for better employee pay or other investments in physical assets. Before an SEC rule change in the 1980s, buybacks were rare, but now they are an engine of escalating CEO pay.⁶² Sen. Tammy Baldwin (D-Wisc) promotes the Reward Work Act which bans buybacks altogether. It also requires that a third of board members be elected by a firm’s employees.⁶³ A bill authored by Sen. Bernie Sanders (I-Vt.) and Rep. Ro Khanna (D-Calif.) would prohibit buybacks where CEO pay exceeds 150 times that of the company’s median pay. Senators Cory Booker (D-N.J.) and Bob Casey (D-Pa.) have introduced the Worker Dividend Act that requires companies that buy back stocks to also pay out a commensurate sum to all of its employees.⁶⁴ The SEC should require that shareholders approve buybacks, rather than directors.⁶⁵ Finally, Congress should simply ban executive stock sales during buybacks altogether.

Equity-based pay should include provisions that prevent executives from reaping crisis windfalls. To prevent executives from receiving preferential protection from the economic crisis, corporations should be banned from repricing executive stock options or resetting the value of stock grants that may now be underwater. Any equity awards should include conditions reflecting best practices on both clawbacks and equity holding requirements.

A sizeable portion of pay for aided companies should be deferred and used to pay corporate penalties. Following the 2008 financial crash, the Justice Department found widespread fraud. However, prosecutors brought no charges against any senior individuals. Some officials cited the complication of identifying culpable individuals but that left shareholders to shoulder the fines. To improve compliance we call for the system advocated for by William Dudley, then president of the New York Federal Reserve, which says that senior bankers (such as the 2,000 most senior at JP Morgan) must defer a substantial portion of pay.⁶⁶ If the bank must pay a penalty, this pool is used to pay the fine instead of shareholder funds. This will motivate managers to police one another. Rep. Katie Porter (D-Calif.) sponsors a bill that calls on all corporations to sequester a portion of compensation for their top five officers (or explain to shareholders why they do not).

Rep. Ben McAdams (D-Utah) proposes a measure that allows the SEC to grant restitution to investors and disgorgement from ill-gotten gains, regardless of a statute of limitations. This bill repairs the damage done in the Supreme Court’s decision in *Kokesh v. SEC*. The bill establishes

[quantitative-analysis.com/article/right-on-schedule-ceo-option-grants-and-opportunism/DA0C243E4AE7E58B78D2E20E78520A9A/share/f9663ff7226e5992e78e2f25ad6301d6f6105b2a](https://www.quantitative-analysis.com/article/right-on-schedule-ceo-option-grants-and-opportunism/DA0C243E4AE7E58B78D2E20E78520A9A/share/f9663ff7226e5992e78e2f25ad6301d6f6105b2a)

⁶² Comm. Robert Jackson, Speech at the Center for American Progress, Securities and Exchange Commission (June 11, 2018), <https://bit.ly/3czxyi2>.

⁶³ Reward Work Act, S.2605 (2018), <https://bit.ly/34RgRMt>.

⁶⁴ Press Release, Office of Senator Cory Booker, “Booker, Casey Introduce Bill Aimed at Corporate Short-termism, Stock Buybacks,” (March 7, 2018), <https://bit.ly/3aCEXvA>.

⁶⁵ Lenore Palladino, *Stock Buybacks: Driving a High-Profit, Low-Wage Economy*, ROOSEVELT INSTITUTE (March 2018), <https://bit.ly/3axIn73>.

⁶⁶ Bartlett Naylor, *Decimate Wall Street*, HUFFINGTON POST (December 22, 2014), <https://bit.ly/2xWbI9W>.

restitution and forfeiture of ill-gotten gains as statutory responses separate from a penalty. We support this measure as a vehicle to make victims whole and remove any ability that bad actors could calculate that their scams could be more lucrative than a subsequent penalty. We also support Rep. Vincente Gonzalez' (D-Texas) bill that expands the statute of limitations from five years to ten years for recovering civil monetary penalties. We also support Rep. Porter's bill to increase the size of penalties from the current per-violation cap of \$181,000 to \$1 million for individuals, and from \$905,000 to \$10 million for corporations.

Public Citizen also supports a measure to require the SEC to study stock buybacks under rule 10b-18. This measure takes a welcome step to address the glut of stock buybacks that have accelerated since the SEC relaxed anti-manipulation rules in 1982. On the surface, a stock buyback represents a declaration of management indolence. Stock buybacks raise stock prices, and when senior executive pay is paid in stock options, this can generate an unjustified bonus.

When Congress approved the \$2.3 trillion CARES Act, it contained essentially no conditions on senior executive pay. It required only that certain airline and other executives limit their compensation to \$3 million and half of the amount above this \$3 million they received in 2019.⁶⁷ There are no limits on pay for executives at other aided firms.

Nearly 60 organizations have petitioned Congress for limits. CEOs of aided firms should receive no more than 50 times the median of their employees' pay. Senior executives should have a sizeable portion of their pay sequestered for a "penalty pot." If the firm is found to have abused the aid or engaged in misconduct that requires it to pay a penalty, taxpayers should not subsidize that penalty; the penalty pot from deferred executive compensation would be used. This deputizes all senior executives to police one another, since misconduct by any will impact them all. Further, buybacks should be banned, corporation deductions for pay to any individual of more than \$1 million should be prohibited, and re-pricing options should be prohibited. Re-pricing is where the original price where a bonus kicks in is lowered, such as in a major stock dip.⁶⁸ More than 100 House Democrats have called for similar reforms.⁶⁹

Conclusion

The American public supports pay reform. Polls affirm that Americans believe CEOs are overpaid relative to their line workers.⁷⁰ Over time, polls have shown shifting but always strong support for limiting CEO pay.⁷¹ ⁷² Polls show widespread support for higher income taxes and a wealth tax. One October 2019 poll shows that Americans' top priority regarding tax policy is making sure the

⁶⁷ See Title IV, CARES Act

⁶⁸ *Petition to Limit Executive Compensation During Covid-19 Crisis*, PUBLIC CITIZEN (April 30, 2020) <https://www.citizen.org/article/petition-to-limit-executive-compensation-during-covid-19-crisis/>

⁶⁹ Sarah Anderson, *100 House Democrats Call for Cap on CEO-Worker Pay Gaps at Bailed-Out Firms*, Institute for Policy Studies, (March 21, 2020) <https://ips-dc.org/100-house-democrats-call-for-cap-on-ceo-worker-pay-gaps-at-bailed-out-firms/>

⁷⁰ *The CEO-Worker Pay Gap*, INSTITUTE FOR POLICY STUDIES (February 2019), <https://bit.ly/2VoSyCI>.

⁷¹ Frank Newport, *Americans Split on Government Action to Limit Executive Pay*, GALLUP (April 5, 2018), <https://bit.ly/34Rpiaw>.

⁷² From Gabriel Zucman, *Triumph of Influence*, Oct 2019.

wealthy pay their fair share. Another poll shows strong support for an additional 10-percentage point tax on income above \$2 million.⁷³

Those engrossed in the pandemic must not repeat this neglect from the unfulfilled rulemaking from the 2010 Dodd-Frank Act. Now that trillions in taxpayer dollars are leaving Washington, lawmakers must not let it fatten the bank accounts of executives at those firms being aided. Limits must be placed, conditions established. This is basic. Ideally, corporate America will learn that real pay reform will be good for the entire economy, will lead to less misconduct, and honest drug-making.

⁷³ Millionaires Surtax: A Winning Issue in 2020, MILLIONAIRES SURTAX, <https://bit.ly/2VBdl68>.

APPENDIX:

The Intersection of Executive Compensation and Health Care Expense

The U.S. health system costs four times as much to run as the system in Canada.⁷⁴ There is little debate that profiteering drives this expense. Part of that profiteering is the extraordinary CEO and senior manager pay in the health care industry. For example, the CEO of Regeneron Pharmaceuticals pocketed \$118 million in 2018. The CEO of HCA Healthcare took in \$109 million, the Pfizer CEO made \$47 million, and the Humana CEO took in \$27 million.⁷⁵ Just these singular annual payments are enough not only to secure a luxurious future for these CEOs, but also their offspring, with no need ever to work again. Yet these CEOs will undoubtedly receive similar windfalls in future years, as well. Below these CEOs are countless other senior executives who also receive millions of dollars annually. These are the routine paychecks financed by the high prices that average Americans pay for health insurance, co-pays and for care services.

In 2016, the U.S. spent 17.8 percent of its gross domestic product (GDP) on healthcare. Other countries' spending ranged from a low of 9.6 percent of GDP in Australia to a high of 12.4 percent of GDP in Switzerland.⁷⁶ A sizeable amount of this difference in spending finds itself in the bank accounts of health provider business. Drug pricing, surprise billing and the opioid crisis demonstrate the problem of misplaced pay incentives in the health care industry.

The high cost of prescription medicines in the U.S. demonstrates how profiteering subordinates health care results. Since 1996, pharmaceutical corporations have increased the list price of a vial of insulin from \$21 to over \$275.⁷⁷ For example, patients with serious diabetes can pay \$3,000 a month for insulin in the United States. In Canada, the comparable bottle of insulin costs \$21.⁷⁸ Drug price gouging is all too common. Corporations abuse their monopolies to jack-up prices. As a Public Citizen commentary noted, "Pharma CEOs get rich, patients die rationing insulin."⁷⁹ These high drug prices raise stock prices which raises stock-based compensation of their executives.

Consider Allergan. A Public Citizen report noted that "[A] closer examination of the corporation's record reveals a catalogue of abuses, showing just how deeply the pharmaceutical industry business

⁷⁴ Melissa Healey, *U.S. health system costs four times more to run than Canada's single-payer system*, LOS ANGELES TIMES (January 7, 2020), <https://lat.ms/2RjMBw>. <https://www.latimes.com/science/story/2020-01-07/u-s-health-system-costs-four-times-more-than-canadas-single-payer-system>

⁷⁵ Bob Herman, *Health care CEOs took home \$2.6 billion in 2018*, AXIOS (May 16, 2019), <https://bit.ly/3evPCvq>.

⁷⁶ Lisa Rapaport, *U.S. health spending twice other countries with worse results*, REUTERS (March 13, 2018), <https://reut.rs/2xAUnmE>.

⁷⁷ Carolyn Johnson, *Why Treating Diabetes Keeps Getting More Expensive*, WASHINGTON POST (Oct. 31, 2016) <https://www.washingtonpost.com/news/wonk/wp/2016/10/31/why-insulin-prices-have-kept-rising-for-95-years/>

⁷⁸ Emily Miller, *U.S Drug Prices vs. The World*, DRUG WATCH (January 25, 2018), <https://bit.ly/3acyMy9>.

⁷⁹ *Pharma CEOs Get Rich, Patients Die Rationing Insulin*, Public Citizen (website viewed July 17, 2020) <https://www.citizen.org/article/pharma-ceos-get-rich-patients-die-rationing-insulin/>

model is broken” Allergan “has repeatedly used dubious tactics to boost profits — from paying off its competitors, to gaming the patent system, to hiking the prices of old medicines.” Recently, “Allergan has entered settlements for a billion dollars over its anticompetitive conduct and remains enmeshed in several other lawsuits, with possible legal exposure for billions more. Between 2006 to 2012, its former subsidiary sold 26 billion opioid pills, more than 80 for every American.”⁸⁰

Critics, including the firm’s own shareholders, lambasted compensation plans for leading to these legal costs. One institutional investor highlighted the “stunningly excessive level of management compensation.”⁸¹ One Allergan CEO was “lined up to receive \$38.7 million in compensation” as a golden parachute, according to a media account.⁸² In 2019, the CEO received \$9.2 million in compensation. This included more than \$6 million worth of stock options.⁸³ The board of directors, which approves executive compensation, is also paid, in part, in stock options. Approximately half of the more than \$300,000 that each receives comes from stock-based compensation.⁸⁴

Congress has investigated the connection between raising drug prices and winning greater executive compensation. For example, a Senate committee reviewed the connection between the pay of AbbVie Chairman and CEO Richard Gonzalez and the sales of its arthritis treatment Humira. Since 2014, AbbVie has nearly doubled the price of Humira. The drug now carries a list price of more than \$60,000 per year. AbbVie has aggressively kept low-cost biosimilar competition off the U.S. market.⁸⁵ In 2017, Humira generated \$18.3 billion in sales, a 14.6 percent increase from the previous year. Humira sales accounted for about 65 percent of the company’s \$28.1 billion in revenue. In turn, this increase factored in “the compensation for AbbVie’s top executives,” according to one account.^{86 87}

CEO Gonzalez received a total of \$22.6 million for his performance in 2017, \$4.3 million of which was his cash bonus. The rest of his compensation was base salary and a mix of stock, restricted shares and options. “This strikes me as problematic,” Sen. Ron Wyden, (D-Ore.), noted. “Would

⁸⁰ ZAIN RIZVI, PUBLIC CITIZEN, BY ANY MEANS NECESSARY: HOW ALLERGAN GAMED THE SYSTEM TO RAISE DRUG PRICES AND FLOOD THE COUNTRY WITH PILLS (January 2020), <https://bit.ly/2KfEgxA>.

⁸¹ David Tepper on behalf of APPALOOSA LP, Letter to Allergan (Feb. 19, 2019), <https://tinyurl.com/qwnvrmd>.

⁸² Carly Helfan, *Pharma Allergan CEO Saunders lines up for \$39M parachute after AbbVie buy*, FIERCEPHARMA (Aug. 14 2019), <https://tinyurl.com/uym6u4h>.

⁸³ *Allergan, Proxy Statement*, SECURITIES AND EXCHANGE COMMISSION (2020) https://www.sec.gov/Archives/edgar/data/1631650/000156459019011278/aimt-def14a_20190523.htm

⁸⁴ *Allergan, Proxy Statement*, SECURITIES AND EXCHANGE COMMISSION (2020) https://www.sec.gov/Archives/edgar/data/1631650/000156459019011278/aimt-def14a_20190523.htm

⁸⁵ Berkely Lovelace Jr., *Senate panel grills pharma CEO over executive bonuses and sales of AbbVie blockbuster drug Humira*, CNBC (February 27, 2019), <https://cnb.cx/3esCnvr>.

⁸⁶ Berkely Lovelace Jr., *Senate panel grills pharma CEO over executive bonuses and sales of AbbVie blockbuster drug Humira*, CNBC (February 27, 2019), <https://cnb.cx/3esCnvr>.

⁸⁷ According to this account, “Humira sales are one of the company’s four main financial targets — along with net revenues, operating margin and return on assets — that accounted for 60 percent of Gonzalez’s short-term incentive plan. The plan pays out a cash award for each of the top five executives equal to up to 200 percent of their base salary, depending on if they meet the targets and other performance measures.” Berkely Lovelace Jr., *Senate panel grills pharma CEO over executive bonuses and sales of AbbVie blockbuster drug Humira*, CNBC (February 27, 2019), <https://cnb.cx/34SluWE>.

you make a smaller bonus if you dropped the price of Humira?” In response, Gonzalez acknowledged, “It is clear it would be a part of the evaluation.”⁸⁸

The opioid crisis emerged from similar profiteering by senior managers. Opioids are a class of strong, highly addictive painkillers. Before the 1980s, many doctors refrained from prescribing such sustained pain killers following surgeries, deciding that the patient would be better suffering some discomfort over the short-term rather than risk long-term addition to pain killers. Then the opioid industry began to promote so-called scientific studies claiming that the painkillers were not addictive.^{89 90 91} It took decades before this industry link was identified and disinterested research debunked the finding.⁹² As the Centers for Disease Control and Prevention (CDC) summarized, “In the late 1990s, pharmaceutical companies reassured the medical community that patients would not become addicted to prescription opioid pain relievers, and healthcare providers began to prescribe them at greater rates. This subsequently led to widespread diversion and misuse of these medications before it became clear that these medications could indeed be highly addictive.”⁹³

But the faux findings were convenient to otherwise well intended caregivers. Private insurance favored opioid treatments over more expensive therapies. Explained one expert, “Most insurance, especially for poor people, won't pay for anything but a pill.”⁹⁴ In addition to opioids distributed through doctor prescriptions, an illegal market developed.

In fact, opioids are addictive and are readily abused. In 2000, the CDC counted approximately 8,000 fatalities from opioid abuse. By 2010, this grew to nearly 20,000 annually. In 2017, the figure surpassed 45,000.⁹⁵

Subsequent litigation laid bare the financial motivations behind the promotion of opioid sales by leading opioid manufacturers and distributors. The Sackler family, which owned Purdue Pharma, reaped generous rewards from the opioid crisis, notably its flagship brand OxyContin, which it introduced in 1996.

⁸⁸ Berkely Lovelace Jr., *Senate panel grills pharma CEO over executive bonuses and sales of AbbVie blockbuster drug Humira*, CNBC (February 27, 2019), <https://cnb.cx/34SluWE>.

⁸⁹ Subsequently, it was found that this research was unsound, and, moreover, funded secretly by the opioid industry. Danny Hakim, Roni Caryn Rabin, and William Rashbaum, *Lawsuits Lay Bare Sackler Family's Role in Opioid Crisis*, NEW YORK TIMES, <https://nyti.ms/2xJfGCI>.

⁹⁰ Richard D. DeShazo, Mckenzie Johnson, and Kathryn Rodenmyer, *Backstories on the US Opioid Epidemic: Intentions Gone Bad, and Industry Gone Rogue, and Watch Dogs Gone to Sleep*, AMERICAN JOURNAL OF MEDICINE, <https://bit.ly/2wXvsJU>.

⁹¹ For example, in 1980, a letter to the editor the New England Journal of Medicine reported that of 11,882 hospitalized patients treated with narcotics, less than 1 percent of them became addicted. The letter was subsequently “uncritically cited” in 439 articles published in scientific journals. Richard D. DeShazo, Mckenzie Johnson, and Kathryn Rodenmver, *Backstories on the US Opioid Epidemic: Intentions Gone Bad, and Industry Gone Rogue, and Watch Dogs Gone to Sleep*, AMERICAN JOURNAL OF MEDICINE, <https://bit.ly/2wXvsJU>.

⁹² Richard D. DeShazo, Mckenzie Johnson, and Kathryn Rodenmyer, *Backstories on the US Opioid Epidemic: Intentions Gone Bad, and Industry Gone Rogue, and Watch Dogs Gone to Sleep*, AMERICAN JOURNAL OF MEDICINE, <https://bit.ly/2wXvsJU>.

⁹³ *Opioid Overdose Crisis*, NATIONAL INSTITUTE ON DRUG ABUSE (February 2020), <https://bit.ly/2RTn9WK>.

⁹⁴ Owen Amos, *Why Opioids are Such an American Problem*, BBC NEWS (October 25, 2017), <https://bbc.in/3ezwaOl>.

⁹⁵ Linked from [Overdose Death Rates](#). By [National Institute on Drug Abuse](#) (NIDA). Data source is [CDC's searchable database, called CDC Wonder. 2002-2015 chart. 2002-2017 chart](#)

Even as the opioid crisis became widespread and well publicized, Sackler family members looked to capitalize further. For example, in 2011 Sackler “family members peppered the sales staff with questions about how to expand the market for the drugs.” One asked “if they could sell a generic version . . . in order to ‘capture more cost sensitive patients.’”⁹⁶

Explained one observer, “The pill is stronger than morphine and sparked the opioid crisis that’s now killing⁹⁷ more than 100 people a day in America and has spawned millions of addicts.”⁹⁸ The family had helped fund the faux science, and marketed the addictive drug aggressively.⁹⁹ Said attorney Michael Moore, who led litigation against Purdue, “Greed is the main thing. The market for OxyContin should have been much, much smaller, but they wanted to have a \$10bn drug and they didn’t tell the truth about their product.”¹⁰⁰ A group of senators concluded that Purdue’s opioid marketing campaign, which accelerated the epidemic, that has claimed an estimated 400,000 lives, grew from a “significant incentive bonus compensation for [the CEO] for achieving ambitious opioid sales targets.” The senators expressed concern that Purdue is using profits from selling more prescription opioids to reward high-level employees with massive bonuses.¹⁰¹

Eventually, litigation concerning the company’s role in the opioid crisis led the firm to declare bankruptcy. Even after that, high compensation did not abate. Even now, the congressional critics say this bonus culture persists. For example, the CEO of Purdue received a \$1.3 million incentive bonus payment even though he “is a named defendant in multiple lawsuits, which allege he personally designed Purdue’s intentionally deceptive opioid marketing campaign.” The senators noted that “the payment is based on aggressive performance incentives similar to those used to encourage opioid sales.” In conclusion, senators investigating the company argued, “By maintaining the aggressive incentive plan *for* [the CEO], the Board is showing that it does not recognize the role the incentive program played in accelerating the opioid crisis into a national tragedy”¹⁰²

Purdue is not the only company where pay fueled pill pushing. McKesson has been one of the largest distributors of opioids. Here, too, the CEO’s pay linked to hitting targets related to distribution metrics. Even in a year when McKesson faced litigation stemming from its role in the opioid crisis, the CEO received a \$4 million bonus for hitting financial targets tied to distribution,¹⁰³

⁹⁶ Danny Hakim, Roni Caryn Rabin and William K Rashbaum, *Lawsuits Lay Bare Sackler Family’s Role in Opioid Crisis*, NEW YORK TIMES (April 1, 2019), <https://nyti.ms/2VkUfRn>.

⁹⁷ *Opioid Overdose Statistics*, CENTER FOR DISEASE CONTROL, <https://bit.ly/2XPDU91>.

⁹⁸ Joanna Walters, *Meet the Sacklers: feuding over blame for the opioid crisis*, THE GUARDIAN (February 13, 2018), <https://bit.ly/2VDkh1e>.

⁹⁹ Barry Meier, *In Guilty Plea, OxyContin Maker to Pay \$600 Million*, NEW YORK TIMES (May 10, 2007), <https://nyti.ms/3akJByh>.

¹⁰⁰ Joanna Walters, *Meet the Sacklers: feuding over blame for the opioid crisis*, THE GUARDIAN (February 13, 2018), <https://bit.ly/2VDkh1e>.

¹⁰¹ Press Release, Office of Senator Tammy Baldwin, *Baldwin, Colleagues Call on Purdue Pharma to Cancel \$1.3 Million Bonus For CEO* (December 17, 2019), <https://bit.ly/3eBeWjw>.

¹⁰² Press Release, Office of Senator Tammy Baldwin, *Baldwin, Colleagues Call on Purdue Pharma to Cancel \$1.3 Million Bonus For CEO* (December 17, 2019), <https://bit.ly/3eBeWjw>.

¹⁰³ Bob Herman, *More Lawsuits roll in against opioid makers, distributors*, AXIOS (January 5, 2018), <https://bit.ly/2VtxoTZ>.

in addition to a retirement package of \$159 million.¹⁰⁴ ¹⁰⁵ Eventually, McKesson settled with the Department of Justice for \$150 million on charges that it “failed to report suspiciously large orders of prescription opioids from its pharmacy customers,” according one account.¹⁰⁶ The firm “is also contending with more than 1,000 civil suits across the U.S. related to its distribution of controlled substances.”¹⁰⁷

¹⁰⁴ Joseph Walker, *Longtime McKesson CEO to Step Down*, WALL STREET JOURNAL (Nov. 1, 2018), <https://on.wsj.com/3brzvNE>.

¹⁰⁵ The CEO also reduced compensation for its Teamster truck drivers. Erika Fry, *Big McKesson Shareholder, Governance Experts Say the Crisis Should Have Cost the CEO Some Bonus Pay*, FORTUNE (June 10, 2017), <https://bit.ly/2Vo6IUl>.

¹⁰⁶ Joseph Walker, *Longtime McKesson CEO to Step Down*, WALL STREET JOURNAL (Nov. 1, 2018), <https://on.wsj.com/2zdZVE91541112805>.

¹⁰⁷ Joseph Walker, *Longtime McKesson CEO to Step Down*, WALL STREET JOURNAL (Nov. 1, 2018), <https://on.wsj.com/2zdZVE91541112805>.