The Asset Management Industry
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INVESTMENT COMPANY INSTITUTE

MEMO# 34092

April 1, 2022

ICI Files Comment Letter on the SEC's Share Repurchase Disclosure and Insider Trading Plans Proposals

[34092]

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TO: ICI Members SUBJECTS: Closed-End Funds
Compliance
Disclosure RE: ICI Files Comment Letter on the SEC's Share Repurchase Disclosure and Insider Trading Plans Proposals

Earlier today, ICI filed the attached comment letter on two sets of Securities and Exchange Commission rulemakings intended to: modernize share repurchase disclosure ("Share Repurchase Proposal");[1] and address potentially abusive practices associated with certain trading arrangements, grants of options, and gifts of securities ("Trading Arrangements Proposal").[2] The letter strongly recommends that the Commission exclude exchange-traded closed-end funds ("funds") from each proposal.[3]

Background

The Share Repurchase Proposal would require an issuer, including a fund, to provide more frequent disclosure on proposed new Form SR describing its equity securities purchases for each day that the issuer, or an affiliated purchaser, purchases its own shares.[4] In addition, the Share Repurchase Proposal would enhance the existing periodic disclosure required about these purchases.[5]

The Trading Arrangements Proposal would require a person, including a fund, that uses a Rule 10b5-1(c)(1) trading arrangement ("trading arrangement") as an affirmative defense to an insider trading charge to adhere to several additional conditions before relying on the defense.[6] The proposed conditions would include, among other things, a "cooling-off" period of 30 days after the adoption or modification of a trading arrangement for issuers before any trading can commence.[7]

Summary of ICI's Comment Letter

ICI strongly recommends that the SEC exclude funds from the proposals. ICI notes that the proposals intend to address concerns that issuers and their "insiders"[8] would engage in abusive trading tactics either to increase company share prices to enhance executive

compensation and insider stock values or otherwise to profit from insider trading information. These concerns, however, are misplaced for funds, as fund insiders have little to no ability or incentive to engage in those practices. Funds are pass-through investment vehicles that, by their nature, inhibit a fund insider's ability to engage in the abusive trading tactics described. Fund market share prices are based primarily on a fund's NAV, which value is transparent, computed pursuant to strict pricing requirements, and promptly reflects share repurchases. The transparency provides fund shareholders with the requisite information to assess the impact that a share repurchase might have on fund share values and neutralizes any information asymmetries that fund insiders might have over fund shareholders, eliminating the need for funds to separately report repurchases. Also, fund compensation arrangements generally are not tied to fund market share prices or earnings per share directly, and ICI is unaware of any fund insiders who are compensated in fund shares or options, giving them little to no incentive to manipulate fund share prices. Accordingly, the letter strongly recommends that the Commission exclude funds from each proposal.

If the Commission determines to apply any final requirements related to the Share Repurchase Proposal to funds, then ICI strongly recommends that the SEC exclude them from the new Form SR reporting requirements and, instead, require funds to provide the daily information from the Form SR reporting requirements less frequently in their semi-annual Form N-CSR filings. If, however, the Commission applies the Form SR requirements to funds, ICI strongly recommends that it at least apply a de minimis repurchase threshold under which a fund would not be required to file the form (e.g., applying a threshold that permits a fund that purchases less than one percent of the total number of shares of that class outstanding not to file the form).

If the Commission determines to apply any additional conditions related to the Trading Arrangements Proposal to funds, the letter recommends that it at least exclude them from the 30-day cooling-off period for issuers. Imposing the requirement would inhibit funds needlessly from quickly creating, adopting, and implementing a legitimate share repurchase plan under a fund trading arrangement that takes advantage of then-current market conditions.

Kenneth Fang
Associate General Counsel

endnotes

[1] See Share Repurchase Disclosure Modernization, Securities Exchange Act Release No. 93783 (Dec. 15, 2021), available at https://www.sec.gov/rules/proposed/2021/34-93783.pdf. For a summary of the Share Repurchase Proposal, please see ICI Memorandum No. 33963 (Dec. 17, 2021), available at https://www.ici.org/memo33963.

[2] See Rule 10b5-1 and Insider Trading, Securities Exchange Act Release No. 93782 (Jan. 13, 2022), available at https://www.sec.gov/rules/proposed/2022/33-11013.pdf. For a

summary of the Trading Arrangements Proposal, please see ICI Memorandum No. 33964 (Dec. 17, 2021), available at https://www.ici.org/memo33964.

[3] For purposes of this memo and the letter, the term "funds" excludes closed-end funds that are not traded on a national securities exchange (e.g., interval funds and tender offer funds) and other investment companies registered under the Investment Company Act of 1940. The Share Repurchase Proposal appropriately would not apply to those issuers. The letter supports excluding unlisted entities, such as those issuers, that transact at the shares' net asset value ("NAV") because they repurchase or redeem their shares solely to provide their shareholders with liquidity, leaving no room for manipulation. In addition, we understand that those entities do not implement the types of trading arrangements that are the subject of the Trading Arrangements Proposal.

[4] Issuers would need to file the Form SR before the end of the business day following the day on which the issuer executes a share repurchase. The Form SR would require information about the purchases (e.g., identification of the class of securities purchased, the total number of shares purchased, the average price paid per share, the aggregated amount of shares purchased on the open market, and the aggregate total number of shares purchased in reliance on Rule 10b-18 and Rule 10b5-1 under the Securities Exchange Act of 1934).

[5] Funds would provide this disclosure on Form N-CSR. Currently, the form requires funds to provide information about fund share purchases over the period (e.g., total number of shares purchased, average price paid, number of shares purchased as part of a publicly announced plan or program, maximum number of shares that may yet be purchased), aggregated and reported on a monthly basis. The proposed Form N-CSR amendments would add requirements for a fund to disclose:

- The objective or rationale for its share repurchases and the process or criteria used to determine the amount of the repurchases;
- Any policies and procedures relating to purchases and sales of the issuer's securities by its officers and directors during a repurchase program, including any restriction on such transactions;
- Whether it made repurchases pursuant to a plan that is intended to satisfy the affirmative defense conditions of Rule 10b5-1(c) under the Securities Exchange Act, and if so, the date that the plan was adopted or terminated; and
- Whether purchases were made in reliance on the Rule 10b-18 non-exclusive safe harbor.

[6] Rule 10b5-1(c)(1) under the Securities Exchange Act provides an affirmative defense to Rule 10b-5 thereunder, for insider trading charges when trades are made pursuant to a trading arrangement (i.e., a binding contract, an instruction to another person to execute the trade for the instructing person's account, or a written plan, subject to several conditions).

[7] Other proposed conditions would:

- Require a "cooling-off" period of 120 days after the adoption or modification of a trading arrangement for directors or officers;
- Require a certification from directors and officers that they are not aware of any material non-public information about the issuer or the security when they adopt a trading arrangement and that they are adopting the contract, instruction, or plan in

good faith and not to evade insider trading prohibitions;
- Provide that the affirmative defense does not apply to multiple overlapping Rule 10b5-1 trading arrangements for open market trades in the same class of securities;
- Limit the availability of the affirmative defense for a single-trade plan to one single-trade plan during any consecutive 12-month period; and
- Require that a person asserting the affirmative defense to enter the trading arrangement in good faith and not as a plan to evade insider trading prohibitions.

[8] For purposes of this memo and the letter, we use the term "insiders" to refer to officers and directors of an issuer.
