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Reining in Abuse: SEC Proposes Amendments Regarding Rule 10b5-1 Insider Trading Plans

For years, institutional investors have been clamoring to tighten the rules governing plans that allow corporate executives to buy and sell their own companies' stock without incurring insider trading liability. On December 15, 2021, the SEC finally answered those calls and announced proposed amendments to Rule 10b5-1, which govern such plans. **page 2**

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Reining in Abuse: SEC Proposes Amendments Regarding Rule 10b5-1 Insider Trading Plans

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For years, institutional investors have been clamoring to tighten the rules governing plans that allow corporate executives to buy and sell their own companies' stock without incurring insider trading liability. On December 15, 2021, the SEC finally answered those calls and announced proposed amendments to Rule 10b5-1, which govern such plans. The SEC Commission's three Democrats and two Republicans all voted for the proposed amendments, although some did not approve of every single proposal.

"We welcome these proposed amendments, which we have long supported after seeing time and time again how corporate insiders have abused the current rule," said Steven J. Toll, co-chair of Cohen Milstein's securities litigation practice group. Julie G. Reiser, the practice group's other co-chair, concurred. "Many of the proposed changes will strengthen institutions' ability to confront illegal insider trading in the courtroom," she said.

PRE-ARRANGED TRADING PLANS THAT ALLOW CORPORATE INSIDERS TO BUY AND SELL COMPANY STOCK WITHOUT INCURRING LIABILITY, 10B5-1 PLANS HAVE BEEN CRITICIZED AS ENABLING INSIDERS TO PROFIT FROM MATERIAL NON-PUBLIC INFORMATION – THE VERY BEHAVIOR THEY WERE DESIGNED TO PREVENT.

Rule 10b5-1 and Its Abuse

Rule 10b5-1, which was adopted over 20 years ago in 2000, provides corporate insiders protection from insider trading claims if their trades were exercised according to a written pre-arranged plan that was devised before the executive was aware of any material non-public information ("MNPI"). Although these plans are not a prerequisite to an executive's sale of stock, they have become widespread because they provide an effective shield against securities fraud lawsuits.

Instead of preventing trading on MNPI, critics say these plans can enable such behavior due to design loopholes. In some circumstances, for example, insiders create multiple overlapping plans and then cancel certain plans if they learn of MNPI that likely will increase the stock price. Incredibly, the current rules allow for the cancellation of a 10b5-1 plan *even if the cancellation is based on MNPI*.

Written to address these types of problems, the proposed SEC amendments fall into two main categories: (1) restrictions to the plans themselves and (2) disclosure requirements for the plans.

Proposed Restrictions on the Plans

One of the most popular proposed amendment is to require a "cooling off period" for any trades to take place after a plan has been created. Supporters of such a restriction include former SEC Chair Jay Clayton, who was appointed by President Trump.

Currently, an insider can create a 10b5-1 plan and then execute a trade based on that plan the same day. Under the new proposal, corporate officers or directors could not trade until 120 days after establishing a 10b5-1 plan. If the trading plan is entered into by an issuer, i.e., the company itself, the cooling off period would need to be only 30 days.

Another important amendment would "eliminate the affirmative defense for any trades by a trader who has established multiple overlapping trading arrangements for open market purchases or sales of the same class of securities." This would eliminate the ability of insiders to game the system by setting up multiple plans and then later deciding to cancel certain plans that would execute trades that would result in losses.

Moreover, there is a proposal to sharply curtail the use of plans that are limited to a single-trade. Unlike what many envision Rule 10b5-1 plans to be, which is a set plan to sell securities at multiple, prearranged dates over an interval of time whether the stock is up or down, single-trade plans are set up to execute just a single trade at one moment in time. Some have argued single-trade plans are not "plans" at all, but more equivalent to a date-triggered order and should be completely prohibited under Rule 10b5-1. A recent Stanford study from January 2021 found that single-trade plans generally avoided losses of some four percent, indicating their abuse.[1] Therefore, the SEC now proposes to limit their use to only one plan per 12-month period. Although the SEC does not propose banning single-trade plans, partly because they envision legitimate, one-time liquidity needs for such a plan, they did invite the public to make the case for a ban when submitting their comments.

'WE WELCOME THESE PROPOSED AMENDMENTS, WHICH WE HAVE LONG SUPPORTED AFTER SEEING TIME AND TIME AGAIN HOW CORPORATE INSIDERS HAVE ABUSED THE CURRENT RULE,' SAID STEVEN J. TOLL, CO-CHAIR OF COHEN MILSTEIN'S SECURITIES LITIGATION PRACTICE GROUP.

Finally, while current rules require that the plans be **entered into** in good faith, a proposed amendment would require them to be **operated** in good faith. According to the SEC, this amendment "is intended to make clear that the affirmative defense would not be available to a trader that cancels or modifies their plan in an effort to evade the prohibitions of the rule or uses their influence to affect the timing of a corporate disclosure to occur before or after a planned trade under a trading arrangement to make such trade more profitable or to avoid or reduce a loss."

Proposed New Disclosure Requirements

On the disclosure front, the proposed amendments would require issuers to disclose their policies and procedures on insider trading. The disclosure of such policies would be required annually and must also "provide detailed and meaningful information," such as how the issuer ensures compliance.

In addition, issuers would need to disclose their option grant policies and exhibit a tabular showing of all option grants they made within 14 days of the disclosure of nonpublic information, while also disclosing the market price of the security the trading day before and after such release of information. These disclosures would make it easier to detect likely links between knowledge of MNPI and manipulated trades.

1 *See* David F. Larcker, Bradford Lynch, Philip Quinn, Brian Tayan, and Daniel J. Taylor, Gaming the System: Three Red Flags" of Potential 10b5-1 Abuse, Stanford Closer Look Series, January 19, 2021.

Under the proposed rules, issuers would need to disclose each quarter any adoption or termination of Rule 10b5-1 plans by its directors, officers, or the issuer. Currently, issuers are not required to disclose such plans. In fact, executives do not even have to say whether the trades they report on SEC Form 4 were made pursuant to such a plan.

Public Response

The SEC has invited public comments to the proposed rules, which must be received within 45 days of their publication in the Federal Register. Although the proposed amendments were announced on December 15, 2021, they have yet to be published in the Federal Register, so the deadline clock has not yet started to tick.

So far, there have been very few substantive comments submitted through the formal process; most are terse statements from individuals. One of the most consequential comments comes from the Securities Industry and Financial Markets Association ("SIFMA"), which complained of the limited time allotted for public comments without providing any commentary on the proposed rules. SIFMA's critique echoed one by Commissioner Elad Roisman the day the proposed amendments were announced. Roisman, one of the SEC's two Republican members until he resigned effective January 21, said the 45-day limit was "shorter than our customary comment periods, which have typically been 90 or at least 60 days." He also noted that the period for commentary falls over several major holidays.

Two Republican U.S. Senators followed with the same criticism in a letter to SEC Chairman Gary Gensler on January 10, 2022. Senators Pat Toomey (R-Pa.) and Patrick McHenry (R-N.C.) expressed dismay at the "unprecedented pattern" of issuing proposed rules with shorter comment periods, especially considering they were issued during the holiday season. They noted that customarily more time is allotted for public comments and that then-President Barack Obama recommended federal agencies allow at least 60 days and sometimes 120 days for commentary depending on the complexity of the issues.

The SEC has so far refused to extend the 45-day period for comments, which starts after the proposed amendments are published in the Federal Register. In the past, the SEC would have published the proposed rules in the Federal Register by now, something that generally happens two to three weeks after an announcement. The SEC, however, did reissue the proposed rule on January 13, 2022 without any substantive changes. It is not yet clear whether the delay in the proposed amendments' publication in the Federal Register or its reissuance on January 13 is a way of extending the deadline without appearing to bend to outside pressure.

Although they have not yet provided a formal comment, the Council of Institutional Investors ("CII") applauded the SEC for the proposed amendments, many of which were suggested in CII's rule-making petition to the SEC nearly a decade ago. ■

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GROUND-BREAKING SETTLEMENT REACHED IN PINTEREST SHAREHOLDER DERIVATIVE LITIGATION

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THE SETTLEMENT IS THE FIRST OF ITS KIND TO EMBRACE DIVERSITY GOALS AROUND A COMPANY'S PRODUCT AND REQUIRES PINTEREST TO COMMIT $50 MILLION TO WORKPLACE AND BOARD-LEVEL REFORMS DESIGNED TO PROTECT EMPLOYEES FROM DISCRIMINATORY TREATMENT AND TO PROMOTE DIVERSITY.

Pinterest, Inc. has agreed to spend $50 million on workplace reforms to settle a lawsuit in which the lead plaintiff Employees' Retirement System of Rhode Island ("ERSRI"), represented by Cohen Milstein, alleged the company's leadership fostered a culture of racial and gender bias that caused financial and reputational harm to Pinterest. Cohen Milstein has filed with the court a motion for preliminary approval of the settlement on behalf of ERSI and other Pinterest shareholders.

Originally filed by Cohen Milstein on November 30, 2020, *In re Pinterest Derivative Litigation*, Lead Case No. 3:20-cv-08331-WHA, alleged that officers and directors, including Pinterest Chairman and Chief Executive Officer Ben Silbermann, Co-Founder and Board of Directors ("Board") member Evan Sharp, and Chief Financial Officer Todd Morgenfeld, breached their fiduciary duties by waste of corporate assets, abuse of control, and violation of Section 14(a) of the Securities Exchange Act of 1934.

Pinterest is an online visual discovery engine people use to find lifestyle inspiration, including ideas for recipes, home decor, style, travel destinations, and more. Pinterest launched in 2010 and has hundreds of millions of primarily female monthly active users around the world.

The case stems from an allegedly systematic culture, policy, and practice of illegal discrimination on the basis of race and sex at Pinterest that goes back to at least February 2018. Top Pinterest executives and members of its Board of Directors personally engaged in, facilitated, or knowingly ignored the discrimination and retaliation against people who spoke up and challenged the company's white, male leadership clique. As a result of defendants' illegal misconduct, the company's financial position and its goodwill and reputation among its user base (which Pinterest's success depends upon) were harmed and continued to be harmed.

Prior to filing the complaint, plaintiffs began to build their case by obtaining documents pursuant

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to a Section 220 books and records demand. After briefing an opposition to defendants' motion to dismiss, the parties agreed to explore mediation and ultimately agreed to a settlement. The settlement is the first of its kind to embrace diversity goals around a company's product. It also requires Pinterest to commit $50 million to a holistic set of workplace and board-level reforms designed to protect employees from discriminatory treatment and to promote diversity, equity, and inclusion (DEI) throughout its workplace and product. Key requirements of the settlement include:

- Release of former employees from non-disclosure agreements ("NDAs") who want to discuss the facts of their mistreatment.
- The Audit Committee of Pinterest's Board will be responsible for the implementation and oversight over certain reforms designed to create equal opportunities for employees.
- A Board member will act as a co-sponsor with the CEO for diversity, equity, and inclusion initiatives, which will help ensure accountability exists for Pinterest's top executives.
- The company will conduct external bi-annual pay equity audits that review performance ratings, promotions, and compensation across gender and racial categories.
- Diversity reports to shareholders will describe progress made in implementing pay equity and DEI goals.

The settlement also requires enhancements to Pinterest's recruiting, hiring, and training. Combined, these reforms will substantially increase the value of the company for its investors and help ensure its continued future growth, as well as improve the workplace experience for Pinterest's employees.

"We pushed for these sweeping reforms to support Pinterest's employees with a fair and safe workplace, and to strengthen the company's brand and performance by ensuring that the values of inclusiveness are made central to Pinterest's identity," said Rhode Island General Treasurer Seth Magaziner on behalf of ERSRI. "This holistic approach will fundamentally support and positively impact Pinterest's workplace culture in the years to come."

A preliminary approval hearing is scheduled for January 27, 2022. ■

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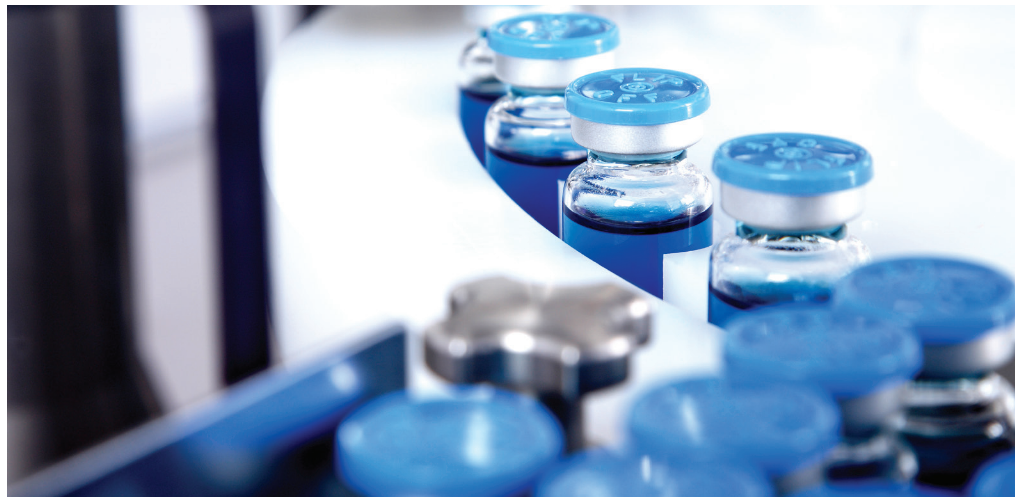
"WE PUSHED FOR THESE SWEEPING REFORMS TO SUPPORT PINTEREST'S EMPLOYEES WITH A FAIR AND SAFE WORKPLACE, AND TO STRENGTHEN THE COMPANY'S BRAND AND PERFORMANCE BY ENSURING THAT THE VALUES OF INCLUSIVENESS ARE MADE CENTRAL TO PINTEREST'S IDENTITY," RHODE ISLAND GENERAL TREASURER SETH MAGAZINER ON BEHALF OF THE STATE'S PENSION FUND, WHICH LED THE SUIT.

COHEN MILSTEIN APPOINTED TO REPRESENT FORMER CELGENE SHAREHOLDERS IN SUIT AGAINST BRISTOL-MYERS SQUIBB



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On December 22, 2021, the Hon. Jesse M. Furman of the U.S. District Court for the Southern District of New York appointed Cohen Milstein's client, Mangrove Partners Master Fund ("Mangrove"), as the lead plaintiff in a securities fraud lawsuit against Bristol-Myers Squibb ("BMY") and its officers and directors.

The security at issue in this case is not common stock, but rather a type of security known as a contingent value right ("CVR"), which former Celgene Corporation shareholders received as part of BMY's acquisition of Celgene. Each CVR entitled its holder to a $9 payment if BMY received Food and Drug Administration ("FDA") approval of three drugs (previously in development by Celgene) by specified target dates. Because BMY failed to obtain timely FDA approval for one of those drugs by its target date at the end of 2020—the cancer drug Liso-cel—the company was able to avoid the entire payout to CVR holders, which was estimated to be around $7.4 billion.

In October 2021, a group of investment funds (the "Group") filed a complaint alleging that BMY had slow-walked the approval process for Liso-cel despite having told investors in a proxy statement about the Celgene acquisition that it would diligently pursue approval of the three drugs on which the CVR payout depended. The initial complaint did not challenge any statements made in the nearly two years between the proxy statement and target date for approval of Liso-cel, even though the defendants had made numerous statements in that time about how they were diligently pursuing FDA approval.

With a few days left before the 60-day statutory deadline to apply to serve as lead plaintiff, Cohen Milstein filed a lawsuit on behalf of individual investor Ehab Khalil with similar claims and a longer class period that encompassed more of defendants' statements about Liso-cel approval.

Mangrove and the Group filed competing motions for appointment as lead plaintiff. The parties' briefing centered on two main issues. The first was whether Khalil's complaint was substantially different from the initial complaint, in which case it would be necessary to issue a new notice and restart the 60-day period to file lead-plaintiff motions. Judge Furman ruled that the allegations in the two complaints arose from the same course of events—misleading statements about the FDA approval process for Liso-cel—and thus a new notice was not necessary.

The second issue was whom to select as lead plaintiff. Mangrove was the presumptive lead plaintiff under the statutory scheme and the approach followed by the courts—selecting the movant with the largest financial stake in the litigation as measured by using the longest class period of the related complaints. The Group argued, however, that the court should determine the movants' financial stake based only on the claims and class period contained in the initial complaint, because only the initial complaint was "properly noticed." This argument was unsupported by case law, and it was mooted by the court's ruling that a new notice and notice period were not required for Khalil's complaint.

The Group also argued that Mangrove should not be appointed lead plaintiff because its claim to having the largest financial stake relied on a class-period-expanding complaint filed by another Cohen Milstein client just days before the lead-plaintiff deadline. Judge Furman explained that there was no reason to suspect an improper motive behind the timing of Khalil's complaint. And, picking up on an argument in Mangrove's briefs, he probed the Group about why its own complaint had not included more claims and a broader class period—a seemingly strategic choice that maximized the Group's chances of being appointed lead plaintiff.

Finally, the Group asked the Court to appoint it as a separate lead plaintiff for those Celgene shareholders who received CVR's in the merger and to appoint Mangrove as a lead plaintiff for those who purchased CVR's in the open market after the merger became effective. The Court rejected that argument. Ruling from the bench, Judge Furman appointed Mangrove as lead plaintiff for the entire case and all the claims and approved its selection of Cohen Milstein as lead counsel. The case is *In re Bristol-Myers Squibb Co. CVR Securities Litigation* (S.D.N.Y.) 1:21-cv-8255 (JMF). ■

PLAINTIFFS ALLEGE THAT BY "SLOW-WALKING" THE APPROVAL PROCESS FOR A DRUG IN DEVELOPMENT, BRISTOL-MYERS SQUIBB UNLAWFULLY AVOIDED PAYING $7.4 BILLION TO FORMER CELGENE SHAREHOLDERS WHO HAD RECEIVED A SECURITY KNOWN AS CONTINGENT VALUE RIGHT ("CVR") AS PART OF BRISTOL-MYERS SQUIBB'S 2019 ACQUISITION OF CELGENE.

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SEVENTH CIRCUIT REFUSES TO ENFORCE A FORUM BYLAW THAT WOULD HAVE DEPRIVED BOEING INVESTORS OF THEIR RIGHT TO ASSERT A DERIVATIVE ACTION UNDER THE EXCHANGE ACT

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In December 2019, the Seafarers Pension Plan ("Seafarers"), represented by Cohen Milstein, filed a derivative action in federal district court in Chicago under Section 14(a) of the Securities Exchange Act of 1934 ("Exchange Act"), alleging that The Boeing Company's ("Boeing") board members and officers made materially false and misleading statements about the development and operation of the 737 MAX airplane in Boeing's 2017, 2018, and 2019 proxy materials. Seafarers alleged that these false and misleading statements caused stockholders to re-elect directors who for years had countenanced the poor oversight of passenger safety, regulatory compliance, and risk management during the 737 MAX's development, to approve Boeing's executive compensation plans, and to reject a shareholder proposal to separate the CEO and Chair positions, thereby causing massive harm to Boeing.

Boeing's directors and officers moved to dismiss, seeking to enforce Boeing's forum bylaw, which strips federal courts of their exclusive jurisdiction over derivative Exchange Act claims by designating the Delaware Court of Chancery—a state court without jurisdiction over these federal claims—as the exclusive jurisdiction for all derivative claims asserted on Boeing's behalf. The district court agreed, and the Seafarers Pension Plan appealed the decision to the United States Court of Appeals for the Seventh Circuit. In January 2022, a panel of the Seventh Circuit issued a 2-1 opinion, *Seafarers Pension Plan v. Bradway*, No. 20-2244, — F.4th — (7th Cir. 2022) ("*Seafarers*"), reversing the district court's decision to enforce Boeing's forum bylaw against the Seafarers' derivative Section 14(a) claims and finding the bylaw unenforceable under both Delaware and federal law.

The Seventh Circuit held that "[b]ecause the federal Exchange Act gives federal courts exclusive jurisdiction over actions under it, applying the bylaw to this case would mean that plaintiff's derivative Section 14(a) action may not be heard in any forum. That result would be contrary to Delaware corporation law, which respects the non-waiver provision in Section 29(a) of the federal Exchange Act, 15 U.S.C. § 78cc(a)." Notably, the anti-waiver provision in the Exchange Act prevents parties from opting out of that federal law in favor of state law, regardless of any similarities between the laws.

The Seventh Circuit found Delaware law, including Section 115 of the Delaware General Corporation Law ("DGCL"), prohibits Delaware corporations from using a forum bylaw to "foreclose entirely" a stockholder's derivative action under Section 14(a). The Seventh Circuit found two key phrases in Section 115 determinative: "consistent with applicable jurisdictional requirements" and "courts in this State." First, the Seventh Circuit held that as applied, Boeing's bylaw violates Section 115 because it is "inconsistent with" the Exchange Act's jurisdictional requirement providing for cases to be heard in federal court. As support for this reading of the statute, the Seventh Circuit cited Section 115's synopsis, stating, "Section 115 is also not intended to authorize a provision that purports to foreclose suit in a federal court based on federal jurisdiction, nor is Section 115 intended to limit or expand the jurisdiction of the Court of Chancery...." Second, the Seventh Circuit explained that references to courts "in" a state include both state and federal courts located in the state, as opposed to courts "of" a state. The Seventh Circuit also noted that the Delaware Supreme Court's decision in *Salzberg v. Sciabacucchi*, 227 A.3d 102 (Del. 2020), supported this interpretation, stating, "*Salzberg* expressly presumed the reference to 'courts in the state' in the bylaws authorized by the new Section 115 included federal courts," and pointing out that Boeing's bylaw did not include federal courts. Further, the Seventh Circuit rejected the defendants' argument that *Salzberg* allows such a bylaw under Section 109(b) of the DGCL, emphasizing that *Salzberg* stressed the "harmony between Delaware corporation law and federal securities laws" when it stated: "This Court has viewed the overlap of federal and state law in the disclosure area as 'historic,' 'compatible,' and 'complimentary.'"

Turning to federal law, the Seventh Circuit distinguished federal cases where the federal courts had enforced forum provisions in international agreements, including the seminal U.S. Supreme Court decision, *M/S Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1 (1972). Notably, the Seventh Circuit stated that "*Bremen* differs from this case most importantly in that it involved a purely private contractual dispute" and did not involve a federal claim or a federal statute with a non-waiver provision like Section

IN JANUARY 2022, THE SEVENTH CIRCUIT REVERSED A DISTRICT COURT'S DECISION TO ENFORCE BOEING'S FORUM BYLAW AGAINST THE SEAFARERS PENSION PLAN'S DERIVATIVE SECTION 14(A) CLAIMS AND FOUND THE BYLAW UNENFORCEABLE UNDER BOTH DELAWARE AND FEDERAL LAW.

THE APPEALS COURT'S DECISION IS AN IMPORTANT WIN FOR INVESTORS. IT TELLS COMPANIES THEY CANNOT USE A FORUM SELECTION BYLAW TO CLOSE THE COURTHOUSE DOORS TO INVESTORS ASSERTING FEDERAL-ONLY DERIVATIVE CLAIMS.

29(a) of the Exchange Act. The Seventh Circuit further reasoned that in international business transactions, the "presumptive validity" of choice of law and forum provisions offer predictability. However, extending forum provisions to "domestic investments" where the provisions waive federal securities rights and remedies and limit available remedies to those under state law "would undermine the pivotal decisions by Congress in 1933 and 1934 to assume the dominant role in securities regulation after decades of ineffective state regulation." The Seventh Circuit also looked to the U.S. Supreme Court's warning in *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth Corp.*, 473 U.S. 614 (1985) that "in the event that the choice-of-forum and choice-of-law clauses operated in tandem as a prospective waiver of a party's right to purse statutory remedies for antitrust violations, we would have little hesitation in condemning the agreement as against public policy."

The Seventh Circuit majority rejected the dissent's "novel proposal" to allow a "Delaware state court to hear a derivative action under Section 14(a), despite the Exchange Act's provision for exclusive federal jurisdiction" as inconsistent with Delaware law, the Exchange Act's anti-waiver provisions, and U.S. Supreme Court decisions. Accordingly, the Seventh Circuit held that Boeing's forum provision, as applied, "was contrary to Delaware corporation law and federal securities law" because it deprived the federal courts of their exclusive authority to hear derivative Exchange Act claims.

The Seventh Circuit's decision is an important win for investors. It tells companies they cannot use a forum bylaw to close the courthouse doors to investors asserting federal only derivative claims. ■

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FIDUCIARY FOCUS

MASSACHUSETTS PRIM BOARD IS LATEST TO INCREASE ALLOCATION TO DIVERSE INVESTMENT MANAGERS

Last November, the Massachusetts Pension Reserves Investment Board ("MassPRIM") approved $1 billion in investments for emerging and diverse managers over the next two years. MassPRIM's announcement represented part of the fund's broader $96 billion strategy to meet its FUTURE initiative, which seeks to substantially increase allocation to diverse and emerging managers to at least 20 percent of assets under management. The FUTURE initiative was created to help MassPRIM meet diversity goals originally established in a bill championed by Massachusetts State Treasurer Deborah Goldberg, who chairs MassPRIM. Treasurer Goldberg said that "by investing $1 billion into emerging-diverse program, [PRIM] is taking important steps in addressing the inequities endemic in the financial sector."

Goldberg's FUTURE initiative is the most recent example of public employee pension funds' leadership and prioritization of diversity in investments. Efforts by public funds to diversify investment managers can be traced to early adopters like the New York Common Retirement Fund ("NYSCRF"), the California Public Employees Retirement System ("CalPERS"), and the California State Teachers' Retirement System ("CalSTRS"). The emerging managers program established by the $248 billion NYSCRF in 1994 has $6.7 billion in commitments, for example.

Efforts by both public and private institutional investors to improve their records of hiring diverse asset managers appeared to gain new urgency following the nationwide protests over racial inequality sparked by the murder of George Floyd by a Minneapolis police officer.

In October 2020, Illinois State Treasurer Michael Frerichs led a national effort urging Russell 3000 companies to disclose racial, ethnic, and gender data about their board of directors. In September 2020, Connecticut State Treasurer Shawn Wooden partnered with the Ford Foundation to put together a coalition of CEOs "to advance social change, racial justice, and greater economic prosperity for all."

On the private investment side, Vanguard said in December 2020 that it would vote against directors who do not push for more racial and gender diversity on their company's boards. In December 2021, BlackRock, the world's largest asset manager, announced that its 2022 proxy voting guidelines would push U.S. companies to "aspire to 30% diversity" on their boards of directors and encourage them to include least two women directors and at least one director from an underrepresented group on their boards. BlackRock defined underrepresented groups as those including "individuals who identify as Black or African American, Hispanic or Latinx, Asian, Native American or Alaska Native, or Native Hawaiian or Pacific Islander; individuals who identify as LGBTQ+; individuals with disabilities; and veterans." That same month, Goldman Sachs updated its proxy policies to say

it expected large corporations—those listed in the S&P 500 and FTSE 100—"to have at least one diverse director from an underrepresented ethnic minority group on their board" and all public companies with boards larger than 10 members to include at least two women directors. And in his 2022 letter to portfolio company boards, State Street Global Advisors ("SSGA") CEO and President Cyrus Taraporevala reiterated SSGA's "belief that strong, capable, independent boards exercising effective oversight are the linchpin to create long-term shareholder value." Announcing an enhancement to State Street's gender diversity policy, Taraporevala said SSGA was prepared to vote against board leaders if their companies did not have at least one female director by 2022 and 30 percent female representation in 2023. He also repeated SSGA's pledge to expand its diversity focus to include race and ethnicity, pledging "voting action against responsible directors" of S&P 500 and FTSE 100 companies that do not have a "person of color" on their boards or failed to disclose information about their boards' racial and ethnic makeups.

Despite the historical efforts by pension funds to diversify investment managers and the more recent developments of both public and private institutional investors to diversify company board of directors, however, some institutional investors remain reluctant to embrace the concept of diversity. The argument falls back to economist Milton Friedman who argued in a 1970 *New York Times* article that the social responsibility of businesses should focus on increasing profits, not "providing employment" or "eliminating discrimination." More recently, *The Wall Street Journal*'s editorial board referred to such diversity initiatives as "virtue signaling at the expense of someone else." In other words, they believe diversity falls outside an institutional investor's fiduciary duty to maximize risk-adjusted returns for its beneficiaries.

THERE ARE SEVERAL STRONG ARGUMENTS THAT PENSION FUNDS CAN SQUARE THEIR LONG AND ESTABLISHED PURSUIT OF DIVERSIFYING INVESTMENT MANAGERS WHILE MEETING THEIR FIDUCIARY DUTIES.

Yet there are several strong arguments that pension funds can square their long and established pursuit of diversifying investment managers while meeting their fiduciary duties.

First, extensive research suggests that corporate diversity results in better financial performance. The Carlyle Group, a private equity manager, found a positive correlation between board diversity and profits among the companies it holds in its investment portfolio. The Carlyle Group's study, which examined the last three years of financial results, showed that companies with at least two diverse directors out-earned less diverse companies by 12 percent per year on average. Using 2019 data, meanwhile, Global management firm McKinsey & Company ("McKinsey") found that companies in the top quartile for racial and ethnic diversity on executive teams were 33 percent more likely to have above-average profitability than companies in the bottom quartile. Consulting firm FSG recently conducted a six-month study of 12 leading companies and found these companies generated new sources of growth and profit by advancing racial equity.

Second, evidence suggests that diversity creates better governance and informs better decision-making. Research indicates that diverse groups perform better than like-minded groups because such diversity results in more careful information processing that's absent in homogenous groups.

EXTENSIVE RESEARCH SUGGESTS THAT CORPORATE DIVERSITY RESULTS IN BETTER FINANCIAL PERFORMANCE. THERE IS ALSO EVIDENCE THAT DIVERSITY CREATES BETTER GOVERNANCE AND INFORMS BETTER DECISION-MAKING.

Diversity has another benefit, too: diverse firms can help mitigate risk. Studies have found that diverse board of directors, particularly those with gender diversity, approve less financially risky policies than homogenous board of directors. Furthermore, diversity can help reduce litigation risks. In 2020 alone, the United States Equal Employment Commission secured $440 million from victims of discrimination. Such discrimination can also harm the reputation of a company or institutional investor.

Finally, public pension funds can factor diversity as part of their fiduciary duty. The most recent guidance comes from the U.S. Department of Labor's October 2021 proposed rule on duties of prudence and loyalty for investments. In the Department's proposed rule, fiduciaries may give "appropriate consideration" of environmental, social, and governance ("ESG") factors for investments when carrying out a risk-return analysis. Specifically, the proposed rule cites workplace diversity and inclusion as an example of ESG factors. The Department's proposed rule then cites 15 different studies in which diversity has a material impact on employee recruitment and return, performance and productivity, and litigation. Among the studies and reports cited are the McKinsey and FSG ones discussed above.

For years, some scholars and others adhered to the idea that increasing diversity doesn't meet fiduciary standards because it sacrifices beneficiaries' financial interests in the name of a purely "social" goal. However, public pension funds like NYSCRF, CalPERS, and CalSTRS have long demonstrated the opposite: that institutional investors with more diverse staff, boards, and investment managers can make more money over the long term. As the country grapples with continuing gaps in opportunity for underrepresented populations, the need for diversity seems even more evident. As most recently demonstrated by MassPRIM's FUTURE initiative, a well-designed program that considers diversity no longer raises any real fiduciary questions. Those questions have been answered by the Department of Labor's proposed rules and associated studies. Now, the real question becomes whether more institutional investors will follow the lead of these public pension funds. ■

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COHENMILSTEIN IN THE NEWS

- "Omicron Spike Forces Plaintiffs Firms to Reassess Trial and Case Strategy," *The National Law Journal* – January 14, 2022
- "Investor Alleges Nikola Board Was Blind to Fraud," *Law360* – January 13, 2022
- "Boeing Investors Get 737 Max Crash Litigation Revived on Appeal," *Bloomberg Law* – January 7, 2022
- "Google $13 Million Street View Privacy Deal Survives Appeal Bid," *Bloomberg Law* – December 27, 2021
- "Chicken Price-Fixing Deals Totaling $181M Get Final OK," *Law360* – December 21, 2021
- "Ex-Kruse Western Worker Advances $244 Million Stock Plan Suit," *Bloomberg Law* – December 14, 2021
- "The SEC Whistleblower Program's First Decade: $1 Billion in Awards and Counting," *The National Law Journal* – December 2, 2021
- "Performance Sports Investors Score $13M Deal in Fraud Suit," *Law360* – December 2, 2021
- "Pinterest Agrees to Spend $50 Million on Reforms to Resolve Discrimination Allegations," *The New York Times* – November 24, 2021
- "Judge Approves Over $600 Million Settlement in Flint Water Crisis, With Children Set to Benefit," *The Washington Post* – November 11, 2021
- "SolarWinds Hit with Del. Derivative Suit Over Sunburst Hack," *Law360* – November 5, 2021
- "BlackRock's $9.65 Million 401(k) Settlement Clears Final Hurdle," *Bloomberg Law* – November 4, 2021
- "When Bullish Finance Stories Are Not Exactly What They Appear," *Columbia Journalism Review* – October 29, 2021
- "Mandatory Arbitration at Work Surges Despite Efforts to Curb It," *Bloomberg Law* – October 28, 2021
- "Bayer Must Face Some Investor Allegations on Roundup Deal Risks," *Bloomberg Law* – October 20, 2021
- "Dignity Health Judge Blesses $100M ERISA Deal on Third Try," *Law360* – October 19, 2021
- "Stiffed Investors Win Arbitration Cases, but Never See a Dime. Do Regulators Have a Fix?" *Barron's* – October 18, 2021
- "Reforming Dodd-Frank from the Whistleblower's Vantage," *American Business Law Journal* – October 14, 2021
- "Whistleblowers Are Key to Protecting SPAC Investors," *Bloomberg Law* – October 13, 2021

AWARDS & ACCOLADES

- Cohen Milstein Recognized as a *Law360* "Practice Group of the Year" in Three Categories: Benefits; Class Actions; and Employment. – January 18, 2022
- Cohen Milstein Named to *Law360*'s Inaugural List of "Pulse Prestige Leaders," – December 13, 2021
- Cohen Milstein Recognized Among the Top Firms Nationally in ERISA and Labor & Employment Litigation by *U.S. News – Best Lawyers* "Best Law Firms" – November 5, 2021
- Cohen Milstein Named to *Law360*'s Inaugural List of "Pulse Social Impact Leaders," – November 1, 2021
- Six Cohen Milstein Attorneys – Including Securities Litigation & Investor Protection Attorneys Christopher E. Lometti and Laura H. Posner – Recognized in 2021 Edition of *New York Metro Super Lawyers* – October 1, 2021

UPCOMING EVENTS

- **February 17-22** | National Labor & Management Conference (NLMC) 45th Annual Conference, Diplomat Beach Resort, Hollywood, FL – Arthur Coia
- **February 26-28** | National Association of State Retirement Administrators (NASRA) Winter Meeting, Westin Washington, Washington, DC – Richard Lorant and Julie Goldsmith Reiser
- **March 13-15** | National Association of State Treasurers (NAST) 2022 Legislative Conference, The Watergate Hotel, Washington, DC – Jay Chaudhuri and Julie Goldsmith Reiser
- **March 20-22** | County Commissioners Association of Pennsylvania (CCAP) Spring Conference, Hilton Harrisburg, Harrisburg, PA – David Maser
- **April 23-6** | Texas Association of Public Employee Retirement Systems (TEXPERS), 2022 Annual Conference, Worthington Renaissance, Fort Worth, TX – John Dominguez and Richard Lorant

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> “I need to be satisfied that no stone has been left unturned so that I have all the facts I need to consider when evaluating whether there was securities fraud.”

Catherine A. Torell is the Director of Securities Research and Analysis and a member of the Securities Litigation & Investor Protection practice group. Cathy joined the firm in 2002 and draws on her more than 30 years of experience in securities litigation to research the factual and legal merits of every filed federal securities fraud class action. Cathy's analyses are integral to how the firm's clients are advised of the potential importance of a case. For this issue of the Shareholder Advocate, *Cathy talked with Editor Christina Saler.*

I have lived … on Long Island, New York since I was four years old. My parents bought a home in Smithtown where one of my siblings still lives today. With two older brothers, two older sisters and always a large German Shepherd dog, our home was a busy place. Today, I live about thirteen minutes from my childhood home and, to the surprise of my family, my husband and I have gravitated to tiny dogs. We have had six Yorkies over the years who couldn't be more different (and spoiled!) than the German Shepherds I had growing up.

I have wanted to be a lawyer since … the fourth grade. At the time, I would read every true crime book that I could find in the library. I was intrigued by the investigations that led to identification, capture and ultimate convictions of criminals. It has always been so important to me that wrongdoers not get away with their offenses—and I feel that way about our cases. In college, I was a pre-law and political science major. My plan was to work a few years in the legal profession as a paralegal, go to law school and then become a prosecutor. The paralegal position I took was with a plaintiff's firm specializing in securities fraud litigation. I worked at that same firm during summers throughout law school and realized that investigating and prosecuting securities fraud was just as interesting to me as the true crimes I had read about as a child.

My favorite aspect of analyzing cases … is the investigation part of sifting through SEC filings, analyst reports, news articles and all the information I can dig up to try and put the pieces together to determine if the company and its officers and directors misled investors. I need to be satisfied that no stone has been left unturned so that I have all the facts I need to consider when evaluating whether there was securities fraud.

I'm currently watching … the NBC television show *The Blacklist*. James Spader is a high profile criminal who, in exchange for immunity, works with the FBI to find the most dangerous criminals that he encountered while in the underworld. The show is in its ninth season and worth watching if you like Spader and crime thrillers. ■

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