

March 3, 2006 - STOCK Act Fact Check

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Washington, DC - Rep. Louise M. Slaughter (D-NY-28), Ranking Member of the House Rules Committee, today issued the following explanation of the STOCK Act which she recently co-authored with Rep. Brian Baird (D-WA-3).

SUMMARY of S.T.O.C.K. (Stop Trading on Congressional Knowledge) Act

- Prohibits members or employees of Congress from buying or selling stocks, bonds, or commodities futures based on nonpublic information about pending or prospective legislative action.

- Prohibits those outside of Congress from buying or selling stocks, bonds, or commodities futures based on nonpublic information about pending or prospective legislative action if that information is obtained from a member or employee of Congress.

- Prohibits members, employees, or persons with nonpublic information from disclosing information about any pending or prospective legislative action if they believe that information will be used to buy or sell stocks, bonds, or commodities futures.

- Requires members of Congress and employees to report the purchase, sale, or exchange of any stock, bond, or commodities future in excess of \$1,000 within 30 days. Members and employees who choose to place their stock holdings in blind trusts or mutual funds are exempt from this reporting requirement.

- Requires firms that specialize in "political intelligence" and obtain their information directly from Congress to register

with the House and Senate, much like lobbying firms are now required to do.

MYTH vs. FACT

MYTH: Congressional insider trading is already a violation of current insider trading laws.

FACT: Just as anyone else, Members of Congress and staffers are subject to current insider trading laws. However, current insider trading laws do not apply to nonpublic information about current or upcoming congressional activity.

EXAMPLE 1

The CEO of Company A is in a private meeting in the office of Congressman B. During the meeting, Company A's CEO tells Congressman B that their recently launched product is defective and that they are going to announce next week a full recall of the product. This information has not been shared with the public. After the meeting, Congressman B sells all of his stock in Company A. **THIS IS ILLEGAL UNDER CURRENT INSIDER TRADING LAWS.**

EXAMPLE 2

Congressman B learns that the Chairman of the Appropriations Committee has decided to provide a multi-million dollar defense contract for Company A in the Defense Appropriations bill. This information has not been released to the public, but will almost certainly drive Company A's stock price up when it becomes public knowledge. Congressman B buys stock in Company A. THIS IS NOT ILLEGAL UNDER CURRENT INSIDER TRADING LAWS, AND IS WHAT THE LEGISLATION ADDRESSES.

Under current insider trading laws, there are two basic ways in which a person can be held liable for insider trading.

First, an insider of the company may not trade in the company's stock on the basis of material nonpublic information about the company. An insider of the company is anyone who is an agent or fiduciary of the company or someone who otherwise owes a duty of trust or confidence to the company.

Second, under the misappropriation theory of insider trading, the person does not need to owe a fiduciary duty to the company. However, to be held liable, the person must violate a fiduciary duty to the source of the information. House Rules do not clearly imply that Members of Congress or their staffers have a duty of confidentiality to Congress and it would be difficult to conclude that there was such a duty. The work of Congress depends on open lines of communication between Members and constituents and organizations. For this reason, if we want this practice to be illegal, we must create a broader prohibition that does not require a duty of confidentiality.

"If a congressman learns that his committee is about to do something that would affect a company, he can go trade on that because he is not obligated to keep that information confidential.... He is not breaching a duty of confidentiality to anybody and therefore would not be liable for insider trading."

- Thomas Newkirk, a partner with law firm Jenner & Block and a former official with the SEC's enforcement division, as quoted in Wall Street Journal, "Bill Seeks to Ban Insider Trading By Lawmakers and Their Aides" (3/28/06)

"Effective regulation of problematic Congressional trading thus requires a broader prohibition than the securities law definition of insider trading."

- Steven Bainbridge, Professor of Law at UCLA, who teaches or has taught Business Associations, Unincorporated Business Associations, Advanced Corporation Law, Corporate Finance, Securities Regulation, and Mergers and Acquisition, in "Insiders on The Hill" (<http://www.tcsdaily.com/article.aspx?id=033006D>)

MYTH: Even if congressional insider trading is not covered by current insider trading laws, congressional insider trading is illegal under other laws.

FACT: In 1958, the House of Representatives adopted the Code of Ethics for Government Service into its Ethics Rules. Clause 8 of the Code of Ethics states that "Any person in Government service should...[n]ever use any information coming to him confidentially in the performance of governmental duties as a means for making a private profit." However,

this is a House Rule, enforceable only by the House Ethics Committee on an internal basis, and not a law under which a Member or staffer can be prosecuted. Recent years have proven that House Ethics Rules are rarely, if ever enforced. In those cases where they are enforced, Members receive little more than a slap on the wrist. In addition, there is currently no mechanism in place within the House to track and monitor this. If we want to put an end to this practice, we must develop a new law that can and will be enforced.

In addition, the Code of Ethics for Government Service has not been adopted by the Senate and therefore does not apply to Senators or Senate staffers.

Finally, House Rules do not have any effect on those outside of the House. The Code of Ethics for Government Service has no impact on "political intelligence" firms who gather information from Members of Congress or their staffers and share that information with outside investors. In addition to shutting down congressional insider trading by Members and staffers, the legislation will prohibit trading based on information gathered and sold by "political intelligence" firms.

MYTH: The legislation imposes onerous disclosure requirements on Members and staffers.

FACT: If a Member of Congress or staffer otherwise required to make financial disclosures under House Rules holds his or her stocks in a blind trust or mutual fund, there are no new disclosure requirements. However, if a Member or staffer trades stocks outside of a blind trust or mutual fund, and the value of a trade exceed \$1,000, he or she will have to disclose the trade within 30 days. Under current House Rules, Members and staffers have to report these trades once per year.

30 days is the same length of time required for disclosure of privately-funded congressional trips. In addition, this reported requirement is far less onerous than that imposed on corporate leaders who have to report within 48 hours.

MYTH: This law will have no practicable effect because congressional insider trading is not a problem.

FACT: In December of last year in an article entitled "Washington Whispers to Wall Street," BusinessWeek reported that the political intelligence business started with a couple of cottage firms in the early 1970's and has grown to an industry which is estimated to earn between \$30 million and \$40 million a year. Prominent players include the Washington research shops of Prudential, Lehman Brothers, and Stanford Washington Research Group, owned by Stanford Financial Group of Houston.