

United States Senate

SELECT COMMITTEE ON ETHICS
HART SENATE OFFICE BUILDING, ROOM 220
SECOND AND CONSTITUTION AVENUE, NE
WASHINGTON, DC 20510-6425

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Restrictions on Insider Trading Under Securities Laws and Ethics Rules

Below you will find an explanation of the new insider trading provision that was enacted as a part of the Stop Trading on Congressional Knowledge Act of 2012 (STOCK Act) on April 4, 2012. This memorandum also describes the existing laws, rules, and standards that prohibit insider trading. If you have any questions, want to discuss your particular circumstances, or wish to arrange a briefing on this topic, you are strongly encouraged to contact the Ethics Committee's staff at (202) 224-2981.

The STOCK Act clarified and confirmed that Members and staff, like members of the general public, are prohibited from engaging in insider trading. It is not intended, however, to chill legitimate communications made in good faith between public officials and their constituents, inhibit government transparency, or otherwise hinder the dissemination of public information about government activities.

What is Insider Trading?

“Insider trading” is the use of material, nonpublic information to purchase or sell a security, including using confidential information gained because of one’s Senate position to make a profit or avoid a loss. “Material” information is what a reasonable investor would want to know when making an investment decision. “Nonpublic” means confidential or not widely disseminated to the public. A “security” is broadly defined to include stocks, bonds, and other types of investments.

Federal Securities Laws Bar Insider Trading by Anyone, including Senators and Staff

This section describes the securities laws, including the STOCK Act, that prohibit anyone from trading on the basis of material, nonpublic information with the intent to deceive, manipulate, or defraud. The laws also prohibit people from disclosing confidential information or “tipping” another to trade when they intended to personally benefit from that disclosure. Conversely, inadvertently sharing information in good faith, without the intent to benefit from such disclosure, is not enough to violate securities laws. Moreover, while Senators and staff are prohibited from using *nonpublic* information for making a trade, a great deal of Congressional work is conducted on the *public* record or in the public realm during committee hearings and markups, floor activity, and speeches.

The New Insider Trading Provision. The STOCK Act amended the existing securities laws to clarify and confirm that each Senator and staff person is prohibited from insider trading because they owe:

a duty arising from a relationship of trust and confidence to the Congress, the United States Government, and the citizens of the United States with respect to material, nonpublic information derived from such person's position as a Member of Congress or employee of Congress or gained from the performance of such person's official responsibilities.*

This means that Members and staff who trade on material, nonpublic information gained in the performance of their official duties may have breached that duty and, thus, violated the law if they acted with the intent to deceive, manipulate, or defraud. A willful or knowing violation may be prosecuted criminally, with substantial fines and imprisonment. Civil violations are also subject to fines.

Existing Securities Law Prohibits Trading on Information Obtained Through Official Duties. Securities laws prohibit anyone from misappropriating material, nonpublic information in violation of a duty of trust or confidence owed to the source of the information, such as an employer. Members and staffers could violate a federal anti-fraud regulation of the Securities and Exchange Commission, Rule 10b-5, by purchasing securities based on information obtained in the course of their official duties, or derived from their Senate position, if that information was material and nonpublic and they breached the duty of trust and confidence described above.

Existing Securities Law Prohibits Passing on Inside Information to Others Who Trade. It is also impermissible to pass on material, nonpublic information to others who may profit themselves or help the "tipper" to profit. Members or staffers who are tippers of material, nonpublic information may be liable if they breached their duty of confidentiality by tipping another individual who then trades, and they receive some resulting direct or indirect personal benefit, be it financial, reputational, or otherwise. For example, a benefit may result when a tipper seeks to make a gift to a trading friend or relative by passing on material, nonpublic information. The Member or staffer must have expected to receive a personal benefit – and cannot have solely made an inadvertent disclosure or shared information in good faith without expecting to receive a personal benefit.

The Existing Prohibitions Apply Outside of Your Senate Duties, Too. Furthermore, Members and staff, just like all members of the public, are prohibited from insider trading based on information received outside of their official duties. For example, if a corporate insider "tips" a Senator or staffer to trade in that corporation's securities based on material, nonpublic information and the Senator or staffer knew or should have known that there was a breach of the insider's fiduciary duty to the corporation's shareholders, the Senator or staffer becomes subject to the insider's duty and is prohibited from trading based on that confidential information.

* Pub. L. No. 112-105, § 4(b) (Apr. 4, 2012).

Government Ethics Rules Also Bar Insider Trading

Insider trading is also prohibited by the federal government ethics standards and rules discussed below, violations of which may serve as grounds for action by the Committee.

Federal Government Ethics Standards. The Code of Ethics for Government Service, which contains general ethical principles for all federal government officials, restricts the use of nonpublic information for private gain. Specifically, paragraph 8 states that a Senator or staffer shall “[n]ever use any information coming to him confidentially in the performance of governmental duties as a means for making private profit.” “Confidential information” is nonpublic information that Members or staff gain because of their Senate position and reasonably know is not publicly available.

Additionally, paragraph 2 of the Code states that any person in government service should “[u]phold the Constitution, laws, and legal regulations of the United States and of all governments therein and never be a party to their evasion.” Other paragraphs of the Code state that government officials must “[p]ut loyalty to the highest moral principles and the country” above loyalty to others, and to uphold all of these principles, “ever conscious that public office is a public trust.”

Senate Nondisclosure Rules. Senate rules prohibit disclosing or misusing confidential information. Senate Rule 29.5 states:

Any Senator, officer, or employee of the Senate, who shall disclose the secret or confidential business or proceedings of the Senate, including the business and proceedings of the committees, subcommittees and offices of the Senate, shall be liable, if a Senator, to suffer expulsion from the body; and if an officer or employee, to [suffer] dismissal from the service of the Senate, and to punishment for contempt.

This rule applies to information obtained in a variety of circumstances, including information received in a closed, nonpublic hearing; information gathered during the confidential stages of a committee investigation; and classified national security information. Members’ personal offices and Senate committees may impose additional, more specific rules on the confidential treatment of certain types of information in their offices.

Senate Conflicts of Interest Rules. Additionally, the Senate’s main conflict of interest rule (Rule 37.1) prohibits Members and staff from “cashing in” on their official positions:

A Member, officer, or employee of the Senate shall not receive any compensation, nor shall he permit any compensation to accrue to his beneficial interest from any source, the receipt or accrual of which would occur by virtue of influence improperly exerted from his position as a Member, officer, or employee.

The Senators who drafted the rule intended “that this paragraph should be read as a broad prohibition against members, officers or employees deriving financial benefit, directly or

indirectly, from use of their official position[s].” Another provision (Rule 37.7) requires committee staff to divest themselves of “any substantial holdings which may be directly affected” by the actions of their Committees.

Senate Gifts Rule. The Senate gifts rule (Rule 35) also prohibits Members and staff from using inside information when trading and defines a “gift” to include any gratuity, favor, or other item with a monetary value. Accordingly, Members and staff who use a “tip” of material, nonpublic information to buy or sell securities in order to make a profit or avoid a loss would have received an improper gift.

In sum, those who intentionally use confidential information coming to them by virtue of their Senate responsibilities or position to make a profit or avoid a loss, or to assist others to do so, will be deemed to have violated ethics standards and rules, engaged in conduct reflecting discredit on the Senate, and potentially violated securities laws and regulations.