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# INSIDER TRADING IN CONGRESS

*Who Do Our Representatives Really Serve?*

*Image courtesy of Politico*

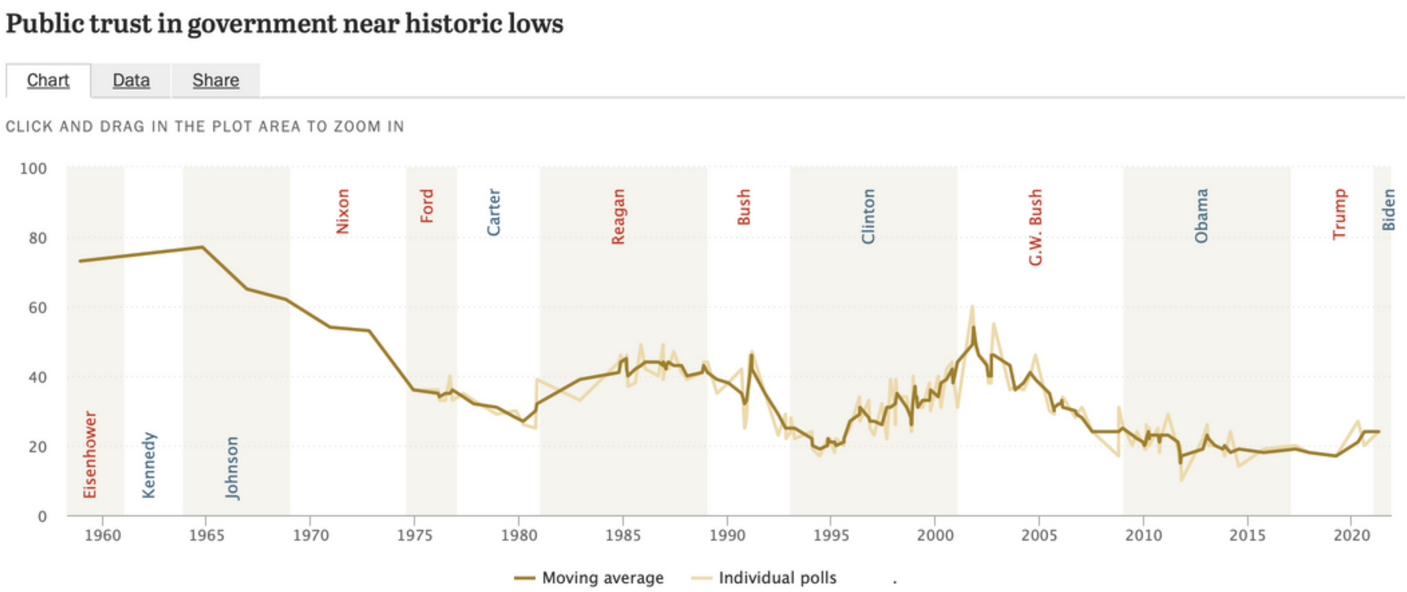
*An explainer by Catherine Flaherty*

# INTRODUCTION

On January 24th, 2020, U.S. Senators sat in on a private meeting with the Committees on Health and Foreign Relations where top health officials briefed them on the significance of the Covid-19 outbreak and its potential effect on the United States. Shortly after - and before the news became public - at least three Senators began to sell millions in shares of travel and hospitality companies and buy stock in telework and biotech companies.

The timing of these trades raises concerns about transparency in Congress. Our representatives have access to private information on a wide range of issues affecting our country - from the economy to healthcare to defense. Often, they draft policies or advocate for legislation based on this knowledge before it enters the public sphere. However, if a Congress member begins to invest in a defense company and then the government enters a contract with them, what mechanisms are in place to ensure that there is no conflict of interest?

Only one-quarter of the American public expresses trust in government officials on Capitol Hill. Not only does this affect the efficiency and integrity of Congress, but it also erodes the democratic values that define us as a nation. If policymakers want more support, stricter insider trading laws is but one of many routes Congress can take to build back public trust in their institution.




*Graph courtesy of Pew Research Center*

# WHAT IS INSIDER TRADING?

Insider trading is the buying and selling of a public company's stock based on non-public information. In many instances, this practice is illegal under the U.S. Securities and Exchange Commission (SEC) rules because the information has the potential to change the value of a stock once made public. Among other things, the SEC outlines that violations may include disclosures of "significant capital investment plans… negotiations concerning acquisitions or dispositions… major new contracts… a change in control or significant change in management… or financial results." For those who do participate, harsh penalties are set in place that involve fines up to $5 million or imprisonment for up to 20 years.

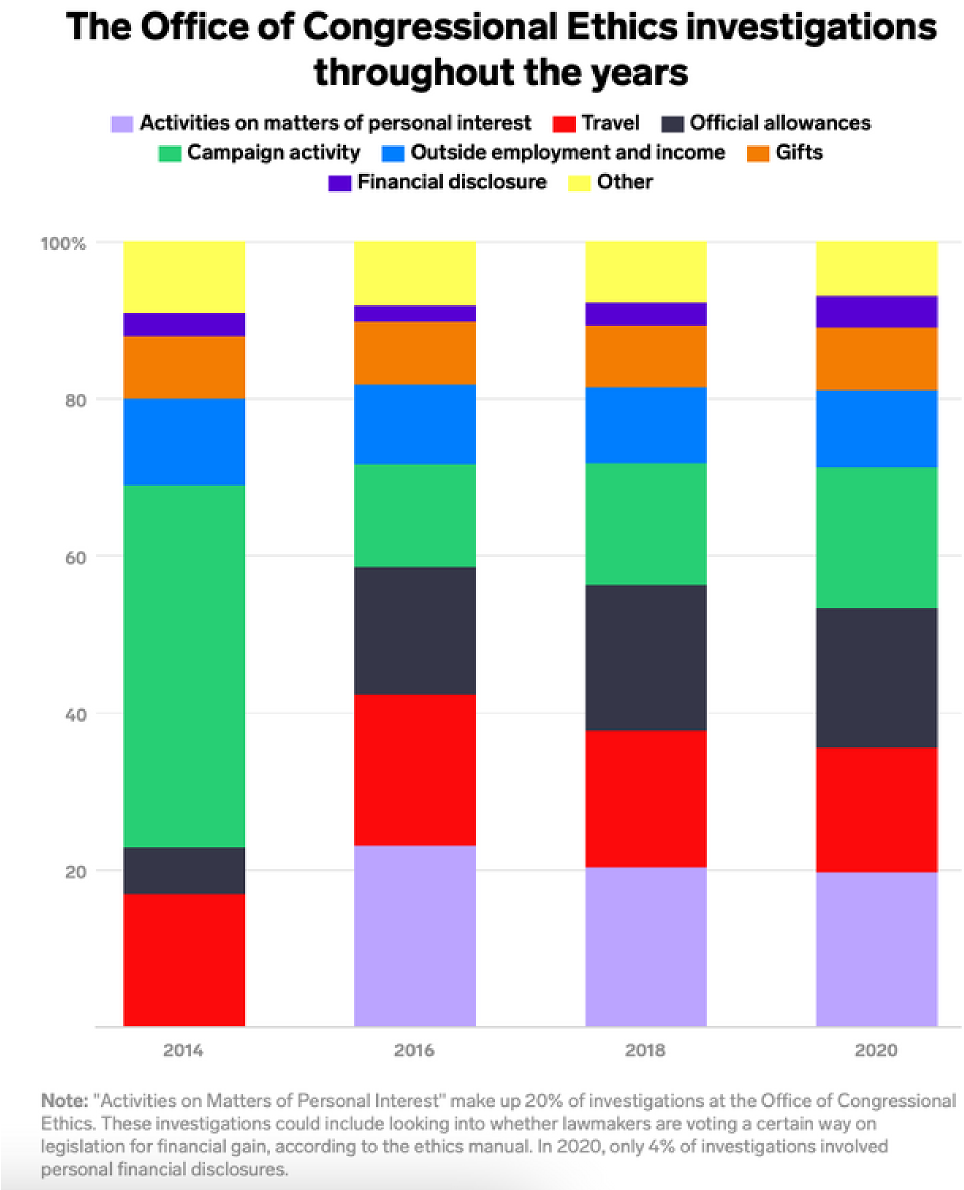
Rules against insider trading are necessary to ensure fair participation in markets. If a market is - or appears to be - already rigged in favor of leaders who have access to sensitive information, the general public is likely to be discouraged from investing because the risks would be higher in comparison to individuals who already have information about upcoming market shifts or advancements. Members of Congress, who are tasked with representing the public's interests in the highest legislative body in the nation, must be able to make decisions independent of any personal financial gains. If not, trust in political institutions - just as it would in economic markets - will only decline.

# THE STOCK ACT OF 2012

Up until the last decade, congressional insider trading was legal and widespread. However, growing concerns after the Great Recession about both the role of money in politics and the integrity of public servants triggered a reevaluation of trading requirements. The Stop Trading on Congressional Knowledge (STOCK) Act was passed in April 2012 as an amendment to the Ethics in Government Act of 1978, which had created the original standards of disclosing financial information to the public. And, despite the increasingly polarized climate, it received overwhelming bipartisan support - winning with margins of 96-3 in the Senate and 417-2 in the House.

The STOCK Act applies to all members of Congress, employees of Congress, executive branch employees (including the President and Vice President) and various other judicial and ethics office members. It requires that reports of investment transactions over $1,000 be filed within 45 days of a trade, and that all financial disclosures be made publicly available on agency websites and databases. The STOCK Act also mandates the disclosure of mortgage payments and prohibits special access to Initial Public Offerings (IPOs). It helped streamline a reporting process that was previously ambiguous.

However, the STOCK Act's enforcement system is still minimal and inconsistent, and there is no government database that tracks violations or fines. First offenders are supposed to be fined $200, but there is no way of knowing if the fines were actually enforced and paid. It "entirely depends on the honor system," as explained by a senior congressional aide, and financial disclosure investigations conducted by the Office of Congressional Ethics comprise less than 4% of their annual caseload.




*Graph courtesy of Business Insider*

# HOW HAVE CURRENT LAWS BEEN EXPLOITED?

Despite the STOCK Act, a 2021 analysis of congressional financial documents revealed that 54 Congress members and 182 senior-level staffers were in direct violation of conflict-of-interest laws. Additionally in 2021, Congressional members and their immediate families bought $267 million and sold $364 million worth of assets, with their returns on stock investments higher than the average of the American public.

Included in these numbers are the following representatives and how much they failed to timely disclose:

- Rep. Pat Fallon (R-TX) - dozens of trades worth over $17 million
- Rep. Diana Harshbarger (R-TN) - more than 700 trades worth over $10 million
- Rep. Susie Lee (D-NV) - over 200 trades worth over $3 million
- Rep. Kevin Hern (R-OK) - nearly two-dozen stocks worth over $2.5 million
- Rep. Kim Schrier (D-WA) - over $1 million in Apple stock

Additionally:

- While promoting legislation that would benefit the cannabis industry, Rep. John Yarmuth (D-KY) bought stock in several cannabis companies
- After an aerospace company's president testified before a congressional subcommittee, Rep. Brian Mast (R-FL) purchased $100,000 of their stock
- The wife of Sen. Rand Paul (R-KY) bought stock in pharmaceutical companies in the first few weeks of the pandemic
- In January 2020 following an initial briefing on Covid-19, Sen. Dianne Feinstein (D-CA), Kelly Loeffler (R-GA), and Richard Burr (R-NC) sold millions in travel and hospitality companies and bought stock in telework and biotech companies

# WHY YOU SHOULD CARE

Elected officials have a duty to serve their constituency to the best of their ability, and voters should be able to trust that their representative's actions are made in good faith. Requiring financial disclosure statements and enforcing rules against insider trading help minimize various conflicts of interests surrounding legislative decisions. Our representatives should not have the option of putting personal financial gain over their duty to serve the American people. Doing so undermines our entire democratic process and threatens to leave our nation's sacred legislative body up to the discretion of broader market forces.

# WHAT SOLUTIONS HAVE BEEN PROPOSED?

**Idea #1**

Reformists have considered that lawmakers who hold stocks in the area or companies discussed in proposed legislation should recuse themselves from voting. However, the issue with this proposal is significant. The highest duty that a Congress member has is to cast their vote in accordance with their constituency's values, and to silence their vote is to refuse the representation of tens of thousands of Americans.

**Idea #2**

Others have suggested that investing in any stock related to a legislators' committee assignment should be prohibited. However, the characteristics of a particular stock and its relation to a committee could be subjective, which could make the enforcement process inconsistent and inefficient.

**Idea #3**

The most practical solution to dramatically reduce conflict of interests is to ban lawmakers from trading stocks except those held in a blind trust. Through this option, investment portfolios would be managed by independent trustees and would not require knowledge or consent of the beneficiary. The Transparent Representation Upholding Service and Trust in Congress (TRUST) Act and the Ban Congressional Stock Trading Act would require all Congress members and their families. Currently, there are only 10 members of Congress who opt for their portfolio to be managed through a blind trust.

# CONCLUDING THOUGHTS

Members of the U.S. Congress are responsible for sponsoring and passing legislation that affect over 330 million citizens domestically and billions around the world. Their policy decisions - on issues ranging from military defense to healthcare to cannabis - affect every aspect of our lives. Should legislatures choose to rebuild public trust in their institution and eliminate any perceived or actual conflict of interests, stricter insider trading laws should be considered. If not, the public has the right to question who Congress really serves - the American people, the market, or themselves.

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