112TH CONGRESS
2d Session

SENATE

REPORT
112–244

STOCK ACT

R E P O R T

OF THE

COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS UNITED STATES SENATE

TO ACCOMPANY

S. 2038

TO PROHIBIT MEMBERS OF CONGRESS AND EMPLOYEES OF CONGRESS FROM USING NONPUBLIC INFORMATION DERIVED FROM THEIR OFFICIAL POSITIONS FOR PERSONAL BENEFIT, AND FOR OTHER PURPOSES

DECEMBER 3, 2012.—Ordered to be printed

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Mr. LIEBERMAN, from the Committee on Homeland Security and Governmental Affairs, submitted the following

R E P O R T

[To accompany S. 2038]

The Committee on Homeland Security and Governmental Affairs, having considered an original bill (S. 2038) to prohibit Members of Congress and employees of Congress from using nonpublic information derived from their official positions for personal benefit, and for other purposes, having considered the same, reports favorably thereon and recommends that the bill do pass.

CONTENTS

I. PURPOSE AND SUMMARY

The Stop Trading on Congressional Knowledge Act of 2012 (STOCK Act), S. 2038, responds to concerns that Members of Congress and their staff may be exempt from laws prohibiting persons from engaging in financial transactions based on so-called insider information. It amends securities and commodities laws to make clear that Members and staff are not so exempt, and it amends financial disclosure laws to ensure that Members and their staffs more quickly and transparently report their financial transactions.

II. BACKGROUND AND NEED FOR THE LEGISLATION

During the ordinary course of their work, Members of Congress and congressional staff sometimes come into possession of nonpublic information about matters that could affect the value of stocks, commodities, or other financial instruments. Several observ-

ers have recently suggested that some Members of Congress and their staffs have profited by using such "insider information" to make timely investments.[1]

Two studies of the investments of Members of Congress reached different conclusions about whether the performance of those investments suggests that Members have traded in financial markets on the basis of nonpublic information. One study, conducted in 2004 by Dr. Alan Ziobrowski, a Professor at the Robinson College of Business at Georgia State University, found what he termed "abnormal returns" in the individual stock transactions of some Senators over the period of 1993 to 1998.[2] Analyzing the purchases and sales of Senators who reported transactions on their annual financial disclosure reports over that period, Dr. Ziobrowski reported that the investments of those Senators outperformed the market by nearly 1% per month.[3] The data underlying the Ziobrowski study, though, show that a minority of Senators were buying or selling individual stocks in a given year (ranging from 25 to 38 Senators in each of the years studied) and that just four Senators collectively accounted for nearly half of all the transactions in the sample.[4]

A 2011 study analyzing the stock portfolios of Members of Congress reached a different conclusion than the Ziobrowski study. Andrew Eggers of the London School of Economics and Jens Hainmueller of the Massachusetts Institute of Technology found that, between 2004 and 2008, the average investor in Congress *underperformed* the market by 2–3% annually.[5] Eggers and Hainmueller reconstructed the daily holdings of the 422 Members of the House and Senate who reported owning U.S. stocks in this period. The authors concluded that "the evidence for congressional 'insider trading' is in fact surprisingly weak"[6] and found Members of Congress, overall, to be "rather poor investors."[7] The authors posited that "the most likely explanation for the poor performance of members of Congress is that they are simply not that different from other investors."[8]

These studies, yielding different results, do not provide a definitive answer about Members' investing behavior. The Committee nonetheless concluded that it is of the utmost importance for the American people to have full confidence that all Members of Congress act to serve the American people rather than their own financial interests. It therefore reported S. 2038 to establish a clear policy that insider trading will not be tolerated within the halls of Congress, and to ensure that any instances of insider trading by

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[1] *See, e.g.*, Brody Mullins *et al.*, Congress Staffers Gain from Trading in Stocks, Wall St. J., Oct. 11, 2010; Peter Schweizer, Throw Them All Out (2011); 60 Minutes: Insiders (CBS television broadcast, Nov. 13, 2011).

[2] Alan J. Ziobrowski *et al.*, Abnormal Returns from the Common Stock Investments of the U.S. Senate, 39 J. Fin. & Quantitative Analysis 661 (2004) ("Ziobrowski study"). In testimony before Congress, Dr. Ziobrowski explained that the "abnormal returns" he found in his study were the difference in profits earned by Members of Congress and profits earned by the market as a whole. Statement of Alan J. Ziobrowski before the Subcommittee on Oversight and Investigations, House Committee on Financial Services (July 13, 2009), p. 3.

[3] Ziobrowski study, p. 15.

[4] *Id.* at 6.

[5] Andrew Eggers and Jens Hainmueller, Capitol Losses: The Mediocre Performance of Congressional Stock Portfolios, 2004–2008 (December 2, 2011), http://www.mit.edu/jhainm/Paper/Eggmueller_CapitolLosses.pdf.

[6] *Id.* at 2.

[7] *Id.* at 3.

[8] *Id.* at 22.

Members or their staff will be subject to the same civil and criminal laws that apply to everyone else.

Insider trading

There is no statute that specifically prohibits insider trading—by Congress or anyone else. Rather, the law governing insider trading is based on many years of court decisions interpreting section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act"),[9] which grants the Securities and Exchange Commission (SEC) broad authority to prohibit "manipulative and deceptive devices" in connection with the purchase or sale of securities, and the associated SEC Rule 10b–5,[10] which broadly prohibits fraud and deception in connection with the purchase or sale of securities.

Under the relevant court decisions, it is a violation of section 10(b) of the Exchange Act and Rule 10b–5 to trade securities on the basis of material, nonpublic information in violation of a fiduciary or other similar relationship of trust or confidence—a duty that is owed either to the corporation's shareholders (the "classical theory" of insider trading liability) or to the source of the information (the "misappropriation theory").

The archetypical example of the classical theory of insider trading liability is the corporate insider who buys or sells shares of the company he works for based on material nonpublic information obtained on the job. The Supreme Court explained in *Chiarella* v. *United States* that trading on such information violates Rule 10b–5 because "a relationship of trust and confidence [exists] between the shareholders of a corporation and those insiders who have obtained confidential information by reason of their position with that corporation."[11] The classical theory applies to corporate insiders—officers, directors and employees of a corporation—as well as to "temporary" insiders such as attorneys, accountants and consultants to a corporation.[12] Rule 10b–5 also reaches those who "tip" material, nonpublic information to others who trade, as well as "tippees" who trade on such information.[13]

The misappropriation theory—the one more likely to be applied in a case of insider trading by a Member of Congress—was first accepted by the Supreme Court in 1997, in the case of United States vs. O'Hagan.[14] In that case, the defendant was a lawyer at a firm that represented the offeror in a tender offer for the Pillsbury company. The SEC alleged that the defendant learned of the upcoming tender offer from another lawyer at the firm and bought shares in Pillsbury before the offer was announced. Although the defendant did not have a fiduciary or other duty to the shareholders of Pillsbury—as would be traditionally required under the classical theory of insider trading liability—the Court nonetheless held that he could be prosecuted for violations of section 10(b) and Rule 10b–5, because he breached a duty he owed to the source of the nonpublic information about the tender offer—his own law firm.

Neither Congress nor the courts have ever excluded Members of Congress or any other category of individuals from the insider trad-

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[9] 15 U.S.C. § 78j(b).
[10] 17 C.F.R. 240.10b–5.
[11] 445 U.S. 222, 228 (1980).
[12] *Dirks* v. *SEC*, 463 U.S. 646, 655 n.14 (1983).
[13] *Dirks* v. *SEC*, 463 U.S. at 660–62.
[14] 521 U.S. 642 (1997).

ing laws. Some have observed, however, that the case law, as developed by decades of court rulings, may present challenges to the SEC or the Department of Justice (DOJ) in pursuing a case against a Member of Congress.[15] On December 1, 2011, the Committee held a hearing to obtain a better understanding of these challenges.[16] On the specific legal issue of the reach of section 10(b) and Rule 10b–5, the Committee heard testimony from three distinguished securites experts, Professor Donna Nagy of the Indiana University Maurer School of Law, Professor Donald Langevoort of Georgetown University Law Center, and Professor John Coffee, Jr. of Columbia Law School. Mr. Robert Khuzami, Director of the Division of Enforcement of the SEC also submitted a written statement for the record.

The witnesses were in agreement that Congress enjoys no exemption from insider trading law.[17] Professor Coffee laid out a number of specific factual scenarios that could allow, in his opinion, the SEC to successfully prosecute a Member of Congress—for example, if a Member traded on material non-public information relating to a tender offer (conduct which is prohibited by SEC Rule 14e–3),[18] or if a Member knowingly received a "gift of information" from an insider who would himself or herself be barred from trading.[19]

The witnesses did not have a uniform view, though, on how courts might apply the misappropriation theory to Members of Congress. The specific question in dispute is this: If a Member traded (or tipped) on the basis of material nonpublic information gained during the course of the Member's public service, would a court find that the Member owed a duty of trust and confidence to the source of the information that had been violated by the act of trading (or tipping)? For example, if a Member learned in a confidential briefing by agency officials of an upcoming regulatory action that would have a substantial impact on the stock price of a particular company, could the Member be held liable for insider trading for trading or tipping on the basis of that information?

Professor Nagy pointed out that "[p]rosecutors and courts have cast a tremendously wide net" in applying Rule 10b–5, and that "the linchpin has been a securities trader (or tipper) who breached a duty of entrustment by secretly profiting from the use of material nonpublic information that rightfully belongs to somebody else."[20] As an example, Professor Nagy cited a recent case involving a chemist at the Food and Drug Administration (FDA) who was charged with violating the law when he traded on material nonpublic information about pending drug approvals that he obtained as a result of his job. The chemist was alleged to have breached his duty of trust and confidence to his employer in using that infor-

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[15] *See, e.g.*, Stephen M. Bainbridge, Insider Trading Inside the Beltway, 36 J. Corp. L. 281 (2011).

[16] Insider Trading and Congressional Accountability: Hearing Before the Senate Committee on Homeland Security and Governmental Affairs, 112th Cong. (Dec. 1, 2011) [hereinafter ____ Testimony at HSGAC Hearing Dec. 1, 2011].

[17] Professor Donna Nagy testimony at HSGAC Hearing Dec. 1, 2011 at page 1; Professor Donald Langevoort testimony at HSGAC Hearing Dec. 1, 2011 at page 2; Professor John Coffee testimony at HSGAC Hearing Dec. 1, 2011 at page 4; Robert Khuzami written testimony submitted for HSGAC Hearing Dec. 1, 2011 at page 5.

[18] 17 C.F.R. § 240.14e–3.

[19] Coffee testimony at HSGAC Hearing Dec. 1, 2011 at page 3.

[20] Nagy testimony at HSGAC Hearing Dec. 1, 2011 at page 4.

mation to trade securities.[21] Likewise, Professor Nagy submitted, congressional employees would be liable for insider trading based on well-established employer-employee misappropriation precedents.[22]

While acknowledging that Members of Congress may not be considered traditional "employees" of the federal government, Professor Nagy noted the Constitution's repeated reference to public offices being held in "trust" and concluded that there should be little doubt that Members of Congress owe duties of trust and confidence to a host of parties. According to Professor Nagy, such duties may be owed to, among others, the citizen-investors they serve, the United States, the Congress itself, and federal officials outside of Congress who rely on a Member's loyalty and integrity.[23]

Professors Langevoort and Coffee agreed with Professor Nagy that congressional staff have a clear employment relationship with Congress and therefore owe a duty of trust and confidence to Congress with respect to material nonpublic information gained as a result of their employment.[24] They questioned, though, whether courts would find that the unique nature of an elected office of Congress gives rise to a fiduciary-like duty owed by Members of Congress to anybody. Professor Langevoort submitted:

> [A]s elected officials, members of Congress are not employees or agents in any conventional sense, and so it becomes difficult to identify a separate owner of the information to which they owe a legally enforceable fiduciary duty of loyalty. Under our constitutional system, duly elected Members have a status separate and distinct from that of partner, agent or employee, far different from those with whom in mind the misappropriation theory was devised.[25]

A very strong argument can be made that Members of Congress can be prosecuted under the insider trading prohibitions in existence today. However, given the uncertainty that exists in how a Court would ultimately rule on this issue, it is incumbent upon Congress to eliminate any doubt and state clearly that the insider trading laws that apply to the general public also apply to Members of Congress. The Committee agrees with Professor Langevoort's explanation of the importance of clarifying that the insider trading prohibitions apply to Members of Congress:

> [T]he prohibition performs an expressive function in signaling to the people of the U.S. and around the world that

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[21] *SEC* v. *Cheng Yi Liang, et al.,* Exchange Act Rel. No. 21097 (March 29, 2011), http://www.sec.gov/litigation/litreleases/2011/lr21907.htm.

[22] *Id.* at 5. Mr. Khuzami cited to other cases involving federal employees: *United States* v. *Royer*, 549 F.3d 886 (2d. Cir. 2008) (affirming conviction of a FBI agent for tipping information about ongoing investigations and information on law enforcement databases); *SEC* v. *John Acree*, Litigation Rel. No. 14231, 57 SEC Docket 1579 (Sept. 13, 1994) (announcing a settled action with a former employee of the Office of the Comptroller of the Currency for trading on the basis of material nonpublic information concerning banks). *See also SEC* v. *Saunders*, Litigation Rel. No. 9744, 26 SEC Docket 75 (Sept. 2, 1981) (announcing settled action with the former Director for Communications for a division of the Naval Electronics Systems Command for purchasing securities while in possession of material nonpublic information concerning a contract award).

[23] Nagy testimony at HSGAC Hearing Dec. 1, 2001 at page 5. Professor Nagy is also the author of a law review article explaining her theory. Donna M. Nagy, Insider Trading, Congressional Officials and Duties of Entrustment, 91 B.U.L. Rev. 1105 (2011).

[24] Langevoort testimony at HSGAC Hearing Dec. 1, 2011 at page 9; Coffee testimony at HSGAC Hearing Dec. 1, 2011 at page 5.

[25] Langevoort testimony at HSGAC Hearing Dec. 1, 2011 at page 7.

> our markets are open, transparent and fair, and not rigged in favor of the economically or politically powerful. It is part of the American brand of deep and liquid capital markets that invite participation by ordinary retail investors as well as large financial institutions. Public trust in the openness and fairness of marketplace institutions is important for economic stability and growth . . . Just the perception (whether or not accurate) that Congress is "above" the prohibition that applies broadly outside of Capitol Hill threatens our long-standing commitment to fair and open markets.[26]

S. 2038 thus affirms that, under the insider trading prohibitions, Members of Congress and their staff owe a duty arising from a relationship of "trust and confidence" to Congress, the United States Government, and to the citizens of the United States. This ensures that Members and staff are subject to the same liabilities and remedies as any other person who violates the securities laws.

Additionally, the bill provides for similar coverage of Members and their staffs under commodities laws. Unlike the body of law covering securities trading under SEC Rule 10b–5, the commodities laws have not given rise to a broad prohibition on insider trading. The recent Dodd-Frank legislation, however, included provisions explicitly prohibiting federal executive branch employees from engaging in commodities trading based on nonpublic information gained as a result of their jobs.[27] S. 2038 amends these provisions to also cover Members of Congress and their staffs.

The bill also amends the Ethics in Government Act[28] to shorten the time in which Members and staff must report covered stock and securities transactions to 30 days. Members and high-level congressional staff currently have to report such transactions only once a year, as part of their annual financial disclosure forms. Consistent with Justice Brandeis' adage that "sunlight is the best disinfectant," the bill will provide more timely information about these transactions and ensure the public has prompt access to the information.

"Political Intelligence"

Other versions of the STOCK Act referred to the Committee (S. 1871 and S. 1903) also would amend the Lobbying Disclosure Act (LDA)[29] to require the disclosure and registration of people involved in collecting "political intelligence." Such individuals contact congressional or Executive branch officials seeking information about possible government actions regarding particular companies or industries. After gathering such information, political intelligence consultants then analyze, package, and sell the resulting product to, among others, individuals or companies who use the material to inform investment decisions. It is the Committee's understanding that the term "political intelligence" was intended to capture activity by those who only seek information about the workings of the government and do not seek to influence the workings of the government one way or another. If they did attempt to

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[26] Langevoort testimony at HSGAC Hearing Dec. 1, 2011 at pages 2–3.
[27] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111–203, § 746.
[28] 5 U.S.C. App. §§ 101 *et seq.*
[29] 2 U.S.C. §§ 1601 *et seq.*

exert such influence, they would fall under the existing provisions of the Lobbying Disclosure Act, which already impose disclosure mandates on those contacting legislative and executive branch officials in an effort to influence government policy decisions.

The Committee has very limited information before it about the scope of the "political intelligence industry" or its implications for either the political process or the financial markets. Before Congress enacts legislation that could result in quarterly disclosure requirements for many businesses that seek information on the activities of the government, there needs to be better information about the nature of political intelligence activities: what information is being sought and received—whether it is merely the same information passed along to any member of the public who calls his or her Senator or House Member or an agency, or something different; the extent to which investors rely on information they obtain from political intelligence collectors; whether the work of these individuals differs markedly from that of the financial press; and what effect the sale of this information may have on our financial markets.

For these reasons, S. 2038 requires the Government Accountability Office (GAO), working in consultation with the Congressional Research Service (CRS), to study the issue and report back to Congress on its findings. The bill directs GAO to examine such issues as the prevalence of the sale of political intelligence, the effect it may have on financial markets, the extent to which the information sold is nonpublic, and the benefits, as well as the legal and practical issues that may arise, from imposing disclosure requirements on those who engage in political intelligence activities. The Committee is also interested in the First Amendment implications of requiring disclosure, outside of the existing definition of lobbying, as a prerequisite for communicating with Congress or agencies of the federal government.

The Committee also notes that the LDA provides for both civil and criminal penalties for violations. The Committee believes that, to comport with due process values, any statutory disclosure requirements under the LDA must be clear so that individuals facing civil or criminal penalties have fair notice of whether or not disclosure is required. For purposes of the GAO study, though, the Committee has provided an expansive definition of political intelligence so that GAO can look broadly at the issue and provide sufficient information to Congress that may then be used in targeting specific problems. For purpose of the study, this section defines political intelligence as information that is (1) derived by a seller from direct communications with executive branch and legislative branch officials and (2) provided in exchange for financial compensation to a client who intends, and who is known by the seller to intend, to use the information in informing investment decisions.

The Committee is confident that GAO has the ability and the flexibility to conduct a thorough analysis of this issue and better inform any future congressional action in this area.

Overarching issues

In crafting S. 2038, the Committee sought to affirm that Members and their staffs are covered by insider trading law while also (1) legislating in a way that does not undermine the interactions

of Members and the general public; (2) leaving undisturbed the large body of law related to insider trading and other securities and anti-fraud laws; and (3) recognizing that existing prohibitions under House and Senate ethics rules also provide remedies against illegal insider trading.

In crafting S. 2038, the Committee made clear that while Members and their staffs are not shielded from insider trading law, nothing in the bill can be construed in derogation of existing obligations, duties and functions of a Member of Congress or an employee of Congress. Every day, Members and their staff exchange information and views with constituents and numerous other individuals, including representatives of companies, associations, non-profit organizations, and the media. These interactions are vital to the democratic process. Exchanges of information between Congress and the American public allow Members to explain actions that Congress is taking, or is considering. And these exchanges allow the American people to share with Members their views on how actions of the government may help, or hurt, them. In this respect, the role of a Member of Congress is very different from the role of a corporate insider.

The Committee has heard some concerns that the STOCK Act leaves Members and their staff vulnerable to charges of "tipping" if someone makes a trade based on information derived from the routine sharing of information between Congress and constituents. The Committee believes that such fears are unfounded and that the STOCK Act should have no chilling effect on the flow of information from Congress to the citizenry. To prove a case of insider trading, the SEC must show that a trade was made, in breach of a duty of trust and confidence, based on material, nonpublic information. In the case of tipping, there must also be some personal benefit to the tipper in communicating the information to the tippee.

Additionally, under all fraud cases brought under section 10b of the Exchange Act, there must be a showing that the defendant acted with "scienter." The Supreme Court explained in *Ernst & Ernst* v. *Hochfelder* that, in the context of Rule 10b–5, scienter "refers to a mental state embracing intent to deceive, manipulate or defraud."[30] As Mr. Khuzami explained in testimony before the House Financial Services Committee:

> [Scienter] is the single biggest thing that protects the unwary from being trapped in a violation that inadvertently occurred. You have to be acting with corrupt intent, knowledge, or recklessness. If you act in good faith, you are not going to be guilty.[31]

Thus, while Members and their staff should not be shielded from prosecution if each element of insider trading law is shown, they also should not fall inadvertently into violation of Rule 10b–5 when, in good faith, they engage in discourse with members of the public on matters related to their official duties.

Second, S. 2038 ensures that the shade of the umbrella of insider trading law covers Members of Congress and their staff; it does not

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[30] 425 U.S. 185, 193, n. 12 (1976).

[31] H.R. 1148, The Stop Trading on Congressional Knowledge Act: Hearing Before the House Financial Services Committee, 112th Cong. (Dec. 6, 2011), Hearing Print 112–90 at 32.

change the size of the umbrella or the cast of its shade. In affirming that the insider trading prohibitions apply to Members of Congress in the same way they apply to everyone else, S. 2038 makes it clear that nothing in the Act—not the affirmation of the underlying duty of trust and confidence, nor the instructions to issue interpretive guidance or the guidance that may be issued as a result—can be construed to limit or otherwise alter the construction of the antifraud provisions of the securities laws or the authority of the SEC or DOJ under those provisions. S. 2038 includes a rule of construction that makes this point clear. Likewise, nothing in the bill should be construed to alter or impair existing statutes on mail and wire fraud,[32] honest services,[33] or other anti-corruption statutes.

Nor does S. 2038 suggest that existing House and Senate ethics rules are insufficient to discipline a Member or a staffer who engages in insider trading. As a starting point, the Code of Ethics for Government Service states in paragraph 8 that a 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 private profit." The Code was passed by the House and Senate by Concurrent Resolution in 1958,[34] has been explicitly incorporated into House ethics rules,[35] and is listed in the Rules of the Senate Select Committee on Ethics as one source for the Committee's investigative and disciplinary jurisdiction.[36]

Other specific ethics rules prohibit use of official position for public gain. For example, Senate Rule XXXVII prohibits a Member, officer or employee of the Senate from receiving any compensation, or allowing any compensation to accrue to his beneficial interest "which would occur by virtue of influence improperly exerted from his position as a Member, officer, or employee." The Senate Ethics Manual explains that this provision was intended "as a broad prohibition against members, officers or employees deriving financial benefit, directly or indirectly, from the use of their official position[s]."[37] Rules limiting gifts to Members and staff under Senate Rule XXXV may be violated under certain factual scenarios—a Member who receives and trades on a "tip" from a corporate insider, for example, or a staffer who tips a third party in exchange for something of personal benefit. Moreover, it is well established that "[t]he Senate or House may discipline a Member for any misconduct, including conduct or activity which does not directly relate to official duties, when such conduct unfavorably reflects on the institution as a whole."[38] Thus, the ethics rules provide ample basis for the disciplining of Members or staff who engage in insider trading.[39]

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[32] 18 U.S.C. §§ 1341, 1343.

[33] 18 U.S.C. § 1346.

[34] Code of Ethics for Government Service, H.R. Con. Res. 175, 85th Cong., 72 Stat. B12 (1958).

[35] 72 Stat., Part 2, B12, H.Con.Res. 175, 85th Cong. (July 11, 1958).

[36] United State Senate Select Committee on Ethics, Senate Ethics Manual, 108th Congress, 1st Session (2003) at 387.

[37] *Id.* at 66 (quoting from the "Nelson Report" which accompanied the original Senate Code of Ethical Conduct, S. Rep. No. 95–49).

[38] *Id.* at 13.

[39] For example, on November 29, 2011, the House Committee on Ethics issued a memorandum to all Members and staff summarizing House rules and standards of conduct that may apply to use of nonpublic information when engaging in a personal financial transaction. Memo-

Continued

III. LEGISLATIVE HISTORY

In November, 2011, Senators Scott Brown and Kirsten Gillibrand introduced S. 1871 and S. 1903, respectively, two similar versions of the STOCK Act, both of which were referred to the Senate Committee on Homeland Security and Governmental Affairs. On December 1, 2011, the Committee held a hearing entitled "Insider Trading and Congressional Accountability." The Committee heard testimony from the three professors of securities law noted above as well as from Melanie Sloan, Executive Director of Citizens for Responsibility and Ethics in Washington, and Robert L. Walker, Of Counsel, Wiley Rein LLP and former Chief Counsel and Staff Director of both the Senate and House Ethics Committees. Mr. Robert Khuzami, Director of Enforcement for the SEC, submitted a statement for the record.

On December 14, 2011, the Committee considered, as an original bill, a revised version of the STOCK Act based on the Gillibrand and Brown bills, additional Committee research, and the suggestions received at the Committee's December 1 hearing. (The bill received the number S. 2038 after the Committee reported it.)

At its December 14 business meeting, the Committee considered an amendment offered by Senators Collins and Lieberman adding an explicit statement that Members and employees of Congress are not exempt from current insider trading prohibitions. The Collins-Lieberman amendment also clarified that the bill "affirms" (rather than "states") a duty of trust and confidence owned by Members and their staff, and that nothing in the bill diminishes the "duties and functions" of a Member or employee of Congress (in addition to not diminishing their "obligations").

Senator Levin offered a second degree amendment to the Collins-Lieberman amendment, aimed at clarifying that the duty owed by Members and their staff is one "arising from a relationship of trust and confidence" owed to Congress, the United States Government, and the citizens of the United States. The Committee adopted both the Levin second degree amendment and the Collins-Lieberman amendment (as amended) by voice vote. Senators present for both votes were Lieberman, Levin, Akaka, Carper, Tester, Begich, Collins, Coburn, Brown, Johnson, Portman, and Paul.

The Committee next adopted by voice vote an amendment offered by Senators Begich, Tester, Lieberman, Levin, Brown and Carper requiring the electronic filing and electronic disclosure of financial disclosure forms filed by Members of Congress and senior congressional staff. Senators present for this vote were Lieberman, Levin, Akaka, Carper, Tester, Begich, Collins, Coburn, Brown, Johnson, Portman, and Paul.

The Committee then considered an amendment offered by Senator Paul aimed at making clear that insider trading laws cover all federal employees. Senator Lieberman offered a second degree amendment, which clarified that nothing in the section added by the Paul amendment should be construed to be in derogation of existing laws, regulations, or ethical obligations of federal employees. The Committee adopted the Lieberman second degree amendment and the underlying Paul amendment, both by voice vote. Senators

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randum to All House Members, Officers and Employees from Committee on Ethics on Rules Regarding Personal Financial Transactions (Nov. 29, 2011).

present for both votes were Lieberman, Levin, Akaka, Begich, Collins, Coburn, Brown, Johnson, Portman, and Paul.

The Committee ordered the bill, as amended, reported favorably by a roll call vote of 7–2. Senators Lieberman, Levin, Akaka, Begich, Collins, Brown, and Portman voted in favor of the bill, while Senators Coburn and Johnson voted in opposition. Senators Carper, Pryor, Landrieu, McCaskill, Tester, and Moran asked to be recorded in favor of the bill by proxy, while Senator McCain asked to be recorded against the bill by proxy.

IV. SECTION-BY-SECTION SUMMARY OF THE BILL

Section 1: Short title

The short title of the bill is the "Stop Trading on Congressional Knowledge Act of 2012" (STOCK Act).

Section 2. Use of nonpublic information for personal benefit prohibited

This section amends the Congressional Accountability Act[40] by adding to it a new title (Title VI) that prohibits Members and employees of Congress from using nonpublic information derived from their positions in Congress for personal benefit and makes it clear that existing insider trading prohibitions under the securities laws apply to Members and staff of Congress. The new title contains the following sections:

"Section 601. Definition"

This section defines the terms "Member of Congress" and "employee of Congress."

"Section 602. General prohibition"

This section lays out the general prohibition that Members and staff shall not use any nonpublic information that is derived from their positions in Congress, or gained from performance of their duties, for personal benefit.[41]

"Section 603. Implementing rules"

This section directs the Ethics Committees in the Senate and House to issue rules to carry out the purposes of Section 602.

"Section 604. Applicability to securities laws"

The dispute over the applicability of insider trading laws to Congress centers largely on the issue of whether Members and staff of Congress owe a legally enforceable duty to the source from which they receive material, non-public information. This section explicitly states that Members and staff [42] are not exempt from the securities laws, including the insider trading prohibitions, and that

[40] 2 U.S.C. §§ 1301 *et seq.*

[41] At the Committee's business meeting to consider the bill, some Members expressed concern that the breadth of the general prohibition is unclear. Members agreed to work together to refine its scope and suggest new language for consideration by the full Senate when the bill is reported to the Senate floor.

[42] As discussed above, the Committee received expert testimony noting that there is little doubt that Congressional employees would be liable for insider trading under the misappropriation theory. The Committee sees no harm, though, in affirmatively stating this coverage.

they owe a duty arising from a relationship of trust and confidence under the securities laws.

Specifically, subsection (a)(1) provides that Members and employees of Congress are not exempt from the broad anti-fraud provisions of the securities laws, including the insider trading prohibitions. Subsection (a)(2) provides that, for purposes of insider trading prohibitions under the Securities Exchange Act, the Section 602 prohibition against Members and employees using nonpublic information for personal benefit affirms a duty arising from a relationship of trust and confidence owed by each Member of Congress and each employee of Congress to Congress, the United States Government, and the citizens of the United States.

Subsection (b) authorizes the Securities and Exchange Commission to issue rules to implement this section and otherwise ensure that Members and staff are subject to insider trading prohibitions.

"Section 605. Appropriate punitive, disciplinary, and other remedial action"

This section ensures that Members and staff who violate the prohibition under Section 602 are subject to appropriate disciplinary actions.

"Section 606. Rule of construction"

This section provides that nothing in this title diminishes existing obligations, duties, and functions of Members and employees of Congress, and it makes clear that the STOCK Act does not limit or otherwise alter existing securities laws.

Section 3. Technical, conforming, and clerical amendments

This section makes technical changes to the Congressional Accountability Act.

Section 4. Conforming changes to the Commodity Exchange Act

This section makes conforming changes to section 4c(a) of the Commodity Exchange Act[43] to ensure that the insider trading prohibitions under that Act apply to Members and staff of Congress.

Section 5. Prompt reporting of financial transactions

This section amends existing financial disclosure rules to require Members, officers and employees of Congress, for themselves and for their spouses and dependent children, to report the purchase or sale of stocks, bonds, commodities futures, and other forms of securities within 30 days after such a transaction takes place.

Section 6. Report on political intelligence activities

This section requires that, no later than 12 months after the date of enactment of the STOCK Act, GAO, in consultation with CRS, is to submit a report to Congress assessing the role of "political intelligence" in the financial market. This report is intended to shed light on the practice and better inform any future congressional action in this area.

Specifically, the section requires GAO to provide an analysis of: what is known about the prevalence of the sale of political intel-

[43] 7 U.S.C. § 6c(a).

ligence and the extent to which investors rely on such information; what is known about the effect that the sale of political intelligence may have on the financial markets; the extent to which information which is being sold would be considered nonpublic information; the legal and ethical issues that may be raised by the sale of political intelligence; any benefits from imposing disclosure requirements on those who engage in political intelligence activities; and any legal and practical issues that may be raised by the imposition of disclosure requirements on those who engage in political intelligence activities.

Section 7. Public filing and disclosure of financial disclosure forms of Members of Congress and Congressional staff

This section provides for greater transparency of financial disclosure forms filed by Members, candidates for Congress, and employees of Congress.

Subsection (a) requires financial disclosure reports filed in 2012 (including the new transaction reports required by the STOCK Act) to be posted on the House and Senate web sites. This basic form of transparency will be maintained until the development of an e-filing and disclosure system under the second part of this section.

Subsection (b) then requires the Secretary of the Senate and the Clerk of the House to develop systems to allow e-filing by individuals who are required to file forms with them, and to establish a public database enabling members of the public to search, sort and download data from the e-filings.

Section 8. Federal employees

Section 8 affirms that employees in the executive and legislative branches also are subject to insider trading prohibitions. The Committee finds no doubt among securities experts that federal employees are already covered by insider trading laws.[44] The Committee finds no harm, though, in affirming that federal employees owe a duty of trust and confidence to the United States government and the citizens of the United States.

Subsection (a) of this section prohibits federal employees from using any nonpublic information that is derived from their positions, or gained from performance of their duties, for personal benefit.

Subsection (b) then requires the relevant offices responsible for administering ethics requirements to issue rules and regulations to carry out the purposes of subsection (a): the Office of Government Ethics for the executive branch, the ethics committees of the House and Senate for the legislative branch, and the Judicial Conference for the judicial branch. Individual agency ethics offices would be free to issue supplemental rules and regulations pertaining to agency-specific restrictions.

Subsection (c) then provides that, for purposes of insider trading prohibitions under the Securities Exchange Act, the prohibition set forth in subsection (a) about federal employees using nonpublic information for personal benefit states a duty of trust and confidence of each federal employee to the United States government and the citizens of the United States.

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[44] *See* n.22, *supra.*

Subsection (d) ensures that Federal employees that violate the prohibition under Section 602 are subject to appropriate disciplinary actions.

Subsection (e) defines the term "federal employee."

Subsection (f) contains a rule of construction that makes clear that nothing in this section shall be construed to be in derogation of existing laws, regulations, or ethical obligations of Federal employees. In many instances federal employees are held to stricter ethics obligations than Members and subsection (f) ensures that existing rules and regulations are not narrowed by the requirements in this section.

V. EVALUATION OF REGULATORY IMPACT

Pursuant to the requirements of paragraph 11(b) of rule XXVI of the Standing Rules of the Senate, the Committee has considered the regulatory impact of this bill. The Congressional Budget Office states that S. 2038 contains no intergovernmental or private-sector mandates as defined in the Unfunded Mandates Reform Act and would not affect the budget of state, local, or tribal governments.

VI. CONGRESSIONAL BUDGET OFFICE COST ESTIMATE

JANUARY 31, 2012.

Hon. JOSEPH I. LIEBERMAN,
Chairman, Committee on Homeland Security and Governmental Affairs, U.S. Senate, Washington, DC.

DEAR MR. CHAIRMAN: The Congressional Budget Office has prepared the enclosed cost estimate for S. 2038, the STOCK Act.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is Matthew Pickford.

Sincerely,

DOUGLAS W. ELMENDORF.

Enclosure.

S. 2038—STOCK Act

S. 2038 would amend the Congressional Accountability Act of 1995 and the Ethics in Government Act. The legislation would require the Senate and the House of Representatives to implement an electronic filing system for financial disclosure forms and provide the public with on-line access to that information in a searchable database. S. 2038 also would make clear that Members of Congress, Congressional employees, and federal employees are prohibited from using nonpublic information for personal financial benefit. In addition, the legislation would require more timely reporting of information about financial transactions by Members and staff.

Based on information from Congressional staff, CBO estimates that implementing the financial disclosure system required under S. 2038 would cost $4 million over the 2012–2013 period primarily for new computer hardware and software and additional labor. In addition, maintaining the new system would cost $1 million annually, CBO estimates. In total, CBO estimates that implementing the legislation would cost about $9 million over the 2012–2017 period, assuming appropriation of the necessary amounts.

The Statutory Pay-As-You-Go Act of 2010 establishes budget-reporting and enforcement procedures for legislation affecting direct spending or revenues. Enacting S. 2038 could increase revenues from civil and criminal fines imposed on federal employees who use nonpublic information for personal financial benefit or who fail to file financial disclosure forms; therefore, pay-as-you-go procedures apply. Civil fines are recorded in the budget as revenues and deposited into the general fund of the Treasury. Criminal fines are recorded as revenues, deposited in the Crime Victims Fund, and spent in subsequent years. CBO expects that any net effect associated with collecting and spending such penalties would not be significant in any year.

S. 2038 contains no intergovernmental or private-sector mandates as defined in UMRA and would not affect the budgets of state, local, or tribal governments.

The CBO staff contact for this estimate is Matthew Pickford. This estimate was approved by Theresa Gullo, Deputy Assistant Director for Budget Analysis.

VII. CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with paragraph 12 of rule XXVI of the Standing Rules of the Senate, the following changes in existing law made by S. 2038, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, existing law in which no change is proposed is shown in roman).

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CONGRESSIONAL ACCOUNTABILITY ACT OF 1995

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TITLE IV—ADMINISTRATIVE AND JUDICIAL DISPUTE-RESOLUTION PROCEDURES

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SEC. 413. PRIVILEGES AND IMMUNITIES.

The authorization to bring judicial proceedings under sections 405(f)(3), 407, and 408, *or to bring a judicial proceeding to enforce the prohibition under section 602,* shall not constitute a waiver of sovereign immunity for any other purpose, or of the privileges of any Senator or Member of the House of Representatives under article I, section 6, clause 1, of the Constitution, or a waiver of any power of either the Senate or the House of Representatives under the Constitution, including under article I, section 5, clause 3, or under the rules of either House relating to records and information within its jurisdiction.

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TITLE VI—USE OF NONPUBLIC INFORMATION FOR PERSONAL BENEFIT PROHIBITED

SEC. 601. DEFINITION.

In this title—

(1) the term "Member of Congress" means a member of the Senate or the House of Representatives, a Delegate to the House of Representatives, and the Resident Commissioner from Puerto Rico; and

(2) the term "employee of Congress" means—

(A) an employee of the Senate; and

(B) an employee of the House of Representatives.

SEC. 602. GENERAL PROHIBITION.

No Member of Congress and no employee of Congress shall use any nonpublic information derived from the individual's position as a Member of Congress or employee of Congress, or gained from performance of the individual's duties, for personal benefit.

SEC. 603. IMPLEMENTING RULES.

The Select Committee on Ethics of the Senate and the Committee on Standards of Official Conduct of the House of Representatives shall issue rules or regulations to carry out the purpose of section 602.

SEC. 604. APPLICABILITY TO SECURITIES LAWS.

(a) IN GENERAL.—

(1) NOT EXEMPT.—Members of Congress and employees of Congress are not exempt from the prohibitions arising under section 10(b) of the Securities Exchange Act of 1934 and Rule 10b–5 thereunder, including the insider trading prohibitions.

(2) DUTY.—For purposes of the insider trading prohibitions arising under 10(b) of the Securities Exchange Act of 1934 and Rule 10b–5 issued thereunder (or any successor to such Rule), section 602 affirms a duty arising from a relationship of trust and confidence owed by each Member of Congress and each employee of Congress to Congress, the United States Government, and the citizens of the United States.

(b) RULEMAKING AUTHORITY.—The Securities and Exchange Commission may issue such rules or regulations as the Commission determines are necessary or appropriate to implement subsection (a) or to otherwise ensure that Members of Congress and employees of Congress are subject to the insider trading prohibitions that apply generally.

SEC. 605. APPROPRIATE PUNITIVE, DISCIPLINARY, AND OTHER REMEDIAL ACTION.

A Member of Congress or an employee of Congress who violates the prohibition under section 602 shall be subject to appropriate punitive, disciplinary, and other remedial action in accordance with any applicable laws, resolutions, rules, or regulations.

SEC. 606. RULE OF CONSTRUCTION.

Nothing in this title shall be construed to be in derogation of existing obligations, duties and functions of a Member of Congress or an employee of Congress or to limit or otherwise alter the securities laws, the authority of the Securities and Exchange Commission under such laws, or other laws of the United States.

TITLE V—GOVERNMENT ORGANIZATION AND EMPLOYEES

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APPENDIX—ETHICS IN GOVERNMENT ACT OF 1978

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TITLE I—FINANCIAL DISCLOSURE REQUIREMENTS OF FEDERAL PERSONNEL

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§ 101. Persons required to file

(a) * * *
(b) * * *
(c) * * *
(d) * * *
(e) * * *
(f) * * *
(g) * * *
(h) * * *
(i) * * *

(j) Within 30 days after any transaction required to be reported under subparagraph 102(a)(5)(B) of this Act, a Member of Congress or officer or employee of Congress shall file a report of the transaction.

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§ 105. Custody of and public access to reports

(a) * * *
(b) * * *
(c) * * *

(d)*(1)* Any report filed with or transmitted to an agency or supervising ethics office or to the Clerk of the House of Representatives or to the Secretary of the Senate pursuant to this title shall be retained by such agency or office or by the Clerk or the Secretary of the Senate, as the case may be.

(2) Such report shall be made available to the public[for a period of six years after receipt of the report]—

(A) in the case of a Member of Congress until a date that is 6 years from the date the individual ceases to be a Member of Congress; and

(B) in the case of all other reports filed pursuant to this title, for a period for six years after receipt of the report.

(3) After [such six-year period] *the relevant time period identified under paragraph (2),* the report shall be destroyed unless needed in an ongoing investigation, except that in the case of an individual who filed the report pursuant to section 101(b) and was not subsequently confirmed by the Senate, or who filed the report pursuant to section 101(c) and was not subsequently elected, such reports shall be destroyed [one] *1* year after the individual either is no longer under consideration by the Senate or is no longer a can-

didate for nomination or election to the Office of President, Vice President, or as a Member of Congress, unless needed in an ongoing investigation.

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TITLE 7—AGRICULTURE

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CHAPTER 1—COMMODITY EXCHANGES

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SEC. 6c. PROHIBITED TRANSACTIONS.

(a) IN GENERAL.—

(1) * * *

(2) * * *

(3) CONTRACT OF SALE.—It shall be unlawful for any employee or agent of any department or agency of the Federal Government *or any Member of Congress or congressional employee* who, by virtue of the employment or position of the *Member*, employee or agent, acquires information that may affect or tend to affect the price of any commodity in interstate commerce, or for future delivery, or any swap, and which information has not been disseminated by the department or agency of the Federal Government holding or creating the information *or by Congress* in a manner which makes it generally available to the trading public, or disclosed in a criminal, civil, or administrative hearing, or in a congressional, administrative, or Government Accountability Office report, hearing, audit, or investigation, to use the information in his personal capacity and for personal gain to enter into, or offer to enter into—

(A) a contract of sale of a commodity for future delivery (or option on such a contract);

(B) an option (other than an option executed or traded on a national securities exchange registered pursuant to section 78f(a) of Title 15); or

(C) a swap.

(4) NONPUBLIC INFORMATION.—

(A) IMPARTING OF NONPUBLIC INFORMATION.—It shall be unlawful for any employee or agent of any department or agency of the Federal Government *or any Member of Congress or congressional employee* who, by virtue of the employment or position of the *Member,* employee or agent, acquires information that may affect or tend to affect the price of any commodity in interstate commerce, or for future delivery, or any swap, and which information has not been disseminated by the department or agency of the Federal Government holding or creating the information *or by Congress* in a manner which makes it generally available to the trading public, or disclosed in a criminal, civil, or administrative hearing, or in a congressional, administrative, or Government Accountability Office report, hearing, audit, or investigation, to impart the information in his personal capacity and for personal gain with intent to

assist another person, directly or indirectly, to use the information to enter into, or offer to enter into—

(i) a contract of sale of a commodity for future delivery (or option on such a contract);

(ii) an option (other than an option executed or traded on a national securities exchange registered pursuant to section 78f(a) of Title 15); or

(iii) a swap.

(B) KNOWING USE.—It shall be unlawful for any person who receives information imparted by any employee or agent of any department or agency of the Federal Government *or any Member of Congress or congressional employee* as described in subparagraph (A) to knowingly use such information to enter into, or offer to enter into—

(i) a contract of sale of a commodity for future delivery (or option on such a contract);

(ii) an option (other than an option executed or traded on a national securities exchange registered pursuant to section 78f(a) of Title 15); or

(iii) a swap.

(C) THEFT OF NONPUBLIC INFORMATION.—It shall be unlawful for any person to steal, convert, or misappropriate, by any means whatsoever, information held or created by any department or agency of the Federal Government *or by Congress* that may affect or tend to affect the price of any commodity in interstate commerce, or for future delivery, or any swap, where such person knows, or acts in reckless disregard of the fact, that such information has not been disseminated by the department or agency of the Federal Government holding or creating the information or *by Congress* in a manner which makes it generally available to the trading public, or disclosed in a criminal, civil, or administrative hearing, or in a congressional, administrative, or Government Accountability Office report, hearing, audit, or investigation, and to use such information, or to impart such information with the intent to assist another person, directly or indirectly, to use such information to enter into, or offer to enter into—

(i) a contract of sale of a commodity for future delivery (or option on such a contract);

(ii) an option (other than an option executed or traded on a national securities exchange registered pursuant to section 78f(a) of Title 15); or

(iii) a swap, provided, however, that nothing in this subparagraph shall preclude a person that has provided information concerning, or generated by, the person, its operations or activities, to any employee or agent of any department or agency of the Federal Government to Congress or any Member of Congress or congressional employee voluntarily or as required by law, from using such information to enter into, or offer

to enter into, a contract of sale, option, or swap described in clauses (i), (ii), or (iii).

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