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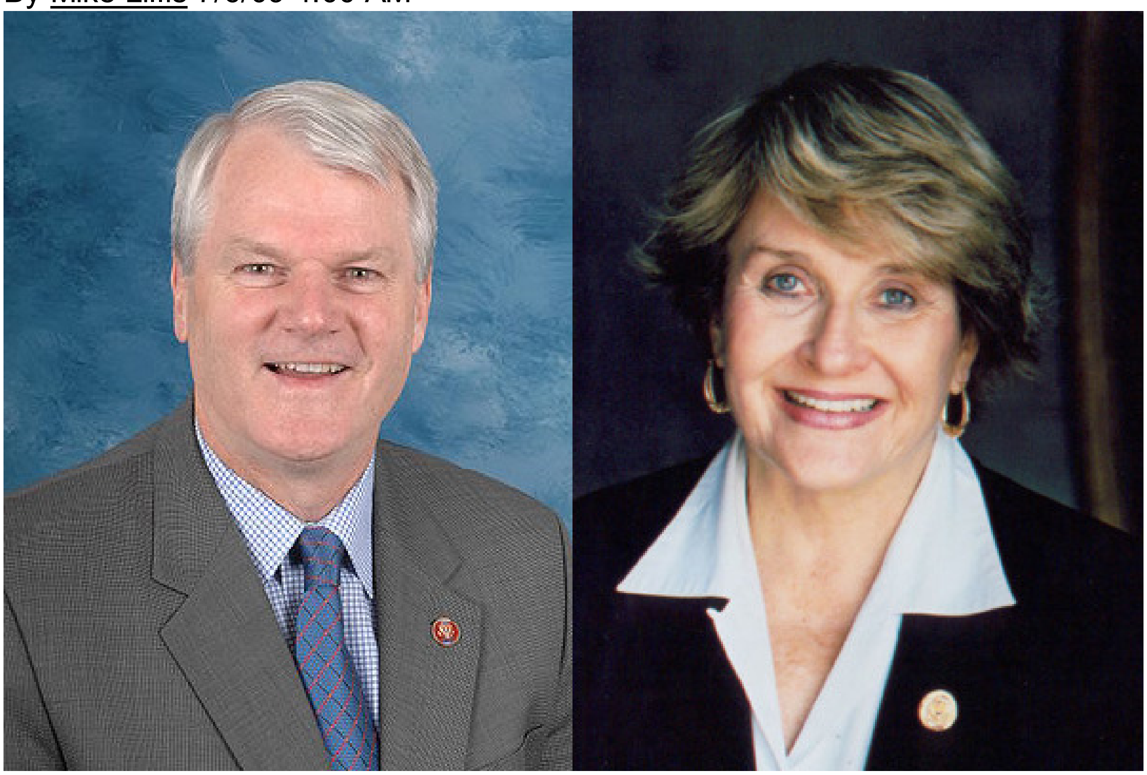
Bill Threatens Congress' Shield From Insider Trading Laws

Current Law Allows Congress to Profit From Valuable, Non-Public Information Floating on Hill

By Mike Lillis 7/6/09 4:00 AM



Reps. Brian Baird (D-Wash.) and Louise Slaughter (D-N.Y.) sponsored a bill to prevent members of Congress from trading on information gleaned from working on the Hill. (house.gov)

In November of 2005, then-Senate Majority Leader Bill Frist (R-Tenn.) took to the upper-chamber floor with a major announcement. The Senate, he revealed, would soon put its full weight behind legislation creating a multi-billion dollar fund to settle lawsuits from victims of asbestos exposure — lawsuits that had already bankrupted several building supply companies.

"I am pleased to inform my colleagues that asbestos reform will be the first major legislation that we consider in late January when we return," Frist said at the time.

Illustration by: Matt Mahurin

For most of the country, Frist's speech was the first notice of that strategy. But for some Wall Street investors, his plan was old news that translated into big money. Indeed, shares of the world's largest sheet-rock company, Chicago-based USG Corp., jumped more than $2 — and trading volume nearly tripled — the day *before* Frist delivered his announcement.

Somehow, someway, the message that Congress was moving to help companies like USG had dribbled onto Wall Street before the rest of the world knew a thing about it. And trading on such leaks, it turns out, is perfectly legal.

Now, a small group of Democrats, backed by a host of public-interest groups, wants to prevent the use of similar non-public information to guide investment decisions. Under the bill, sponsored by Reps. Brian Baird (D-Wash.) and Louise Slaughter (D-N.Y.), lawmakers and their staffs would be prohibited from trading in stocks, bonds and commodities markets based on insider knowledge gleaned from their everyday duties on Capitol Hill. The proposal would also prohibit the transfer of such information to other parties — a spouse; a brother-in-law; a political intelligence firm — who then use the information for trading purposes.

In a telephone interview last month, Baird said there's no clean evidence that such insider trading is endemic in Washington. "But in a town that trades on information," he added, the likelihood that it's happening is "almost a certainty."

"There's no question that we get access to information," Baird said. "There need to be bright-light firewalls between public and non-public [information]."

With most lawmakers dabbling to some extent in stocks and other publicly traded commodities, watchdog groups warn that the opportunities for members to use or convey non-public information — even if it's done 100 percent unconsciously — are frequent. This has particularly been the case during the long string of government-funded bailouts of the finance industry that's marked the last 18 months.

Last September, for example, as Wall Street was crumbling but before the extent of the troubles were clear, the heads of the Federal Reserve and the Treasury Department called congressional leaders to an emergency, closed-door meeting to announce their plan for an unprecedented, multi-billion dollar rescue of the nation's financial sector.

One day later, at least 10 senators traded stock or mutual funds related to the finance industry, according to personal financial disclosure forms submitted by lawmakers last month.

At least one of those lawmakers, Sen. Richard Durbin (D-Ill.), had attended the meeting the evening before, an episode first reported by Bloomberg last month. A Durbin spokesman told Bloomberg that the senator didn't use any information from that closed-door gathering to counsel his trades the following day.

While there's no evidence to refute that claim, public-interest advocates argue that the mere appearance of lawmakers' abusing their powers can lead to a dangerous erosion of public trust in all government officials.

"If it appears to be the case, then everyone's under suspicion," said Laura MacCleery, deputy director of campaign finance at New York University's Brennan Center for Justice. "You want politicians to be beyond reproach. You want a system that protects the innocent and makes it impossible for the guilty to operate."

While current law prevents insider trading on non-public information gotten through corporate channels, the Securities and Exchange Commission does not have similar powers to regulate trades made on non-public information obtained through *government* channels.

That loophole could allow lawmakers and other federal employees to make millions of dollars on insider investments, Baird said. If they're later accused of getting insider information, he added, they've got a simple defense: "Not from the company, I didn't."

In March, a coalition of public interest groups, including the League of Women Voters, Common Cause and Public Citizen, endorsed the House bill in a letter to Baird and Slaughter that explained the loophole further. "Under current law, 'insider trading' is defined as the buying or selling of securities or commodities based on non-public information in violation of confidentiality — either to the issuing company or the source of information," the groups wrote. "Most federal officials and employees do not owe a duty of confidentiality to the federal government and thus are not liable for insider trading."

There is some evidence that, consciously or not, federal lawmakers tend to use their informational advantage to reap better Wall Street returns than other investors find. A 2004 study conducted by researchers at Georgia State University, for example, found that trades made by selected senators between 1993 and 1998 produced returns more than 12 percent higher than the rest of the market.

"These results," the researchers concluded, "suggest that Senators knew appropriate times to both buy and sell their common stocks."

Such findings might make a strong case for adoption of safeguards like the Baird-Slaughter bill. But it's not easy to get Congress to police itself. Indeed, despite having both control of the White House and comfortable majorities in Congress, Democrats this year seem poised to ignore proposals reforming campaign finance laws and eliminating automatic congressional pay raises.

Melanie Sloan, executive director of the Center for Responsibility and Ethics in Washington, said the Baird-Slaughter bill fits into the same category. "There's rarely support," she said, "for things that limit lawmakers' behavior."

Robert M. Stern, president of the Center for Governmental Studies, a Los Angeles-based non-profit research group, agreed, maintaining that the Baird-Slaughter proposal has little chance of getting anywhere anytime soon.

"I don't think I would hold my breath for that one," Stern said, adding, "It's so typical of legislators holding everyone up to standards except themselves."