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Congressional Insider Trading: Story Finally Sticks

By **Justin Rohrlich** Nov 14, 2011 11:20 am

A new book and a "60 Minutes" interview brings an old story to light.



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FREE LEVEL II QUOTES

Last night, *60 Minutes* featured an interview with Peter Schweitzer of the Hoover Institution, who discussed corruption in Washington, D.C.

Namely, insider [trading](#) by the congressmen and senators who wrote the laws prohibiting the practice in the first place.

"This is a venture opportunity," [Schweitzer](#) told CBS's Steve Kroft. "This is an opportunity to leverage your position in public service and use that position to enrich yourself, your friends, and your family."

[Schweizer's latest book](#), *Throw Them All Out*, will be released in bookstores tomorrow. It will highlight suspicious stock trades by House Speaker John Boehner, Representative Spencer Bachus, former House Speaker Nancy Pelosi, and other powerful names, including Congressman Dennis Hastert and Senator Judd Gregg.

We took a look at [Congressional insider trading back](#) in February, as Galleon Group founder Raj Rajaratnam prepared to stand trial on insider trading charges involving 35 stocks, among them **Google (GOOG)**, **Advanced Micro Devices (AMD)**, **IBM (IBM)**, and **Goldman Sachs (GS)**.

It was particularly shocking to find out that if Rajaratnam had been a US Senator rather than a \$7 billion hedge fund manager when he made the trades in question, there would have been no criminal proceedings at all. Because, as Craig Holman, legislative representative at government watchdog group Public Citizen explained, the [Securities and Exchange Act](#) does not apply to members of Congress.

"Any inside, non-public knowledge they gain can be acted upon," Holman told me in a telephone interview. "Some of the stories are just... breathtaking."

It gets worse. Not only are legislators free to trade in ways that would put a civilian in handcuffs, congressional staffers and lobbyists are also exempt from insider trading regulations.

Even Henry Manne, the economist who famously made a case for legalizing insider trading in his book *Insider Trading and the Stock Market* [draws the line here](#). In an email to ProCon.org, he wrote:

In my 1966 book I said unequivocally that insider trading by any government officials on information received in the course of their work should be outlawed. The economic consequences of this trading on stock prices will be the same as any other informed trading, but there are many other aspects to the economic argument for legalizing insider trading generally that just will not pass the "smell test" for government officials. The compensation argument for corporate insider trading cuts in exactly the opposite direction for government officials. We do not want them to receive extra compensation or outside compensation for doing their jobs. And, of course, all too frequently their access to this information is merely another form of a bribe, and that sure as hell is not legal.

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Congressional insider trading is not a new phenomenon; a handful of media reports have surfaced over the past several years, but, as Holman says, the story “never really stuck.”

In a 2009 article on The Hill's “Congress Blog,” Holman [explained the loophole](#).

The Securities and Exchange Commission (SEC) does not have the authority to hold employees of Congress or the Executive Branch liable for using non-public information gained from official proceedings for insider trading. 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. Most federal officials and employees do not owe a duty of confidentiality to the federal government and thus are not liable for insider trading.

Of course, members of Congress do owe a duty of confidentiality to the citizenry by whom they were elected. That’s why congressional ethics rules specifically state that members must not use privileged information gleaned during the course of their duties for personal gain.” But the rule is just a rule; it is not legally binding, and the SEC has never brought an enforcement action against any member of the Senate or the House.

A couple of years ago, a radio segment on American Public Media looked at [two cases of suspicious financial activity](#) that took place on both sides of the aisle during the initial days of the [financial](#) crisis back in September, 2008.

“A year ago this week Treasury Secretary Hank Paulson and Fed Chairman Ben Bernanke dashed to Capitol Hill. They hastily met with a small group of congressional leaders to tell them that the country was teetering on the edge of financial catastrophe,” correspondent Steve Henn said. “Paulson and Bernanke asked Congress to spend hundreds of billions to save the banks.”

The next day, according to personal financial disclosures, Henn said that John Boehner, who was GOP House Minority Leader at the time -- and was present at the meeting -- “cashed out of a fund designed to profit from inflation” and “[s]ince he sold, it's lost more than half its value.”

Henn also pointed out that Senator Dick Durbin, an Illinois Democrat, “sold more than \$40,000 in mutual funds and reinvested it all with Warren Buffett.” Durbin was also at the meeting.

But insider trading is a notoriously difficult charge to prove. Durbin said that, “like millions of others he was worried about his retirement.” Boehner said his “stockbroker acted alone without even talking to him,” and both men say they did not benefit from information picked up from Paulson or Bernanke.

As for staffers, one example reported by the *Wall Street Journal* this past October involved an aide to Republican Senator Mike Crapo of Idaho, a member of the Senate Banking Committee.

Filings show that the aide, Karen Brown, traded **Bank of America (BAC)** stock seven times in 2009, buying on three occasions in April and selling in September, for a minimum profit of 43%.

The *Journal* noted that the purchases were made while BofA was [discussing the results of the government's stress tests](#). When the findings were made public on May 7, a few short weeks after Brown established her position, the bank’s stock rose as investor [confidence](#) returned.

Senator Crapo's office says Brown's husband was the one actually doing the trading, “independent of any direction from Mrs. Brown,” and that she later filed an amended financial disclosure form reflecting this. A spokeswoman added, “There is no relation between Senator Crapo’s service on the Banking Committee and any decisions made by Mr. Brown regarding the trades in question.”

A 2004 study in the *Journal of Financial and Quantitative Analysis* titled “Abnormal Returns from the Common Stock Investments of the US Senate,” examined Senators’ mandatory financial disclosure reports between 1993 and 1998.

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“Our goal in this research is to determine if the Senators’ investments tend to outperform the overall market,” Georgia State [business](#) professor Alan Ziobrowski wrote. “Such a finding would support the notion that Senators use their informational advantage for personal gain. We test whether the common stocks purchased and sold by US Senators exhibit abnormal returns.

“Assuming returns are truly ‘incidental,’ we hypothesize that US Senators should not earn statistically significant positive abnormal returns on their common stock acquisitions (the null). Rejection of the null, i.e. a finding of statistically significant positive abnormal returns, would suggest that Senators are trading stock based on information that is unavailable to the public, thereby using their unique position to increase their personal wealth.”

What Ziobrowski and his co-authors found was that during the period studied, US Senators’ stock portfolios annually outperformed the market by 12%. Over the same period, US households annually underperformed the market by 1.4%.

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 7 COMMENTS



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OWEN HADDOCK

In the old days, I heard you greased a politician by hiring his former law firm. A nice retainer for advising on a project already figured out, kept legislation on track. Another was just a subtle, you allow a discounted participation in an income real estate project. Say your piece of the action has a fair market value of \$25000. The greased pol or other public servant get it for a paper value of \$10000. Years ago we heard of Congressmen getting outsized participation in new offerings, which excluded deserving public investors. The congressman quickly sold positions which got cash in his or her hands without using the plain white envelope. The Tea Party is after

government corruption, but it'll be interesting to see if they bother to track republican bribes? WSOs are after the corrupt financial systems, but it'll be just as interesting to see if they go after Democrats getting free loans and donations from big banks? Lots to be done and the political spectrum has common cause if it'll just look at it long enough.



Aaron

This makes me just furious! I will NEVER trust any of our elected officials until it becomes MANDATORY that when they are elected ALL THEIR FAMILY ASSETS are placed in a blind trust, and that they cannot under any circumstances communicate with the administrator.

The Occupy Wall Street group needs to change their name to Occupy Washington DC with demands that this insider trading be stopped immediately.

Aaron Ashcraft



smntstatus1

Check out this awesome site called <http://insidertrading.procon.o...> that has a whole bunch of interesting information about insider trading and Congress:

1. Top 10 Richest US Senators' Top Stock Trades in 2007 and Potential Conflicts of Interest

<http://insidertrading.procon.o...>

2. US Congressional Ethics Rules on Insider Trading

<http://insidertrading.procon.o...>

3. History of Insider Trading, 1611-2011, with an Emphasis on Congressional Insider Trading

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William Kellett

Huh? "and members who have been consistently identified as corrupt by a watchdog group."

What members, what watchdog group? Elaborate please.



@jporter

Before you know it, one of our more enterprising Congressmen will start his or her own Congressional Committee Fund and start taking two and twenty.



Chris

Thanks for the article. I find it disturbing yet unsurprising that members of Congress

continue to exempt themselves from the consequences of laws that they pass. Other examples include the laws they pass that would cut Veteran's benefits, Social Security payments, and Medicare benefits. However, we do not see any cuts in the benefits or pay that they receive. I am a firm believer in the old adage "What's good for the goose is good for the gander."



david

No wonder they spend millions to compete for these offices. We as a nation of working stiffs have to use only what is old news to invest and guess at the outcome with only hind sight to see our mistakes [loses]- imagine if we were senators or representatives and were given the future or opportunities to invest in sure things with information no else was able to act on. These laws are against all sanity and good public service which our federal elected officials are supposed to uphold -- apparently they are saying to us all -- WE ARE THE CHOSEN ONES AND IT'S YOUR FAULT -- I say get rid of them all who have used these laws to further their own financial gain.

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