

April 9, 2012

The STOCK Act

President Obama and Congress Enact the Stop Trading on Congressional Knowledge Act

On April 4, 2012, President Obama signed the Stop Trading on Congressional Knowledge Act (the “STOCK Act” or “Act”). The STOCK Act amends the Securities Exchange Act of 1934 (the “Exchange Act”) and the Commodity Exchange Act (the “CEA”) to prohibit members of Congress, as well as executive and judicial branch officials, from engaging in insider trading in securities or derivatives based on their access to nonpublic material information as government officials.

The STOCK Act does exactly what its name says it will do: the Act is designed to stop government officials and employees from trading in securities or derivatives based on information or knowledge they derive as a result of their positions as government officials or employees. The Act does so by amending Section 21A of the Exchange Act to impose an explicit duty on members and employees of Congress as well as executive and judicial branch officials and employees with respect to material nonpublic information. For purposes of Section 10(b) and Rule 10b-5 under the Exchange Act, these government officials and employees owe “a duty arising from a relationship of trust and confidence to the United States Government and the citizens of the United States with respect to material, nonpublic information derived from such person’s position.”¹ The STOCK Act also amends the CEA to prohibit members of Congress and their employees from entering into futures, options or swap contracts if the members or employees possess nonpublic information that may affect the price of any future, option or swap. The STOCK Act expands the prohibition that currently applies to any employee of any department or agency of the Federal Government.

The STOCK Act also prohibits any person from knowingly using nonpublic information imparted by any employee or member of Congress, as well as a member or employee of the executive or judicial branch, to enter into a future, option or swap. In a similar manner, the STOCK Act prohibits the use of material

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nonpublic information by persons who receive such information from employees or members of Congress or employees or officials of the judicial or executive branch in violation of such government employee's or official's duty under the Exchange Act. Under current insider trading laws, a tippee (i.e. someone who receives insider information) violates the Exchange Act prohibition on insider trading if the tippee knows or should have reason to know that the person providing the tip had a fiduciary duty to keep the information in the tip confidential. If a person knows that information received from an employee or official of the Federal Government is nonpublic and then trades on that information, such person would be engaging in insider trading.

The text of the STOCK Act does not define or explain the term "nonpublic governmental information" for purposes of assessing the duty imposed by Section 21A of the Exchange Act. The corresponding CEA provisions may provide some guidance on this topic: It prohibits government officials or employees or their tippees from entering into derivatives contracts based on

information which has not been disseminated by the department or agency of the Federal Government holding or creating the information or by Congress or the judiciary 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.²

Therefore, unless the information is published in some public manner, the employee or member of Congress or any employee or official of the executive or judicial branch or any person receiving such information must refrain from trading on such information.

While included as part of the Senate Bill, the Congressionally enacted final STOCK Act does not contain provisions requiring persons and firms engaging in political intelligence activities to register under the Lobbying Disclosure Act of 1995. Under the Senate Bill, firms that engage in political intelligence activities (i.e. activities relating to information that is derived from direct communications with an executive branch employee or an employee or member of Congress and that is used to inform investment decisions) would have had to register as political intelligence consultants and identify themselves as such when communicating with executive branch employees or employees or members of Congress. The STOCK Act did not contain these provisions but still requires that the Comptroller General of the United States to prepare a report on such activities and deliver it to Congress. It is unclear at this time what steps Congress will take, if any, after receipt of this report.

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¹ Section 21A of the Exchange Act as amended by Section 9 of the STOCK Act.

² Section 4c(a)(4)(A) of the CEA as amended by Section 5 of the STOCK Act.

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