

INSIDER TRADING

By Attorney Michael H. Wald

By now almost everyone has read about recent "insider trading" scandals. Each day brings some new twist to this problem that plagues the traders of stocks, bonds and other paper investments, what are known as securities. Since the entire area of insider trading is so complex, let's narrow down the topic to a few basic areas. First, we need to define insider trading. This is hard to do as no clear definition exists. Generally, insider trading is considered the use of "material" information, not readily available to the general investing public, on which one or more individuals trade securities for profit. The "key" is that the people who trade with the information know that it is unavailable to the person/persons with whom they are dealing.

The Insider Trading Act of 1984 has a provision in which those who trade on inside information can be made to return any illegal profits plus an additional penalty of three times that amount. While these penalties seem sufficient, they are only part of what can happen. Some traders have been barred from ever again dealing with securities. In addition, they can face civil suits from those investors who were injured by their illegal actions. Severe criminal sanctions are available, too. Convicted traders can and do go to jail, and fines have been imposed. Most of those traders who have admitted their guilt, have been cooperating with the continuing investigation by the government agency which enforces the insider trading laws, the Securities and Exchange Commission (SEC). Even though a few large traders have been caught, the vast majority of insider trading takes place in ways that do not fit within the definition of illegal activity. The reason: people are using "immaterial" information.

Current proposals for reform of insider trading laws call for a better definition of the problem. One proposal would make it illegal to trade on any information that is apt to have a material effect on the price of a security if the information isn't available to a "discerning investor." This is a vast broadening of the law by a mere manipulation of the current definition, and, therefore, is difficult to explain to the general public which is crying out for harsher sanctions. This proposal would encompass the rumors, overheard tips, comments by family members, tips from friends, "the grapevine," and corporate news wire stories in advance of print all of which frequently escape regulation under the current language of the law.

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