The STOCK Act, Insider Trading, and Public Financial Reporting by Federal Officials

Jack Maskell
Legislative Attorney

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Summary

The STOCK Act (Stop Trading on Congressional Knowledge Act of 2012) was signed into law on April 4, 2012. It affirms and makes explicit the fact that there is no exemption from the "insider trading" laws and regulations for Members of Congress, congressional employees, or any federal officials. The law also expressly affirms that all federal officials have a "duty" of trust and confidentiality with respect to nonpublic, material information which they may receive in the course of their official duties, and a duty not to use such information to make a private profit.

The STOCK Act, as part of the law's regulation of securities transactions by public officials, now requires expedited, periodic public disclosure of covered "financial transactions" by all officials in the executive and legislative branches of the federal government who are covered by the public reporting provisions of the Ethics in Government Act of 1978, as amended. The act thus works to require not only *annual* public reporting of such transactions (which reporting has been required since 1978), but also now requires public reporting within 30 days of receipt of a notice of a covered financial transaction (but in no event more than 45 days after such transaction). These periodic reports are filed with reference to any financial transactions of $1,000 or more in securities, but are not required for transactions in mutual funds or income-producing real property.

The act as originally adopted had required all public financial disclosure statements filed under the Ethics in Government Act in the legislative and executive branches to eventually be made in electronic form, and to be posted on the Internet where they may be publicly searched, sorted, and, if a log-in protocol is followed, downloaded from official government websites. Because of safety concerns, privacy threats, and the possibility of malicious use of such data, federal executives and employees complained about the Internet posting of their detailed financial information, and filed suit to stop the requirement to post such information on the Internet. Congress responded by amending the Stock Act to delay the Internet posting requirements of the public personal financial disclosure reports until a study could be made on the potential impact of having such personal financial information available on the Internet. Legislation (S. 716, 113th Congress) was signed into law on April 15, 2013 (P.L. 113-7, 127 Stat. 438) which permanently rescinds the requirement for Internet posting for most covered employees in the legislative and executive branches of the United States Government. However, the requirement for Internet posting of the financial disclosure reports and all financial information filed by Members of Congress, the President and Vice President, candidates for Congress, and federal officials appointed by the President and confirmed by the Senate in positions on the Executive Schedule at Levels I (cabinet level) and II, remains in effect, and such information and reports are still required to be posted on the Internet.

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On April 4, 2012, the STOCK Act (Stop Trading on Congressional Knowledge Act of 2012) was signed into law.[1] The act clarifies and confirms that the "insider trading" rules apply to all government officials, including Members of Congress, and provides for more transparency and access to the reports on the personal financial information, assets, and transactions of federal officers and employees.

The STOCK Act has, in summary, four major features:

- First, the law reaffirms the fact that the existing "insider trading" provisions of securities law and regulations do not contain any exemption or exclusion for Members of Congress, congressional staff, or other federal officials. Furthermore, the law makes explicit the duty of confidentiality and trust that all public employees have concerning material, nonpublic information that comes to them by virtue of their federal employment.
- Secondly, the law requires the establishment of an electronic filing system for certain financial disclosure reports that must be filed by legislative and executive branch officials under the Ethics in Government Act of 1978, and requires that the public reports of personal financial information filed by Members of and candidates to Congress, the President, the Vice President, and presidentially appointed and Senate confirmed officials at levels I (cabinet positions) and level II of the Executive Schedule are to be available to be publicly accessed on the Internet in a searchable and sortable format.
- Thirdly, the law requires public reporting within 30 days after receiving a report concerning, but no later than 45 days after, a covered financial transaction in income-producing property (such as the purchase or sale of stocks or bonds) by all legislative and executive branch personnel who are required to file the annual public financial disclosure reports under the Ethics in Government Act of 1978.
- Finally, the law expands the list of crimes, conviction of which would result in a Member of Congress losing all of his or her creditable service as a Member for congressional pension purposes, and broadens the time period when such conviction would apply to federal pension forfeiture.

Insider Trading

The provisions of the new law expressly affirm that there exists no exemption for Members of Congress, congressional employees, or for other federal officers or employees from the "insider trading" prohibitions in federal securities law and regulation.[2] It should be emphasized that there never was any exemption or exception from the "insider trading" provisions of securities law for Members of Congress, congressional staff, or for other federal employees, and such persons were subject to the insider trading restrictions in the same manner as members of the general public.[3]

[1] P.L. 112-105, 112th Cong., 126 Stat. 291 (2012); S. 2038, 112th Congress, as amended and passed by the House on February 9, 2012, and adopted by the Senate, agreeing to the House Amendments, on March 22, 2012. Amendments to the STOCK Act made by S. 3510, 112th Congress, were signed by the President on August 16, 2012, P.L. 112-173, and revisions to the effective dates for Internet posting of information were also made in P.L. 112-178 and P.L. 112-207.

[2] P.L. 112-105, Sections 4 (Members of Congress and the legislative branch) and 9 (executive and judicial branches).

[3] Securities Exchange Act of 1934, 15 U.S.C. §§78a *et seq.*, specifically 15 U.S.C. §78j(b); and the Insider Trading (continued...)

However, certain media reports and allegations created the public impression that Members of Congress and staff were actually exempt or had "excepted themselves" from the insider trading provisions.[4] This legislation addressed that perception.

In addition to affirming that the insider trading restrictions of securities law and regulation apply to Members of Congress and to other federal officials, the STOCK Act further affirms expressly that each officer and employee of the legislative branch, each executive branch official, and each judicial officer and employee owes a duty of trust and confidence to the United States and the citizens of the United States with respect to material, nonpublic information derived from such person's public employment.[5]

The STOCK Act directs the ethics entities in the House and Senate—the House Ethics Committee and the Senate Select Committee on Ethics—to issue interpretations of chamber rules "clarifying" that Members and staff are prohibited from using nonpublic information derived from their positions "as a means for making a private profit." Although such explicit regulations already exist in the executive branch,[6] the legislation directs that the Office of Government Ethics issue such interpretive guidance, and that the Judicial Conference of the United States issue such guidance to federal judges and to judicial employees.

From the inclusiveness of the language of the legislation, and from previous guidance, it would appear that the restrictions on the use of nonpublic, material information extends not only to trading directly by the Member of Congress or by staff on such information, but would extend also to passing on such material, nonpublic information to another so that such other person may make a private profit for himself or herself, or for the public official.[7]

Commodity Exchange Act

The STOCK Act expressly includes Members and employees of Congress within those employees or agents of the federal government, including all executive branch and judicial branch officers and employees, who are prohibited from using nonpublic information, imparting such

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Sanctions Act of 1984, P.L. 98-376, and 15 U.S.C. §§78t-1(a), (b), and §78ff; S.E.C. regulations at 17 C.F.R. §§240.10b-5, 240.10b-5-1, 240.10b-5-2. *See* testimony of Robert Khuzami, Director, Division of Enforcement, U.S. Securities and Exchange Commission, before the House Financial Services Committee, December 6, 2011 (http://www.sec.gov/news/testimony/2011/ts120611rk.htm); note also Donna M. Nagy, *Insider Trading, Congressional Officials, and Duties of Entrustment,* 91 BOSTON UNIV. L.R. 1105 (2011). Members of Congress were and are subject to the restrictions to the extent that any enforcement action by an entity outside of Congress must conform to the "Speech or Debate" privilege in the United States Constitution, art. I, §6, cl. 1.

[4] See, for example, Wall Street Journal, "Congress's Insider-Trading Non-Scandal," at A15 (November 16, 2011).

[5] P.L. 112-105, Sections 4(b) and 9(b)(2). Existing congressional rules and executive branch regulations and standards recognize such a "duty of trust" of federal officials (See Standing Orders of the Senate, §87, *Senate Manual*, S. Doc. 107-1, at 118-119 (2002); *House Ethics Manual*, 110th Cong., 2nd Sess., at 2 (2008); Code of Ethics for Government Service, ¶ 8 (H. Con. Res. 175, 72 Stat., pt. 2, B12 (July 11, 1958)), 5 C.F.R. §§2635.702, 2635.703. Federal case law has expressly recognized the "fiduciary" relationship of trust towards to the public inherent in the position of a Member of Congress. United States v. Podell, 572 F.2d 31, 32 (2d Cir. 1978).

[6] 5 C.F.R. §§2635.702, and 2635.703.

[7] See House Ethics Committee discussion of "tipping" violations, in Memorandum to All House Members, Officers and Employees, "Rules Regarding Personal Financial Transactions," November 29, 2011; see 15 U.S.C. §78j(b), and 17 C.F.R. §240.10b-5.

nonpublic information, or stealing or converting nonpublic information to purchase or sell commodities, commodities futures, or options, for personal gain.[8]

Initial Public Offerings (IPOs)

The STOCK Act amends the Securities Exchange Act of 1934 to provide that all officers or employees of the federal government who are required to file annual public financial disclosure reports under the Ethics in Government Act are prohibited from purchasing securities that are the subject of an "initial public offering ... in any manner other than is available to members of the public generally."[9]

Public Financial Disclosure Reports

Under existing and pre-STOCK Act law, Members of Congress and certain employees of the legislative branch (including those paid at a rate of pay exceeding 120% of the base salary of a GS-15), as well as executive branch officials who occupy "a position classified above GS-15," or, if not on the General Schedule are in a position compensated at a "rate of basic pay ... equal to or greater than 120 percent of the minimum rate of basic pay payable for GS-15," are generally subject to the public financial disclosure provisions of the Ethics in Government Act of 1978, as amended.[10] Those employees compensated at the rate of pay described above are required to file detailed public financial disclosure statements by May 15 of the following year if the individual works for the government for more than 60 days in the calendar year. These disclosure reports have been available to the public for viewing at the office of the agency ethics officer, or a copy may be furnished to those requesting a copy.[11]

Elimination of Mortgage Exemption for Personal Residences of Certain Officials

Under existing law in the Ethics in Government Act, one of the "liabilities" of over $10,000 that did not have to be disclosed on an annual personal financial disclosure report was the mortgage on officers' or employees' personal residences.[12] By removing the exemption for such disclosure from reports made by the President, the Vice President, Members of Congress, and nominees and incumbents in positions which are appointed by the President and confirmed by the Senate (other than Foreign Service officials below the rank of ambassador, military personnel at or below grade 0-6, or special government employees), the STOCK Act now requires disclosure of information about the mortgages on such officials' own personal residences.[13]

[8] P.L. 112-105, Section 5, amending the Commodity Exchange Act, 7 U.S.C. §6c(a).

[9] P.L. 112-105, Section 12, amending 15 U.S.C. §78u-1.

[10] See now 5 U.S.C. app. §101(f).

[11] 5 U.S.C. app. §105(b).

[12] 5 U.S.C. app. §102(a)(4)(A).

[13] P.L. 112-105, Section 13.

Prompt Public Reporting of Financial Transactions

The Ethics in Government Act of 1978 has, since its enactment, required the *annual* public reporting of all "transactions" in income-producing property of over $1,000 in value for covered executive and legislative branch officers and employees.[14] This requirement applies generally to the purchase or sale of such assets as stocks, bonds, commodity futures, or other securities, as well as the purchase or sale of real property which is income producing (such as rental property).

The STOCK Act requires, as of July 3, 2012, the public reporting of covered transactions exceeding $1,000 in many of these income-producing assets to be made within 30 days of receiving notice of the transaction, but not later than 45 days after the transaction, from all federal officers and employees in the legislative and executive branches who are required to file public financial disclosure reports under the Ethics in Government Act of 1978, as amended.[15] This requirement for more prompt public reporting of financial transactions will *not* apply to a widely held investment fund, such as mutual funds, if the fund is publicly traded, the assets are widely diversified, and the reporting individual neither exercises nor is allowed to exercise control over the financial interests of the fund.[16] Furthermore, the periodic transaction reports generally apply only to transactions in securities, and do not apply to transactions in things such as real property. Such transactions in income producing real property, or in such holdings as mutual funds, must still, however, be reported on the *annual* financial disclosure reports of the official. In clarifications adopted as an amendment to the STOCK Act in August of 2012, it is now clear that reporting individuals who are required to file periodic transaction reports must file such reports with respect to covered transactions by the official's spouse or dependent children, except in very limited and unusual circumstances.[17]

Although the requirement for Internet posting of the periodic financial transaction forms filed by most federal officials will be rescinded in legislation recently passed by Congress, the underlying requirement to report such transactions to the proper, relevant ethics office within 30 days of receiving notice of the transaction, but not later than 45 days after the transaction, remains in force and continues to be required by *all* covered officials—that is, for all public filers—in the legislative and executive branches of government.

Internet Posting of Disclosure Reports; Electronic Reporting

The STOCK Act as originally adopted had required the posting on the respective official websites of the House and Senate the annual financial disclosure reports, as well as the new prompt reporting disclosures of financial transactions, made in 2012 by Members, officers of the House

[14] 5 U.S.C. app. §102(a)(5). Such reporting is also required of judicial branch employees and federal judges and justices. 5 U.S.C. app. §102(f)(11) and (12).

[15] P.L. 112-105, Section 6.

[16] P.L. 112-105, Section 14.

[17] P.L. 112-173, Section 2, 126 Stat. 1310 (August 16, 2012). With respect to filers in the House of Representatives, the periodic reporting of spousal and dependent children transactions is effective January 1, 2013. P.L. 112-178, Section 3(a), 126 Stat. 1409 (September 28, 2012).

or Senate, candidates to Congress, and employees of the entire legislative branch who are required to file public financial disclosure reports under the Ethics in Government Act.[18] Similarly, the public disclosure reports made in 2012 by officers and employees of the entire executive branch under the Ethics in Government Act (including the periodic transactions reports) had been required under the original provisions of the STOCK Act to be posted on the official websites of the respective executive branch agencies.[19] In subsequent reporting years, these reports were to be posted on the publicly accessible websites no later than 30 days after filing.[20]

With regard to such Internet postings of the detailed financial information of nearly 30,000 federal employees in the executive and legislative branches of government, concerns were expressed by federal employees, officials, and employee associations over increasing the opportunities and potential for identity theft, the increased prevalence of "data mining" on the Internet for malicious purposes, and concerns over the safety of federal workers and their families, particularly those who serve abroad. Additionally, a group of federal executive employees filed suit against the provision in the United States District Court for the Southern District of Maryland.[21] In that case, on March 27, 2013, the court denied in part the government's motion to dismiss the suit, and strongly indicated its view that forced publication of employees' financial reports on the Internet, in light of new technologies and communications, might violate a constitutional "right to informational privacy" of federal employees.[22] Although the Supreme Court and courts in other federal circuits have not necessarily recognized an expanded personal "privacy" right under the Constitution to this extent,[23] the District Court in Maryland indicated that such interests were protected under precedents in the Fourth Circuit.

In response to such concerns and judicial actions, Congress had delayed the implementation of the requirement for Internet posting of personal financial data for most federal officials until the potential impact of these new Internet disclosures may be studied by the National Academy of Public Administration [NAPA].[24] Issuing their study on March 28, 2013, the NAPA, in a detailed report, concluded that "the online posting requirement does little to help detect conflicts of interest and insider trading, but that it can harm federal missions and individual employees."[25] The panel thus recommended that "the online posting requirement be indefinitely suspended while continuing the implementation of all the other provisions of the STOCK Act."

Under the latest amendments to the STOCK Act passed by Congress, the disclosure reports and periodic transactions reports for high level officials—the President, Vice President, Members of Congress, candidates to Congress, and Presidential appointed and Senate confirmed officials on

[18] P.L. 112-105, Section 8(a)(1) .

[19] P.L. 112-105, Section 11(a)(1).

[20] P.L. 112-105, Sections 8(a)(1), 11(a)(1).

[21] Senior Executives Association v. United States, Civil Action No. 8:12-cv-02297 (S.D. Md. March 27, 2013).

[22] The court had earlier, on September 13, 2012, granted a motion for a temporary preliminary injunction upon the implementation of the requirement for Internet posting of such information for executive branch employees.

[23] See, e.g., discussion of "informational privacy" in Congressional Research Service, Library of Congress, THE CONSTITUTION OF THE UNITED STATES OF AMERICA, ANALYSIS AND INTERPRETATION [CONSTITUTION ANNOTATED], S. Doc. 108-17, at 1778-1787 (2004); see also Duplantier v. United States, 606 F.2d 654 (5th Cir. 1979), upholding public financial disclosure requirement of the Ethics in Government Act for federal judges against privacy challenge.

[24] P.L. 112-178, Section 2, 126 Stat. 1408-1409 (September 28, 2012).

[25] National Academy of Public Administration, THE STOCK ACT: AN INDEPENDENT REVIEW OF THE IMPACT OF PROVIDING PERSONALLY IDENTIFIABLE FINANCIAL INFORMATION ONLINE, at *i* ,53-61(March 2013).

the Executive Schedule I (cabinet level) and Executive Schedule II—continue to be required to be posted on the Internet.[26] However, for all other officers and employees in the legislative and executive branches of government who must file public reports with their agencies, these reports will no longer be required to be posted on the Internet.[27]

By January 1, 2014, the Clerk of the House and Secretary of the Senate, as well as the appropriate entities in the executive branch of government, are instructed to develop and implement an electronic filing system for the financial disclosure reports required to be filed under the Ethics in Government Act for Members of and candidates for Congress, the President, the Vice President, and presidentially appointed and Senate confirmed officials on Levels I and II of the Executive Schedule.[28] The system is to allow the public to search these reports on the Internet and, with a login, to be able to download the reports. The system for the executive branch is to be maintained on the official website of the Office of Government Ethics.

In the legislative branch, the reports filed by Members of Congress are to be kept for a period of six years after the date the person is no longer a Member; and other reports filed by legislative officers and employees are to be retained for a period of six years after receipt.[29]

Pensions of Members of Congress

Under current law, if convicted of certain offenses relating to corruption in public office while serving as a Member, a Member of Congress forfeits all of his or her creditable service as a Member for federal pension purposes.[30] This bill expands that provision so that a Member of Congress would lose the credit for service as a Member for pension purposes if convicted of one of the numerous corruption offenses not only during time served as a Member of Congress, but also if convicted of any of such offenses while the President, the Vice President, or as an elected official of a state or local government.[31]

The STOCK Act also adds numerous other federal criminal laws for which a final felony conviction would result in losing creditable service as a Member of Congress for federal pension purposes. Such other criminal offenses include conflicts of interest (18 U.S.C. §203); conspiracy to make false claims (18 U.S.C. §286); making false claims to the government (18 U.S.C. §287); vote buying (18 U.S.C. §597); illegal solicitation of political contributions from federal employees (18 U.S.C. §602); soliciting political contributions in a federal building or office (18 U.S.C. §607); theft, conversion, or embezzlement of government funds or property (18 U.S.C. §641); false statements to the government (18 U.S.C. §1001); obstruction of proceedings before

[26] S. 716, 113th Congress, now P.L. 113-7, 127 Stat. 438 (April 15, 2013).

[27] S. 716, 113th Congress, Section 1, P.L. 113-7, 127 Stat. 438 (April 15, 2013); see also P.L. 112-173, Section 1, 126 Stat. 1310 (Aug. 16, 2012); P.L. 112-178, Section 1(a) and (b), 126 Stat. 1408 (September 28, 2012), and P.L. 112-207, Section 1 (December 7, 2012).

[28] S. 716, 113th Congress, Section 1(b), P.L. 113-7, 127 Stat. 438 (April 15, 2013).

[29] P.L. 112-105, Section 8(c).

[30] 5 U.S.C. §8332(o) (CSRS), and 5 U.S.C. §8411(l) (FERS), added by the "Honest Leadership and Open Government Act of 2007," P.L. 110-81, title IV. See also "Hiss Act" provisions, at 5 U.S.C. §8311 et seq., relating to national security offenses. See generally, CRS Report 96-530, *Loss of Federal Pensions for Members of Congress Convicted of Certain Offenses*, by Jack Maskell.

[31] P.L. 112-105, Section 15(a).

government agencies (18 U.S.C. §1505); attempt to evade or defeat paying taxes (26 U.S.C. §7201), among other offenses.[32]

Other Provisions

Influencing Private Employment Decisions

Section 18 of the Stock Act amends 18 U.S.C. Section 227 to include officers and employees of the executive branch of government in the prohibition on wrongfully attempting to influence private employment decisions based on partisan political affiliations.

Negotiations for Post-Government Employment

The STOCK Act now requires any individual who must file a public financial disclosure report under the Ethics in Government Act to report all negotiations or agreements for future private employment within three days after commencement of such negotiations or agreement to the employee's supervising ethics office, and then to recuse himself or herself when there is a conflict of interest or an appearance of a conflict of interest "with respect to the subject matter of the statement."[33] These provisions do not appear to supersede, but appear to add to, the existing criminal conflict of interest provision in 18 U.S.C. Section 208. With respect to all executive branch employees, 18 U.S.C. Section 208 requires recusal of such executive branch officer and employee from any particular governmental matter when that matter may affect the financial interests of "any person or organization with whom he [the employee] is negotiating or has any arrangement concerning prospective employment." Additionally, there are detailed executive branch regulations on negotiating and seeking private employment, at 5 C.F.R. Section 2635, Subpart F, Sections 2635.601 - 2635.606.

Bonuses to Fannie Mae and Freddie Mac Executives

The STOCK Act prohibits the receipt of bonuses by "senior executives" at the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation during any period of conservatorship for those entities after the passage of this act.[34]

Study on Political Intelligence

The STOCK Act had required a report to be made by the Comptroller General of the Government Accountability Office, in consultation with the Congressional Research Service, within one year concerning the role of "political intelligence" in the financial markets, including the extent that such information sold is considered nonpublic; the legal and ethical issues in the sale of political intelligence; benefits from imposing reporting and registration requirements on those who engage in political intelligence; and legal and practical issues in imposing such reporting and registration

[32] P.L. 112-105, Section 15(b).

[33] P.L. 112-105, Section 17.

[34] P.L. 112-105, Section 16.

requirements.[35] The Government Accountability Office has released this report discussing potential issues in the implementation of such registration requirements, the difficulties of measuring the impact of a particular piece of "political intelligence" on financial markets, the practical issues in attempting to determine the public or non-public nature of particular disclosures, and discussing the costs versus the benefits of a registration scheme for political intelligence firms similar to the registration of lobbyists and lobbying firms.[36]

Author Contact Information

Jack Maskell
Legislative Attorney
jmaskell@crs.loc.gov, 7-6972

[35] P.L. 112-105, Section 7.

[36] United States Government Accountability Office, "POLITICAL INTELLIGENCE, Financial Market Value of Government Information Hinges on Materiality and Timing," GAO-13-389 (April 2013).