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What’s So Wrong With Insider Trading Anyway?

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An investment banker passes along a tip to his brother about upcoming mergers involving his bank’s clients. The brother slips the tip to his brother-in-law, who uses the information to make more than $1 million from trading he did ahead of the deals. There’s no evidence that the banker received compensation for leaking the information, other than possibly some warm fuzzies for helping a family member make a lot of money. Is their family relationship enough to justify convicting the brother-in-law for insider trading? Or did the banker need to receive something tangible — say, a fancy new car or a duffel bag full of cash — in return?

Today, the Supreme Court is trying to figure out the answer to those questions. The court will hear arguments in Salman v. United States, a case in which Bassam Salman, the brother-in-law in the scenario above, is asking the court to reconsider his conviction on charges of conspiracy and securities fraud. It’s a case that could bring the government’s sweeping crackdown on insider trading — led by federal prosecutors in New York, who have brought charges against more than 100 people since 2009 — to a screeching halt.

The case revolves around the question of what qualifies as insider trading. More specifically: Must the person leaking the information benefit financially? That riddle has bedeviled government prosecutors since a federal appeals court ruled in 2014 that the person providing the tip must receive a concrete reward for leaking information and the person receiving information must know about it.

To everyday investors, the situation in Salman’s case may seem plain unfair: Why should he get the information — and the financial rewards it brings — just because he has a relative able to spill corporate secrets? But critics of insider-trading regulations ask, “What’s so wrong with insider trading anyway?” Markets rely on the exchange of information, after all, and that makes the line between standard financial research and an illegal exchange of nonpublic information notoriously difficult to draw. A select few shouldn't be able to benefit from special access that lets them trade on impending news before the public can act on it, but the stock market relies on people digging up new and valuable pieces of information for their own profit. In the process, they clarify how much companies are worth.

For years, some economists and lawyers have argued that insider trading is essentially a victimless crime. Others contend that insider trading is good for the economy. The debate goes back at least as far as 1966, when a legal scholar named Henry Manne published a book arguing that insider trading is benign, or even useful, because more information makes the stock market more efficient and accurate — no matter how the information has been acquired. If this is true, then passing tips back and forth among family members could just be another aspect of trading.

Critics of insider trading, however, believe that insiders should not benefit from leaking information in advance, which is one reason the definition of "benefit" is so crucial to the overall concept. In Salman's case, the government is arguing that sharing tips with relatives *does* offer a benefit, albeit one that's not as concrete as cash, for example. Any other definition, it claims, would allow corporate insiders to pass all kinds of nonpublic information to their relatives or friends to use how they wished, as long as the insiders received no compensation in return. Salman's attorneys, on the other hand, say that if the government isn't required to prove that the tipper received a material benefit, almost anyone who receives a stock market tip could get caught in the insider dragnet. Collecting data on people engaged in insider trading is difficult, but according to a forthcoming study, exchanges of information like the one in Salman's case could account for a sizable proportion of the illegal information flowing through the stock market: 23 percent of the "tippers" and "tippees" in the study were family members and 35 percent were friends.

Ross Levine, a professor of finance and banking at the University of California-Berkeley, said there's evidence to show that insider trading can hurt the economy. "There are logical arguments to be made for not worrying too much about insider trading, but empirically, they're outweighed by the fact that insider trading seems to damage the integrity and functioning of markets," he said. For example, he said, if stock market outsiders believe they have less accurate information than insiders, they'll perceive prices to be inaccurate and be less willing to invest in a particular firm, driving down the share price.

There's also evidence that enforcing insider trading laws can encourage innovation. In a 2015 study, Levine compared countries that had implemented insider-trading laws at different points to see if there were differences in the amount and quality of new products and ideas. He found that for industries that produced intangible products like software, following through on insider trading laws spurred innovation. Because it's harder to assess the value of tech firms than, say, a steel company, outside investors need to feel that they're on close-to-level footing with insiders. If the outsiders feel their research is accurate, they can invest in the companies with the best products, which in turn promotes innovation. "That's how the market is supposed to work," Levine said. "Without those laws, the market would deteriorate."

Samuel Buell, a professor at Duke University School of Law, told me that insider trading isn't a victimless crime. The victim is the market, he said, which in turn affects the economy as a whole. But it is an invisible crime, which makes its impact harder to assess empirically. This is compounded by the fact that the current state of insider trading law *is* confusing and counterintuitive — in large part because there is no statute prohibiting it. Instead, the law of insider trading has been built by the courts over the past 80 years, based on a Depression-era law banning securities fraud.

"Things would be much simpler if instead of this device the courts have jerry-rigged over the years, we actually had a law that states who has a duty to refrain from trading certain kinds of information and who doesn't," Buell said. But because the Supreme Court's role isn't to create new law, it can only add to the existing system, rather than offering a new one.

Terry Hendershott, a finance professor at the University of California-Berkeley, agreed that clearer legal boundaries are necessary so that it's plain to everyone what's permitted and what isn't. But he cautioned against placing too many restrictions on the flow of information. "People inside the financial system are professionals, so they're always going to know more than the average investor, and that's the way it should be," he said. Ideally the professionals shouldn't pay bribes to acquire it, but if the pros can't dig up more information than amateurs, Hendershott said, "they should find another job."

If the ruling in the Salman case results in substantial new challenges for prosecutors trying to put insider traders behind bars, one question is whether that will make investors more or less confident in the market. "In the end, market confidence is all about perception, not reality," Buell said. "Insider-trading prosecutions can make it seem like cheaters are getting caught or that there are lots of cheaters out there."

If Congress tries to make new insider-trading laws in response to the ruling, it's likelier to be moved by a basic fairness argument about equal access to information than by an argument about economic efficiency. But even an attempt to draw a new legal line between legitimate financial research and insider trading may not satisfy everyday investors' yen for fairness. "If the market was completely fair, that would mean nobody knew anything," Hendershott said. "The challenge is to stamp out theft in a way that doesn't stop people from doing their own research and discovering what firms are worth. But we shouldn't delude ordinary people into thinking that they can beat the professionals, just because we have laws against insider trading."

Insider trading, high frequency trading, computer driven algorithms and short sellers. Almost sounds like a Billy Joel song. Naked short selling?Â That's what they get for beating out Goldman Sachs for the coveted "Lead Underwriter" role in what will become a Harvard Business School case study. In Morgan Stanley's case that puts an entirely new wrinkle on insider trading allegations. In this case, the non-public information was not used to initiate an action. It wasn't used to buy or dump shares.Â No one gets hurt because there was bound to be a loser anyway on the transaction, if you believe in Zero Sum kinetics. If anything, the Rajaratnam series of events indicates that what is so called "insider information" doesn't even necessarily lead to profits. But what drives insider trading laws, and what bothers most people about it, is the issue of fairness. Trading on insider information is not a victimless crime. There is another party on the other side of that transaction, since the number of shares in the market is fixed. What are that personâ€™s (or investment fundâ€™s) rights? My guess is that Sokolâ€™s situation is not something that will result in any kind of criminal charge, though it may result in SEC sanctions. Raj Rajaratnam, on the other hand, is fighting for his future in a courtroom. If courtroom testimony and the confessions of others w Uncategorized. October 5, 2016. Whatâ€™s So Wrong With Insider Trading Anyway? by admin. 0. Share: An investment banker passes along a tip to his brother about upcoming mergers involving his bankâ€™s clients. The brother slips the tip to his brother-in-law, who uses the information to make more than $1 million from trading he did ahead of the deals. Thereâ€™s no evidence that the banker received compensation for leaking the information, other than possibly some warm fuzzies for helping a family member make a lot of money.Â Itâ€™s a case that could bring the governmentâ€™s sweeping crackdown on insider trading â€” led by federal prosecutors in New York, who have brought charges against more than 100 people since 2009 â€” to a screeching halt. â€“ read more. Share What's being stolen? The information. From whom, who created and owns the information?Â So insider trading is considered bad in a society only if you want companies to be able to raise money through public securities offerings. Promoted by Adam Fayed. I have some savings of around 70k pounds.Â Aside from whether it is right or wrong, there are real questions about the ability to enforce these laws. I think the SEC brings something like 200 cases a year. There are something like 17000 public companies.