

Testimony
Before the Committee on House Administration
Hearing on “Examining Stock Trading Reforms for Congress”

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Chairperson Lofgren, Ranking Member Davis, and distinguished members of the Committee on House Administration, my name is Jennifer Schulp, and I am the Director of Financial Regulation Studies at the Cato Institute’s Center for Monetary and Financial Alternatives.

I thank you for the opportunity to take part in today’s hearing entitled, “Examining Stock Trading Reforms for Congress.”

As you know, the questions raised by members of Congress trading stocks are not new. They were most recently addressed by the STOCK Act in 2012,¹ as amended in 2013, which clarified the applicability of insider trading prohibitions to lawmakers and required periodic disclosure of stock transactions. Despite the passage of that Act, concerns have persisted about the stock trading activities of lawmakers, including some trading during the COVID-19 pandemic that has drawn both public scrutiny and governmental investigations. In response, many have questioned whether members of Congress should be subject to further restrictions on their abilities to hold or trade stocks.

Despite recent polling that shows widespread public support for banning lawmakers from owning or trading individual stocks,² these measures are not justified to prevent insider trading by members of Congress and fail to consider the broader question of addressing conflicts of interest that is necessary to increase the public’s trust in Congress. Because financial conflicts of interest present complex tradeoffs—not easily solved by a simple prohibition on

¹ Stop Trading on Congressional Knowledge Act of 2012 (STOCK Act), Pub. L. No. 112-105, 126 Stat. 291 (2012).

² Data for Progress, available at https://www.filesforprogress.org/datasets/2021/2/dfp_feb_21_congress_stocks_toplines.pdf; Karl Evers-Hillstrom, “Three in four vote support banning lawmakers from trading stocks: poll,” The Hill (January 6, 2022), available at <https://thehill.com/homenews/news/588630-76-percent-of-voters-support-banning-lawmakers-from-trading-stocks-poll>; Claire Williams, “Most Voters of All Parties Support Congressional Stock Trading Restrictions,” Morning Consult (January 19, 2022), available at <https://morningconsult.com/2022/01/19/ban-stock-trading-congress-poll/>.

conduct—the better focus is on increasing transparency. In this way, the STOCK Act laid the correct foundation of disclosure for both discouraging legally questionable trading and providing voters with important information about the potential and actual conflicts of interest that their elected representatives face.

New Restrictions Are an Unnecessarily Broad Solution to Prevent Insider Trading

The STOCK Act made clear that members of Congress could be subject to insider trading liability for trading on material, non-public information learned from a member’s official duties.³ Preventing such insider trading has been widely invoked today as a reason for prophylactically banning lawmakers from owning or trading individual stocks. But such measures are not tailored to address a problem that already has legal remedies, and such broad restrictions have the potential to themselves create other negative consequences.

To begin, despite headlines to the contrary, there is little evidence that unlawful insider trading is widespread on Capitol Hill. Recent research has found that lawmakers reap no particular outsized return on their stock investments, including for investments made in areas where lawmakers hold committee assignments.⁴ Research finding that there is a congressional advantage in trading tends to draw on pre-STOCK Act trading data⁵ or to present anecdotal conclusions.⁶

It is true that even in the absence of this evidence, there is a public perception fed by questionable trading that members of Congress may be using information to trade for their own financial advantage. Questioning lawmakers’ trading is more than fair, and has been made possible, in part, by the STOCK Act’s reporting requirements. But determining whether such trading is unlawful is already contemplated by existing law. Just because no insider trading prosecutions have been brought against lawmakers under the STOCK Act’s provisions since its enactment—or that prosecuting insider trading violations by members of Congress is

³ STOCK Act, § 3; 15 U.S.C. § 78u-1(g).

⁴ William Belmont, Bruce Sacerdote, Ranjan Sehgal and Ian Van Hoek, “Relief Rally: Senators As Feckless As the Rest of Us at Stock Picking,” National Bureau of Economic Research Working Paper 26975 (April 2020), available at <https://www.nber.org/papers/w26975>; William Belmont, Bruce Sacerdote, Ranjan Sehgal and Ian Van Hoek, “Do senators and house members beat the stock market? Evidence from the STOCK Act,” *Journal of Public Economics* 207 (2022). These studies examine trading between 2012 and 2020, and find no superior investment performance for members of Congress. These studies are consistent with a study examining pre-STOCK Act trading. Andrew C. Eggers and Jens Hainmueller, “Capitol Losses: The Mediocre Performance of Congressional Stock Portfolios, 2004-2008,” *The Journal of Politics*, Vol. 75, No. 2 (April 2013), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1762019.

⁵ Serkan Karadas, “Trading on Private Information: Evidence from Members of Congress” (2015), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2712297. This study uses a data set of congressional trading from 2004-2010, prior to the STOCK Act, to conclude that the performance of congressional portfolios is driven by private information acquired by lawmakers.

⁶ Unusual Whales, “Congressional Trading in 2021,” available at https://unusualwhales.com/i_am_the_senate/full. While this type of analysis may be useful for providing voters with information about their elected representatives, it is not rigorous analysis of whether insider trading occurs, or is widespread, among lawmakers.

challenging for a number of reasons⁷— it does not follow that their stock ownership or trading should be prohibited, especially where there is no evidence that potential violations of the law are widespread.

Moreover, limiting the flow of information to the market from any particular subset of traders has the potential to harm market efficiency.⁸ Prohibitions on insider trading already have this effect by preventing a stock’s price from reflecting all of the information known about the stock. A broad-based ban on stock trading or ownership could add to that inefficiency by preventing lawmakers’ trades from contributing information that allows the markets to engage in price discovery. Because the type of information that members of Congress are privy to relates not just to individual companies, but to entire industries and the whole economy, it would be desirable for such information to be absorbed quickly into the market, rather than kept out—particularly when doing so does not violate existing insider trading law.

Finally, and perhaps most importantly, a stock ownership or trading ban enacted to prevent insider trading by members of Congress does not appear to address the actual problem faced by legislators. The Securities and Exchange Commission (SEC) considers insider trading to “undermine investor confidence in the fairness and integrity of the securities markets.”⁹ But, there is reason to believe that the public polling calling for congressional stock trading reform does not indicate a crisis of faith in the markets, but rather indicates a lack of trust in lawmakers.¹⁰ That issue requires a different—and wider—frame of reference for considering policy solutions.

New Restrictions Are a Poor Solution for Addressing Existing Conflicts of Interest

Focusing solely on the question of trading or owning individual stocks obscures the broader questions of preventing lawmakers from using their positions for personal, financial gain and combatting the public perception that lawmakers are doing so. This task is complicated by the fact that members of Congress are uniquely positioned: they have access to information that may impact the value of particular stocks, and they have the ability to impact

⁷ Robert Anello, “How Senators May Have Avoided Insider Trading Charges,” *Forbes* (May 26, 2020), available at <https://www.forbes.com/sites/insider/2020/05/26/how-senators-may-have-avoided-insider-trading-charges/?sh=5c9e238e27ba>.

⁸ See, e.g., Henry G. Manne, “Insider Trading: Hayek, Virtual Markets, and the Dog that Did Not Bark,” *Journal of Corporation Law*, Vol. 31, No. 1 (Fall 2005), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=679662.

⁹ U.S. Securities and Exchange Commission, Investor.gov, “Insider Trading,” available at <https://www.investor.gov/introduction-investing/investing-basics/glossary/insider-trading>.

¹⁰ Congressional Job Approval, RealClearPolitics, available at https://www.realclearpolitics.com/epolls/other/congressional_job_approval903.html (showing a composite job approval for Congress at 21%); Pew Research Center, “Public Trust in Government: 1958-2021,” available at <https://www.pewresearch.org/politics/2021/05/17/public-trust-in-government-1958-2021/> (finding only 24% of respondents in April 2021 trust government to do what is right just about always or most of the time).

the value of particular stock themselves by legislating, calling for investigations, or otherwise exerting their political influence.

These potential conflicts of interest can exist not only in a lawmaker's ownership of individual stocks, but also in their ownership of mutual funds and exchange traded funds, their crypto holdings, and their business interests, among other places. Indeed, a very similar potential for personal enrichment exists with respect to holdings in investment funds that track the performance of other assets, regardless of the diversification of those funds, because lawmakers are privy to information that affects more than just individual companies. Importantly, these conflicts of interest are not limited to the lawmaker alone but may arise through the interests of their families and staff. Restricting a lawmaker's abilities to own or trade individual stocks addresses only a narrow portion of these potential conflicts and, as such, may do little in the long-term to enhance voters' trust in Congress.

The question, then, is how to manage this multitude of potential conflicts. The overarching framework to addressing this question is the Ethics in Government Act.¹¹ While this framework does restrict some lawmaker conduct, the primary method employed is disclosure. To that end, lawmakers are subject to extensive financial disclosure requirements, including annual disclosures about their assets, liabilities, and income.¹² The STOCK Act's disclosure requirements supplement these annual disclosures by requiring periodic disclosure of certain financial transactions in stocks, bonds, commodities, futures, and other securities. Given the interrelationship between stock holdings and other financial interests, and the similar conflicts presented by each, stock holdings should be subject to the same method of conflict mitigation as other financial interests.

While it is tempting to conclude that the only way to manage a conflict of interest is to eliminate it, such a solution is impractical when looking at the range of potential financial conflicts of interest that lawmakers face. Moreover, seeking to eliminate a particular conflict—such as trading in individual stocks—may have wider effects on the quality of representation that voters receive, either by discouraging some from running for elected office or by decreasing the connections between representatives and the impact of the decisions that they are making.

Transparency Best Balances the Interests of Voters

Instead of relying on prohibitions, which are incomplete and may have unintended consequences, disclosures bring the conduct of lawmakers into the light, permitting judgment by both the voters who grant them their positions and those tasked with enforcing the laws.

¹¹ 5 U.S.C. §101, *et seq.*

¹² U.S. House of Representatives Committee on Ethics, Instruction Guide Financial Disclosure Statements and Periodic Transaction Reports (2020), available at <https://ethics.house.gov/sites/ethics.house.gov/files/documents/CY%202020%20Instruction%20Guide%20for%20Financial%20Disclosure%20Statements%20and%20PTRs.pdf>.

The STOCK Act provides a good foundation for this transparency. In fact, watchdog groups have aggregated this information in user friendly formats for voters and others to use.¹³

The STOCK Act, however, has fallen short of its potential in some respects. As has been widely reported, lawmakers have a poor record in complying with the trade reporting requirements,¹⁴ and penalties for non-compliance have been inconsistently applied.¹⁵

It is premature to declare the disclosure regime of the STOCK Act insufficient when it has not been consistently enforced. Options should be considered for increasing compliance with the STOCK Act's disclosure requirements, including ensuring the consistency of penalties for noncompliance. The level and structure of penalties should also be revisited to ensure that penalties are sufficient to provide a deterrent effect to discourage noncompliance. Given technological improvements since the STOCK Act was passed, it is worth considering whether aspects of reporting can be automated, easing both submission by lawmakers and review for compliance with the requirements.

It is also worth revising the disclosure requirements of the STOCK Act to determine whether additional transparency is desirable and feasible. For example, there currently is a long lag between the execution of a trade and the deadline for disclosure: 30 days after the transaction or no more than 45 days after the trade if the lawmaker did not become aware of the trade when executed. Lawmakers are given a 30-day grace period beyond those generous time periods before which their submission is determined to be non-compliant. The grace period itself seems to be at odds with timely reporting, but even the required reporting periods are multiple times longer than required by the SEC for trade reporting by public company insiders.¹⁶ Shortening the time for reporting would provide additional transparency.

It is also worth considering whether additional transparency should be provided with respect to lawmaker non-compliance. Publicly reporting when disclosure was not filed in a timely manner and when a lawmaker was penalized for such deficiencies can provide information to voters as to whether their elected representatives are meeting their disclosure obligations.

¹³ A number of websites track this information, including Capitol Trades (<https://www.capitoltrades.com/>), House Stock Watcher (<https://housestockwatcher.com/>), Senate Stock Watcher (<https://senatestockwatcher.com/>), among others.

¹⁴ Dave Levinthal, "57 members of Congress have violated a law designed to stop insider trading and prevent conflicts-of-interest," Business Insider (March 3, 2022), available at <https://www.businessinsider.com/congress-stock-act-violations-senate-house-trading-2021-9>.

¹⁵ Camila DeChalus, Kimberly Leonard, and Dave Levinthal, "Congress and top Capitol Hill staff have violated the STOCK Act hundreds of times. But the consequences are minimal, inconsistent, and not recorded publicly," Business Insider (December 15, 2021), available at <https://www.businessinsider.com/congress-stock-act-violations-penalties-consequences-2021-12>.

¹⁶ By way of comparison, corporate insiders must report trades to the SEC within two business days. See Securities and Exchange Commission, Insider Transactions and Forms 3, 4, and 5, available at <https://www.sec.gov/files/forms-3-4-5.pdf>.

Enhancing transparency permits voters to choose whether the conflicts faced by their elected representatives are problematic, even if those trades are perfectly legal. Providing voters with the information to make those choices limits unintended consequences of additional restrictions and puts the choices in the hands of the voters, where they belong.

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Thank you for the opportunity to provide this information, and I welcome any questions that you may have.