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Congress Finally Addresses Insider Trading. . . For Itself

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Insider trading has been of great attention over the last few years, resulting in some high profile prosecutions and large fines. Yet, until very recently, Congress has been immune from the constraints against insider trading. Both the Senate and House of Representatives recently passed bills that would prevent their members from trading on confidential market-moving information.

One aspect of the bills should be of particular interest for the hedge fund industry because it seeks to rein in the so-called "political intelligence" industry. The sponsor of the Senate bill, Joseph Lieberman, defined political intelligence as information intended to be used in analyzing the markets and, in turn, for the purposes of informing investment decisions. Under the bill, political intelligence firms who sell this information will have to register similar to lobbyists. Another key aspect of the bill is the restriction against trading on pertinent confidential information that may impact the decision making of certain asset managers that rely on the use of political intelligence.

In the face of the duty of confidentiality, there may be a large impact on firms that supply political intelligence and on the asset managers who rely upon it. One study showed that the use of political intelligence is, ultimately, more important to investment firms than the fundamentals of a company. The firms that trade on political intelligence stand to be the most impacted if this legislation passes.

In the end, some form of the bills will pass. The issue will be whether political intelligence is available any longer or, if so, to what extent can this information be used to make investment decisions. In the end, firms that either trade in or rely upon political intelligence will be forced to revisit their business models to address the ever changing regulatory world in which we live. The key will be flexibility to address these changes as they come to pass.