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Insider Trading

Tamar Frankel

*Boston University School of Law, tfrankel@bu.edu*

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INSIDER TRADING

Tamar Frankel*

ABSTRACT

This article focuses on the nature and position of corporate insiders. The discussion leads to a suggestion that one punishment of insiders who misappropriated what is not theirs—the information—is to disqualify them for a position of corporate power.

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* Professor of Law Emerita, Boston University School of Law.
I. INTRODUCTION

FIFTY years ago, the Supreme Court interpreted Rule 10b-5 under the Securities Exchange Act of 1934, imposing criminal sanctions on insider traders. In that case, the trading was triggered by information, discovered by some employees of Texas Gulf Sulphur Corporation, that had the potential of greatly raising the value of the corporation’s shares. The employees bought options on the corporation’s shares in the hopes of benefiting from the high probability of an extraordinary rise in the value of the shares.

With time, the number of court cases involving insider trading has risen. Arguments about the range and detail of the prohibition have continued. Millions of dollars in fines and even prison sentences in a few cases have not seemed to deter these violations. The purpose of this Article is to analyze the source of insider trading fraud and propose an additional type of punishment, which might be more persuasive to potential violators and more effective in preventing insider trading.

Part I of the Article discusses the definition of the term “insider trading.” Part II describes the kind of information that constitutes “inside information.” Part III offers the reasons for prohibiting the use of inside information before the information becomes public. Lastly, Part IV proposes to add a type of punishment to deter insider traders and those who pay for insider information.

II. WHAT DOES TRADING BY INSIDERS MEAN?

This question is not unreasonable. After all, securities investors have different expertise, different free time to follow the markets, different ability to judge market trends and information, and different risk tolerance. Let each investor and trader gather information about which investments to buy and sell and “let the best information-gatherer win!” Besides, there are many experts in the securities trading area who, like doctors, lawyers, and experts in finance, offer advice to investors. These experts could counteract those who have insider information.

Yet, the reaction of the securities experts is puzzling. It seems that quite a few experts in this area would gladly pay for insider information. The reason why these experts are ready and eager to purchase insider information lies in the nature of this type of information. This information is not expert information. Anyone, or almost everyone, with sufficient basic knowledge of the securities markets could understand it, evaluate it, and decide whether to act upon it. Insider information is information that is (i) not usually hard for investors to understand; (ii) not publicly available; and most importantly (iii) timely information for investments. Traders

2. See SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 856 (2d Cir. 1968) (en banc).
3. See id. at 841–42, 844.
on inside information do not need special wisdom or special risk tolerance. The prohibition on insider trading is linked to (i) **fraud by trusted persons** and (ii) **its impact on the securities markets**.

Trusted persons (i.e., fiduciaries) may not misappropriate or offer to others information that does not belong to them. How does fraud on the corporations relate to the securities markets rules? In this case the use of insider information involves two combined wrongs. One is the use of misappropriated—stolen—information. It is information that does not belong to the trading insiders. This information is not false. In fact, it is usually quite reliable. But it is entrusted to insiders as fiduciaries. Fiduciaries may not use it for their own benefit, as the information does not belong to them.

The other part of the wrong is its adverse impact and fraud on the investing public. To be sure, investors in the securities markets do not have equal information about traded securities. They may, and can, draw information from various sources, paid and unpaid, direct and overheard. However, insiders commit fraud not only on the source of the entrusted information, but also on the other outside investors and the market system.

Yet, investors are not required to draw on the same sources of information. So, why is drawing on this particular source of insiders deemed fraud on the securities system? One answer is that no investor may use information received fraudulently. The use of the stolen information perpetuates fraud on a societal level—on the investors in these securities as well as on the securities markets.

Thus, fraud on the issuing corporation constitutes fraud on the investors as well as on the securities markets as institutions, which fraud corrupts. This is why even if the source of the insider information agreed to its use by the insiders, the insiders’ trades are fraudulent. Whenever the information that affects corporate securities market prices is not publicized and insiders make use of it, the outside investors are defrauded, and the financial system becomes tainted with suspicion and mistrust. Insider trading links fraud of the corporation’s shareholders with fraud of the securities markets.

The law does not require equality of knowledge or wisdom, or low or high risk tolerance of the investing securities traders. But, it does require securities issuers to disclose information in order to maintain a measure of investors’ trust in the securities market. No one may spread false information to mislead investors. Laws that require securities issuers to disclose information require the information to be true. The concept of

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4. See 17 C.F.R. § 240.10b-5.
5. See id.; see also Chiarella v. United States, 445 U.S. 222, 228 (1980) (holding that a duty to disclose material information arises when a party has information another party is entitled to know because of a fiduciary relation between them); Dirks v. Sec. Exch. Comm'n, 463 U.S. 646, 655–61 (1983) (extending liability to tippee where insider has breached its fiduciary duty by disclosing to tippee and tippee knows or should know of breach); United States v. O'Hagan, 521 U.S. 642, 651–63 (1997) (recognizing liability
fraud includes not only distribution of misinformation but also unfair preference related to the source of information, regardless of whether the information is false or not.

Therefore, the Securities and Exchange Commission (SEC) rule dealing with insider trading grounds its prohibition in fiduciary duties of “trust and confidence” of insiders to their corporations or to other sources of their information. Rule 10b-5 imposes a “duty of trust or confidence” under a list of circumstances: “[w]henever a person agrees to maintain information in confidence,” whenever a person communicates material nonpublic information and knows or should know that the person that communicated the nonpublic information expects it to be confidential, or when the information is received from a “spouse, parent, child, or sibling.”

III. WHAT KIND OF INFORMATION CONSTITUTES INSIDE INFORMATION?

Usually, inside information has a number of features:

(i) The information is very likely to significantly affect the market prices of particular securities, either bringing the securities’ prices up or down, in a very short time. For example, in the Texas Gulf Sulphur case, the information involved a discovery by a mining corporation of a very rich ore in land, which was not yet fully acquired by the corporation, but the corporation had legal rights to acquire. The corporation was expected to fairly quickly negotiate with the land owner and announce its finding, leading to a substantial rise in the price of its securities. In fact, the insiders bought options to buy the corporation’s securities, rather than the corporation’s securities themselves, thus reducing the possible rise in the securities prices before the announcement of the information. In addition, options were less expensive than the price of the securities and thereby had a greater potential of increasing the insiders’ profits. As expected, the corporation did not announce the discovery and waited until the land was acquired.

(ii) Very few people know this information. In Texas Gulf Sulphur, the corporation covered the excavations, which revealed the rich finding. This coverage reduced the potential spread of the information to noninsiders. Other investors would have found it near impossible or very costly to discover this information. Therefore, they were not likely to buy the corporation’s securities, and thus would not raise the demand and the price of the securities.

(iii) The situation provides an opportunity for insiders to gain high returns by quick and fairly low-risk investments once the information is

where insider trades in shares of his corporation on basis of material nonpublic information or where a person misappropriates confidential information for securities trading purposes in breach of a duty owed to the source of information).

6. 17 C.F.R. § 240.10b5-2(b)(1)–(3).

7. See Texas Gulf Sulphur Co., 401 F.2d at 843–57.
made public, and investors will then rush to buy the corporation’s securities.

(iv) The prohibition on the use of inside information covers not only the insiders but also any person in possession of inside information that tips others about it, as well as a knowing “tippee” who trades on the basis of the information. Furthermore, the tipper—the insider—need not benefit financially from his or her tipping.8 That is, perhaps, because tipping inside information to others can provide psychological and other satisfactory present or future rewards. The harm to the system and to other investors need not be linked to the insider’s financial rewards so long as it rewards the tippees.

Insider trading is pernicious and appears in other contexts prohibited by law. Thus, a special kind of insider trading—market timing—has arisen in the context of investment companies. In this case, investors in shares of a mutual fund pay the fund’s managers for information about content of the fund’s portfolio securities. This information was made public only at 4:00 p.m. of each day on which the New York Stock Exchange was open.9 Only those who paid for the information could redeem their shares or buy fund shares at a profitable price. Moreover, continuous redemptions and purchases by these informed investors harmed uninformed investors because the increased trading in the funds’ shares required fund managers to keep more cash and raised trading costs as well.10

Another form of insider trading involves members of Congress dealing in policy decisions that affect publicly traded companies. The Stop Trading on Congressional Knowledge (STOCK) Act directs the congressional ethics committees to issue guidance clarifying that a member or employee of Congress may not use nonpublic information derived from their position or “gained from the performance of [their] official responsibilities as a means for making a private profit.”11 In addition, the Act makes it clear that “[m]embers of Congress and employees of Congress are not exempt from the insider trading prohibitions arising under the securities laws,”12 Further, the Act requires members of Congress and congressional staff to report certain financial transactions,13 and also requires that financial disclosure forms of members and employees of Congress be made available

12. Id. § 4(a); see id. § 4(b)(2) (codified at 15 U.S.C. § 78u-1(g) (2012)) (providing that “each [m]ember . . . or employee of Congress owes a duty arising from a relationship of trust and confidence . . . with respect to material, nonpublic information derived from such person's position . . . or gained from the performance of such person's official responsibilities”).
13. See id. § 6 (codified at 5 U.S.C.A. app. 4 § 103(f) (West 2012)).
to the public. 14 But, Congress subsequently eliminated the online disclosure requirement for these financial transaction reports. 15

A somewhat similar issue arises in an entirely different context, but with a similar result relating to trade secret issues. 16 “The relationship between an employer and an employee is a confidential one.” 17 When the employee’s knowledge and skills are “tied up” with trade secrets 18 and their employee is “intimately familiar” with the trade secret from the employment, there is a “substantial likelihood” that the knowledge will be used in the subsequent employment. 19 Where “there is a high degree of probability that the subsequent competitive employment will lead to the wrongful use or disclosure” of trade secrets, an employer may be able to enjoin such employment even if there was no covenant not to compete. 20

IV. WHAT ARE THE REASONS FOR PROHIBITING THE USE OF INSIDE INFORMATION?

A. WHAT ARE THE DIFFERENCES BETWEEN EXPERTS AND INSIDERS?

Not all investors are experts. If the uninformed investors suspect, or are convinced, that the informed expert investors will do better in their trading, they may either refrain from trading or may seek experts to guide them. Therefore, experts can benefit from their expertise either by trading on their own account or by offering their expertise to nonexperts and charging for their services.

The expertise required in determining securities investments is first composed of general knowledge of the securities markets and information about particular issuers. The second aspect of expertise can be derived from insider trading. Both expert trading and insider trading have this feature in common. The judgment of both is affected by information about a particular issuer, and in both cases the information might impact the issuer’s securities prices within a relatively short period of time.

14. See id. § 8 (codified at 5 U.S.C.A. app. 4 § 105 (West 2012)).
16. 1 ROGER M. MILGRIM & ERIC E. BENSEN, MILGRIM ON TRADE SECRETS § 5.01, at 5-3 (Matthew Bender & Co. 2017) (1967).
17. Id. at § 5.02[1], at 5-6 (updated Apr. 2015).
18. See id. at § 5.02[3][d], at 5-43 (updated Sept. 2011).
19. See id. at 5-43 to -50.
20. See id. at § 5.02[3][d], at 5-55 to -56 (updated Dec. 2013) (internal citations omitted).
B. **Why Is Trading on Expert Information Permissible While Trading on Inside Information Constitutes a Criminal Offense?**

One answer to this question of why trading on expert information is permissible, while trading on inside information constitutes a criminal offense, is that anyone can buy the service of experts. This is because it is available, while, by definition, timely and important inside information is not publicly available, nor is it available to experts. Society benefits and is enriched by experts and their service to nonexperts. Therefore, the use of experts does not constitute a violation of the law; on the contrary, it is encouraged by law.

In addition, usually, experts are fiduciaries. They are legally prohibited from using their knowledge at the expense of those who rely on them. After all, when the truth is uncovered, not only those who suffered from breach of trust but others as well will shun the experts. Thus, if it is difficult to distinguish the true and honest experts from the fraudulent ones, investors will avoid all experts to the detriment of society at large.

C. **Insiders May or May Not Be Experts, but Are the Holders of Unique Information**

Insiders are trusted not to use their inside information, which others cannot legally gain or use. Therefore, it is not the use of any information, but rather the use of *nonpublic information* that constitutes information use as a violation of the law. This nonpublic information can be stolen, bought, and even created. In all these situations, the use of this information could undermine the public's trust in the markets, and thus harm both individuals and the system as whole.

D. **The Main Assumption Underlying Rule 10b-5 and the Texas Gulf Sulphur Case Is That Investors' Trust Is a Basic Condition to Assuring Successful Securities Markets**

Investors' trust is a foundation of the securities system. We learned that when trust is undermined, the securities markets will dry up, as they did in 1929, and to some extent in 2008. Being sensitive to the impact of market "runs," we have established a highly detailed regulatory system to avoid them. In great part, the regulation is based on disclosure of the truth, the whole truth, and nothing but the truth. Law imposes on issuers a duty to publicly offer relevant detailed information about the corporation's affairs, as well as trustworthiness (fiduciary duties) on in-
termediaries,\textsuperscript{21} advisers,\textsuperscript{22} and managers of pooled securities investments (mutual funds).\textsuperscript{23}

Thus, the crucial part of Rule 10b-5 consists of regulating the source of nonpublic information, that is, the insiders—those who by virtue of their position acquire information or create information that outside investors do not have. And, as noted, the information (and use of the information), which the insiders possess, is not theirs. They hold the information as fiduciaries; if they use it for any other purpose besides that for which they hold it, they are deemed to have stolen the information.

It should be noted that if the same information is used by outsiders who happened to overhear it or gain it without collaboration with insiders, the use of this same information by these outsiders is not prohibited.\textsuperscript{24} That is because the wrong is not merely in possessing inside information, but in its use by (i) insiders or (ii) others who knowingly accept from insiders the information and use it.

E. Throughout the Years, the Number of Cases Against Insiders Who Traded on Inside Information Has Risen and the Analysis of the Cases Has Become Very Detailed\textsuperscript{25}

In addition, executives who wish to buy or sell stock in their own company must file Form 4 with the Securities and Exchange Commission.\textsuperscript{26} Yet, ways to circumvent the prohibition on insider trading have increased with cunningness and complexity. Insider trading has been linked to numerous items contained in other items, with little information about their source. Further, the use of technology and the construction of items within items has drowned insider trades, thus making the string of insiders harder to identify. If a link or part of the items subject to the violation

\textsuperscript{21}. See e.g., \textit{In re Daisy Sys. Corp.}, 97 F.3d 1171, 1178–80 (9th Cir. 1996) (finding a fiduciary relationship between investment banker and client based on facts and circumstances); Leib v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 461 F. Supp. 951, 953–54 (E.D. Mich. 1978), aff'd, 647 F.2d 165 (6th Cir. 1981) (holding that broker has fiduciary duty to customer with nondiscretionary account or where “broker has usurped actual control over a technically non-discretionary account”).


\textsuperscript{23}. See 15 U.S.C. § 80a-35(b) (2012) (imposing fiduciary duty on adviser of an investment company with respect to compensation paid by company to adviser).

\textsuperscript{24}. See Chiarella v. United States, 445 U.S. 222, 228 (1980).


\textsuperscript{26}. U.S. SEC. & EXCH. COMM’N, FORM 4, STATEMENT OF CHANGES OF BENEFICIAL OWNERSHIP OF SECURITIES, https://www.sec.gov/about/forms/form4data.pdf [https://perma.cc/L494-Ff6M].
is missing then, arguably, no violation was committed, regardless of the results.

An example of outsiders trading with the help of insiders in mutual funds is the Putnam case, which reflects the Texas Gulf Sulphur principles. In that case, insiders—the managers of mutual funds—knew the details of the funds’ trades.\(^\text{27}\) The trades were large, and they had an impact on market prices. This was the inside information, as the outside shareholders did not have it, and could not have acquired it unless they were told by the insiders. The fund managers and other insiders had no difficulty in buying or selling the securities to be traded by the funds and thereby gain or avoid losses from the funds’ large trades that affected market prices. But, conversely, outside shareholders did not have this information and could not gain or avoid losses.

Interestingly, the assets managed by Putnam were significantly reduced not so much by the court’s decision or its application but by the investors, who happened to be very large institutions. After they withdrew their investments, Putnam remained alive, but nearly empty. Although it never regained its prior size, it has survived and may be growing.\(^\text{28}\)

Insiders are trusted not to use inside information that others cannot legally acquire or learn about. Therefore, it is not the use of any information, but the use of any information that is nonpublic information that makes the use a violation of the law. Such inside information could be stolen, bought, or created.

The Putnam case and the Texas Gulf Sulphur case reflect the same violation. In the Putnam case there were insiders—managers of funds—who knew when and how much they would trade in fund assets. In Texas Gulf Sulphur, the employees knew about the discovery and its implication.

V. A SUGGESTED APPROACH TO DETER INSIDER TRADING

Currently, the mechanisms for deterring insider trading consist of money fines, sometimes very large, and, increasingly, prison sentences.\(^\text{29}\)


For example, the SEC “obtained a $13.9 million penalty against former Goldman Sachs board member Rajat K. Gupta for illegally tipping corporate secrets to former hedge fund manager Raj Rajaratnam.” Gupta was also “permanently barred from serving as an officer or director of a public company.” Gupta allegedly “disclosed confidential information to Rajaratnam about Berkshire Hathaway Inc.’s $5 billion investment in Goldman Sachs, as well as nonpublic details about Goldman Sachs’s financial results.” In addition, the SEC obtained a $92.8 million penalty judgment against Rajaratnam, which was “the largest penalty ever assessed against an individual in an SEC insider trading case.”

If we shift our focus from the impact of insider trading on the market to the insider traders themselves, we generally find that they are not the hungry kind. In fact, many are wealthy individuals in high corporate and financial entity positions. They hire excellent lawyers, fight with the regulators, and settle the cases against them by paying large sums of money. Yet, they do not lose face. It seems that they continue to have the support of their colleagues and, in general, maintain the backing of colleagues. Needless to say, there is a continued search for loopholes in the law and for ways to get around the regulation and the regulators.

For example, Rule 10b5-1 allows insiders to trade when the trades coincide unintentionally with inside information. That was assured by creating a “fixed formula” for trading. Therefore, if a trade coincided with inside information, it would not be in violation of the law if the trade followed the formula—blindly and automatically. However, one such insider began to change and adjust the formula of the fixed trades, presumably according to his inside information, whether specific or general. Thus, the mechanism no longer assured that the trades were not affected by insider information. But, this insider was charged with violating the rule. In sum, this case demonstrates that one can trade on inside information even though one seems not to be doing so.

The number of cases against inside traders demonstrates that insiders who trade on inside information have found sufficient justifications for continuing to do so. On September 8, 2017, Bloomberg noted that three

31. Id.
34. See 17 C.F.R. § 240.10b5-1 (2017).
of a corporation’s “senior executives sold shares worth almost $1.8 million in the days after the company discovered a security breach that may have compromised information on about 143 million U.S. consumers,” and the corporation waited over a month before it disclosed that breach.\textsuperscript{36} The Securities and Exchange Commission announced on September 7, 2017, that it charged a former Amazon financial analyst who leaked confidential information to friends.

It is significant that among these traders are insiders in hedge funds who typically serve very wealthy investors and organizations, and are themselves quite wealthy by any standard.\textsuperscript{37} These facts do not deter insiders from gaining money the “insider trading way.” Therefore, further solutions should be sought. One way is to examine the type of traders who might usually violate the law. If they are sued, then their activities are publicized.

There are wealthy persons who have paid insiders for their inside information.\textsuperscript{38} There are insiders who traded information with other insiders.\textsuperscript{39} There are groups of insiders who meet in various social and athletic functions that can trade valuable information.\textsuperscript{40} Apart from the money, there are desirable psychological benefits for insiders who crave recognition and a sense of belonging to the powerful elite.\textsuperscript{41}


\textsuperscript{41} See, e.g., Emily A. Malone, Note, Insider Trading: Why to Commit the Crime from a Legal and Psychological Perspective, 12 J.L. & Pol’y 327, 333–35 (2003) (suggesting that in ImClone scandal (1) by selling stock before information was released traders would avoid loss and “not endanger the social status they enjoyed as wealthy individuals”; (2)
In sum, inside information can be an important source of power and money for insiders, the position holders, the wealthy, and the actors close to the management of other people’s money. Not surprisingly, many of these insiders occupy fiduciary positions.

A. How Does the Law Deter Insider Trading?

Inside traders face “collateral consequences” on conviction. For example, an inside trader “is often unable to return to his or her livelihood after serving imprisonment.” Further, a Securities and Exchange Commission enforcement action for insider trading is “damaging” to one’s career. Thanks to the Internet and Google, “an SEC case would result in the loss of job and become a permanent record on Google.” A criminal conviction can be even more damaging. “The collateral damage from the felony record is a preclusion from various lines of work, making rebuilding much more tough.”

B. However, While Inside Traders May Not Be Able to Continue Their Career in the Same Capacity, They May Be Able to Maintain a Positive Lifestyle

One hedge fund manager settled with the SEC and was barred from managing other investors’ money. His hedge fund pleaded guilty in an insider trading scandal and was shut down. However, the fund was converted to a “family office” and the manager set up a hedge fund next door. He maintained his lifestyle, including his $13 billion net worth, his art collecting, his philanthropic activities, and was believed to be attempting to redeem himself to again be allowed to handle other investors’ money. Indeed, a number of white-collar criminals have returned from prison to enter “polite society.” For example, some have written memoirs, some have become television personalities, some have formed their own firms or become involved with consulting or in public relations, and one even founded a philanthropic foundation.

broker “could have enjoyed potential career advancement associated with sharing inside information with an important client”; and (3) CEO, “by tipping off friends and family, would have strengthened his social relationships with them” (citing ELIZABETH SZOCKY, THE LAW AND INSIDER TRADING: IN SEARCH OF A LEVEL PLAYING FIELD 5 (1993); Charles Gasparino & Jerry Markon, Merrill Aide Will Plead Guilty, Cooperate on Martha Stewart, WALL ST. J., Sept. 26, 2002, at A1)).

42. See Hristova, supra note 25, at 303 (citing Ellen S. Podgor, The Challenge of White Collar Sentencing, 97 J. CRIM. L. & CRIMINOLOGY 731, 739 (2007)).

43. Id. (quoting Podgor, supra note 42, at 739).


C. How Can the Law Further Deter Such People from Benefitting from Their Position?

In addition to monetary punishment, the law should explicitly authorize courts to disqualify or demote such traders from any position as insiders—that is, any position that enabled them to gain, find out, or receive inside information. For example, insider traders should be disqualified from acting in the capacity of a director and officer of any public enterprise, in whatever form that takes. In addition, insider traders should be disqualified from acting in any service that involves financial trading or financial institutions, or any other service that involves contact with these institutions and services. Such a prohibition is already imposed on fiduciaries and parties that are involved in the financial arena.47 In addition, insider traders should be disqualified from acting in certain fiduciary positions for life, or disqualified for a specific period of time. Such disqualifications are neither unique nor new. Lawyers,48 physicians,49 brokers,50 and advisers51 have been subject by law to these types of disqualifications for many years.

Thus, this prohibition should state that no one who was found to have violated the prohibition on insider trading or on tipping inside information should be permitted to serve as a director, officer, employee, majority shareholder, servicer, or outside servicer of any kind, for any institution, whether a corporation or any other legal organization. No such person should hold any such position in a privately held or a publicly held entity. The court, or the jury, or a regulator, might choose among these positions and allow or disallow a defendant to act in such a capacity. The court or jury should also establish the period of the prohibition. Further, similar deterrents should be imposed on those who pay insiders for inside information.

Some insider traders may be hungry for more money, disdain the regulators, be proud of their smart circumvention of the law, and enjoy bragging about their cunning ways around the law. One usual weakness of such people is the pain of public shame.52 To be sure, there are people

47. See 15 U.S.C. § 80a-9(b) (2012) (authorizing SEC to prohibit persons from serving in certain capacities for investment company or certain affiliates); id. § 80b-3(f) (authorizing SEC to suspend or bar persons from association with investment adviser).
49. See, e.g., MASS. GEN. LAWS ch. 112, § 5 (2013) (authorizing board of registration in medicine to "revoke, suspend, or cancel" certificate of physician registration).
50. See FINRA R. 8310(a)(3)-(4) (2008) (stating that FINRA may suspend membership of member, expel member, or cancel membership of member).
52. See Hristova, supra note 25, at 306 (suggesting that shaming may be particularly appropriate for insider traders as “reputation and the loss of reputation are of particular importance to inside traders, who are unlikely to take challenges to their public images lightly”); Jayne W. Barnard, Reintegrative Shaming in Corporate Sentencing, 72 S. CAL. L.
who do not care how they are described publicly. But, there are many who do. Being publicly shamed conflicts with insider traders fundamental drive to be admired and envied. Therefore, a threat of shame may be more deterring to such people, as they may not be bothered by a court judgment that they have done wrong or by chastisement in the press. However, disqualification and shame may be an effective deterrent.

Commentators have suggested that some business leaders are narcissists and that narcissists have characteristics that would make them suited to being business leaders. In addition, a sample of British senior business managers had “statistically equivalent mean scale scores” of narcissism compared with mental illness and psychopathic disorder patient samples.

The American Psychiatric Association’s Diagnostic and Statistical Manual of Mental Disorders sets out the diagnostic criteria for “narcissistic personality disorder”:

A pervasive pattern of grandiosity (in fantasy or behavior), need for admiration, and lack of empathy, beginning by early adulthood and present in a variety of contexts, as indicated by five (or more) of the following:

1. Has a grandiose sense of self-importance (e.g., exaggerates achievements and talents, expects to be recognized as superior without commensurate achievements).
2. Is preoccupied with fantasies of unlimited success, power, brilliance, beauty, or ideal love.
3. Believes that he or she is “special” and unique and can only be understood by, or should associate with, other special or high-status people (or institutions).
4. Requires excessive admiration.
5. Has a sense of entitlement (i.e., unreasonable expectations of especially favorable treatment or automatic compliance with his or her expectations).
6. Is interpersonally exploitative (i.e., takes advantage of others to achieve his or her own ends).
7. Lacks empathy: is unwilling to recognize or identify with the feelings and needs of others.
8. Is often envious of others or believes that others are envious of him or her.

Rev. 959, 967 (1999) (suggesting that “especially for top-level managers and members of their social class, fear of being shamed before their family members and peers may even exceed the fear of criminal prosecution, exposure to civil lawsuits, or other forms of officially imposed sanctions”).


54. See Board & Fritzon, supra note 53, at 23–25.
(9) Shows arrogant, haughty behaviors or attitudes.\textsuperscript{55}

Parts of criterion (2) above (i.e., preoccupation with success and power) suggest that some business leaders might be deterred by the possibility of loss of their position or a prohibition on, or disqualification regarding, their activity. More business leaders may be deterred by shame. Shame may be defined according to the measures of behavior (not the terms of the legal and fair measures), and may be a punishment that some persons, especially in prominent positions, might fear almost as much as prison.\textsuperscript{56} Conversely, absence of any publicity may be as painful a punishment for criminal activity. Erasing a well-known person’s public notoriety can be tremendously painful to a person who basks in it.

Publicity, or perhaps absence of admiring publicity, can constitute a severe punishment for some people. However, this type of punishment may open the door to the regulators’ unconstitutional activities. To be sure, we do not have such punishments in our criminal code or securities regulation. But, the press may be offered an opportunity to serve society by showing that insider traders are engaging in criminal offenses. This notoriety might deter.

These findings need not be generalized, but they may support disqualification of insider traders. After all, when leadership changes its behavior, the culture of most, if not the entire group of followers, is likely to change as well. The punishment suggested here may lead not only to pain for some wrongdoers, but also to a culture of principles, which power-holders are more likely to follow and lead their followers to.

\textsuperscript{55} AM. PSYCHIATRIC ASS’N, DIAGNOSTIC AND STATISTICAL MANUAL OF MENTAL DISORDERS 669 (5th ed. 2013).

\textsuperscript{56} See Dan M. Kahan & Eric A. Posner, Shaming White-Collar Criminals: A Proposal for Reform of the Federal Sentencing Guidelines, 42 J.L. & ECON. 365, 370–71 (1999) (arguing that shaming, unlike fines, causes reputational damage and, like imprisonment, “eliminates the possibility of generating new assets through cooperative ventures”). Similarly, shaming may be more effective than fines. See id. at 381 (arguing that fines “are open to the interpretation that society is attaching a price tag to, rather than prohibiting, the punished behavior: we cannot condemn someone morally for buying what we are willing to sell, even if we are charging a high price for it”).