Insider Trading Laws Haven’t Kept Up With the Crooks

The laws around insider trading are outdated and unclear. They don’t even define “insider trading.” We have a way to fix that.

By Preet Bharara and Robert J. Jackson Jr.
Mr. Bharara is a former United States attorney. Mr. Jackson is a Securities and Exchange commissioner.

Oct. 9, 2018

America’s insider trading laws are hopelessly out of date. As a result, fraudsters have evaded law enforcement scrutiny, and honest market participants are sometimes confused about the rules of the road.

As a former United States attorney for Manhattan (Mr. Bharara) and a current commissioner of the Securities and Exchange Commission (Mr. Jackson), we have sworn to uphold and enforce the law, to protect the fairness and integrity of our financial markets against those who would undermine them. Our work is guided by a simple idea: If you engage in misconduct that harms investors, you should be held accountable.

Insider trading cases are of special significance. They are a manifestation of America’s basic bargain: that the well-connected should not have unfair advantages over the everyday citizen. When regulators and prosecutors make a commitment to punish insider trading, it sends a message that you don’t need special access to make an honest buck. Fighting insider trading is a refusal to accept a rigged system.

But the truth is, we often struggle to hold bad actors accountable for insider trading. In large part, that’s because our insider trading laws do not clearly define what the standard is.

Unlike most other developed countries, the United States lacks a law that expressly bans insider trading. Instead, the government brings insider-trading cases under a Depression-era law that generally prohibits “fraud” in securities markets. As a result, what we now understand as the laws against insider trading have been written by federal judges in their decisions interpreting a statute that never mentions the words “insider trading.” Although there is a commonly accepted idea of what constitutes insider trading — trading based on material, nonpublic information associated with a breach of duty — that can be a difficult legal standard to apply.
The result is a legal haziness that leaves both investors and defendants unclear about what sorts of information-sharing or other activities by investors would be considered insider trading, and what are the acceptable forms of data-gathering and research that are part of any healthy, functioning financial marketplace.

The government’s commitment to fairness should be unambiguous. But, while the government has brought many strong insider trading cases, a good bit of insider trading law remains ambiguous.

Suppose that a corporate insider gives a friend nonpublic information — a planned merger that has not yet been announced, for example — and the friend makes illicit profits trading on that information. Can the insider be held accountable? The answer, it turns out, depends on whether a court is convinced that the insider obtained a “benefit” by tipping her friend — a subject on which judges of all stripes often disagree. Ordinary investors may be surprised to learn that there is any confusion about this question. And defendants facing potential criminal liability should have more clarity about what the law is.

Or what if a hacker finds his way into a corporate computer system and trades on the sensitive information he uncovers? Will that hacker face charges of insider trading? This time, the answer depends on whether the information was obtained through sufficiently “deceptive” practices, like misrepresenting one’s identity to gain access to information, rather than just mere theft, like exploiting a weakness in computer code. Again, we think ordinary investors would be deeply concerned that any trading on the basis of hacked information might evade punishment. Insider trading law should not allow the possibility that profits obtained through illicit trading could fund the cyberattacks that the American government and companies are constantly facing.

The uncertainty in insider trading law invites debate over the legality of misconduct that has no place in our markets. But this is a fixable problem: The law can be updated and made clearer. Ideally, Congress would take the lead. But bipartisan proposals to update the law have languished for years. The S.E.C., however, does have the authority to clarify insider trading law. The commission should use that authority before the next wave of corporate abuses.

That’s why we are announcing the creation of the Bharara Task Force on Insider Trading, a panel of experts that will propose new insider trading reforms to protect American investors.
The task force will be led by Mr. Bharara and will consist of eight distinguished former regulators and prosecutors, judges, academics and defense lawyers who have agreed to put forth concrete proposals to update the insider trading law. We hope the S.E.C., and perhaps even Congress, will consider the group’s recommendations.

The shoddy state of American insider-trading law affects everyone. Prosecutors and regulators are stuck enforcing laws that are ill-suited to 21st-century misconduct. Lawyers struggle to tell their clients what they can and cannot do within the bounds of the law. And ordinary Americans are left asking whether financial markets are stacked in favor of those who skirt the rules. Our law should leave no doubt about the answer to that question.

Preet Bharara was the United States attorney for the Southern District of New York from 2009 to 2017. Robert J. Jackson Jr. is a member of the Securities and Exchange Commission.

*Follow The New York Times Opinion section on Facebook and Twitter (@NYTopinion).*