

## INSIDER TRADING PROHIBITION ACT

SEPTEMBER 27, 2019.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Ms. WATERS, from the Committee on Financial Services,  
submitted the following

### R E P O R T

together with

### MINORITY VIEWS

[To accompany H.R. 2534]

[Including cost estimate of the Congressional Budget Office]

The Committee on Financial Services, to whom was referred the bill (H.R. 2534) to amend the Securities Exchange Act of 1934 to prohibit certain securities trading and related communications by those who possess material, nonpublic information, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

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The amendment is as follows:  
Strike all after the enacting clause and insert the following:

**SECTION 1 SHORT TITLE.**

This Act may be cited as the “Insider Trading Prohibition Act”.

**SEC. 2. PROHIBITION ON INSIDER TRADING.**

(a) IN GENERAL.—The Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is amended by inserting after section 16 the following new section:

**“SEC. 16A. PROHIBITION ON INSIDER TRADING.**

“(a) PROHIBITION AGAINST TRADING SECURITIES WHILE IN POSSESSION OF MATERIAL, NONPUBLIC INFORMATION.—It shall be unlawful for any person, directly or indirectly, to purchase, sell, or enter into, or cause the purchase or sale of or entry into, any security, security-based swap, or security-based swap agreement, while in possession of material, nonpublic information relating to such security, security-based swap, or security-based swap agreement, or relating to the market for such security, security-based swap, or security-based swap agreement, if such person knows, or recklessly disregards, that such information has been obtained wrongfully, or that such purchase or sale would constitute a wrongful use of such information.

“(b) PROHIBITION AGAINST THE WRONGFUL COMMUNICATION OF CERTAIN MATERIAL, NONPUBLIC INFORMATION.—It shall be unlawful for any person whose own purchase or sale of a security, security-based swap, or entry into a security-based swap agreement would violate subsection (a) (referred to in this subsection as the ‘communicating person’), wrongfully to communicate material, nonpublic information relating to such security, security-based swap, or security-based swap agreement, or relating to the market for such security, security-based swap, or security-based swap agreement, to any other person if—

“(1) the other person—

“(A) purchases, sells, or causes the purchase or sale of, any security or security-based swap or enters into or causes the entry into any security-based swap agreement, to which such communication relates; or

“(B) communicates the information to another person who makes or causes such a purchase, sale, or entry while in possession of such information; and

“(2) such a purchase, sale, or entry while in possession of such information is reasonably foreseeable.

“(c) STANDARD AND KNOWLEDGE REQUIREMENT.—

“(1) STANDARD.—For purposes of this section, trading while in possession of material, nonpublic information under subsection (a) or communicating material nonpublic information under subsection (b) is wrongful only if the information has been obtained by, or its communication or use would constitute, directly or indirectly—

“(A) theft, bribery, misrepresentation, or espionage (through electronic or other means);

“(B) a violation of any Federal law protecting computer data or the intellectual property or privacy of computer users;

“(C) conversion, misappropriation, or other unauthorized and deceptive taking of such information; or

“(D) a breach of any fiduciary duty, a breach of a confidentiality agreement, a breach of contract, or a breach of any other personal or other relationship of trust and confidence.

“(2) KNOWLEDGE REQUIREMENT.—It shall not be necessary that the person trading while in possession of such information (as proscribed by subsection (a)), or making the communication (as proscribed by subsection (b)), knows the specific means by which the information was obtained or communicated, or whether any personal benefit was paid or promised by or to any person in the chain of communication, so long as the person trading while in possession of such information or making the communication, as the case may be, was aware, consciously avoided being aware, or recklessly disregarded that such information was wrongfully obtained or communicated.

“(d) DERIVATIVE LIABILITY.—Except as provided in section 20(a), no person shall be liable under this section solely by reason of the fact that such person controls or employs a person who has violated this section, if such controlling person or employer did not participate in, profit from, or directly or indirectly induce the acts constituting the violation of this section.

“(e) EXEMPTED TRANSACTIONS.—

“(1) IN GENERAL.—The Commission may, by rule or by order, exempt any person, security, or transaction, or any class of persons, securities, or transactions, from any or all of the provisions of this section, upon such terms and conditions as it considers necessary or appropriate, if the Commission determines that such action is not inconsistent with the purposes of this section. The prohibitions of this section shall not apply to any person who acts at the specific direction of, and solely for the account of, a person whose own securities trading, or communications of material, nonpublic information, would be lawful under this section.

“(2) AUTOMATIC TRADING.—

“(A) IN GENERAL.—Not later than 180 days after the date of the enactment of this section, the Commission shall determine if any automatic trading transactions should be exempted from any of the provisions of this section and shall make such determination available to the public, including on the website of the Commission.

“(B) INTERIM APPLICATION.—During the period between the date of the enactment of this section and the date on which the Commission makes a determination pursuant to subparagraph (A), automatic trading transactions shall be exempted from the provisions of this section.

“(C) AUTOMATIC TRADING TRANSACTION DEFINED.—For the purposes of this paragraph, the term ‘automatic trading transaction’ means any purchase or sale of a security, security-based swap, or security-based swap agreement that—

“(i) occurs automatically; or

“(ii) is made pursuant to an advance election.”

(b) CONFORMING AMENDMENTS.—The Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is further amended—

(1) in section 21(d)(2), by inserting “, section 16A of this title” after “section 10(b) of this title”;

(2) in section 21A—

(A) in subsection (g)(1), by inserting “and section 16A,” after “thereunder,”; and

(B) in subsection (h)(1), by inserting “and section 16A,” after “thereunder,”; and

(3) in section 21C(f), by inserting “or section 16A,” after “section 10(b)”.

#### PURPOSE AND SUMMARY

H.R. 2534, the Insider Trading Act, sponsored by Rep. Jim Himes, formally codifies the prohibition against insider trading, creating a clear, consistent standard for both courts and market participants to follow. The bill largely codifies the existing case law on insider trading. However, the bill overturns a controversial judicially-imposed requirement that an individual who receives insider information know about the specific personal benefit received by the individual who discloses the information.<sup>1</sup>

#### BACKGROUND AND NEED FOR LEGISLATION

Insider trading is prosecuted under the general securities fraud section of the Securities Exchange Act of 1934.<sup>2</sup> The definition of insider trading, which has been developed by the courts over several decades, refers to undisclosed trading on material, nonpublic corporate information by individuals who are under a duty of trust and confidence that prohibits them from using such information for their own personal gain.<sup>3</sup> Individuals who are subject to this duty also may not disclose (or “tip”) the information to outsiders (known as “tippees”), who then trade on the information themselves even though they know the information was wrongfully obtained. In this

<sup>1</sup>See *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014).

<sup>2</sup>Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)]; 17 C.F.R. § 240.10b-5.

<sup>3</sup>See generally *Chiarella v. United States*, 445 U.S. 222, 226-230 (1980); *Dirks v. SEC*, 463 U.S. 646, 653-654 (1983); *Salman v. United States*, No. 15-628, slip op. at 1 (2016); see also *In re Cady, Roberts & Co.*, 40 S.E.C. 907 (1961).

case, both the tipper and tippee may be liable. An insider's tip of confidential information to an outsider is a breach of the insider's duty if the insider "personally will benefit, directly or indirectly, from his disclosure."<sup>4</sup>

In 2014 the Second Circuit held that even though a tippee may know that the information was wrongfully disclosed, the government must also prove that they knew about the specific *personal benefit* that the insiders received.<sup>5</sup> This holding has made it significantly more difficult for the government to successfully prosecute insider trading cases. The bill would overturn this controversial court requirement and establish a clear, legislative standard for illegal insider trading.

During an April 4, 2019 hearing before the Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets, Professor John Coffee of Columbia Law School testified that the bill "expands liability in ways that should not be controversial." Representatives from Public Citizen and North American Securities Administrators Association (NASAA) both testified their strong support for the bill. The U.S. Chamber of Commerce expressed concerns that the bill could create a strict liability standard without any intent on the defendants' part and that it could "outlaw" the safe harbor for trades conducted through preestablished plans under Rule 10b5-1. The bill, as amended, does not impose strict liability, and instead requires defendants to know or recklessly disregard the fact that insider information was obtained illegally or that the trading would constitute wrongful use of the information. In addition, the bill clarifies that the safe harbor for insider trading plans is not repealed.

#### SECTION-BY-SECTION ANALYSIS

##### *Section 1. Short title*

Section 1 states that the short title of the bill is the Insider Trading Prohibition Act.

##### *Section 2. Prohibition on insider trading*

Subsection (a) amends the Securities Exchange Act of 1934 to by adding a new section 16A.

Subsection (a) of the new section 16A expressly prohibits any person from buying or selling, or causing the purchase or sale, of any security, security-based swap, or security-based swap agreement if the person knows or recklessly disregards that the information has been wrongfully obtained, or that a purchase or sale would constitute the wrongful use of that information.

Subsection (b) of the new section 16A expressly prohibit persons covered by subsection (a) of the new section 16A from communicating certain material, nonpublic information to any other person if the other person (A) purchases or sells, or causes the purchase or sale of, any security, security-based swap, or security-based swap agreement or (B) communicates the information to another person who makes or causes such purchase, sale or entry while aware of such information, and such purchase, sale, or entry while aware of the information is reasonably foreseeable.

<sup>4</sup>*Dirks*, 463 U.S. at 662.

<sup>5</sup>*See Newman*, 773 F.3d at 452.

Subsection (c) of the new section 16A provides certain standards and requirements. Paragraph (1) provides that trading while aware of material, nonpublic information or communicating this information is wrongful only if the information has been obtained by, or its communication or use would constitute (directly or indirectly): theft, bribery, misrepresentation, or espionage; a violation of any Federal law protecting computer data or intellectual property or privacy of computer users; the conversion, misappropriation, or deceptive taking of information; or a breach of a fiduciary duty, confidentiality agreement, contract, or other relationship of trust and confidence.

Paragraph (2) of the new section 16A(c) establishes the bill's knowledge requirement. It provides that the knowledge requirement is satisfied so long as the person trading while aware of the information or making the communication was aware, recklessly disregarded being aware, or recklessly disregarded that the information was wrongfully obtained or communicated. The provision expressly states that it is not necessary that the person trading on or communicating the information know the specific means by which the information was obtained or communicated, or if there was any personal benefit that was paid or promised by or to any person in the chain of communication.

Subsection (d) of the new section 16A provides that no person can be held liable for violating any provisions of this bill solely because the person controls or employs a person who violates the provisions of this bill, if such person or employer did not participate in, or directly or indirectly induce the acts constituting a violation of section 16A.

Subsection (e) of the new section 16A provides the Securities and Exchange Commission with the authority to exempt any person, securities, transaction, or any class of persons, securities, or transactions from any or all provisions of this bill. It also provides an affirmative defense for any person who acts at the specific direction, and solely for the account of another person whose actions would be lawful under this section. Subsection (e) also provides authority for the SEC to exempt certain automatic trading transaction, including those that satisfy the requirements of Rule 10b-5-1.

Subsection (b) of Section 2 makes certain conforming amendments

#### HEARINGS

The Committee on Financial Services held a hearing on April 3, 2019 entitled, "Putting Investors First: Reviewing Proposals to Hold Executives Accountable," examining matters related to holding public company executives accountable to both investors and the general public, including H.R. 2534. Testifying before the Subcommittee was Professor John Coffee, Adolf A. Berle Professor of Law and Director of the Center on Corporate Governance at Columbia Law School; Melanie Lubin, Maryland Securities Commissioner (on behalf of the North American Securities Administrators Association); Remington A. Gregg, Counsel for Civil Justice and Consumer Rights, Public Citizen; and Tom Quaadman, Vice President, U.S. Chamber Center for Capital Markets Competitiveness, Chamber of Commerce of the United States of America.

## COMMITTEE CONSIDERATION

The Committee on Financial Services met in open session on May 8, 2019 and ordered H.R. 2534 be reported favorably to the House by a voice vote.

## COMMITTEE VOTES AND ROLL CALL VOTES

In compliance with clause 3(b) of rule XIII of the Rules of the House of Representatives, the Committee advises there were no roll call votes on H.R. 2534.

STATEMENT OF OVERSIGHT FINDINGS AND RECOMMENDATIONS OF  
THE COMMITTEE

In compliance with clause 3(c)(1) of rule XIII and clause 2(b)(1) of rule X of the Rules of the House of Representatives, the Committee's oversight findings and recommendations are reflected in the descriptive portions of this report.

## STATEMENT OF PERFORMANCE GOALS AND OBJECTIVES

Pursuant to clause (3)(c) of rule XIII of the Rules of the House of Representatives, the goals of H.R. 2534 are to codify insider trading prohibitions that are currently contained in case law.

## NEW BUDGET AUTHORITY AND CBO COST ESTIMATE

Pursuant to clause 3(c)(2) of rule XIII of the Rules of the House of Representatives and section 308(a) of the *Congressional Budget Act of 1974*, and pursuant to clause 3(c)(3) of rule XIII of the Rules of the House of Representatives and section 402 of the *Congressional Budget Act of 1974*, the Committee has received the following estimate for H.R. 2534 from the Director of the Congressional Budget Office:

U.S. CONGRESS,  
CONGRESSIONAL BUDGET OFFICE,  
*Washington, DC, June 19, 2019.*

Hon. MAXINE WATERS,  
*Chairwoman, Committee on Financial Services,  
House of Representatives, Washington, DC.*

DEAR MADAM CHAIRWOMAN: The Congressional Budget Office has prepared the enclosed cost estimate for H.R. 2534, the Insider Trading Prohibition Act.

If you wish further details on this estimate, we will be pleased to provide them. The CBO staff contact is David Hughes.

Sincerely,

PHILLIP L. SWAGEL,  
*Director.*

Enclosure.

<b>H.R. 2534, Insider Trading Prohibition Act</b>			
As ordered reported by the House Committee on Financial Services on May 8, 2019			
By Fiscal Year, Millions of Dollars	2019	2019-2024	2019-2029
Direct Spending (Outlays)	0	0	0
Revenues	0	*	*
Deficit Effect	0	*	*
Spending Subject to Appropriation (Outlays)	0	*	n.e.
Pay-as-you-go procedures apply?	Yes	<b>Mandate Effects</b>	
Increases on-budget deficits in any of the four consecutive 10-year periods beginning in 2030?	No	Contains intergovernmental mandate?	No
		Contains private-sector mandate?	Yes, Cannot Determine Costs
n.e. = not estimated; * = between -\$500,000 and \$500,000.			

H.R. 2534 would define and prohibit illegal insider trading.<sup>1</sup> It also would prohibit instances in which one person wrongfully communicates nonpublic, material information to another person in connection with securities trading, regardless of whether or not a payment or a promised personal benefit was involved. Under H.R. 2534, the Securities and Exchange Commission (SEC) would determine if the new insider trading prohibitions also apply to automated security-trading transactions.

Current law prohibits the use of “any manipulative or deceptive device or contrivance” when trading securities.<sup>2</sup> Likewise, federal regulations prohibit people from engaging in “any act, practice, or course of business which operates . . . as a fraud or deceit” in connection with securities trading.<sup>3</sup> To date, the SEC has used those general anti-fraud provisions, informed by judicial decisions and case law, to prosecute instances of illegal insider trading.

CBO expects that H.R. 2534 would expand the SEC’s authority to prosecute unlawful insider traders. The SEC might commence more enforcement actions and impose additional penalties if illegal insider trading continued at the same rate following enactment; but the agency would probably commence fewer enforcement actions if enactment of H.R. 2534 deterred illegal insider trading.

Under current law, the SEC is authorized to collect fees sufficient to offset its annual appropriation; therefore, CBO estimates that any net effect on discretionary spending would be negligible, assuming appropriation actions consistent with that authority.

Also under current law, people found guilty of illegal insider trading are subject to criminal and civil penalties, which are recorded in the federal budget as revenues. CBO estimates that revenue collections and associated direct spending of criminal penalties would not significantly change under the bill.

H.R. 2534 contains private-sector mandates as defined in the Unfunded Mandates Reform Act (UMRA). However, CBO cannot esti-

<sup>1</sup>According to the Securities and Exchange Commission, “illegal insider trading refers generally to buying or selling a security, in breach of a fiduciary duty or other relationship of trust and confidence, on the basis of material, nonpublic information about the security.”

<sup>2</sup>15 U.S. Code 78j.

<sup>3</sup>17 CFR 240.10b-5.

mate whether the cost of those mandates would exceed the threshold established in UMRA (\$164 million in 2019, adjusted annually for inflation).

H.R. 2534 would exempt employers from liability for insider trading solely for employing a person who has violated the new prohibitions in the bill. This exemption would be a mandate under UMRA because it would remove a private right of action. Further, the SEC would be allowed to exempt a person, transaction, or security from requirements in the bill, thereby shielding additional entities from liability. The cost of the mandate would be the foregone net value of awards and settlements that would have been granted for such claims in the absence of the bill. CBO cannot estimate the number of suits that would have been brought or the amount of potential foregone settlements, and, therefore, cannot determine whether the cost would exceed UMRA's annual private-sector threshold.

If the SEC increased fees to offset the costs associated with implementing the bill, H.R. 2534 would increase the cost of an existing mandate on private entities required to pay those assessments. CBO estimates that the incremental cost of the mandate would be very small.

H.R. 2534 contains no intergovernmental mandates as defined in UMRA.

The CBO staff contacts for this estimate are David Hughes (for federal costs) and Rachel Austin (for mandates). The estimate was reviewed by Theresa Gullo, Assistant Director for Budget Analysis.

#### COMMITTEE COST ESTIMATE

Clause 3(d)(1) of rule XIII of the Rules of the House of Representatives requires an estimate and a comparison of the costs that would be incurred in carrying out H.R. 2534. However, clause 3(d)(2)(B) of that rule provides that this requirement does not apply when the committee has included in its report a timely submitted cost estimate of the bill prepared by the Director of the Congressional Budget Office under section 402 of the *Congressional Budget Act*.

#### UNFUNDED MANDATE STATEMENT

Pursuant to Section 423 of the *Congressional Budget and Impoundment Control Act* (as amended by Section 101(a)(2) of the *Unfunded Mandates Reform Act*, Pub. L. 104-4), the Committee adopts as its own the estimate of federal mandates regarding H.R. 2534, as amended, prepared by the Director of the Congressional Budget Office.

#### ADVISORY COMMITTEE

No advisory committees within the meaning of section 5(b) of the Federal Advisory Committee Act were created by this legislation.

#### APPLICATION OF LAW TO THE LEGISLATIVE BRANCH

Pursuant to section 102(b)(3) of the *Congressional Accountability Act*, Pub. L. No. 104-1, H.R. 2534, as amended, does not apply to terms and conditions of employment or to access to public services or accommodations within the legislative branch.

## EARMARK STATEMENT

In accordance with clause 9 of rule XXI of the Rules of the House of Representatives, H.R. 2534 does not contain any congressional earmarks, limited tax benefits, or limited tariff benefits as described in clauses 9(e), 9(f), and 9(g) of rule XXI.

## DUPLICATION OF FEDERAL PROGRAMS

Pursuant to clause 3(c)(5) of rule XIII of the Rules of the House of Representatives, the Committee states that no provision of H.R. 2534 establishes or reauthorizes a program of the Federal Government known to be duplicative of another federal program, a program that was included in any report from the Government Accountability Office to Congress pursuant to section 21 of Public Law 111–139, or a program related to a program identified in the most recent Catalog of Federal Domestic Assistance.

## CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with clause 3(e) of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, H.R. 2534, as reported, are shown as follows:

## CHANGES IN EXISTING LAW MADE BY THE BILL, AS REPORTED

In compliance with clause 3(e) of rule XIII of the Rules of the House of Representatives, changes in existing law made by the bill, as reported, are shown as follows (existing law proposed to be omitted is enclosed in black brackets, new matter is printed in italic, and existing law in which no change is proposed is shown in roman):

**SECURITIES EXCHANGE ACT OF 1934**

## TITLE I—REGULATION OF SECURITIES EXCHANGES

\* \* \* \* \*

**SEC. 16A. PROHIBITION ON INSIDER TRADING.**

(a) *PROHIBITION AGAINST TRADING SECURITIES WHILE IN POSSESSION OF MATERIAL, NONPUBLIC INFORMATION.*—It shall be unlawful for any person, directly or indirectly, to purchase, sell, or enter into, or cause the purchase or sale of or entry into, any security, security-based swap, or security-based swap agreement, while in possession of material, nonpublic information relating to such security, security-based swap, or security-based swap agreement, or relating to the market for such security, security-based swap, or security-based swap agreement, if such person knows, or recklessly disregards, that such information has been obtained wrongfully, or that such purchase or sale would constitute a wrongful use of such information.

(b) *PROHIBITION AGAINST THE WRONGFUL COMMUNICATION OF CERTAIN MATERIAL, NONPUBLIC INFORMATION.*—It shall be unlawful for any person whose own purchase or sale of a security, security-based swap, or entry into a security-based swap agreement would violate subsection (a) (referred to in this subsection as the ‘communicating person’), wrongfully to communicate material, nonpublic information relating to such security, security-based swap, or

security-based swap agreement, or relating to the market for such security, security-based swap, or security-based swap agreement, to any other person if—

(1) the other person—

(A) purchases, sells, or causes the purchase or sale of, any security or security-based swap or enters into or causes the entry into any security-based swap agreement, to which such communication relates; or

(B) communicates the information to another person who makes or causes such a purchase, sale, or entry while in possession of such information; and

(2) such a purchase, sale, or entry while in possession of such information is reasonably foreseeable.

(c) **STANDARD AND KNOWLEDGE REQUIREMENT.**—

(1) **STANDARD.**—For purposes of this section, trading while in possession of material, nonpublic information under subsection (a) or communicating material nonpublic information under subsection (b) is wrongful only if the information has been obtained by, or its communication or use would constitute, directly or indirectly—

(A) theft, bribery, misrepresentation, or espionage (through electronic or other means);

(B) a violation of any Federal law protecting computer data or the intellectual property or privacy of computer users;

(C) conversion, misappropriation, or other unauthorized and deceptive taking of such information; or

(D) a breach of any fiduciary duty, a breach of a confidentiality agreement, a breach of contract, or a breach of any other personal or other relationship of trust and confidence.

(2) **KNOWLEDGE REQUIREMENT.**—It shall not be necessary that the person trading while in possession of such information (as proscribed by subsection (a)), or making the communication (as proscribed by subsection (b)), knows the specific means by which the information was obtained or communicated, or whether any personal benefit was paid or promised by or to any person in the chain of communication, so long as the person trading while in possession of such information or making the communication, as the case may be, was aware, consciously avoided being aware, or recklessly disregarded that such information was wrongfully obtained or communicated.

(d) **DERIVATIVE LIABILITY.**—Except as provided in section 20(a), no person shall be liable under this section solely by reason of the fact that such person controls or employs a person who has violated this section, if such controlling person or employer did not participate in, profit from, or directly or indirectly induce the acts constituting the violation of this section.

(e) **EXEMPTED TRANSACTIONS.**—

(1) **IN GENERAL.**—The Commission may, by rule or by order, exempt any person, security, or transaction, or any class of persons, securities, or transactions, from any or all of the provisions of this section, upon such terms and conditions as it considers necessary or appropriate, if the Commission determines that such action is not inconsistent with the purposes of this

*section. The prohibitions of this section shall not apply to any person who acts at the specific direction of, and solely for the account of, a person whose own securities trading, or communications of material, nonpublic information, would be lawful under this section.*

**(2) AUTOMATIC TRADING.—**

*(A) IN GENERAL.—Not later than 180 days after the date of the enactment of this section, the Commission shall determine if any automatic trading transactions should be exempted from any of the provisions of this section and shall make such determination available to the public, including on the website of the Commission.*

*(B) INTERIM APPLICATION.—During the period between the date of the enactment of this section and the date on which the Commission makes a determination pursuant to subparagraph (A), automatic trading transactions shall be exempted from the provisions of this section.*

*(C) AUTOMATIC TRADING TRANSACTION DEFINED.—For the purposes of this paragraph, the term “automatic trading transaction” means any purchase or sale of a security, security-based swap, or security-based swap agreement that—*

- (i) occurs automatically; or*
- (ii) is made pursuant to an advance election.*

\* \* \* \* \*

**INVESTIGATIONS; INJUNCTIONS AND PROSECUTION OF OFFENSES**

**SEC. 21.** (a)(1) The Commission may, in its discretion, make such investigations as it deems necessary to determine whether any person has violated, is violating, or is about to violate any provision of this title, the rules or regulations thereunder, the rules of a national securities exchange or registered securities association of which such person is a member or a person associated, or, as to any act or practice, or omission to act, while associated with a member, formerly associated with a member, the rules of a registered clearing agency in which such person is a participant, or, as to any act or practice, or omission to act, while a participant, was a participant, the rules of the Public Company Accounting Oversight Board, of which such person is a registered public accounting firm, a person associated with such a firm, or, as to any act, practice, or omission to act, while associated with such firm, a person formerly associated with such a firm, or the rules of the Municipal Securities Rulemaking Board, and may require or permit any person to file with it a statement in writing, under oath or otherwise as the Commission shall determine, as to all the facts and circumstances concerning the matter to be investigated. The Commission is authorized in its discretion, to publish information concerning any such violations, and to investigate any facts, conditions, practices, or matters which it may deem necessary or proper to aid in the enforcement of such provisions, in the prescribing of rules and regulations under this title, or in securing information to serve as a basis for recommending further legislation concerning the matters to which this title relates.

(2) On request from a foreign securities authority, the Commission may provide assistance in accordance with this paragraph if

the requesting authority states that the requesting authority is conducting an investigation which it deems necessary to determine whether any person has violated, is violating, or is about to violate any laws or rules relating to securities matters that the requesting authority administers or enforces. The Commission may, in its discretion, conduct such investigation as the Commission deems necessary to collect information and evidence pertinent to the request for assistance. Such assistance may be provided without regard to whether the facts stated in the request would also constitute a violation of the laws of the United States. In deciding whether to provide such assistance, the Commission shall consider whether (A) the requesting authority has agreed to provide reciprocal assistance in securities matters to the Commission; and (B) compliance with the request would prejudice the public interest of the United States.

(b) For the purpose of any such investigation, or any other proceeding under this title, any member of the Commission or any officer designated by it is empowered to administer oaths and affirmations, subpoena witnesses, compel their attendance, take evidence, and require the production of any books, papers, correspondence, memoranda, or other records which the Commission deems relevant or material to the inquiry. Such attendance of witnesses and the production of any such records may be required from any place in the United States or any State at any designated place of hearing.

(c) In case of contumacy by, or refusal to obey a subpoena issued to, any person, the Commission may invoke the aid of any court of the United States within the jurisdiction of which such investigation or proceeding is carried on, or where such person resides or carries on business, in requiring the attendance and testimony of witnesses and the production of books, papers, correspondence, memoranda, and other records. And such court may issue an order requiring such person to appear before the Commission or member or officer designated by the Commission, there to produce records, if so ordered, or to give testimony touching the matter under investigation or in question; and any failure to obey such order of the court may be punished by such court as a contempt thereof. All process in any such case may be served in the judicial district whereof such person is an inhabitant or wherever he may be found. Any person who shall, without just cause, fail or refuse to attend and testify or to answer any lawful inquiry or to produce books, papers, correspondence, memoranda, and other records, if in his power so to do, in obedience to the subpoena of the Commission, shall be guilty of a misdemeanor and, upon conviction, shall be subject to a fine of not more than \$1,000 or to imprisonment for a term of not more than one year, or both.

(d)(1) Whenever it shall appear to the Commission that any person is engaged or is about to engage in acts or practices constituting a violation of any provision of this title, the rules or regulations thereunder, the rules of a national securities exchange or registered securities association of which such person is a member or a person associated with a member, the rules of a registered clearing agency in which such person is a participant, the rules of the Public Company Accounting Oversight Board, of which such person is a registered public accounting firm or a person associated with

such a firm, or the rules of the Municipal Securities Rulemaking Board, it may in its discretion bring an action in the proper district court of the United States, the United States District Court for the District of Columbia, or the United States courts of any territory or other place subject to the jurisdiction of the United States, to enjoin such acts or practices, and upon a proper showing a permanent or temporary injunction or restraining order shall be granted without bond. The Commission may transmit such evidence as may be available concerning such acts or practices as may constitute a violation of any provision of this title or the rules or regulations thereunder to the Attorney General, who may, in his discretion, institute the necessary criminal proceedings under this title.

(2) **AUTHORITY OF A COURT TO PROHIBIT PERSONS FROM SERVING AS OFFICERS AND DIRECTORS.**—In any proceeding under paragraph (1) of this subsection, the court may prohibit, conditionally or unconditionally, and permanently or for such period of time as it shall determine, any person who violated section 10(b) of this title, *section 16A of this title* or the rules or regulations thereunder from acting as an officer or director of any issuer that has a class of securities registered pursuant to section 12 of this title or that is required to file reports pursuant to section 15(d) of this title if the person's conduct demonstrates unfitness to serve as an officer or director of any such issuer.

(3) **MONEY PENALTIES IN CIVIL ACTIONS.**—

(A) **AUTHORITY OF COMMISSION.**—Whenever it shall appear to the Commission that any person has violated any provision of this title, the rules or regulations thereunder, or a cease-and-desist order entered by the Commission pursuant to section 21C of this title, other than by committing a violation subject to a penalty pursuant to section 21A, the Commission may bring an action in a United States district court to seek, and the court shall have jurisdiction to impose, upon a proper showing, a civil penalty to be paid by the person who committed such violation.

(B) **AMOUNT OF PENALTY.**—

(i) **FIRST TIER.**—The amount of the penalty shall be determined by the court in light of the facts and circumstances. For each violation, the amount of the penalty shall not exceed the greater of (I) \$5,000 for a natural person or \$50,000 for any other person, or (II) the gross amount of pecuniary gain to such defendant as a result of the violation.

(ii) **SECOND TIER.**—Notwithstanding clause (i), the amount of penalty for each such violation shall not exceed the greater of (I) \$50,000 for a natural person or \$250,000 for any other person, or (II) the gross amount of pecuniary gain to such defendant as a result of the violation, if the violation described in subparagraph (A) involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement.

(iii) **THIRD TIER.**—Notwithstanding clauses (i) and (ii), the amount of penalty for each such violation shall not exceed the greater of (I) \$100,000 for a natural person or \$500,000 for any other person, or (II) the gross amount of

pecuniary gain to such defendant as a result of the violation, if—

(aa) the violation described in subparagraph (A) involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; and

(bb) such violation directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons.

(C) PROCEDURES FOR COLLECTION.—

(i) PAYMENT OF PENALTY TO TREASURY.—A penalty imposed under this section shall be payable into the Treasury of the United States, except as otherwise provided in section 308 of the Sarbanes-Oxley Act of 2002 and section 21F of this title.

(ii) COLLECTION OF PENALTIES.—If a person upon whom such a penalty is imposed shall fail to pay such penalty within the time prescribed in the court's order, the Commission may refer the matter to the Attorney General who shall recover such penalty by action in the appropriate United States district court.

(iii) REMEDY NOT EXCLUSIVE.—The actions authorized by this paragraph may be brought in addition to any other action that the Commission or the Attorney General is entitled to bring.

(iv) JURISDICTION AND VENUE.—For purposes of section 27 of this title, actions under this paragraph shall be actions to enforce a liability or a duty created by this title.

(D) SPECIAL PROVISIONS RELATING TO A VIOLATION OF A CEASE-AND-DESIST ORDER.—In an action to enforce a cease-and-desist order entered by the Commission pursuant to section 21C, each separate violation of such order shall be a separate offense, except that in the case of a violation through a continuing failure to comply with the order, each day of the failure to comply shall be deemed a separate offense.

(4) PROHIBITION OF ATTORNEYS' FEES PAID FROM COMMISSION DISGORGEMENT FUNDS.—Except as otherwise ordered by the court upon motion by the Commission, or, in the case of an administrative action, as otherwise ordered by the Commission, funds disgorged as the result of an action brought by the Commission in Federal court, or as a result of any Commission administrative action, shall not be distributed as payment for attorneys' fees or expenses incurred by private parties seeking distribution of the disgorged funds.

(5) EQUITABLE RELIEF.—In any action or proceeding brought or instituted by the Commission under any provision of the securities laws, the Commission may seek, and any Federal court may grant, any equitable relief that may be appropriate or necessary for the benefit of investors.

(6) AUTHORITY OF A COURT TO PROHIBIT PERSONS FROM PARTICIPATING IN AN OFFERING OF PENNY STOCK.—

(A) IN GENERAL.—In any proceeding under paragraph (1) against any person participating in, or, at the time of the alleged misconduct who was participating in, an offering of penny stock, the court may prohibit that person from participating in an offering of penny stock, conditionally or uncondi-

tionally, and permanently or for such period of time as the court shall determine.

(B) DEFINITION.—For purposes of this paragraph, the term “person participating in an offering of penny stock” includes any person engaging in activities with a broker, dealer, or issuer for purposes of issuing, trading, or inducing or attempting to induce the purchase or sale of, any penny stock. The Commission may, by rule or regulation, define such term to include other activities, and may, by rule, regulation, or order, exempt any person or class of persons, in whole or in part, conditionally or unconditionally, from inclusion in such term.

(e) Upon application of the Commission the district courts of the United States and the United States courts of any territory or other place subject to the jurisdiction of the United States shall have jurisdiction to issue writs of mandamus, injunctions, and orders commanding (1) any person to comply with the provisions of this title, the rules, regulations, and orders thereunder, the rules of a national securities exchange or registered securities association of which such person is a member or person associated with a member, the rules of a registered clearing agency in which such person is a participant, the rules of the Public Company Accounting Oversight Board, of which such person is a registered public accounting firm or a person associated with such a firm, the rules of the Municipal Securities Rulemaking Board, or any undertaking contained in a registration statement as provided in subsection (d) of section 15 of this title, (2) any national securities exchange or registered securities association to enforce compliance by its members and persons associated with its members with the provisions of this title, the rules, regulations, and orders thereunder, and the rules of such exchange or association, or (3) any registered clearing agency to enforce compliance by its participants with the provisions of the rules of such clearing agency.

(f) Notwithstanding any other provision of this title, the Commission shall not bring any action pursuant to subsection (d) or (e) of this section against any person for violation of, or to command compliance with, the rules of a self-regulatory organization or the Public Company Accounting Oversight Board unless it appears to the Commission that (1) such self-regulatory organization or the Public Company Accounting Oversight Board is unable or unwilling to take appropriate action against such person in the public interest and for the protection of investors, or (2) such action is otherwise necessary or appropriate in the public interest or for the protection of investors.

(g) Notwithstanding the provisions of section 1407(a) of title 28, United States Code, or any other provision of law, no action for equitable relief instituted by the Commission pursuant to the securities laws shall be consolidated or coordinated with other actions not brought by the Commission, even though such other actions may involve common questions of fact, unless such consolidation is consented to by the Commission.

(h)(1) The Right to Financial Privacy Act of 1978 shall apply with respect to the Commission, except as otherwise provided in this subsection.

(2) Notwithstanding section 1105 or 1107 of the Right to Financial Privacy Act of 1978, the Commission may have access to and

obtain copies of, or the information contained in financial records of a customer from a financial institution without prior notice to the customer upon an ex parte showing to an appropriate United States district court that the Commission seeks such financial records pursuant to a subpoena issued in conformity with the requirements of section 19(b) of the Securities Act of 1933, section 21(b) of the Securities Exchange Act of 1934, section 42(b) of the Investment Company Act of 1940, or section 209(b) of the Investment Advisers Act of 1940, and that the Commission has reason to believe that—

(A) delay in obtaining access to such financial records, or the required notice, will result in—

- (i) flight from prosecution;
- (ii) destruction of or tampering with evidence;
- (iii) transfer of assets or records outside the territorial limits of the United States;
- (iv) improper conversion of investor assets; or
- (v) impeding the ability of the Commission to identify or trace the source or disposition of funds involved in any securities transaction;

(B) such financial records are necessary to identify or trace the record or beneficial ownership interest in any security;

(C) the acts, practices or course of conduct under investigation involve—

- (i) the dissemination of materially false or misleading information concerning any security, issuer, or market, or the failure to make disclosures required under the securities laws, which remain uncorrected; or
- (ii) a financial loss to investors or other persons protected under the securities laws which remains substantially uncompensated; or

(D) the acts, practices or course of conduct under investigation—

- (i) involve significant financial speculation in securities;
- or
- (ii) endanger the stability of any financial or investment intermediary.

(3) Any application under paragraph (2) for a delay in notice shall be made with reasonable specificity.

(4)(A) Upon a showing described in paragraph (2), the presiding judge or magistrate shall enter an ex parte order granting the requested delay for a period not to exceed ninety days and an order prohibiting the financial institution involved from disclosing that records have been obtained or that a request for records has been made.

(B) Extensions of the period of delay of notice provided in subparagraph (A) of up to ninety days each may be granted by the court upon application, but only in accordance with this subsection or section 1109(a), (b)(1), or (b)(2) of the Right to Financial Privacy Act of 1978.

(C) Upon expiration of the period of delay of notification ordered under subparagraph (A) or (B), the customer shall be served with or mailed a copy of the subpoena insofar as it applies to the customer together with the following notice which shall describe with

reasonable specificity the nature of the investigation for which the Commission sought the financial records:

\* \* \* \* \*

(5) Upon application by the Commission, all proceedings pursuant to paragraphs (2) and (4) shall be held in camera and the records thereof sealed until expiration of the period of delay or such other date as the presiding judge or magistrate may permit.

(7)(A) Following the expiration of the period of delay of notification ordered by the court pursuant to paragraph (4) of this subsection, the customer may, upon motion, reopen the proceeding in the district court which issued the order. If the presiding judge or magistrate finds that the movant is the customer to whom the records obtained by the Commission pertain, and that the Commission has obtained financial records or information contained therein in violation of this subsection, other than paragraph (1), it may order that the customer be granted civil penalties against the Commission in an amount equal to the sum of—

- (i) \$100 without regard to the volume of records involved;
- (ii) any out-of-pocket damages sustained by the customer as a direct result of the disclosure; and
- (iii) if the violation is found to have been willful, intentional, and without good faith, such punitive damages as the court may allow, together with the costs of the action and reasonable attorney's fees as determined by the court.

(B) Upon a finding that the Commission has obtained financial records or information contained therein in violation of this subsection, other than paragraph (1), the court, in its discretion, may also or in the alternative issue injunctive relief to require the Commission to comply with this subsection with respect to any subpoena which the Commission issues in the future for financial records of such customer for purposes of the same investigation.

(C) Whenever the court determines that the Commission has failed to comply with this subsection, other than paragraph (1), and the court finds that the circumstances raise questions of whether an officer or employee of the Commission acted in a willful and intentional manner and without good faith with respect to the violation, the Office of Personnel Management shall promptly initiate a proceeding to determine whether disciplinary action is warranted against the agent or employee who was primarily responsible for the violation. After investigating and considering the evidence submitted, the Office of Personnel Management shall submit its findings and recommendations to the Commission and shall send copies of the findings and recommendations to the officer or employee or his representative. The Commission shall take the corrective action that the Office of Personnel Management recommends.

(8) The relief described in paragraphs (7) and (10) shall be the only remedies or sanctions available to a customer for a violation of this subsection, other than paragraph (1), and nothing herein or in the Right to Financial Privacy Act of 1978 shall be deemed to prohibit the use in any investigation or proceeding of financial records, or the information contained therein, obtained by a subpoena issued by the Commission. In the case of an unsuccessful action under paragraph (7), the court shall award the costs of the action and attorney's fees to the Commission if the presiding judge

or magistrate finds that the customer's claims were made in bad faith.

(9)(A) The Commission may transfer financial records or the information contained therein to any government authority if the Commission proceeds as a transferring agency in accordance with section 1112 of the Right to Financial Privacy Act of 1978, except that the customer notice required under section 1112(b) or (c) of such Act may be delayed upon a showing by the Commission, in accordance with the procedure set forth in paragraphs (4) and (5), that one or more of subparagraphs (A) through (D) of paragraph (2) apply.

(B) The Commission may, without notice to the customer pursuant to section 1112 of the Right to Financial Privacy Act of 1978, transfer financial records or the information contained therein to a State securities agency or to the Department of Justice. Financial records or information transferred by the Commission to the Department of Justice or to a State securities agency pursuant to the provisions of this subparagraph may be disclosed or used only in an administrative, civil, or criminal action or investigation by the Department of Justice or the State securities agency which arises out of or relates to the acts, practices, or courses of conduct investigated by the Commission, except that if the Department of Justice or the State securities agency determines that the information should be disclosed or used for any other purpose, it may do so if it notifies the customer, except as otherwise provided in the Right to Financial Privacy Act of 1978, within 30 days of its determination, or complies with the requirements of section 1109 of such Act regarding delay of notice.

(10) Any government authority violating paragraph (9) shall be subject to the procedures and penalties applicable to the Commission under paragraph (7)(A) with respect to a violation by the Commission in obtaining financial records.

(11) Notwithstanding the provisions of this subsection, the Commission may obtain financial records from a financial institution or transfer such records in accordance with provisions of the Right to Financial Privacy Act of 1978.

(12) Nothing in this subsection shall enlarge or restrict any rights of a financial institution to challenge requests for records made by the Commission under existing law. Nothing in this subsection shall entitle a customer to assert any rights of a financial institution.

(13) Unless the context otherwise requires, all terms defined in the Right to Financial Privacy Act of 1978 which are common to this subsection shall have the same meaning as in such Act.

(i) INFORMATION TO CFTC.—The Commission shall provide the Commodity Futures Trading Commission with notice of the commencement of any proceeding and a copy of any order entered by the Commission against any broker or dealer registered pursuant to section 15(b)(11), any exchange registered pursuant to section 6(g), or any national securities association registered pursuant to section 15A(k).

#### CIVIL PENALTIES FOR INSIDER TRADING

##### SEC. 21A. (a) AUTHORITY TO IMPOSE CIVIL PENALTIES.—

(1) JUDICIAL ACTIONS BY COMMISSION AUTHORIZED.—Whenever it shall appear to the Commission that any person has violated any provision of this title or the rules or regulations thereunder by purchasing or selling a security or security-based swap agreement while in possession of material, non-public information in, or has violated any such provision by communicating such information in connection with, a transaction on or through the facilities of a national securities exchange or from or through a broker or dealer, and which is not part of a public offering by an issuer of securities other than standardized options or security futures products, the Commission—

(A) may bring an action in a United States district court to seek, and the court shall have jurisdiction to impose, a civil penalty to be paid by the person who committed such violation; and

(B) may, subject to subsection (b)(1), bring an action in a United States district court to seek, and the court shall have jurisdiction to impose, a civil penalty to be paid by a person who, at the time of the violation, directly or indirectly controlled the person who committed such violation.

(2) AMOUNT OF PENALTY FOR PERSON WHO COMMITTED VIOLATION.—The amount of the penalty which may be imposed on the person who committed such violation shall be determined by the court in light of the facts and circumstances, but shall not exceed three times the profit gained or loss avoided as a result of such unlawful purchase, sale, or communication.

(3) AMOUNT OF PENALTY FOR CONTROLLING PERSON.—The amount of the penalty which may be imposed on any person who, at the time of the violation, directly or indirectly controlled the person who committed such violation, shall be determined by the court in light of the facts and circumstances, but shall not exceed the greater of \$1,000,000, or three times the amount of the profit gained or loss avoided as a result of such controlled person's violation. If such controlled person's violation was a violation by communication, the profit gained or loss avoided as a result of the violation shall, for purposes of this paragraph only, be deemed to be limited to the profit gained or loss avoided by the person or persons to whom the controlled person directed such communication.

(b) LIMITATIONS ON LIABILITY.—

(1) LIABILITY OF CONTROLLING PERSONS.—No controlling person shall be subject to a penalty under subsection (a)(1)(B) unless the Commission establishes that—

(A) such controlling person knew or recklessly disregarded the fact that such controlled person was likely to engage in the act or acts constituting the violation and failed to take appropriate steps to prevent such act or acts before they occurred; or

(B) such controlling person knowingly or recklessly failed to establish, maintain, or enforce any policy or procedure required under section 15(f) of this title or section 204A of the Investment Advisers Act of 1940 and such failure substantially contributed to or permitted the occurrence of the act or acts constituting the violation.

(2) ADDITIONAL RESTRICTIONS ON LIABILITY.—No person shall be subject to a penalty under subsection (a) solely by reason of employing another person who is subject to a penalty under such subsection, unless such employing person is liable as a controlling person under paragraph (1) of this subsection. Section 20(a) of this title shall not apply to actions under subsection (a) of this section.

(c) AUTHORITY OF COMMISSION.—the Commission, by such rules, regulations, and orders as it considers necessary or appropriate in the public interest or for the protection of investors, may exempt, in whole or in part, either unconditionally or upon specific terms and conditions, any person or transaction or class of persons or transactions from this section.

(d) PROCEDURES FOR COLLECTION.—

(1) PAYMENT OF PENALTY TO TREASURY.—A penalty imposed under this section shall be payable into the Treasury of the United States, except as otherwise provided in section 308 of the Sarbanes-Oxley Act of 2002 and section 21F of this title.

(2) COLLECTION OF PENALTIES.—If a person upon whom such a penalty is imposed shall fail to pay such penalty within the time prescribed in the court's order, the Commission may refer the matter to the Attorney General who shall recover such penalty by action in the appropriate United States district court.

(3) REMEDY NOT EXCLUSIVE.—The actions authorized by this section may be brought in addition to any other actions that the Commission or the Attorney General are entitled to bring.

(4) JURISDICTION AND VENUE.—For purposes of section 27 of this title, actions under this section shall be actions to enforce a liability or a duty created by this title.

(5) STATUTE OF LIMITATIONS.—No action may be brought under this section more than 5 years after the date of the purchase or sale. This section shall not be construed to bar or limit in any manner any action by the Commission or the Attorney General under any other provision of this title, nor shall it bar or limit in any manner any action to recover penalties, or to seek any other order regarding penalties, imposed in an action commenced within 5 years of such transaction.

(e) DEFINITION.—For purposes of this section, “profit gained” or “loss avoided” is the difference between the purchase or sale price of the security and the value of that security as measured by the trading price of the security a reasonable period after public dissemination of the nonpublic information.

(f) The authority of the Commission under this section with respect to security-based swap agreements (as defined in section 206B of the Gramm-Leach-Bliley Act) shall be subject to the restrictions and limitations of section 3A(b) of this title.

(g) DUTY OF MEMBERS AND EMPLOYEES OF CONGRESS.—

(1) IN GENERAL.—Subject to the rule of construction under section 10 of the STOCK Act and solely for purposes of the insider trading prohibitions arising under this Act, including section 10(b) and Rule 10b-5 thereunder, and section 16A, each Member of Congress or employee of Congress owes a duty arising from a relationship of trust and confidence to the Congress, the United States Government, and the citizens of the United

States with respect to material, nonpublic information derived from such person's position as a Member of Congress or employee of Congress or gained from the performance of such person's official responsibilities.

(2) DEFINITIONS.—In this subsection—

(A) the term “Member of Congress” means a member of the Senate or House of Representatives, a Delegate to the House of Representatives, and the Resident Commissioner from Puerto Rico; and

(B) the term “employee of Congress” means—

(i) any individual (other than a Member of Congress), whose compensation is disbursed by the Secretary of the Senate or the Chief Administrative Officer of the House of Representatives; and

(ii) any other officer or employee of the legislative branch (as defined in section 109(11) of the Ethics in Government Act of 1978 (5 U.S.C. App. 109(11))).

(3) RULE OF CONSTRUCTION.—Nothing in this subsection shall be construed to impair or limit the construction of the existing antifraud provisions of the securities laws or the authority of the Commission under those provisions.

(h) DUTY OF OTHER FEDERAL OFFICIALS.—

(1) IN GENERAL.—Subject to the rule of construction under section 10 of the STOCK Act and solely for purposes of the insider trading prohibitions arising under this Act, including section 10(b), and Rule 10b–5 thereunder, *and section 16A*, each executive branch employee, each judicial officer, and each judicial employee owes a duty arising from a relationship of trust and confidence to the United States Government and the citizens of the United States with respect to material, nonpublic information derived from such person's position as an executive branch employee, judicial officer, or judicial employee or gained from the performance of such person's official responsibilities.

(2) DEFINITIONS.—In this subsection—

(A) the term “executive branch employee”—

(i) has the meaning given the term “employee” under section 2105 of title 5, United States Code;

(ii) includes—

(I) the President;

(II) the Vice President; and

(III) an employee of the United States Postal Service or the Postal Regulatory Commission;

(B) the term “judicial employee” has the meaning given that term in section 109(8) of the Ethics in Government Act of 1978 (5 U.S.C. App. 109(8)); and

(C) the term “judicial officer” has the meaning given that term under section 109(10) of the Ethics in Government Act of 1978 (5 U.S.C. App. 109(10)).

(3) RULE OF CONSTRUCTION.—Nothing in this subsection shall be construed to impair or limit the construction of the existing antifraud provisions of the securities laws or the authority of the Commission under those provisions.

(i) PARTICIPATION IN INITIAL PUBLIC OFFERINGS.—An individual described in section 101(f) of the Ethics in Government Act of 1978 may not purchase securities that are the subject of an initial public

offering (within the meaning given such term in section 12(f)(1)(G)(i)) in any manner other than is available to members of the public generally.

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#### CEASE-AND-DESIST PROCEEDINGS

SEC. 21C. (a) **AUTHORITY OF THE COMMISSION.**—If the Commission finds, after notice and opportunity for hearing, that any person is violating, has violated, or is about to violate any provision of this title, or any rule or regulation thereunder, the Commission may publish its findings and enter an order requiring such person, and any other person that is, was, or would be a cause of the violation, due to an act or omission the person knew or should have known would contribute to such violation, to cease and desist from committing or causing such violation and any future violation of the same provision, rule, or regulation. Such order may, in addition to requiring a person to cease and desist from committing or causing a violation, require such person to comply, or to take steps to effect compliance, with such provision, rule, or regulation, upon such terms and conditions and within such time as the Commission may specify in such order. Any such order may, as the Commission deems appropriate, require future compliance or steps to effect future compliance, either permanently or for such period of time as the Commission may specify, with such provision, rule, or regulation with respect to any security, any issuer, or any other person.

(b) **HEARING.**—The notice instituting proceedings pursuant to subsection (a) shall fix a hearing date not earlier than 30 days nor later than 60 days after service of the notice unless an earlier or a later date is set by the Commission with the consent of any respondent so served.

(c) **TEMPORARY ORDER.**—

(1) **IN GENERAL.**—Whenever the Commission determines that the alleged violation or threatened violation specified in the notice instituting proceedings pursuant to subsection (a), or the continuation thereof, is likely to result in significant dissipation or conversion of assets, significant harm to investors, or substantial harm to the public interest, including, but not limited to, losses to the Securities Investor Protection Corporation, prior to the completion of the proceedings, the Commission may enter a temporary order requiring the respondent to cease and desist from the violation or threatened violation and to take such action to prevent the violation or threatened violation and to prevent dissipation or conversion of assets, significant harm to investors, or substantial harm to the public interest as the Commission deems appropriate pending completion of such proceedings. Such an order shall be entered only after notice and opportunity for a hearing, unless the Commission determines that notice and hearing prior to entry would be impracticable or contrary to the public interest. A temporary order shall become effective upon service upon the respondent and, unless set aside, limited, or suspended by the Commission or a court of competent jurisdiction, shall remain effective and enforceable pending the completion of the proceedings.

(2) APPLICABILITY.—Paragraph (1) shall apply only to a respondent that acts, or, at the time of the alleged misconduct acted, as a broker, dealer, investment adviser, investment company, municipal securities dealer, government securities broker, government securities dealer, registered public accounting firm (as defined in section 2 of the Sarbanes-Oxley Act of 2002), or transfer agent, or is, or was at the time of the alleged misconduct, an associated person of, or a person seeking to become associated with, any of the foregoing.

(3) TEMPORARY FREEZE.—

(A) IN GENERAL.—

(i) ISSUANCE OF TEMPORARY ORDER.—Whenever, during the course of a lawful investigation involving possible violations of the Federal securities laws by an issuer of publicly traded securities or any of its directors, officers, partners, controlling persons, agents, or employees, it shall appear to the Commission that it is likely that the issuer will make extraordinary payments (whether compensation or otherwise) to any of the foregoing persons, the Commission may petition a Federal district court for a temporary order requiring the issuer to escrow, subject to court supervision, those payments in an interest-bearing account for 45 days.

(ii) STANDARD.—A temporary order shall be entered under clause (i), only after notice and opportunity for a hearing, unless the court determines that notice and hearing prior to entry of the order would be impracticable or contrary to the public interest.

(iii) EFFECTIVE PERIOD.—A temporary order issued under clause (i) shall—

(I) become effective immediately;

(II) be served upon the parties subject to it; and

(III) unless set aside, limited or suspended by a court of competent jurisdiction, shall remain effective and enforceable for 45 days.

(iv) EXTENSIONS AUTHORIZED.—The effective period of an order under this subparagraph may be extended by the court upon good cause shown for not longer than 45 additional days, provided that the combined period of the order shall not exceed 90 days.

(B) PROCESS ON DETERMINATION OF VIOLATIONS.—

(i) VIOLATIONS CHARGED.—If the issuer or other person described in subparagraph (A) is charged with any violation of the Federal securities laws before the expiration of the effective period of a temporary order under subparagraph (A) (including any applicable extension period), the order shall remain in effect, subject to court approval, until the conclusion of any legal proceedings related thereto, and the affected issuer or other person, shall have the right to petition the court for review of the order.

(ii) VIOLATIONS NOT CHARGED.—If the issuer or other person described in subparagraph (A) is not charged with any violation of the Federal securities laws before

the expiration of the effective period of a temporary order under subparagraph (A) (including any applicable extension period), the escrow shall terminate at the expiration of the 45-day effective period (or the expiration of any extension period, as applicable), and the disputed payments (with accrued interest) shall be returned to the issuer or other affected person.

(d) REVIEW OF TEMPORARY ORDERS.—

(1) COMMISSION REVIEW.—At any time after the respondent has been served with a temporary cease-and-desist order pursuant to subsection (c), the respondent may apply to the Commission to have the order set aside, limited, or suspended. If the respondent has been served with a temporary cease-and-desist order entered without a prior Commission hearing, the respondent may, within 10 days after the date on which the order was served, request a hearing on such application and the Commission shall hold a hearing and render a decision on such application at the earliest possible time.

(2) JUDICIAL REVIEW.—Within—

(A) 10 days after the date the respondent was served with a temporary cease-and-desist order entered with a prior Commission hearing, or

(B) 10 days after the Commission renders a decision on an application and hearing under paragraph (1), with respect to any temporary cease-and-desist order entered without a prior Commission hearing,

the respondent may apply to the United States district court for the district in which the respondent resides or has its principal place of business, or for the District of Columbia, for an order setting aside, limiting, or suspending the effectiveness or enforcement of the order, and the court shall have jurisdiction to enter such an order. A respondent served with a temporary cease-and-desist order entered without a prior Commission hearing may not apply to the court except after hearing and decision by the Commission on the respondent's application under paragraph (1) of this subsection.

(3) NO AUTOMATIC STAY OF TEMPORARY ORDER.—The commencement of proceedings under paragraph (2) of this subsection shall not, unless specifically ordered by the court, operate as a stay of the Commission's order.

(4) EXCLUSIVE REVIEW.—Section 25 of this title shall not apply to a temporary order entered pursuant to this section.

(e) AUTHORITY TO ENTER AN ORDER REQUIRING AN ACCOUNTING AND DISGORGEMENT.—In any cease-and-desist proceeding under subsection (a), the Commission may enter an order requiring accounting and disgorgement, including reasonable interest. The Commission is authorized to adopt rules, regulations, and orders concerning payments to investors, rates of interest, periods of accrual, and such other matters as it deems appropriate to implement this subsection.

(f) AUTHORITY OF THE COMMISSION TO PROHIBIT PERSONS FROM SERVING AS OFFICERS OR DIRECTORS.—In any cease-and-desist proceeding under subsection (a), the Commission may issue an order to prohibit, conditionally or unconditionally, and permanently or for such period of time as it shall determine, any person who has

violated section 10(b) or *section 16A*, or the rules or regulations thereunder, from acting as an officer or director of any issuer that has a class of securities registered pursuant to section 12, or that is required to file reports pursuant to section 15(d), if the conduct of that person demonstrates unfitness to serve as an officer or director of any such issuer.

\* \* \* \* \*

## MINORITY VIEWS

Committee Republicans support finding and prosecuting bad actors for illegal insider trading, but Committee Republicans do not support H.R. 2534, the *Insider Trading Prohibition Act*, in its current form. There is no one insider trading law. Rather, Congress has allowed the courts to develop a patchwork body of law around insider trading that provides little clarity and security as to what constitutes insider trading. In fact, Congress' own research office stated "the courts expansive view has . . . been called 'a boon to prosecutors' by some reporters."<sup>1</sup> H.R. 2534 does not meet the sponsor of the bill's goals to solve the problem of ambiguity and uncertainty around insider trading law.<sup>2</sup> Without an exclusive and singular prohibition on insider trading, the door will be open for activist judges and overzealous prosecutors and, worse, private plaintiffs' counsel to cherry-pick from a menu of insider trading claim options, producing even more inconsistencies within insider trading law.

Insider trading law is built on a foundation of judge-made law around the anti-fraud provisions of the federal securities laws that has been developed over decades. Committee Republicans are sympathetic to the concerns of the Democrats that there is no statute in this area. To that end, Committee Republicans agreed to voice vote H.R. 2534 out of the Committee with the hope a bipartisan consensus to improve the bill could be achieved.<sup>3</sup>

Committee Republicans unfortunately remain concerned about certain ambiguous wording throughout the bill that remains unchanged from prior versions. For example, the bill prohibits trading on information "relating to the market" for a security, security-based swap, or security-based swap agreement, which could be interpreted by an activist judge far more broadly than the drafters of the bill intend. The bill also does not explicitly provide a standard for the requisite personal benefit test,<sup>4</sup> and thus runs the risk of being read more broadly by judges than the Supreme Court has

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<sup>1</sup> Congressional Research Service, "the Latest Chapter in Insider Trading Law: Major Circuit Decision Expands Scope of Liability for Trading on a Tip" Nicole Vanatko, November 14, 2017.

<sup>2</sup> See, e.g., Office of U.S. Congressman Jim Himes, "Himes Bipartisan Insider Trading Bill Passes Financial Services Committee" (May 10, 2019) (stating that the Insider Trading Prohibition Act would end "decades of ambiguity for a crime that has never been clearly defined by federal law"); see also "Himes Introduces Bipartisan bill to Define and Prohibit Illegal Insider Trading" (Mar. 25, 2015) (discussing the need for a "clear definition of insider trading").

<sup>3</sup> Committee Republicans have been willing to work in a bipartisan fashion with Committee Democrats on good legislation relating to insider trading. See H.R. 4335, the 8-K Trading Gap Act of 2019 (prohibiting trading by corporate insiders relating to certain events prior to the filing of a Form 8-K or public dissemination of material information, voted out of Committee 52-0); H.R. 624, the Promoting Transparent Standards for Corporate Insiders Act (requiring the SEC to study and report on possible revisions to regulations around Rule 10b5-1 trading plans by corporate insiders, with a 413-3 vote on the House floor).

<sup>4</sup> The Supreme Court has consistently ruled that in order to bring an insider trading case involving tippers and tippees, a tipper must receive a personal benefit in order to be convicted of an insider trading violation. See, e.g., *Dirks v. Securities and Exchange Commission*, 463 U.S. 646 (1983).

allowed—or, worse, being read out of the law entirely, which is an overzealous insider trading prosecutor’s or plaintiff lawyer’s dream. Reading the personal benefit test out of the law would have real implications; for example, absent a personal benefit test, corporate insiders who share information with the full expectation of confidentiality could become subject to prosecution simply because that confidentiality was violated.

In addition, while the bill has moved away from a standard of trading while in “possession” of material, non-public information, the current “awareness” standard may still be over-inclusive as Committee Republicans believe liability based on the “use” of material, nonpublic information bill would be more appropriate for ensuring that only those who actively trade on the information are subject to the bill, because individuals should not be penalized for making trades they already planned to make simply because they became aware of additional information.

At best, the overall wording of this bill does not substantively change the law of insider trading; at worst, it is overbroad and will criminalize beneficial trading activity as well as chill the productive flow of information within the marketplace. Committee Republicans are concerned that, were H.R. 2534 to become law, judges interpreting H.R. 2534 may misunderstand that the drafters of the bill intend to apply this law only to cases involving insider trading and do not intend to expand the scope of insider trading law beyond the state of the law as of 2019.

Finally, one of the biggest concerns is the failure of the bill to serve as the exclusive definition of improper insider trading. Committee Republicans have made clear the importance of providing clarity and certainty as it relates to Congress’ intent with regard to insider trading.<sup>5</sup> A predecessor bill that serves as a foundation for H.R. 2534 included an exclusivity provision stating that the bill “shall provide the exclusive standards by which the wrongful use or wrongful communication of material, nonpublic information in connection with the purchase or sale of a security shall be addressed.”<sup>6</sup> Unfortunately, H.R. 2534 does not include that exclusivity provision. Without that wording, H.R. 2534 is simply *another* insider trading law, rather than *the* insider trading law. Absent such an exclusivity clause, judges, prosecutors, and plaintiffs’ lawyers could and likely would still cite to and bring cases under general antifraud provisions and case law, and the SEC would, theoretically, still be able to engage in exemptive rulemaking around the law that might undo the carefully constructed definition of improper insider trading this bill seeks to create. This would give overzealous prosecutors and plaintiffs’ lawyers at least two bites at the apple using potentially varying legal requirements. Thus, failing to include the exclusivity provision runs counter to the claimed concerns of the Democrat drafters regarding the need to provide more certainty and clarity in this area.

Committee Republicans believe that if Congress is going to use its Article I powers to finally legislate in this area, we should do

<sup>5</sup> See Transcript of Hearing of the House Financial Services Committee, May 8, 2019 (Ranking Member McHenry stating that H.R. 2534 presents “an opportunity for Congress to clarify what is a longstanding body of law”).

<sup>6</sup> See S.1380 (100th Cong.), the Insider Trading Proscriptions Act of 1987.

so correctly and completely. This bill accomplishes neither. As a result, Committee Republicans cannot support H.R. 2534 as currently drafted.

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