

Ban On Insider Trading During '8-K Gaps' Heads To Senate

By **Andrew Kragie**

Law360 (January 13, 2020, 8:37 PM EST) -- The House overwhelmingly passed a bill Monday that would prohibit stock trades by company leaders during the window between a major corporate event and its public disclosure, closing what lawmakers call a loophole that facilitates insider trading.

The 8-K Trading Gap Act, approved 384-7, would require public companies to stop executives and directors from trading company stock before reporting significant events on U.S. Securities and Exchange Commission Form 8-K. Covered events include bankruptcies, data breaches, mergers and acquisitions, agreements with customers and suppliers, and leadership changes. SEC rules allow up to four days for reporting, theoretically giving corporate leaders time to make trades using nonpublic information.

"Corporate executives shouldn't be allowed to trade on significant information ahead of the public and investors, but that's exactly what's happening because of this legal loophole," said the bill's sponsor, Rep. Carolyn Maloney, a top Democrat from New York City who chairs the House Financial Services Committee's investor protection subcommittee. "My bill has a very simple solution to this problem: Prohibit executives from trading during the four-day gap between when an event happens and when the company publicly files a Form 8-K to alert the public and shareholders of the event ... It's just common sense."

The bill's name echoes a 2015 academic study that examined a decade of corporate leaders' trades and found that "insiders can — and do — earn significant abnormal profits by trading during 8-K gaps." One of the authors, Robert J. Jackson Jr., became an SEC commissioner in 2018 and helped inform the legislation.

Another author, Columbia Law School professor Joshua Mitts, said Maloney's measure was narrowly tailored to address the problem.

"It's to protect the ordinary investor," Mitts told Law360 on Monday. "Insider trading undermines the fairness of our markets because it give some folks — CEOs and other corporate executives — an advantage over the average investor who has their retirement savings in the stock market."

While existing laws prohibit trading by company leaders on the basis of material nonpublic information, the professor said, "It's often difficult to prove that a given executive was aware of this information at the time they traded, so we needed a prophylactic rule. We needed a blackout period ... That's something only Congress can do."

Mitts argued that the proposal does not overly burden companies or their leaders. The five-page bill exempts automatic trades scheduled well in advance. And companies can make the blackout period as short as one day by filing the Form 8-K quickly or publishing a press release.

The legislation shouldn't prove burdensome for companies, according to Anne E. Beaumont, a litigation partner at Friedman Kaplan Seiler & Adelman LLP who provides compliance training and counseling for financial services firms.

"It certainly strikes me as a hole worth plugging," Beaumont told Law360 on Monday. "What's

described in the proposed legislation seems pretty straightforward. ... If anything, you might be happy to have concrete guidance on it."

The Senate Banking Committee has yet to consider that chamber's version of the bill, which was sponsored by Sen. Chris Van Hollen of Maryland, the top Democrat on the panel's securities subcommittee. He remains "optimistic about the future of this bill" given the broad bipartisan support in the House, his office said Tuesday, and he will push for consideration in the upper chamber.

"Once corporate insiders recognize they have a duty to inform the public about a material event, they should be immediately barred from selling their stock," Van Hollen said in a statement. "Giving them four days to cash in on inside information is a total abuse of the public trust."

Spokespersons for committee Chairman Mike Crapo, R-Idaho, and subcommittee Chairman Pat Toomey, R-Pa., did not immediately respond to questions Monday about the proposal's prospects.

The House also approved three other finance-related bills Monday evening by voice vote, meaning individual "yeas" and "nays" were not recorded.

The Prudential Regulators Oversight Act would require semiannual reports and congressional testimony from leaders of the Federal Reserve, Office of the Comptroller of the Currency, Federal Deposit Insurance Corp. and National Credit Union Administration.

The Cybersecurity and Financial System Resilience Act would mandate annual reports to Congress from those four agencies about how they are tackling cybersecurity concerns.

The Expanding Opportunities for Minority Depository Institutions Act would make permanent a U.S. Department of the Treasury mentorship program for minority-owned banks.

--Editing by Jill Coffey.

Update: This article has been updated with information from Van Hollen's office.