Insider Trading Laws in the United States

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Abstract
This study explores the laws of insider trading in the United States stock market. The research is based on the analysis of public records, legal cases. The research addresses insider trading laws and cases in the United States as a model in terms of what need to be done to have a sufficient enforcement in developing countries, as well as improving laws related to fines and other forms of punishment. A better enforcement and litigation with insider trading and other securities violations are concerns to domestic and foreign investors alike, and can lead to increase investors' confidence, which may, in turn, result in higher levels of investment.
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1. Introduction

Around the world, a large concern regarding publicly traded shares in companies, as well as other financial instruments, is the risk of fraud. Of the many illegal actions that can take place regarding the integrity of the stock market, manipulation and insider trading may be considered two of the worst financial crimes given the relationship between this crime, and loss of trust and confidence in the system. In many countries, legislators have made efforts through the development and implementation of securities laws to address the various legal sanctions against such crimes.

Statement of the Problem:

i. A Global Shift with Insider Trading

While many nations of the world have long had insider trading laws, it was the Great Recession that increased focus on insider trading. Specifically, legal scholars have found that, in the wake of the recession, there had been a marked increase in enforcement of insider trading laws. Nation states, as well as self-regulatory agencies that are responsible for stock market oversight around the world, have increased enforcement efforts based on the belief that stock markets work when there is confidence in the market.

The belief that confidence in the stock market is important to its healthy functioning is not isolated to specific countries. For instance, it was in early 2011 that the United Kingdom showed its seriousness about the problem of insider trading when it sentenced an ex-banker to a lengthy prison term, longer than any previous sentence for the same crime. The United Kingdom's Financial Services Authority (FSA) has shown that, while late to enforcing insider trading laws, starting its first criminal investigation in 2008, that it takes the matter seriously. In 2009, the organization had fined the financial industry that it regulates close to thirty-five million pounds. By 2011, the FSA is reported to have opened more than one hundred investigations into insider trading.

Other countries around the world are also increasing their efforts against insider trading. For example, in 2011 the European Union (EU) created two directives on insider trading. The Criminal Sanctions for Market Abuse Directive and the Markets in Financial Instruments Directive (MIFIDII) were created to reinforce the powers of regulators in terms of their ability to investigate cases of financial fraud as well as their power to punish, or sanction those who break the laws. The directives also seek to ensure sanctions for market manipulation and insider trading based on the belief that sanctions can deter potential offenders from engaging in such financial crimes. MIFIDII also seeks to harmonize sanctions and increase organizational requirements in such areas as product governance and client asset protection.

The United Kingdom is not alone in terms of a seemingly renewed focus on insider trading. Also in 2011, the Chairman of the China Securities Regulatory Commission (CSRC) stated that the organization has zero-tolerance for insider trading crimes. The declaration was made based on the view among observers and Chinese investors that insider trading causes harm to retail investors and has for several decades. Moreover, it has been reported that observers and investors believe that such a zero-tolerance policy is needed to help the stock market in China flourish.

In 2006 China made many changes with its securities laws. These changes include the New Securities Law ("NSL") that revised an estimated forty percent of the original provisions of the law. Amendments were made to over one hundred articles. The NSL changes included increasing protections for smaller shareholders, and increased the power of the CSRC in addressing insider trading and stock manipulation.

Prior to 2009, the country only had a single criminal conviction for insider trading. However, after the announcement of the zero-tolerance policy, China referred fifteen individuals for criminal to be prosecuted for insider trading. In 2011 alone, China's regulators investigated more than forty cases, and imposed fines of 335 million yen among those found guilty. Furthermore, China banned eight investors from the stock market, and punished several individuals, including one with a fourteen-year prison sentence, which, at the time, was the longest sentence for the crime.

Developing nations have also started to take insider trading more seriously in the wake of the Great Recession. For example, Russia, in 2011, decided to make insider trading a crime. Brazil also made changes with its insider trading laws in 2017. The head of Comissao de Valores Mobillarios stated that the nation would focus on the battle against insider trading because investors see the regulation and regulatory environment in Brazil as being weak and unsafe. It was in the fall of 2017 that the country created a new federal law that intensified insider trading as a crime.

Clearly, many nations around the world have shown that they are interested in addressing the problem of insider trading, as it is seen as an unfair advantage in the stock market. Moreover, nations are well aware that their stock markets are often invested in by outsiders through FDI, and that investors might shy away from markets that are viewed as lacking integrity due to such factors as insider trading. It is unclear if these laws are applied in a fair and objective manner. Nonetheless, it is clear that countries around the world have worked to improve their securities laws with regard to insider trading.

ii. Insider Trading and Securities Fraud

In the United States, insider trading is deemed unlawful in light of the fact that it is a type of securities fraud, and fraud is seen as a sort of theft. Moreover, with insider trading, the problem is that one person can trade based on information that is not available to others, making it an uneven playing field.

Closely related to the problem and crime of insider trading is the manipulation of the stock market in terms of both being unethical and illegal. According to the United States Federal Bureau of Investigation, the manipulation of the market is the artificial "raising or lowering of the price of stock on any national securities or commodities exchange or in the over-the-counter (OTC) marketplace." Market manipulation can take several forms, such as stock purchases that either deflate or inflate the volume of sales of stock. Often, the Federal Bureau of Investigation finds that the tactic used is "pump and dump," where many people purchase a volume of stocks to inflate the price and then sell them once a specific price has been reached. Like insider trading, market manipulation is considered fraud in almost all securities exchange markets in the world. Moreover, insider trading is similar to market manipulation in that when insiders purchase stocks based on information, the result is similar to that of market manipulation where the prices of stocks are altered in an unnatural manner. When individuals make investments based on insider trading, they may send an indirect signal that others should invest in the stock.

Insider trading can be viewed as a market timing issue where individuals use information to gain an advantage in the stock market. Some individuals might believe that insider trading is simply taking advantage of information before other members of the market, such as brokers, can. Moreover, some may believe that insider trading does not cause harm because the members of the financial industry and others will eventually gain the same information. The gains made from insider trading, to some people, would be similar to the result of an upcoming merger or acquisition, which can have an impact on the price of a security. However, there are many negative impacts of insider trading.

iii. Negative Impacts of Insider Trading and Securities Fraud

There are several negative economic impacts that are the result of insider trading. Perhaps the most obvious negative economic outcome "is that those who may profit from insider information may indeed use productive resources from actual value-creating activities." This means that individuals who could have made money through value-creating activities, such as investing in corporate expansion or other activities, instead spend money on the illegal activity of insider trading. Furthermore, the problem of efficiency emerges because insider trading leads to the division of the so-called pie as opposed to its expansion. Social loss also occurs from insider trading because productive resources are diverted.

It has been claimed that the argument of market-confidence, which asserts that individuals lose confidence in the market as a result of insider trading, is weak based on the fact that people continue to invest in the stock market in large numbers. The market-confidence argument is based on the view that insider trading is morally wrong and that, more importantly, it leads people to sit on the sidelines of a market due to a failure with regulation. Despite the fact that some believe that the argument is weak, there are people who are concerned about investing in the stock market based on the fear of the loss of stock value. These fears can be based on a number of factors, such as a lack of knowledge about investing, high profile cases of financial fraud such as Bernie Madoff's Ponzi scheme, and insider trading. Despite the fact that there is no link between insider trading and a catastrophic market crash, some individuals might choose not to invest in the market because of insider trading.

Even where insider trading might not lead many people to decide to avoid the market, there is the strong potential for losses for those who are involved in the market. Research finds, for example, that liquidity traders can incur losses when they are trading against those who have an information advantage that comes from insider trading. Moreover, there is a rivalry between those who have information and those who do not, and this might cause some to leave the market. There is also the risk that publicly traded organizations could lose investments as insiders, or those who gain the information, may come to realize that they need to cash out their investments as likely others will when the information becomes public.

Insider trading can have a negative impact on the value of specific stocks.

Research based on empirical evidence finds that when the laws against insider trading are more stringent, there is an association with greater stock price accuracy. This finding implies that lack of insider trading laws, or weak laws, could have a negative impact on stock price accuracy, as well as the liquidity of the stock market. Accurate share prices are considered an important aspect of economic efficiency in terms of the impact of capital allocation. Accurate prices can lead to an increase of value added by organizations, as they utilize scarce resources in their offering of goods or services. It is also suggested that accurate stock prices can reduce firm level agency costs. The findings imply that insider trading can lead to a negative impact on stock value and agency costs.

The problem with insider trading is that it is an act that can lead to benefits for some individuals, at a cost to others with the relationship between a corporation and its shareholders. Research finds that insider trading is an inefficient private benefit of control for managers, as well as others in an organization. The problem is that the benefit comes to the expense of others, such as shareholders. Specifically, research finds that insider trading does not act as an incentive that can closely align the interests of both shareholders and managers. Rather, insider trading can increase agency costs due to the distortion of the process of setting wages. Research also finds that managers could sabotage compensation that is performance based because of the insider trading.

It has been noted that insider trading can have many negative impacts on the organization in addition to unfair advantages for managers and others at the expense of shareholders. One such concern is that insider trading might lead managers to take on too high a level of risk, or focus on products that are value-reducing. Because insider trading is more profitable in a situation of increased stock price volatility, some managers might be encouraged to engage in high risk investment behavior that can lead to less value for the firm. Moreover, because insiders can profit in many cases regardless of the financial performance of the firm, they may become indifferent to the performance of the organization.

The stock market itself can also experience negative impacts from insider trading. Research has found that insider trading has a negative impact on the liquidity of the market. In addition, market makers are a group that have been directly harmed by the crime of insider trading. Market makers might not have been concerned about this problem in the past. However, in later years this theoretical argument has gained more force. This may be due to reports of large losses of options of market makers that result from insider trading. Research also finds that insider trading on options can lead to substantial losses for market makers, more so than those in the equity markets.

Challenges with Enforcement of Insider Trading Laws

Insider trading laws are challenging to enforce in terms of detection of the crime. In general, detection rates are low while the costs of trading are high. For example, based on the assumption that a mere ten percent of insider trading is detected, and these trades lead to $100 million USD on a single day of trading, there could be $900 million USD worth of fraud going undiscovered. Detection rates are low because there are many factors and forces that can influence investment decisions, ranging from personal preference, to the decision to pursue other investment opportunities. “As a consequence, fines and sentences would have to be multiple of damages equal to the reciprocal of the detection rate to sufficiently deter insider trading.”

In addition to challenges associated with detecting insider trading, there are also challenges with reducing this crime. The challenges in stopping insider trading is that it can sometimes be hard to prove, and some individuals are willing to risk insider trading in the absence of legal deterrents, such as lack of prison time and low fines. Not only is there the challenge of reducing insider trading, but there is the issue of costs and punishments that relate to deterring this crime.

iv. Moral Arguments Against Insider Trading

Moral arguments have also been brought up against financial crimes such as insider trading. Many economists take a utilitarian approach to the economy, and many legal systems are based on this ethical concept. This ethical view “classifies an act as good if the result is the greatest good for the greatest number.” The utilitarian view also considers an act a moral one when the majority of the people benefit from it. Insider trading, based on the ethical standard of utilitarianism, is unethical.

In addition to the utilitarian arguments that demonstrate how financial crimes are unethical, rights theories such as contract and property rights are also used to show that these crimes are unethical. Some believe that insider trading is morally wrong because certain people are given privileged access to information. The playing field in the stock market is not level because others take risks that insider traders are able to minimize because of the information they possess. The rights approach considers if contract or property rights are violated because of an act, and property rights have been considered in terms of the right of the corporation. The rights theory can be applied to insider trading because there are cases where "breaches of fiduciary duty violate contract rights, and so are unethical." Hence, various theories of ethics, including the rights theory, view insider trading and other financial actions as wrong when they infringe on the rights of individuals. One such right that many people expect to have is the right to participate in a fair and honest market.

Insider trading is viewed as an unfair practice and has been outlawed in many nations. The crime is thought of as giving people an unfair advantage and creating a situation where "the playing field would no longer be level." Not only does the playing field become uneven, but insider trading can also lead to the loss of investor confidence. When investors lose confidence in the market they may be less willing to invest in companies, companies that need funds to pursue strategies and achieve their growth objectives. Other criticisms of insider trading include claims that it represents an abuse of trust, and that it undermines equal opportunity, confidence, and integrity.

A consequence of insider trading on a country can include its country ratings. Research finds that countries are rated in terms of their risk exposure based on a semi-annual survey of bankers by Institutional Investor. The ratings, which are published every six months, may have an impact on a country in terms of how investors perceive the nation as desirable to invest in.

Insider trading can lead to gains for those who are involved in the crime. When individuals are able to gain information before other investors, the information can be acted on for profit. While the main ethical issue is unfairness, there are also negative outcomes of insider trading on many. A problem is that people can lose trust and confidence in a company that is associated with this crime. As a result, the company can face lower levels of investment that in turn can lead to losses for employees. A company might, for example, choose not to pursue growth strategies that require funding due to a decline in stock value.

Insider Trading in the United States

I. History and Overview of the United States Stock Market

The first United States stock exchange, the Philadelphia Stock Exchange, was founded in 1790, which was soon followed by the New York Stock Exchange in 1792. The state-level laws, referred to as Blue Sky Laws, originally governed the American stock exchanges. "These state laws were meant to protect investors from worthless securities insured by unscrupulous companies and pumped by promoters." The Blue-Sky Laws included the requirement that firms provide a prospectus that states how much interest is received by the promoters and a justification for the interest. However, these laws were deemed weak in terms of content and their enforcement. For example, the firms that wanted to avoid disclosure simply sold shares to investors across state lines.

It was the weakness of the state laws that helped lead to the 1929 stock market crash. With many investors being uninformed, people started to invest, and financial professionals started to trade securities among themselves to drive up prices. Although there was resiliency in the market, "too many of these stock grenades eventually turned the market and, on October 29, 1929, the Great Depression made its dreaded debut with Black Tuesday." Black Tuesday was when the stock market faced one of its largest drops in history, and many traders and investors sold shares in a panic.

The panic and subsequent selloff led to early legislation to protect the public from stock-market-related fraud. In 1933, the Glass-Stegall Act was created. This act was created "to keep banks from tying themselves up in the stock market and prevent them from hanging themselves in the case of a crash.". This was a federal act that was intended to be stronger than the state-level Blue Sky Laws. Blue Sky Laws were created to ensure that companies did not engage in either manipulative or deceptive conduct with regard to their capital-raising efforts. In addition, the act led to the separation of commercial banking from investment banking. The act was enhanced one year later with the creation of the Securities and Exchange Commission.

The SEC, was created to regulate the trade of bonds, stocks, and other securities, such as mutual funds. The Securities and Exchange Commission came about because of calls for reforms; prior to the existence of the agency, "[c]ontrols on the issuing and trading of securities were virtually nonexistent, allowing for any number of frauds and other schemes." In addition, the agency was created to address the fact that controlling stock interests were in the hands of a few, potentially leading to abuses of power.

The U.S. Congress passed three acts that led to the creation of the SEC. "The Securities Act of 1933 required public corporations to register their stock sales and distribution and make regular financial disclosures." In the following year, the Securities and Exchange Act of 1934 created the SEC as a means of regulating over-the-counter markets, brokers, and exchanges and to monitor financial disclosures required of them. In 1935, the Public Utility Holding Company Act allowed the Securities and Exchange Commission to break up large utility companies.

The Securities and Exchange Commission and its efforts to both regulate the stock market and prosecute those who violate its laws is considered vigorous. The anti-insider trading laws criminalized insider trading. However, the criminalization of insider trading did not occur until 1961, close to four decades after the Securities and Exchange Commission was established. Over time, the laws specifically addressing insider trading have evolved as “scandals involving such modern-day Al Capones as Ivan Boesky and Dennis Levine have motivated Congress to enact strong measures to combat insider trading.” Indeed, over time, the weaknesses of various aspects of insider trading laws in the United States have been addressed through such means as the Securities and Exchange Commission gaining more power an authority in areas such as enforcement.

The Securities and Exchange Commission has been aided by the courts in terms of the definition of insider trading. The courts have defined insider trading as an action that encompasses several activities. Court cases have created precedent rulings that have evolved over time. For example, with the case *Re Cady Roberts & Co*., the Securities and Exchange Commission expressed its view that corporate officers have a duty to both the firm and those who invest in the firm. Later, the Securities and Exchange Commission focused on any person who possesses material information that is unavailable to the public and that is shared with the intent of insider trading.

In the United States the classical theory of insider trading is seen with Rule 10b-5. This rule states that a violation has occurred when a corporate insider purchases or sells securities based on information that is considered non-public and material. This theory is applied to the insiders who have a fiduciary duty to the shareholders in the company. The theory is also applicable to people who are considered temporary insiders. A temporary insider is a person, such as an accountant, a lawyer, underwriter, or consultant, who is outside the company but can gain access to information deemed insider information, through the course of their relationship and work for the publicly traded firm. These individuals have a duty to not trade based on the information that they have gained temporary access to.

In addition to the temporary insider, the securities laws of the United States also address those who are known as “tippees.” Tippees are individuals who trade based on the insider, or non-public information that they have received from those who are insiders. In the American legal system, the tipper is liable for insider trading under the law based on specific situations. These situations include if the tipper had non-public, material information about the company, if the tipper shared that information to the person who is a tippee, where the tippee traded in the securities of the company when they had the information that was provided to them by the tipper, where the tippee either should have known or did actually know that there was a violation of trust by the tipper in the sharing of the insider information, and if the tippee was able to financially benefit because of the information that was shared with them. In some cases, a tipper can be held liable even when they did not act in a willful manner but had knowledge that the information that they have shared has broken a confidentiality duty. An interesting aspect of the tippee in the eyes of regulators is the personal benefit. To satisfy this requirement of the law, a tipper can gain either a direct or an indirect benefit. Such benefits can include a benefit in reputation that might result in having the information that is deemed insider information. In addition, the benefit might be a financial gain.

The Securities and Exchange Commission has worked on an increasing number of cases of insider trading over the years. Between 1944 and 1984, the Securities and Exchange Commission only brought 129 civil insider trading actions. Only a small percentage of these actions were prosecuted on a criminal level. In addition, “even where the SEC was successful in civil actions, relief was limited to disgorgement and injunction against future trading.” As a result of federal judges being displeased with this solution, Congress passed the Insider Trading Sanctions Act, allowing an organization to seek a fine of treble gains. The act also led to an increase in the maximum criminal fine.

In the United States, when an individual is accused of insider trading or any other financial crime related to the trading of securities, the Securities and Exchange Commission investigates the case, and the Department of Justice brings charges against the accused. Financial fraud cases are tried in criminal courts. The circuit court of appeals hears appeals to the rulings. Few cases have been heard by the Supreme Court of the United States, though there have been recent cases of insider trading and other financial frauds that have made it to the Supreme Court. For example, the Supreme Court of the United States has heard a case on the matter of disgorgement, a remedy used by the SEC to recoup illegal gains such as from insider trading.

II. Analysis of Some Insider Trading Cases in the United States

One of the most famous and well-publicized cases of insider trading in the United States is the case of Ivan Boesky. Boesky is described as an arbitrageur who faced charges from the Securities and Exchange Commission, as well as the Justice Department. The charge against Boesky was that he had gained “approximately $200M using inside information to make massive stock purchases mere days in advance of takeover announcements by some of the country’s largest corporations.” The scandal would eventually implicate many traders on Wall Street who, along with Boesky, were able to profit greatly through the use of inside information.

The Securities and Exchange Commission monitors trades to detect insider trading. It was in 1985 that the

Securities and Exchange Commission detected unusual activity, and "[w]ith insiders trading privileged information, various company stocks were being purchased in a dramatic fashion just before a major announcement about a merger or sale of the company was made." The investigation into Boesky followed a previous investigation into Dennis Levine, who was Boesky's partner. The evidence against Boesky was considered solid, and he pled guilty in 1986. Future New York City Mayor Rudolf Giuliani struck a deal with Boesky, and Boesky served a three-year prison sentence and paid a staggering $100 million fine for his insider trading activities.

The Ivan Boesky case reflected an increased focus on insider trading on the part of the Securities and Exchange Commission and an increase in penalties. "The prison sentence—the third longest insider trading sentence ever imposed—sent shockwaves of fear through the financial world when it was handed down." Meanwhile, the government viewed the sentence as progress in terms of deterring insider trading. The sentence of Boesky was important as previously few insider traders were sentenced to prison.

A new era of prosecutions followed the Ivan Boesky case. In 1987, for example, as a result of what was called Black Monday, a stock market crash that at the time was the largest one-day loss in the history of Wall Street, the government was pressured to address what many viewed as market regulation failure. "Senate debates on congressional financial reform were peppered with reference to 'nothing short of a white collar crime wave with respect to insider trading' and panic over even legal practices common in the market…even where white collar crime is absent, we suffer economic crime." In addition to the hearings that pressured the Securities and Exchange Commission to take a tougher stand against insider trading, the Boesky case appears to have inspired the Federal Sentencing Guidelines that classified insider trading as a serious offense.

Insider trading in the United States is a problem that is widely covered in the media and well-known to the public. In fact, the SEC itself notes the following:

Insider trading continues to be a high priority area for the SEC's enforcement program. In recent years, the SEC has filed insider trading cases against hundreds of entities and individuals, including financial professionals, hedge fund managers, corporate insiders, attorneys, and others whose illegal tipping or trading has undermined the level playing field that is fundamental to the integrity and fair functioning of the capital markets.

These actions include cases involving a corporate attorney and his wife, a financial analyst for a pharmaceuticals company, and a CEO and his close friend, among numerous other cases.

There are several high-profile cases that illustrate how the Securities and Exchange Commission has addressed issues such as evidence and punishment. One of the most famous cases involved lifestyle guru Martha Stewart, who was convicted of obstruction of justice related to insider trading as opposed to insider trading itself. Nonetheless, her case does illustrate how the SEC addresses issues related to insider trading. In 2001, Martha Stewart sold shares of a company called ImClone two days before the stock of the company "dropped by 16 percent when the Food and Drug Administration said it had rejected ImClone's main drug, Erbitux, for cancer treatment." Stewart owned 4,000 shares of the stock, and in selling it, she avoided a loss of over $45,000, a small amount of her total net worth. The CEO of the company sold $5 million worth of stock.

Although it was simple for the SEC to substantiate a claim against the CEO of ImClone, Sam Waskal, it was more challenging with Stewart. With the CEO, the sale of a large amount of stock prior to such an important announcement from the Food and Drug Administration is considered a red flag. However, with Stewart, although her sale was deemed more than a timing coincidence, the Securities and Exchange Commission lacked the evidence to accuse her of insider trading. To make such an accusation "the government would have to show that Stewart traded while in possession of information that was nonpublic and material-something that is not widely known and that a regular investor would consider important in making a decision about a trade." It was discovered that Stewart made the sale because her stock broker, who also represented Waskal, was aware that Waskal was selling his shares and then shared this information with Stewart; although, the stock broker and Stewart were not aware of the reason behind Waskal's sale.

While many people believe that Stewart was charged with and found guilty of insider trading, she was not. When the media learned of the situation related to her sale of shares in ImClone, she denied the version of events that were claimed. Instead, she stated that she had an earlier agreement with her stock broker to sell shares of ImClone if they dropped below a certain price per share. It was a result of the denials that led to an increase in the ImClone share price. It was based on Section 240.10b-5 of the 1934 Securities Exchange Act that Stewart was charged for securities fraud based on her false and misleading statements made with regard to the stock sale. It was stated in one of the counts against her that the false and misleading statements were made to either slow or stop the loss of value of ImClone stock.

Stewart did not have a duty to not sell based on the information because she had no position on the board or an official tie to the CEO. Hence, Stewart was not charged with insider trading. However, because Stewart had lied about the trade, she was charged with obstruction of justice and was sentenced to five months in prison and five months of house arrest. Moreover, she was placed on probation for two years. Further, Stewart also had to pay a penalty of $195,000. The charges that were filed against Stewart and the subsequent conviction led to punishments that were harsher than any insider trading punishments.

Another recent case of insider trading that has gained a high level of attention is the case of Raj Rajaratnam. Rajaratnam, the head of a hedge fund, gained insider trading tips from numerous Wall Street insiders. It was reported that Rajaratnam would pay individuals for tips; one person he paid was Anul Kumar, who worked at McKinsey & Co. and who is said to have "collected $2 million for tips he provided to Mr. Rajaratnam after the fund manager told him he was underappreciated at McKinsey, prosecutors allege." Mr. Kumar, as well as others, pled guilty to charges of conspiracy to commit securities fraud and securities fraud. Several individuals were involved in the Rajaratnam case including a portfolio manager, a managing director, and even an IBM senior VP.

In the case of Rajaratnam, there was strong evidence against him. In addition to the several people who testified against Rajaratnam, the Securities and Exchange Commission used wiretaps. "In one tape played at trial, Mr. Rajaratnam called a contact and said: 'I heard yesterday from somebody who's on the board of Goldman Sachs that they are going to lose $2 per share.'" In another recorded phone call, Rajaratnam and another individual spoke about the company, Akamai, and how it would lower its earning guidance; this conversation occurred several days before the information was made public. It was such calls that revealed the widespread use of paid informants in this insider trading case.

Based on the evidence, Rajaratnam was found guilty, and more importantly, he faced a harsh punishment. The hedge fund manager "was sentenced to 11 years in prison, the longest-ever term imposed in an insider trading case." The lawyers who represented the convicted asked for no more than eight months while the prosecution wanted more than the eleven years that he was sentenced. This stiff penalty is part of the effort being made to bring an end to insider trading on Wall Street and the sentence has been viewed as historic. The case itself was also historic in that the authorities called it the largest insider trading hedge fund case in history. The United States district judge who presided over the case, Richard Howell, commented that the case reflected a virus in the business culture that has to come to an end.

In addition to the prison sentence, Rajaratnam was ordered to pay a large fine. Like the prison sentence, the fine imposed was the largest that has ever been imposed on an individual for an insider trading case. The judge in the case also fined Rajaratnam $10 million and ordered that he forfeit more than $50 million in profits.

Rajaratnam also had to pay the government $92.8 million in civil penalties. The multi-million-dollar fine and eleven-year jail sentence were clearly harsher than the punishments.

What many of the cases of insider trading in the United States make clear is that the SEC relies on strong evidence when pursuing cases. Although the SEC prefers direct evidence, finding this in cases of insider trading is rare. Often, there is a lack of "smoking guns or physical evidence that can be scientifically linked to a perpetrator." Hence, in many cases of insider trading, the evidence is considered circumstantial. Many cases require that the Securities and Exchange Commission examine events that range from relationships between people and trading patterns to inferences that relate to the timing of stock sales and purchases. In addition, indicators of potential insider trading can include abnormal returns prior to an unscheduled announcement of information deemed price sensitive.

These cases of insider trading often rely on evidence from cooperating witnesses. As in the Ivan Boesky case, Boesky was named by his business partner, who then shared additional names of inside traders with the federal government. The SEC also has the power to acquire evidence through other means. "In its informal investigations, which the staff can conduct without Commission authorization, the staff requests information on a voluntary basis. In its formal investigations, the staff can use the Commission's subpoena power to compel witnesses to testify or to produce books, records, and other evidence." Moreover, in recent years, the Justice Department has used wiretaps, such as in the Raj Rajaratnam case, to overcome the challenge of proving insider trading cases.

It is expected that the United States Justice Department will use more wiretaps as a means of gaining evidence for insider trading cases. The Rajaratnam case validated "the government's use of wiretaps as a means to investigate this type of crime." In the Rajaratnam case, there was criticism of how the wiretaps were used by the prosecution. The Federal Wiretap Act requires that prosecutors in a case establish that listening to private conversations through wiretap technology is a necessity. The Second Circuit ruled that the wiretaps were permissible in the Rajaratnam case. Moreover, and perhaps most importantly, district judges are often unwilling to suppress wiretap-based evidence.

Even though the Securities and Exchange Commission and Department of Justice face challenges detecting insider trading in terms of evidence, the Securities and Exchange Commission has been able to gain the evidence needed for prosecution and has also been able to gain harsher punishments. A development in insider trading "is the increasing severity of punishment upon conviction for insider trading offenses." There has been an increase in the chance of prison time for insider trading offenses, as well as an increase in the length of the sentences, in recent years. Between the years 1993 and 1999, less than five percent of individuals who were convicted and served prison time spent two or more years in prison. More recently, however, the ratio increased to over twenty-five percent between the years 2000 and 2009. Further, between 2010 and 2012, the ratio increased to close to fifty percent. These statistics demonstrate a tenfold increase in prison sentences longer than two years.

There has also been an increase in the size of fines imposed on inside traders. The Raj Rajaratnam case serves as an example. The 1984 Insider Trading Sanctions Act has allowed for higher penalties. In fact, "those who violate insider trading laws face a potential monetary penalty of up to four times their illicit profits." The law also applies to the losses avoided for inside traders. Further, private parties can bring suits against insider trader, and this can be viewed as an additional deterrent to insider trading. Deterrence may also result from the increase in Securities and Exchange Commission activity. The increases in fines are used as punishment but can also help cover the high costs of litigating the cases of the SEC.

The SEC has increased its enforcement actions over the years. In the late 1990s, a turning point occurred with the Securities and Exchange Commission in terms of the number of enforcement efforts. Research shows that "in 1980 the SEC initiated a mere 20 insider trading actions." Later, between the years 1990 and 1995, the organization increased its actions to, on average, thirty-five enforcement actions. Between 2000 and 2005, the Securities and Exchange Commission averaged forty-nine insider trading cases. These statistics demonstrate that prosecutions against insider trading have increased.

Collectively, the increases in fines, prison time, and actions by the Securities and Exchange Commission may have a deterring effect. The efforts made in recent years to address insider trading, such as with the high-profile Raj Rajaratnam case, have signaled a large change with the Securities and Exchange Commission and its efforts to end insider trading. The year 2009 "marks the beginning of a transformative restructuring of the SEC's Enforcement Division, including the introduction of more effective detection technologies, new legal tools (e.g. cooperation agreements) and a commitment to target more sophisticated Wall Street offenders." Legal experts agree that the aggressiveness of the Securities and Exchange Commission in recent years is unprecedented. In fact, one Stanford Law Professor has stated that the Securities and Exchange Commission is not only taking a zero-tolerance approach with insider trading, but that it has also declared a war on the crime. It has also been stated that the aggressive enforcement strategy of the SEC will likely continue in terms of litigating prominent defendants as a means of increasing public confidence in the securities market.

Although measuring and proving deterrence is challenging, evidence does indicate it occurs. For example, research shows "that the price impact on days with prosecuted insider trades is in fact much smaller in the last decade than in the 1980s." Reports indicate that in the sample periods studied, insiders did not scale up their trading volume after prosecutions, suggesting fear of prosecution among traders. Typically, insider volume on a trading day is an estimated 3.1% but falls to 1.5% after prosecution. Research shows that the variation in insider volume is tied statistically to the intensity of Securities and Exchange Commission enforcement.

An additional factor related to the deterrence of insider trading is shareholder litigation. Although civil lawsuits against inside traders have previously been considered rare, these actions are increasing, and the lawsuits can deter the defendant's firm and other members of the industry. Research shows that "shareholders securities litigation, a widely used disciplinary mechanism against managerial opportunism, can deter such trading." Still, even with the risk of litigation, these lawsuits are known to be difficult, and the effectiveness of these lawsuits, such as on the class action lawsuit, have been criticized; the criticisms cite that the lawsuits are often frivolous and driven by attorneys seeking large settlements. Further, the lawsuits might not be as effective as a form of deterrence; the directors and officers involved in insider trading are usually not directly punished. Rather, the liabilities are covered by liability insurance and the organization itself.

The United States' efforts to address insider trading, the history of the SEC, and specific cases demonstrate that increased attention has been paid to the problem of insider trading. Yet despite the efforts of the SEC, remedies do not always "provide an effective deterrent to insider trading." The SEC has gained more power over time to pursue the cases. There have also been many high-profile cases of insider trading that resulted in long prison terms and high fines. These efforts appear to have somewhat of a deterrent effect in terms of insider trading.

5. Conclusion

Many countries around the globe that are currently seeking to achieve economic growth and diversification, a large part of this economic growth and diversification is based on outside investments in the form of foreign direct investment. Because investors may be concerned about investing in these nations, such as with its publicly held companies, due to such acts as insider trading, they also needs to address this securities fraud issue. Moreover, they must address insider trading because of the concern of how it is inherently unfair and how it undermines the integrity of the market.

Developing nations has made efforts to address insider trading. Such efforts have included the creation of laws and their enforcement. Still, the regulatory efforts have several weaknesses including, but not limited to, a lack of transparency, weak punishments in terms of fines and prison time, absence of potentially effective deterrents, and a lack of whistleblowing laws and protections. They should address these weaknesses through such means as borrowing from the model set by the SEC of the United States.

In making the recommended changes and improvements, developing nations can, at the very least, improve the perception of integrity with the market, and to some extent the actual integrity itself. While insider trading might be a crime that is hard to eradicate completely, as with all other crimes, the nations can do more to address insider trading through such means as stronger laws, the enforcement of laws, and public awareness and education of insider trading and whistleblowing. These methods can help the nations achieve the goal of integrity in its markets that, in turn, can help to achieve its goal of economic growth and diversification, often based on foreign direct investment.

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