Investment and Portfolio Management: Insider Trading

You don't have to be a member of the Board of Directors to engage in illegal insider trading. John J. Freeman, a part-time temporary word processor at two investment houses, learned all he needed to know from the desks of co-workers, garbage cans, and from making copies of documents that discussed impending mergers and acquisitions. Even though the documents referred to the companies involved by code, Freeman was able to learn their true identity by piecing together their industry, historical stock prices, names of officers, and geographic location.

Once Freeman knew who and when, he disseminated the information to friends, family, and anyone who would listen via an Internet chat room under the name "TheBren." What Freeman did not know is that among his many listeners were members of the Securities and Exchange Commission (SEC), the FBI, and federal prosecutors. In fact, at any given time,100 specially trained SEC employees are surfing the Net, visiting chat rooms, and reading message boards looking for illegal inside traders. When they identify a red flag, they forward the information to the Office of Internet Enforcement, a special division of the SEC who helps build cases to pursue criminal charges and/or civil lawsuits.

The SEC is not the only surveillance group out in cyberspace. The exchanges monitor trading activity as well. In fact, the American Stock Exchange was the organization who originally identified a problem when they noticed unusual trading patterns prior to the public announcement of these mergers and acquisitions. Once the SEC was notified, it was only a matter of time. Freeman directly told at least 10 people, but as with any valuable secret, the information spread like wildfire. A friend of Freeman's, a waiter at a New York restaurant, made over $285,000. He told a patron who profited by at least $445,000, which was certainly more than he earned in his former career as a school teacher.

While his friends made millions of dollars, Freeman was more conservative and profited by only $70,000-$110,000, plus various non-pecuniary benefits such as cases of wine. This seems to be a small gain given the hefty fines and prison time that is certain to follow. It seems the Internet is affecting the stock market in all sorts of ways, both good and bad. It remains to be seen if the perceived anonymity of the Internet acts as a breeding ground for the conveying of private corporate information. One thing is for certain, however, the SEC is readying themselves by continual efforts and manpower devoted to policing cyberspace.

Questions

1. What is the definition of non-public, or private, information?
2. Who can come into contact with private, or inside, information?
3. When does private corporate information turn into illegal insider trading?
4. Why is the Internet such a high potential breeding ground for inside information?
5. What should you do if you learn of inside information?