Researcher says senator's trades could be first test of STOCK Act

March 29, 2020

Candace Jens, assistant professor of finance, says that before the passage of the STOCK Act, U.S. senators earned an abnormal return of 5.4% by selling stock before it declined in value.

On Feb. 13, Sen. Richard Burr of North Carolina, head of the powerful Intelligence Committee, sold between $628,000 and $1.7 million in stock shortly after receiving classified briefings on the threat of COVID-19. A week later, the stock market began a steep decline.

While Burr claimed the selloff, which was first reported by *ProPublica*, was unrelated to congressional briefings, a Tulane University researcher who studies insider trading among U.S. senators says the transaction followed a familiar script.

"What he appears to have done is exactly the kind of pattern we saw in the data," says Candace Jens, assistant professor of finance at Tulane's A. B. Freeman School of Business. "There would be some type of closed-door or not very well publicized meetings on Capitol Hill, and senators would then sell stocks shortly before the price dropped, so I wasn't surprised that this was the way these trades took place."

In 2017, Jens and co-authors Amanda Heitz, assistant professor of finance at the Freeman School, and Ian Cherry, lecturer in finance at the University of Central Florida, analyzed more than 31,000 stock transactions reported by U.S. senators between 2004 to 2016 to determine whether lawmakers were using non-public information, such as information presented in committee meetings and briefings, to buy and sell stocks.

While the authors found no statistical evidence that senators were profiting through the purchase of stocks, they discovered that between 2004 and 2011 senators earned abnormal returns of 5.4 percent by selling stocks immediately before they dropped in value.

“Almost exclusively, the abnormal returns that senators made on stock transactions came from well-timed sells,” Jens says.

To establish a connection between the senators’ trades and non-public information they might have had access to, the authors focused their analysis on trades made two to six weeks before important bills exited committees and involving companies whose stock might be affected by the legislation. They also ruled out other factors that might explain how individual senators could outperform the market, such as industry knowledge or local expertise.

The results, Jens says, clearly point to senators acting on non-public or not easily accessible information.

“You can keep saying it’s random chance again and again,” Jens says, “but at some point, the evidence starts to pile up.”

Perhaps the most convincing evidence is the timeline. Jens says the senators’ abnormal returns essentially stopped after Nov. 13, 2011, the date that “60 Minutes” aired a widely publicized segment highlighting the issue of insider trading in the Senate. Public outrage in the wake of the expose led to the passage of the Stop Trading on Congressional Knowledge (STOCK) Act, which prohibits senators from trading on information derived from their positions. Since then, Jens says, senators’ returns on both purchases and sales of stocks have more or less mirrored the market.

“The ‘60 Minutes’ episode really moved the needle,” Jens says. “One of our takeaways is that it wasn't necessarily the STOCK Act that changed people’s behavior. It was the media attention. The media attention led to the STOCK Act, but the act passed after the behavior had changed.”

What makes Burr’s case interesting, Jens says, is that it could be the first real test of the STOCK Act. With Wall Street enjoying the longest bull market in history for the past 10 years, senators generally haven’t had reason to unload stocks. COVID-19 changed that, with Burr and four other senators — Diane Feinstein, Ron Johnson, James Inhofe and Kelly Loeffler — each selling stocks in recent weeks. While some of those sales were likely innocent (Inhofe’s transactions, for example, were reportedly part of a systematic sale of assets that started after he became chair of the Armed Services Committee), Burr’s appear to be the most suspicious.

“This appears to be exactly the kind of behavior the law was written to stop,” Jens says.

While the transactions may warrant an investigation, determining that Burr based his sales on information obtained through Congress could be hard to prove.

“The only surefire way to fix this is to mandate that senators hold their investments in a blind trust,” Jens says. “That would totally remove any possibility of information leaking from closed meetings on Capitol Hill into their portfolios.”

Jens’ paper “Change in Capitol: How a '60 Minutes' Expose and the STOCK Act Affected the Investment Activity of U.S. Senators,” co-authored with Amanda Heitz and Ian Cherry, is currently under review.