

**CONGRESS AGAIN CONSIDERS REGULATING PROVIDERS AND USERS OF
POLITICAL INTELLIGENCE**

A report by the U.S. Government Accountability Office (“GAO”) on the role of “political intelligence” in the financial markets has renewed congressional interest in potential regulation of individuals and firms that collect political intelligence and those that use it to inform investment decisions.¹ The April 4, 2013 report, “Political Intelligence, Financial Market Value of Government Information Hinges on Materiality and Timing,” was mandated by Congress in a provision of the 2012 Stop Trading on Congressional Knowledge (“STOCK”) Act.

The report does not take a position on disclosure of, or restrictions regarding, political intelligence gathering or use. However, it does shine a spotlight on this activity that has motivated interested Members of Congress to advocate regulatory legislation—possibly through registration of political intelligence firms with a government agency and disclosure of their clients and activities. These Members claim that such legislation would be a further deterrent to insider trading specifically based on material, nonpublic information obtained from government officials.

Although the passage of legislation for this purpose is by no means certain, such a measure—if enacted—could affect a wide range of financial firms that maintain contact with government officials for the entirely lawful purpose of understanding the potential impact of legislative and executive branch actions on business, financial, and other decisions. In addition, congressional hearings are likely to focus media attention on the role of political intelligence firms in investment decisions. Firms that gather political intelligence, and their clients, should monitor congressional activity for further developments, and consider creating internal policies that address key insider trading issues.

BACKGROUND

The STOCK Act reaffirmed that the insider trading provisions of existing securities laws apply to Members of Congress, congressional staff, and virtually all government employees, and put those officials on notice that they are legally vulnerable if they provide information that may be material and nonpublic to someone who they could reasonably expect might trade on that information.² The version of the STOCK Act approved by the Senate included a provision that

¹ The report is available at <http://www.gao.gov/products/GAO-13-389>. GAO is a legislative branch agency that performs audit and investigative functions for congressional committees.

² For further information on the STOCK Act generally, please see Willkie Farr & Gallagher LLP Client Memorandum, “STOCK Act May Lead to Additional Insider Trading Enforcement Actions” (April 2, 2012), available [here](#). For additional background regarding congressional interest in political intelligence gathering, please see Willkie Farr & Gallagher LLP “Of Interest” release, “The Relationship Between Money Managers and Capitol Hill — Regulators and Lawmakers Take Notice” (Jan. 22, 2007), available [here](#).

would have required firms that gather “political intelligence” to register and disclose their clients. However, the legislation as enacted into law dropped that provision and instead required a GAO study of “political intelligence,” which the STOCK Act defines as information “derived by a person from direct communications with an executive branch employee, a Member of Congress, or an employee of Congress; and provided in exchange for financial compensation to a client who intends, and who is known to intend, to use the information to inform investment decisions.” As indicated by this definition, Congress was particularly interested in firms that gather and sell political intelligence and their clients, rather than financial firms that employ their own personnel to obtain political intelligence for their exclusive use. However, since the insider trading potential arises in either situation, there is no assurance that any proposed legislation will distinguish between these two types of users.

KEY POINTS IN THE GAO REPORT

GAO’s report emphasizes that while government officials are covered by the insider trading laws, the sale and use of political intelligence is not regulated or reported. Not surprisingly, GAO observes that it is difficult to establish the extent to which any single piece of political intelligence may influence an investment decision since firms that gather and disseminate political intelligence often bundle it “with other information sources.” The report also notes the difficulty of determining whether and when intelligence may be regarded as public, nonpublic, material or nonmaterial.

Although GAO discusses the possibility of Congress’s enacting new disclosure requirements for firms providing and/or using political intelligence, GAO also describes a number of significant and complex issues that should be addressed as part of the consideration of any legislation, including:

- clarification of key terms, including the existing definition of “political intelligence” in the STOCK Act;
- concerns about exposure of clients and clients’ interests if political intelligence firms are required to disclose their activities;
- a possible chilling effect or slowing of communications between government officials and political intelligence firms and a much broader group of parties that are interested in legislation but concerned about the risk that asking for information will trigger registration requirements;
- potential litigation based on perceived restrictions on First Amendment rights to communicate with government officials and participate in the political process;
- the impact of disclosure requirements on contractual confidentiality agreements, and, in the case of law firms, attorney-client privilege and an attorney’s duty of confidentiality to clients; and
- what government agency should be responsible for implementing and enforcing registration and disclosure requirements, what information should be required, how it should be collected, and what should be made publicly available and how quickly.

OUTLOOK FOR CONGRESSIONAL ACTION

Despite the fact that the GAO report makes no recommendations and raises serious questions about whether and how government should regulate political intelligence, Members of Congress who advocated regulation of political intelligence firms when the STOCK Act was pending are using the report to revive their efforts. Following release of the report, Senator Charles Grassley (R-IA), the ranking Republican on the Senate Judiciary Committee, and Representative Louise Slaughter (D-NY), the ranking Democrat on the House Rules Committee, issued a joint statement announcing their intent to propose disclosure legislation in this Congress. In the meantime, one or more congressional committees are expected to investigate the heavy trading in major health insurer stocks on April 1, 2013. Reports indicate that this activity appears to have resulted from information anticipating a favorable decision regarding Medicare rates that was circulated by a political intelligence firm immediately prior to the U.S. government's official announcement.

While the prospects for legislation are unclear, the GAO report also indicates that the SEC strongly supports significant disclosure requirements, and is interested in the possible links between political intelligence and insider trading. Some financial firms have chosen to address this situation by drafting internal policies that require legal review before any trading may take place on the basis of political intelligence when there may be a question as to whether the intelligence is public or nonpublic. Those policies also require that any employee or outside consultant gathering political intelligence disclose that fact to government officials and request that the official not disclose any nonpublic information.

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If you have any questions regarding this memorandum, please contact Russell Smith (202-303-1116, rsmith@willkie.com), or the Willkie attorney with whom you regularly work.

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