

Insider trading

Business



Take a position and defend that position on whether or not the fines levied by the SEC are a deterrent to insider trading? The only motive behind penalizing people for unlawful behavior is to discourage their particular illegal actions. Martha Stewart, CEO of the Martha Stewart Living Omnimedia and her stockbroker Peter Bacanovic from Merrill Lynch were fined \$195, 000 and \$75, 000 respectively in 2007 by the SEC. Economically analyzing the situation in which an individual violates the insider trading laws can help in judging whether a penalty serves its purpose of discouraging violation of insider trading laws. An individual would commit such an act after weighing the expected benefits against the expected cost in case he/she get prosecuted successfully. In Martha Stewart case, Martha avoided a loss of \$ 46000 by selling her shares which is duly covered by the fine she was subjected to; Moreover, she lost a great deal of money as a tradeoff for her legal troubles. Furthermore, Martha Stewart Living Omnimedia's stock price fell and Martha was banned to serve as an officer or director of a public company for five years. Peter Bacanovic, on the other hand, was barred from working in securities industry along with a \$ 75000 fine. These penalties are enough to set an example for the public.

What steps should the SEC take to protect the public against insider trading?

SEC can and should take measures to prevent such incidences before their occurrence. They can do so by eliminating the opportunity to insider trading because no matter what the penalty, such violations are very appealing to people as their upside is extremely lucrative. " Research shows that the certainty of punishment, rather than its severity, as well as how particular punishments are perceived, that most greatly impacts whether criminal

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sanctions deliver a potent “ message” to would-be lawbreakers” (Berman, 18). Control person provision suggests certain internal controls that would raise the bonding cost. By incurring bonding costs, a firm’s cost of capital will be reduced. Insider trading leaves behind agency cost and since investors cannot detect insider trading within a firm, they adopt a discounting method to value the firm’s stock that leads to a raise in the firm’s cost of capital. So in essence, incurring bonding cost would reduce the cost of capital which would send a strong signal to the investors that the firm has taken extraordinary measures to control insider trading. So in short SEC should impose the control person provision which would encourage the application of internal controls.

Works Cited

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