

Insider Trading in the Stock Market:
A Paradigm of Utilizing Competing Ethical and Christian Models
to Evaluate Issues of Justice

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Abstract

Insider trading is used as an ethical dilemma in order to consider the various approaches one can take when considering a questionable situation. Arguments supporting and refuting insider trading are briefly addressed and various ethical models or frameworks are considered including – a theological model, legal model, economic models (considering both capitalism and perfect competition), four distributive justice models, Kant’s two categorical imperatives, and utilitarianism. Not surprisingly, these individual models lead to conflicting answers. As a result, it is proposed that one should develop a model assisting them in determining the appropriateness of an activity. The developed model would incorporate a number of the individual frameworks. Two such models have been developed and are discussed. A pedagogical approach to ethical dilemmas is also considered.

Insider Trading in the Stock Market: A Paradigm of Utilizing Competing Ethical and Christian Models to Evaluate Issues of Justice

How does one make decisions regarding issues of justice? What does one do when various ethical and Christian models lead to divergent answers? This paper discusses major ethical models used for deciding the appropriateness of actions. To illustrate how these models are applied, each of the major models is discussed relative to the issue of insider trading. To consider some significant strands of Christian heritage, this paper discusses Roman Catholic, and Anabaptist traditions. It is clear that Christians with different heritages may view issues of justice differently. Two new models for analyzing issues of justice are developed. Each of these models can be applied to a wide spectrum of ethical issues. Consistent with the rest of the paper, the use of these models is demonstrated by applying them to the issue of insider trading. Finally, insider trading is used to illustrate how issues of justice may be explored in a college classroom setting.

Insider trading is an important issue of marketplace justice. However, the discussion of insider trading is not the primary importance of this paper. Rather, it is the desire of the authors that the examination of the various ethical models utilized in this paper will encourage faculty to apply these ethical models to other issues of marketplace justice. It is vital for faculty to engage students in discussions of ethics and ethical issues, and it is hoped that this paper may, to some small degree, encourage and facilitate that process.

Pros and Cons of the Ethical Issue

Within the culture of the United States, it is generally believed that insider trading activities are unacceptable. Velasquez (2002) summarizes two common arguments against insider trading and promotes the effects of insider trading as being harmful. One argument

against insider trading is that the information used by the insider is stolen; it belongs to the corporation. When an asset is used for gain without the owner's permission, then any gain belongs to the owner. Another argument is that the information advantage is unfair.

Velasquez acknowledges that both parties to a stock transaction generally do not have equal knowledge, often because one party has been more diligent in research or analysis. But inside information is fundamentally different. The party without inside information has no way to obtain that information regardless of how much research or analysis he or she performs.

Finally, Velasquez points out the harmful impact of insider trading. Insider trading reduces the size of the market because people are hesitant to participate in a market with significant insider trading. Fewer people participating in a market means the market is less efficient, less liquid, and more variable.

McGee and Block (1992) discuss arguments in favor of insider trading and claim that the overall impact of insider trading is positive. Arguments that favor insider trading support the idea that this activity is acceptable. According to McGee and Block, St. Thomas Aquinas believes "there is no moral duty to inform a potential buyer that the price of the good you are trying to sell is likely to change in the near future" (p. 221). Thus, the insider has no moral duty to disclose that a price change will occur when the non-public information becomes publicly known. Next, McGee and Block argue that insider trading is not fraudulent because there is no loss. Without loss, there can be no fraud (A seller benefits when an insider is buying because the price the seller receives is slightly higher. However, this does not take into account opportunity cost incurred because of future price changes). Finally, no rights are violated, thus the act is not unjust. The rights of non-insiders are not violated because they receive a higher price for their stock. If a corporation believes its rights have been violated, it

has other legal remedies available. McGee and Block conclude that “if the transaction is not fraudulent and the inside trader is not violating anyone’s property rights in information, there is nothing unethical about the practice” (p. 226).

Further, McGee and Block (1992) discuss several alleged advantages of insider trading. Because the stock price partially reflects the inside information, prices are more realistic. The market would become more efficient because it would have a greater likelihood of including all public and private information. Also, insider trading encourages hostile takeovers. Hostile takeovers may be the only way to remove entrenched management. Thus, hostile takeovers and anything that facilitates hostile takeovers are good. Finally, inside information allows firms to indirectly compensate insiders and external parties who are given inside information.

Various Ethical Models for Analyzing Insider Trading

Various ethical models or frameworks are considered when addressing the concept of insider trading. Discussion is given to a theological model, legal model, economic models (considering both capitalism and perfect competition), four distributive justice models, Kant’s two categorical imperatives, and utilitarianism. Perhaps not surprisingly, these models lead to conflicting answers.

Theological Model

The theological framework is important for Christians because they answer to a higher authority and seek God’s guidance and direction in their lives. For many, making sure that their actions align with God’s desire is influential when making a decision. Therefore, the question to ask is, “What is the desire of God?” To properly address this question, the

theological system places its focus on the love for God and mankind, as well as respect for others.

While addressing the importance of love as a basis for determining morality, Hill makes reference to “ethicist Lewis Smedes [who] characterizes love as ‘the hinge for every other moral rule to swing on’” (1997, p. 47). The source for using the love for God and mankind is found in Matthew 22:37-39:

Jesus replied: “‘Love the Lord your God with all of your heart and with all of your soul and with all your mind.’ This is the first and greatest commandment. And the second is like it: ‘Love your neighbor as yourself’” (New International Version).

The other aspect of the theological framework, as previously mentioned, is respect. Respect for all mankind is reinforced by 1 Peter 2:17 which says to, “Show proper respect for everyone: Love the brotherhood of believers, fear God, honor the king.”

If this framework were used to come to an appropriate conclusion, one must answer the question of whether insider trading interferes or misdirects a person’s love for God and His ways. One must also consider whether this particular action encroaches upon the command to love and respect others. If insider trading violates any of these positions, then it should be considered unethical.

Legal Model

The legal model posits that laws reflect the collective moral standards of society. With the legal model as a framework, any action that is legal is also, by definition, ethical. Conversely, any action that is illegal is considered to be unethical.

Carl Fulda indicates how legal requirements can be used as an ethical framework when he states, “The law reflects the thought prevailing in the community, including its

moral values, and thus it becomes a basis of business ethics” (Stevens, 1979, p. 118).

Therefore, it could be said that if enough people within a democratic society deemed a particular action unethical, then that society would establish laws preventing such action.

This statement would indicate that everyone has an equal voice in the determination of such laws; however, that is usually not the case (Hosmer, 1996, p. 74). Special interest groups influence legal considerations, which may not be the desire of the majority in a society.

Hosmer also points out that even advocates of the legal framework will indicate that this system establishes only minimal standards as moral judgments (p. 62).

Certainly legal requirements and moral requirements are similar, but just as certainly is the fact that they are not completely in synch with each other. Laws tend to reflect relatively low levels of standards. Many “wrong” actions are not illegal because a high degree of consensus is usually required to enact necessary legislation. The biggest deficiency with the legal model, however, is that laws address negative requirements and actions. Good ethical decisions, on the other hand, depend on positive requirements and motives.

Notwithstanding these drawbacks to the legal model, it is still very useful to consider the legal restrictions on insider trading. The Securities Exchange Act of 1934 made it illegal to use material, non-public information to achieve personal gains in trading and required insiders to return profits obtained from buying and selling securities using such information (Bettis and Duncan, 1998). This original legislation has been broadened significantly with subsequent legislation in 1968 (Ma and Sun, 1998), in 1980 (Bettis and Duncan), in 1983 (Bettis and Chang, 1996), in 1984 (Rosen, 1993), in 1988 (Rosen), twice in 1990 (Bettis and Duncan; Rosen), twice in 1991 (Bettis and Chang; Breetwor, 1991), in 1997 (Smith, 1997),

and more recently in 2001 with Regulation FD (Bird and Brusiloff, 2000; Munson and Leach, 2001).

It is evident that the legal framework has shortcomings. Even so, the rules of law may still be used as a guide in determining whether a particular action is appropriate and provide an indication of how society feels about a particular action. When examined from a legal perspective, insider trading is clearly unacceptable.

Economic Models

Insider trading can be analyzed by considering both the precepts of capitalism and the assumptions of perfect competition.

Capitalism. One of the components of capitalism, as set forth by Adam Smith, is the ability of individuals to better themselves. Individuals are rewarded under a capitalist system when they are better suited for certain positions, have special talents or have special information. Since insider trading is based upon receiving potential gains for the individual from special information, the capitalist system is considered.

One of the aspects of the capitalist system is captured by Shaw and Barry when they stated the following ideal that coincides in with Adam Smith's Invisible Hand doctrine: "We will, if left free, engage in labor and exchange goods in a way that results in the greatest benefit to society" (1992, p. 157). A means of putting this into useful practice would be to compare the marginal benefits to the marginal costs of a particular action such as insider trading. When considering costs, it is imperative that all costs associated with insider trading be considered. This includes all internal personal costs, as well as all social costs that may result from insider trading (Hosmer, 1996, chap. 2). Many times individuals do not consider

the costs or the undisclosed burden to society; however, it must be considered, as it is a cost that is bore by someone.

When evaluating insider trading, economic theory would indicate that insider trading is ethical if the benefits to the individual(s) and society are greater than the costs. However, if the costs exceed the benefits, trading with privileged information would be unacceptable. In relation to the ethical model being developed to address insider trading, the economic framework will be utilized in conjunction with the utilitarian framework. The framework's importance lies in the benefits versus the costs, not just to those directly affected by the insiders' trade, but by society as a whole.

Perfect competition. Perfect competition has many assumptions: many buyers and sellers, each too small to influence the price, no barriers to market entry or exit, full knowledge on the part of all participants, etc. While these assumptions are rarely, if ever, met, microeconomic theory clearly asserts that strict application of perfect competition to all markets results in "pareto optimality." Pareto optimality is the enviable situation in which the scarce resources of society are being used so efficiently by the producing firms, and the goods and services are being distributed so effectively by the competitive markets, that it would be impossible to make any single person better off without harming some other person (Hosmer, 1991, p. 36).

As Hosmer states so well: "Microeconomic theory is awesomely complete. . . . Microeconomic theory is also enviably unified" (p. 52).

According to the economic model, although perfect competition is rarely or never achieved, because of the significant advantages of a perfectly competitive world, it is still a goal towards which one should strive. Actions, which result in a more perfectly competitive

world, should be encouraged; actions, which lead to a less perfectly competitive world, should be discouraged.

Insider trading, with its inherently unequal information, clearly is counter to perfect competition. The preferred outcome, according to this economic model, is that the inside information be made publicly available so that all market participants have access to it. Barring that, market participants should have access to the same information. Thus, insider trading is not permissible in a perfectly competitive economic model.

Distributive Justice Models

Justice is an important value in America's society and is one of the values on which this nation was founded, as represented by the last portion of the *Pledge of Allegiance* of the United States, which concludes "with liberty and justice for all." As Hosmer addresses John Rawls' theory of Distributive Justice, he states that, "Justice is felt to be the first virtue of social institutions, as truth is the first virtue of systems of thought" (1996, p. 95). As a cornerstone in society, justice is utilized as a means to address ethical dilemmas.

Justice models comprise distributive justice, retributive justice, and compensatory justice. Distributive justice, which includes several methods for determining whether an action is proper, is the only model considered in this paper. Distributive justice focuses on whether benefits and costs to society are distributed in a right, just or fair manner. Retributive justice is concerned with the fairness of the penalties imposed upon those who do wrong. Compensatory justice is concerned with the appropriateness of the compensation for those who have been wronged. This paper is attempting to determine whether insider trading is wrong. Penalties for or compensation resulting from insider trading is beyond the scope of this paper.

Egalitarianism. Egalitarian justice suggests that each person should receive equal benefits (Velasquez, 2002). Obviously there are tremendous incentive issues with such a system. An individual has little extrinsic motivation to do more or better if he or she must share any resulting rewards with all other members of society. An individual trades on inside information in hopes of receiving a benefit. Under strict egalitarianism all such benefit is removed through tax and welfare programs or some other means. Thus, insider trading is unlikely. However, if any insider trading does occur, it is wrong because insider trading tends to promote unequal distribution of benefits.

Capitalism. With the capitalist system of distributive justice, benefits should be distributed based on the value an individual contributes to society (Velasquez, 2002). One could certainly argue that those who possess inside information tend to be higher level managers and presumably these people have contributed more to society. However, this argument is weak. It does not necessarily follow that those who possess inside information have contributed more to society. Often inside information is leaked, and there is no correlation between those who possess it and contribution to society. Because benefits are to be distributed based on contributions to society, and because insider trading is not always consistent with this, one can conclude that insider trading is not appropriate.

Socialism. Insider trading clearly is not acceptable with the distributive justice model of socialism. This model assumes that the benefits of society should be distributed according to people's needs. Profits from insider trading are distributed to those with inside information, which has little correlation with needs. In fact, one could easily make the argument that possession of inside information is inversely correlated with need. Thus, receiving benefits from insider trading is not acceptable.

Libertarianism. In terms applying a libertarian model of justice, one clearly and certainly not surprisingly concludes that insider trading is acceptable. A libertarian believes that all actions are permissible as long as neither party coerces the other. Thus, as long as an individual possessing inside information does not coerce anyone else to buy or sell stock, than the buying or selling of stock by this individual is acceptable. As the U.S. stock market is currently structured, it is hard to imagine how a person with inside information might be able to exercise coercion since one has no idea with whom one is trading (Private transactions, are of course, an exception to this general rule).

If one trades or transacts business with a strict libertarian, the warning *caveat emptor* is certainly in order. In fact, strict libertarian principles may be inconsistent with a civil society. At the very least, it is hard to imagine such a society. A libertarian world would not have speed limits, or any other driving regulations or restrictions; children could begin driving whenever they or their parents believed it was appropriate. Companies could unilaterally choose what information they wished to include in their annual reports, or whether they even wished to issue annual reports. They could choose whether they wished to have their financial statements audited or whether they even wished to release financial statements (audited or unaudited). As a practical matter, companies might have to release audited financial statements on a regular basis, even if not required by any governmental agency, in order to maintain investor confidence. But it seems unlikely that any similar sort of pressure would be exerted on those possessing inside information. Thus, trading on inside information would be rampant, and of course, acceptable.

Kant's Categorical Imperative

Immanuel Kant developed what he called the “categorical imperative” model to determine whether an action is ethical or moral. It is interesting to apply the categorical imperative model to insider trading because the results are not what one might expect.

Kant's first categorical imperative. The categorical imperative is stated in two ways. The first formulation of the categorical imperative states:

An action is morally right for a person in a certain situation if, and only if, the person's reason for carrying out the action is a reason that he or she would be willing to have every person act on, in any similar situation (Velasquez, 2002, p.97).

Put another way, an individual's action is permissible only if that individual would find it acceptable if all people acted the same way in that situation.

Some would certainly argue that based on the categorical imperative, insider trading is not acceptable. At first this seems reasonable. After all, surely people would not find it acceptable to be in the position of executing a trade with someone who possessed inside information. But on further reflection the categorical imperative leads to the exact opposite conclusion. Suppose an individual has stock that he or she wants to sell. If someone with inside information is buying stock, the price the seller receives will be slightly higher than he or she would otherwise obtain. The seller may wish that the inside information would become public so the stock will increase significantly, but presumably that is not an option. The only alternatives under consideration are a stock market without insider trading, or a stock market with insider trading. Because the individual seller will receive slightly more for his or her stock, individuals will rationally accept insider trading.

Kant's second categorical imperative. The second formulation of the categorical imperative leads to the same conclusion. The second formulation is as follows:

An action is morally right for a person if, and only if, in performing the action, the person does not use others merely as a means for advancing his or her own interests, but also both respects and develops their capacity to choose freely for themselves (Velasquez, 2002, p. 99).

The relevant implication of this is that people may be treated only as they have freely consented to be treated ahead of time.

What are the implications for insider trading? Again, at first it certainly appears that insider trading flunks this test and therefore is wrong. After all, surely no one would willingly consent to trade with someone who possesses inside information. However, trading with an insider is very rational and reasonable. By doing so one sells his or her stock for a (slightly) higher price, and therefore is better off. Thus, the rational response for people in the stock market is to consent to trade with people who may be insiders. The second formulation leads to the same conclusion as the first formulation – insider trading is acceptable.

Utilitarianism Model

The focus of utilitarianism is on the outcome. The goal is to pursue the greatest positive result for the greatest number of people. The utilitarianism framework can be viewed from two different perspectives. Jeremy Bentham and John Stuart Mill are credited with developing utilitarianism or more specifically “act utilitarianism.” Act utilitarianism specifies “that we must ask ourselves what the consequences of a particular act in a particular situation will be for all of those affected” (Shaw and Barry, 1992, p. 62). If the action in a particular

situation will bring greater benefit compared to another alternative, it should be pursued; if not, then this action is not acceptable.

The second utilitarian perspective is “rule utilitarianism,” which is offered by Richard Brandt. This version states that moral codes should be used to apply the standard of utilitarianism rather than individual actions (Shaw and Barry, p. 78). The focus should be on the moral codes that are most appropriate for society, so that satisfaction or utility is increased. Thus, rule utilitarianism is used to help determine whether an action is appropriate in general and not just as it pertains to a particular situation.

The dilemma being addressed pertains to insider trading, not as it relates to a unique situation, but in general. As a result, rule utilitarianism will be the approach that will be incorporated in the ethical model. As previously mentioned, this is easily intertwined with the economic framework presented above.

The Creation of Two Different Ethical Models

When considering insider trading from various ethical approaches, the conclusion as to whether insider trading is an acceptable practice is mixed. Some approaches indicate that insider trading is acceptable while others found that it was inappropriate. This makes it hard for an individual (or student) to determine the appropriateness of an action. In an attempt to solidify a person's approach to ethical dilemmas, it is proposed that a model be created that would incorporate several of the individual ethical approaches. This model would serve as a basis for an individual to determine the appropriateness of a situation. Two models are developed below that illustrate this method of addressing an ethical dilemma.

Proposed Model #1

The first ethical model being developed to appropriately address the issue of insider trading is composed of four questions that relate back to various ethical frameworks previously discussed. The first question in the ethical model ties directly back to the theological framework and asks the question of whether the actions of insider trading shows love and respect towards mankind. The second portion of the ethical model ties back to the legal framework and asks the question of whether insider trading is legal. The third component of the model relates to the economic and utilitarian frameworks and questions whether society as a whole benefits from the actions of insiders. The last aspect of the ethical model addresses whether it is fair, right or just for individuals to engage in insider trading. This question has connections that tie back to distributive justice.

Four Questions of the Model

Does the action of insider trading show love and respect towards mankind? When an insider makes a trade using privileged information, someone must take the opposing position. As an example, if the insider buys a security as a result of the special information he or she has, then someone must be the seller to the insider. Therefore, even when the insider is not intentionally trying to harm another, the insider is violating the command of respecting others by exercising an unfair advantage over the other individual. The problem is not that the two parties have different information, but that the individual without inside information cannot get the information that the insider has.

It should also be considered whether the individual without privileged information would follow through with their proposed actions if they were privy to the same information as the insider. If the outsider would alter their actions as a result of the new information, then it can be said that the insider has an unfair advantage and is bettering his or her position at

the expense of others. It is quite likely that the insider would not like others to capitalize on their position at his or her expense. As such, trading with inside information does not show respect towards others.

Is the act of insider trading legal? The government has written several laws that have been used to address the issue of insider trading dating as far back as 1934. The Securities and Exchange Act of 1934 establishes the Securities and Exchange Commission (SEC) and provides one of the more common laws used in attempting to convict individuals of insider trading: Rule 10(b)-5. This rule does not allow trading to occur when it is based on information that is not yet public (Laird, 1995 and Ma and Sun, 1998). Ma and Sun cite further legislation against insider trading. The Williams Act Amendments, established in 1968, formulated laws related to tender offerings and insider trading. In 1984, the Insider Trading Sanctions Act was established giving authority to the SEC to increase the penalties against those who trade with inside information. Congress also passed the Insider Trading and Securities Fraud Enforcement Act of 1988 to increase the penalties on the criminal and civil level as well as carry the penalties over to the derivative markets (1998).

Several cases have been tried on the basis of improper activity regarding insider trading. One popular case involved the Texas Gulf Sulfur Company. The directors and officers of Texas Gulf Sulfur traded on their own accounts using information that was not yet known by the shareholders or the general public (Laird, 1995). As a result, the court ruled against the company. This case represents a failure on the part of the officers and directors to act appropriately in a fiduciary capacity. However, in the case of Chiarella versus the United States, the ruling came down in favor of Chiarella. Chiarella was a printer who was engaged in printing information regarding corporate acquisitions. Chiarella used the special

information obtained from the printing activities and traded securities of the targeted companies. A ruling from the Supreme Court stated that the Trial Court and the Appeals Court failed to show that Chiarella had a fiduciary responsibility to the shareholders of the targeted company (Laird). As a result, this has drawn into question whether trading with inside information is acceptable if no fiduciary responsibility exists.

While some individuals have escaped conviction, it appears that it was the intent of Congress to prohibit the use of inside information. In fact, this is noted in relation to the Texas Gulf Sulfur case.

Moreover, the essence of the rule 10(b) was violated, that anyone who, trading for his own account in the securities of a corporation, has ‘access, directly or indirectly, to information intended to be available only for corporate use and not for personal benefit of anyone’ (Laird, 1995, p. 17).

This can also be seen as Congress has continued to create new laws in an attempt to curtail inside trading activities. The continual pursuit of further legislation indicates that the moral standard society desires to establish would find that insider trading is inappropriate.

Does society as a whole benefit from insider trading? If one considers the benefits that occur from insider trading, it is important to keep in mind that the insider will typically gain from trading on inside information. The insider may also gain if he or she sells the valuable information to others, thus allowing them to partake of the special information. Another potential benefit from trading with inside information is that the market prices may be more accurate since the prices are inclusive of some or all of the privileged information. Henry Manne indicates this by saying that trading on inside information causes trades to occur on “information or probabilities” instead of “rumor or whim” (Werhane, 1989, p. 842).

By allowing traders to capitalize on inside information, the strong form of the efficient market theory may hold true.

In looking at the costs typically associated with trading on privileged information, one must consider the loss of confidence in the securities markets. “As former SEC Chairman John Shad stated, ‘if people get the impression that they’re playing against a marked deck, they’re simply not going to be willing to invest’” (Moore, 1990, p. 177). Investors will lose their trust of the financial community that operates within the investment arena, believing that companies and individuals will take care of themselves before doing what is best for the client or outside investor. This would likely cause problems with fiduciary obligations and responsibilities. Also, if insider trading were allowed, investors would find that the securities markets would be riskier (Moore). In certain instances, if inside trading were allowed, corruption may also increase if the use of privileged information is accepted.

The benefits of insider trading are: the potential gains for the insider from trading with the privileged information, gains that result when the insider sells the information to others, and the proposed increase in market efficiency. The costs of trading with inside information are: the loss of confidence investors have of the market system, loss of trust of the investment professionals, fiduciary conflicts, increased risk in the securities markets, and prospects for corruption. As a result of the potential gains and losses that could be incurred by society, it is not too difficult to rank the costs as having a greater impact than the benefits, thus concluding that insider trading has a negative affect on society.

Is it fair, right, or just for individuals to engage in insider trading? There are two situations that can be presented that will help determine whether insider trading is fair, right

or just. The first point of discussion is that all individuals are not equally informed, while the second is that all individuals are not capable of obtaining access to certain information (Moore, 1990). The fact that not all individuals are equally informed creates differing levels of knowledge between investors. The differences might be a result of experience, training, education and so forth. Is it fair, right or just that people are not equally informed thus allowing certain individuals to profit at the expense of others? In order to respond, one must keep in mind that the information is available for both parties to have. One party has utilized the information while the other has not. Individuals should be compensated appropriately for their differences and rewarded for their efforts. This action is considered fair, right, and just because the information is available for both parties to utilize; however, this does not represent insider trading.

The second situation regarding the accessibility of information is different. Is it fair, right and just for some individuals to be able to capitalize on information that outsiders do not have access to? In this situation, the outsider is placed at a distinct disadvantage, which makes it very difficult for them to compete against the insider without access to that information. When access is limited to a select group of individuals, it can be concluded that the situation is not fair. When people are prevented from obtaining information that other people have access to, the response is that this is not right. When certain individuals have a perpetual advantage because they are privy to special information in relation to others, it can be said that this is not just. Insider trading offers special privileges to certain individuals, while denying access to others. As a result, insider trading is not fair, right or just.

The Results of Ethical Model #1

The ethical model that was developed to address the issue of insider trading poses four questions. The first question, which related to whether insider trading showed love and respect for mankind, indicated that insider trading falls short of showing respect and love towards others. The second question addressed whether the act of insider trading was legal. Evidence was given indicating that it was the intent of Congress, through the passage of laws to prohibit insider trading. This indicates that the moral standard that society desires to establish would find that insider trading is inappropriate. The third question, which asks whether society as a whole benefits from insider trading, indicated that insider trading had a negative impact on society. The final question of the ethical model, which asked whether it is fair, right, or just for individuals to engage in insider trading, brought forth a conclusion which indicated that trading with privileged information was not fair, right or just. In reviewing the responses to the questions making up the ethical model, it is apparent that based on this model, insider trading is considered an unethical practice.

Proposed Model #2

The second ethical model begins by laying out a generic approach for individuals to follow to develop an ethical model. From that a specific model is developed for an individual to utilize when addressing ethical situations. While the second model being proposed is similar to the first model in that they both have four components that they consider, the components for each of the models differ. The four-step process of the second model is as follows: enumerate ones most basic beliefs or *premises*, identify *principles* which result from these premises, determine *policies* which flow from these principles, and finally, consider *practices* which are based on these policies. One goes from premise, to principle, to policy, to practice. This is a process that starts with the very broad, most basic of statements, and

which, through a process of logical, sequential steps, narrows in to a specific practice. This paradigm is not exclusively a Christian model. It can be useful to one of any faith, or even to those with no strong religious belief system. It is especially useful to people, both Christians and non-Christians, because it forces one to identify one's most deeply held beliefs, and to act in accordance with those beliefs.

It is important to note that any premise leads to multiple principles, every principle leads to numerous policies, and each policy leads to several practices. Although presented in a fairly linear and direct manner, in reality there are many alternative paths not considered in this paper. Further, this paradigm is not absolute. As with all ethical models, different people utilizing the same model may arrive at different conclusions. In this situation, it is possible that someone else could begin with the same premise, but by following a different path come to an alternative conclusion about the ethical dilemma of insider trading.

Application of the Four Step Process

Premise. Certainly one foundational premise of the Christian faith is that there is a personal God who cares about individuals and their actions. There are some non-Christians who subscribe to this premise, but one cannot state that all Christians agree with it. Nonetheless, most Christians tend to agree with this premise.

Those in the Methodist or Free Methodist heritage, including one of the authors, are familiar with what has come to be known as John Wesley's quadrilateral (Thorsen, 1990). While Wesley never used this phrase, he taught that Christians could look to four sources of authority, primarily scripture, but also tradition, reason, and experience. It is useful to note that all four of these sources of authority bear witness to the premise of a personal and caring God.

While much more theologically penetrating arguments can be made, Jesus makes it abundantly clear in the Sermon on the Mount that God the Father cares about us.

Look at the birds of the air; they do not sow or reap or store away in barns, and yet your heavenly Father feeds them. Are you not much more valuable than they? . . .

And why do you worry about clothes? See how the lilies of the field grow. They do not labor or spin. Yet I tell you that not even Solomon in all his splendor was dressed like one of these. If that is how God clothes the grass of the field, which is here today and tomorrow is thrown into the fire, will He not much more clothe you, O you of little faith (Matthew 6:26-31, New International Version)?

Principle. In this model the premise is focused on God and the resulting principles are focused on man's actions that arise from this premise. There are two principles resulting from this premise that are appropriate. Both of these principles are logical extensions of the above premise.

The first principle is found in Micah 6:8: "He has showed you, O man, what is good. And what does the Lord require of you? To act justly and to love mercy and to walk humbly with your God." Chewning, Eby, and Roels (1990) believe this is the basis for all actions by a Christian in business. Note that this verse closely parallels the criteria set forth by Hill (1997) that the actions of a Christian must be guided by holiness ("walk humbly with your God"), justice ("act justly"), and love ("love mercy").

From the precept that there is a personal God who cares about an individual's actions, one can also derive the principle that one should love God and love one's neighbor.

Hearing that Jesus had silenced the Sadducees, the Pharisees got together. One of them, an expert in the law, tested Him with this question: "Teacher, which is the

greatest commandment in the Law?” Jesus replied: “‘ Love the Lord you God with all your heart and with all your soul and with all your mind’ [Deuteronomy 6:5]. This is the first and greatest commandment. And the second is like it: ‘Love your neighbor as yourself’ [Leviticus 19:18]. All the Law and the Prophets hang on these two commandments.” (Matthew 22:34-40).

Policy. From these two principles (act justly, love mercy, walk humbly with God; and love God above all else and one’s neighbor as oneself) one can derive numerous policies as to how one should live. Applicable to the discussion in this paper is the policy: One should not withhold relevant information when engaging in transactions. This policy is a clear and logical result of the principle enumerated above. Withholding relevant information is not acting justly or loving one’s neighbor as oneself. Sharing relevant information is acting justly and loving one’s neighbor as oneself.

This policy, that one should not withhold relevant information, is certainly applicable to much more than insider trading. Following this policy means that if one is selling a used car that is clearly a “lemon” one is obligated to reveal to a prospective buyer the known defects with the car. This is a direct result of acting justly, loving mercy, and walking humbly with God. It is a direct result of loving one’s neighbor as oneself.

Practice. From the policy that one should not withhold relevant information when engaging in transactions, it is an easy step to derive the practice: One should not buy or sell stock when he or she possesses material, non-public information. This is self-evident.

The Results of Ethical Model #2

The individual ethical approaches discussed earlier in this paper lead to conflicting results with no clear method for determining which solution is preferred. They are certainly

valid models, and conflicting results is not a reason to discard them. However, the derived model is superior because it starts by forcing one to determine what is most important. What are one's core, fundamental beliefs? Then through a series of logical steps one derives an answer. The methodology utilized in this paradigm provides a clear, unambiguous result. One of the absolutely most basic premises for a Christian is that God is personal cares about the actions of an individual. From this premise one can easily derive the two principles that first, one must act justly, love mercy, walk humbly with God, and, second, one must love God above all else and one's neighbor as oneself. From these two principles one can clearly derive the policy that one should not withhold relevant information when engaging in a transaction. Then it is a very clear and logical conclusion that one should not engage in insider trading. Thus, by starting with the absolutely most fundamental beliefs, in a few steps one can derive the unambiguous result that insider trading is not ethical.

A Pedagogical Approach to Address Insider Trading

In an attempt to have students to wrestle with the issue of insider trading, it would first be necessary for them to understand the efficient market theory and its three components. Once this subject matter had been covered by the instructor, the students would be asked to provide a one sentence summary of each of the three forms of market efficiency, without the use of their notes. This would serve as method to measure the knowledge of the students on the topic of market efficiency. After this exercise was complete, the instructor could use the weaknesses that appeared in the research, related to the strong form of the efficient market hypothesis, in order to introduce the topic of insider trading. At this point, the instructor simply should offer the definition of insider trading and why people might choose to engage in this activity.

Once the students felt comfortable with the definition of insider trading, the instructor could show the movie *Wall Street* (edited version) to the class. As the students watched the movie, they would be asked to identify each instance in which inside information is known by the different characters of the movie. The students also would have to select the instances when insider trading occurs. This activity would help them realize that having inside information is a common occurrence that many people deal with in their place of employment. It also brings to light that possessing privileged information is not bad; it is what is done with that information that could present a problem.

After the students are comfortable with the definition of insider trading, they should write a three to five page paper providing support as to whether or not insider trading is appropriate. This should be approached either from an ethical model they develop so that it is not just one perspective from which the students are basing their decision. Once the papers are complete, the students will post their papers on Blackboard or Web CT and discuss their findings. It may be helpful to establish a minimum number of contributing responses that the students must adhere to.

Once insider trading has adequately been discussed, one additional assignment could be presented, depending upon the time and the depth of coverage desired for the students. The last assignment would relate to the inept morality, which seems to be present in financial corporations (this assignment only will prove effective if the students determine that insider trading is unacceptable). The students would be asked to develop a creative and effective method for instituting change of the ethos in an organization. This would bring the insider trading issue full circle. Initially, students would learn about insider trading; secondly, the students would make a decision determining whether or not this type of activity was

appropriate; and finally, they would make an attempt to determine how to deal with difficult issues they may face in the workplace. Because of the nature of the project, this is would likely be most appropriate for a graduate level course.

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