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Rules on Insider Trading

The 1990 changes in the Securities and Exchange Act (1934) has had sweeping effects on compensation packages of officers of firms. The basic rationale for the changes was to minimize the interpretive inconsistency in Section 16 of the act, thus decreasing court costs because almost all decisions were made on a case-by-case basis.

"The new rules completely alter the focus of the short-swing trading rules as they apply to so-called derivative securities, such as stock options, certain stock appreciation rights (SARs), warrants, convertible securities, put options, and call options. Other changes narrow the definition of the term *officer*, modify the forms used by insiders for reporting their holdings and transactions in company securities, and impose new reporting requirements. Certain provisions remain unchanged."

Prior to the changes, officers of a firm were not allowed to take advantage of several employee stock plans. These plans allowed employees to receive benefits in the form of stock compensation once or twice a year. Previously, if an officer received compensation in this manner, he or she was precluded from selling the stock while employed by the firm because of short-term swings. Since 1990, if the stockholders agree, this form of compensation can be used for officers as long as they hold the stock for at least six months. Formerly any profits earned from selling the stock reverted to the company. The negative side of the new rule is that options given to officers in this manner are no longer tax deferred.

The new legislation also has changed the definition of *officer*. Previously an officer was anyone with the title of vice president or higher. Now the regulations cover only employees who regularly perform "significant policymaking functions." The courts still must determine what constitutes a significant policymaking function.

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