NEWS
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SEC REGULATION OF INVESTMENT NEWSLETTERS:

PROTECTING INVESTORS AS CONGRESS INTENDED

Remarks to Publishers of Investment Newsletters

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Commissioner
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Washington, D. C.

The views expressed herein are those of Commissioner Cox and do not necessarily represent those of the Commission, other Commissioners, or the staff.

I would like to welcome you to the SEC. As a Commissioner, I am pleased to meet with members of the public and of the industries the Commission regulates, and I am glad to have the opportunity to meet with you today.

I plan to speak for about twenty minutes about the Commission's regulation of investment advisers and then to open the session to questions. Some members of the staff are here and may assist in answering questions.

My remarks will center on two main points. The first point is that, by enacting the Investment Advisers Act of 1940, Congress decided that the investing public needs the protections to be found in regulation of investment advisers, including publishers of investment newsletters. The second point is that there are fundamental differences between two cases that have recently received widespread publicity -- the case involving a former Wall Street Journal reporter, R. Foster Winans, and the lawsuit involving Christopher Lowe, a publisher of an investment newsletter. The Lowe case involves an attempt by the Commission to enforce the registration provisions that Congress chose to place in the Investment Advisers Act, whereas the Winans case involves allegations of insider trading, a form of fraud.

Substantial parts of my remarks are drawn from a memorandum prepared by the Office of the General Counsel of the Commission 1/ and from a speech given recently by the Commission's enforcement director, John Fedders. 2/ If you are interested in further reading, copies of the memorandum and of the speech are publicly available. My remarks represent my own views, however, and other members of the Commission or its staff do not necessarily share all the opinions I am expressing today.

I. Advisers Act

I will speak first about the applicability of the Advisers Act to investment newsletters.

1/ Office of the General Counsel, Securities and Exchange Commission, Memorandum on the Application of the Investment Advisers Act of 1940 to Investment Advisory Newsletters (Oct. 16, 1984).

2/ J. Fedders, The Securities and Exchange Commission and the First Amendment -- Enforcement Not Infringement: Enforcing the Securities Laws Does Not Imply Hostility to the Press (Oct. 22, 1984) (remarks at seminar sponsored by The American University School of Communication and the National Center for Business and Economic Communication).

A. Definition of Investment Adviser

By passing the Investment Advisers Act, Congress created a federal system of regulation of investment advisers. It is clear that Congress intended to include within that regulated group those investment advisers who render their advice through publications as well as those who give advice in person. The Advisers Act defines "investment adviser" to mean

> any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities. 3/

The Act goes on to state, however, that the definition does not include "the publisher of any bona fide newspaper, news magazine or business or financial publication of general and regular circulation." 4/

In a 1977 release, the Commission expressed the view that the exclusion of a bona fide newspaper from the definition of investment adviser "is applicable only where, based on the content, advertising material, readership, and other relevant factors, a publication is not primarily a vehicle for distributing investment advice." 5/ The Commission supported this view by referring to the opinion of the United States Court of Appeals for the Second Circuit in the case of SEC v. Wall Street Transcript Corp. 6/ In that case, the Second Circuit stated that the exclusion applies to "those publications which do not deviate from customary newspaper activities to such an extent that there is a likelihood that the wrongdoing which the [Advisers] Act was designed to prevent has occurred." 7/ In SEC v. Lowe, 8/ the Second Circuit reaffirmed

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3/ Investment Advisers Act of 1940 § 202(a)(11), 15 U.S.C. § 80b-2(a)(11).

4/ Id. § 202(a)(11)(D), 15 U.S.C. § 80b-2(a)(11)(D).

5/ Investment Advisers Act Release No. 563 n.1 (Jan. 10, 1977), 42 Fed. Reg. 2953 n.1 (1977).

6/ 422 F.2d 1371 (2d Cir.), cert. denied, 398 U.S. 958 (1970).

7/ Id. at 1377 (footnote omitted).

8/ 725 F.2d 892 (2d Cir. 1984), cert. granted, 53 U.S.L.W. 3235 (U.S. Oct. 1, 1984) (No. 83-1911).

its analysis of the bona fide newspaper exclusion. The Supreme Court has decided to review the Lowe case. 9/

The approach used by the Second Circuit and the Commission has been applied by the Seventh Circuit in the case of SEC v. Suter 10/ and by the United States District Court for the District of Columbia in the case of SEC v. Wall Street Publishing Institute, Inc. 11/ However, the United States Court of Appeals for the District of Columbia Circuit has stayed the decision in Wall Street Publishing Institute, and the case is not expected to be decided until after the Supreme Court decides the Lowe case.

Of the four publications involved in the cases I have mentioned, only The Wall Street Transcript has at this point been found to be a bona fide newspaper. 12/ That publication was unusual, in part because its customary practice was to reprint reports and speeches verbatim, after they had been publicly distributed, with full attribution to their authors. 13/

The Commission's staff has been sensitive to the issues raised by these cases. For instance, in response to inquiries, the staff has said that the publisher of a newsletter containing reports about insider trading or on companies filing reports with the Commission would not be required to register as an investment adviser when the published information is publicly available and is not organized or presented in a manner that suggests the purchase, holding, or sale of any securities, and the categories of information are not highly selective. 14/ As another example, the staff has indicated that the publisher of a newsletter addressed to doctors that primarily would contain excerpts of investment advice, analysis, or reports written and previously published by brokerage houses or registered investment advisers need not be registered. 15/

9/ 53 U.S.L.W. 3235 (U.S. Oct. 1, 1984) (No. 83-1911).

10/ 732 F.2d 1294, 1298-99 (7th Cir. 1984).

11/ 1984 Fed. Sec. L. Rep. (CCH) ¶ 91,575, at 98,936-37 (D.D.C.), stayed pending appeal, 1984 Fed. Sec. L. Rep. (CCH) ¶ 91,635 (D.C. Cir.) (No. 84-5485).

12/ SEC v. Wall Street Transcript Corp., 1978 Fed. Sec. L. Rep. (CCH) ¶ 96,440, at 93,590 (S.D.N.Y.).

13/ Id.

14/ Jack Sonner (pub. avail. March 11, 1983).

15/ P.W. Communications, Inc. (pub. avail. Oct. 15, 1982). For other examples, see E. M. Abramson (pub. avail. Feb. 27, 1984) and Luis de Agustin (pub. avail. Feb. 8, 1982).

Thus, the Commission is circumspect in its administration of the Advisers Act. Nevertheless, the Commission continues to take the view that a publication that is primarily a vehicle for distributing investment advice -- as evidenced by the nature of its contents, advertising material, readership and other relevant factors -- must register as an investment adviser.

B. Registration Requirements

Congress has not imposed extensive requirements on investment advisers, and registration as an adviser is not an unduly burdensome procedure. There are no educational, financial, or other qualifications for registering. Form ADV, the form used to register as an investment adviser, contains questions designed to obtain disclosure of important information such as who owns or controls the investment adviser, the nature of the adviser's business, and the education and business backgrounds of certain employees. The registration fee is only $150 and is required to be paid only once -- not annually.

The Advisers Act imposes some other requirements on registered advisers, including maintenance of certain records and compliance with Commission rules regarding mandatory disclosures and advertising practices and compliance with antifraud provisions, but the regulations are substantially less extensive than those applied to other securities professionals.

The Advisers Act authorizes the Commission to deny, suspend, or revoke an investment adviser's registration only under certain circumstances. They include:

(1) the willful making of a false statement of material fact in a required filing with the Commission;

(2) a conviction for certain felonies or misdemeanors, generally limited to such crimes as bribery, perjury, financial fraud, larceny, theft, or embezzlement;

(3) an injunction against acting as an investment adviser or broker-dealer or in certain similar roles;

(4) the willful violation of a provision of the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Company Act of 1940, or the Advisers Act, or any rule thereunder; and

(5) the willful aiding or abetting of a violation of those statutes or rules or the failure reasonably to supervise a person who violates any of those statutes or rules, unless the adviser has adequate procedures to prevent or detect a violation. 16/

16/ Investment Advisers Act § 203(e), 15 U.S.C. § 80b-3(e).

In addition to finding a violation such as one of these, the Commission must find that any sanction is in the public interest.

Thus, the Advisers Act is designed to screen out only those persons whose past misbehavior indicates a high risk of future misconduct and to subject advisory newsletters to a minimal amount of regulation.

II. Difference Between Winans and Lowe Cases

My second main point is that the recent cases posing challenges to the registration regulations for investment newsletters are different from the case of R. Foster Winans, the former reporter for the Wall Street Journal. 17/ The investment newsletter issue, which is before the Supreme Court in the *Lowe* case, is not the result of an enforcement priority like insider trading. The Winans matter, on the other hand, is one of many cases that have resulted from the Commission's crackdown on insider trading. Of course, the Commission enforces both the Advisers Act and the insider trading laws. But the question of whether the Commission is acting appropriately in applying registration requirements for advisory newsletters is different from the question of whether it is appropriate to prosecute the kind of fraud alleged in the Winans case. As John Fedders, the Commission's enforcement director, pointed out in his recent speech on the subject, the statutory basis for charging insider traders is fundamentally different from the statutory basis for enjoining publishers of investment newsletters. As I have already discussed, Congress clearly wrote the Advisers Act so that it specifically applies to advisory newsletters. Insider trading, on the other hand, is a type of misconduct proscribed by the general antifraud provisions of the Securities Exchange Act of 1934.

The greater concentration of the Commission's enforcement efforts on insider trading than on prosecuting newsletters for alleged violations of the registration requirements is evident from the number of enforcement cases brought in these areas. In the past three years, the Commission has prosecuted seven investment newsletters in order to require the newsletter not to publish without being registered or in order to revoke the newsletter's registration. 18/ These cases also involved fraud allegations.

17/ *SEC* v. *Brant et al.*, No. 84 Civ. 3470 (CBM) (S.D.N.Y. filed May 17, 1984).

18/ *SEC* v. *Lowe*, 556 F. Supp. 1359 (E.D.N.Y. 1983), *rev'd*, 725 F.2d 892 (2d Cir. 1984), *cert. granted*, 53 U.S.L.W. 3235 (U.S. Oct. 1, 1984) (No. 83-1911); *SEC* v. *Blavin*, 557 F. Supp. 1304 (E.D. Mich. 1983), *enforced sub nom. United States ex rel. SEC* v. *Blavin*, No. 83-1041, slip op. (6th

(Footnote Continued)

In contrast to the number of cases against newsletters, during the past three years the Commission has brought approximately 55 insider trader enforcement actions. Indeed, the seven registration-related cases against newsletters are a very small part of the overall total of more than 800 enforcement cases brought in the last three years.

A. The Lowe Case

The first amendment challenge to the registration requirements for newsletters is currently before the Supreme Court in SEC v. Lowe. The case involves the following situation.

Mr. Lowe was convicted in New York of four crimes, including making false representations to a client whose funds Mr. Lowe had misappropriated and third degree larceny for fraudulently drawing checks on an account to which worthless checks had been deposited. The Commission revoked the investment adviser registration of a firm of which Mr. Lowe was president and barred him from association with any investment adviser. Mr. Lowe continued to publish a newsletter despite his bar and the revocation of the registration, and the Commission sued for an injunction against his doing so. Mr. Lowe contended that the first amendment's guarantees of freedom of speech and of the press protect him against the injunction sought by the Commission. In the lower courts, the federal district court refused to issue such an injunction, but the Second Circuit reversed in a 2-1 vote and held in favor of the Commission.

Regardless of who eventually wins in the Supreme Court, I believe it is currently appropriate for the Commission to enforce the registration provisions of the Advisers Act in the face of the constitutional challenge. Congress clearly made the Advisers Act applicable to investment newsletters, and an administrative agency should enforce a statute when there is a substantial basis for the view that it is constitutional. Indeed, the two federal courts of appeals that have addressed the issue have held that

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(Footnote Continued)

18/ Cir. Mar. 14, 1983); SEC v. Suter, No. 83-3011 (7th Cir. 1983); SEC v. Wall Street Publishing Institute, Inc., 1984 Fed. Sec. L. Rep. (CCH) ¶ 91,575 (D.D.C.), stayed pending appeal, 1984 Fed. Sec. L. Rep. (CCH) ¶ 91,635 (D.C. Cir.) (No. 84-5485); SEC v. Options Strategy Associates, Ltd., No. 84 Civ. 4316 (TPG) (S.D.N.Y. filed June 20, 1984); SEC v. Financial News Associates, No. 84-0878-A (E.D. Va. filed August 29, 1984); SEC v. The Oxford Corp., No. 84 Civ. 1833 (LBS) (S.D.N.Y. judgment entered by consent March 19, 1984).

requiring the registration of persons who furnish investment advice through newsletters is consistent with the first amendment. 19/ Of course, if the Supreme Court rules in favor of Mr. Lowe, the Commission will have to reassess its enforcement efforts in order to comply with the Supreme Court decision.

When Mr. Lowe took his case to the Supreme Court, the Commission tried to convince that Court not to review the Second Circuit's decision. I believe that, from the standpoint of litigation strategy, it was appropriate for the Commission to argue against Supreme Court review. Nevertheless, I am glad that the Supreme Court has decided to hear the matter. The issue has attracted substantial attention, and guidance from the country's highest Court would be helpful so that the energies now being spent on this argument can be directed to other tasks.

B. The Winans Case

In the Winans case, the SEC has alleged that Winans -- who was a reporter for the Wall Street Journal's "Heard on the Street" column -- and four co-conspirators purchased or sold the securities of publicly-held companies while in possession of material nonpublic information that the reporter misappropriated. In addition to the SEC's lawsuit, the Justice Department is prosecuting criminal charges in the case. 20/ The Commission's case has been stayed pending disposition of the criminal case.

The SEC's lawsuit alleges that the scheme was carried out when the reporter, in violation of his fiduciary and other duties of trust and confidence owed to the Journal, and duties owed to readers of the Journal, informed another person on 24 separate occasions about stories concerning issuers of publicly-traded securities that would be reported in the Journal in the immediate future. The person allegedly informed, Peter N. Brant, was a stockbroker.

The SEC has alleged that Winans knew that Brant would purchase or sell securities on the basis of the impending story that Winans had described, and that Winans would share in the profits resulting from Brant's trading. It is further alleged that Brant placed orders for securities for the accounts of two other persons and that these persons also knew that information had been leaked from the Journal. The Commission has not accused the Journal of any wrongdoing.

19/ SEC v. Suter, 732 F.2d 1294, 1299-1300 (7th Cir. 1984); SEC v. Lowe, 725 F.2d 892, 900 (2d. Cir. 1984), cert. granted, 53 U.S.L.W. 3235 (U.S. Oct. 1, 1984) (No. 83-1911); SEC v. Wall Street Transcript Corp., 422 F.2d 1371, 1378-81 (2d Cir.), cert. denied, 398 U.S. 958 (1970).

20/ United States v. Winans et al., No. 84 Cr. 605 (S.D.N.Y.).

The Commission has alleged two theories of liability. The first theory is that Winans' leak and use of information about his Journal column was a "misappropriation" of that information from his employer. The second theory is that Winans defrauded his readers when he failed to disclose his intention to profit from the market effect of his column by purchasing and selling securities just before and after articles concerning those securities appeared. This second theory is known as "scalping." Under both theories, the Commission alleges that there has been a violation of antifraud laws applicable to purchases and sales of securities.

The first theory -- misappropriation -- has been developed in insider trading cases. The Second Circuit has approved the misappropriation theory in other cases 21/ and has affirmed the liability of an employee for trading on advance material nonpublic information gleaned from documents or information to which he had access at work.

The scalping theory -- the theory that Winans violated a duty to his readers -- is a theory that has previously been applied to a newspaper columnist. In a case that is similar to the Winans case, the Ninth Circuit held in 1979 that a reporter had a duty to disclose his side dealings that were part of his scalping scheme. 22/ Although the Supreme Court has subsequently handed down two decisions that discuss the need to show a breach of a duty in order to establish a violation of the applicable antifraud laws, 23/ the Commission takes the view that the Ninth Circuit's holding remains good law.

Some have complained that the Winans case represents an SEC attack on the first amendment. As Enforcement Director Fedders has pointed out, what the case really represents is the Commission's efforts toward nonpartisan justice. Anyone, including a reporter, who in breach of a duty purchases or sells securities while in possession of material nonpublic information about an issuer or the trading market for an issuer's securities is subject to prosecution. The Commission has brought insider trading cases against persons with occupations including lawyer, printer, stockbroker, and government official. The Winans case reflects the Commission's views that a journalist is also subject to the insider trading prohibitions of the securities laws, and that the first amendment does not protect fraud.

21/ SEC v. Materia, No. 84-6043, slip op. (2d. Cir. Oct. 1, 1984); United States v. Newman, 664 F.2d 12 (2d Cir. 1981), aff'd mem. after remand, 722 F.2d 729 (2d Cir.), cert. denied, 104 S. Ct. 193 (1983).

22/ Zweig v. Hearst Corp., 594 F.2d 1261 (9th Cir. 1979).

23/ Dirks v. SEC, 103 S. Ct. 3255 (1983); Chiarella v. United States, 445 U.S. 222 (1980).

Nevertheless, it is important to note that the Commission's insider trading prosecutions only cover circumstances in which the purchase or sale of a security is involved. The Winans case does not represent an effort by the Commission to inject itself into the editorial judgments of journalists.

III. Conclusion

To summarize my remarks, the Commission is enforcing the regulatory requirements of the Investment Advisers Act against investment newsletters because Congress has determined that investors who rely on such newsletters need the protections of those requirements. The enforcement of those requirements is fundamentally different from the enforcement of the insider trading provisions undertaken by the Commission in cases such as that of the former Wall Street Journal reporter.

Before I begin to answer questions from the audience, I wish to note that, although I have made some limited remarks about some pending cases, it would be inappropriate for us to argue the merits of those cases here today. The parties involved will have their day in court. With that caveat, the staff and I will be pleased to address your questions if you have any.