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ANOTHER LOOK AT INSIDER TRADING

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COMMISSIONER
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PERHAPS AT NO TIME IN THIS CENTURY, PERHAPS AT NO TIME IN THE HISTORY OF THIS COUNTRY, HAS THE STATE OF OUR CAPITAL MARKETS BEEN A MATTER OF SHARPER CONCERN. WE HEAR FROM HIGH GOVERNMENT OFFICIALS THAT EXCESSIVELY HIGH FEDERAL DEFICITS WILL "CROWD OUT" PRIVATE FINANCING AND CREATE A SEVERE CAPITAL PROBLEM FOR PRIVATE INDUSTRY. THE HYPER-SENSITIVITY OF THE CAPITAL MARKETS HAS BEEN AMPLY EVIDENCED RECENTLY WHEN THE SUGGESTION BY A HIGH GOVERNMENT OFFICIAL THAT "DOUBLE DIGIT" INTEREST RATES MAY AGAIN SHORTLY BE AT HAND LED IN SHORT ORDER TO NEAR PANIC IN MANY QUARTERS WHICH PURPORTEDLY ACCELERATED FINANCING PLANS BY MANY CORPORATE BORROWERS. WE HAVE SEEN MANY DEBT OFFERINGS BY SOUND ISSUERS GOING BEGGING EVEN THOUGH OFFERED AT GENEROUS YIELDS. THE EQUITY MARKET IS STILL MORIBUND AND THE NUMBER OF COMMON STOCK OFFERINGS IN A WEEK CAN USUALLY BE COUNTED ON THE FINGERS OF ONE HAND. EQUITY MARKETS, PARTICULARLY PUBLIC MARKETS, ARE ALL BUT CLOSED COMPLETELY TO ANY

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ISSUERS OTHER THAN THOSE WHICH ARE SEASONED, MATURE AND REPRESENT SAFE OFFORTUNITIES. RESPECTED AUTHORITIES, INCLUDING THE NEW YORK STOCK EXCHANGE, HAVE ESTIMATED THAT DURING THE NEXT DECADE WE WILL HAVE TO RAISE EQUITY CAPITAL ALONE AT THE RATE OF $25 BILLION A YEAR, AN AMOUNT VASTLY IN EXCESS OF THE LARGEST AMOUNT WE'VE EVER RAISED IN THE PAST IN A SINGLE YEAR.

IF THE CAPITAL MARKETS OF THIS COUNTRY ARE TO BE STRAIGHTENED OUT AND THE MANY PROBLEMS AFFLICTING THEM PRESENTLY SOLVED, AND IF AMOUNTS OF CAPITAL NECESSARY TO ASSURE THE FUTURE ECONOMIC DEVELOPMENT OF THE COUNTRY ARE TO BE SECURED, THEN WE MUST PAY CAREFUL ATTENTION TO EVERY CIRCUMSTANCE, EVERY INFLUENCE, EVERY FACTOR, EVERY FORCE WHICH CAN IN ANY MANNER IMPACT OUR SUCCESS IN RAISING THE CAPITAL NEEDED. THIS MEANS THAT OUR TAX POLICIES MUST BE EXAMINED TO DETERMINE WHETHER THEY HINDER OR HELP THE CAPITAL FORMATION PROCESS AND THE WILLINGNESS OF INVESTORS TO PARTICIPATE IN IT; WE MUST EXAMINE GOVERNMENTAL MONETARY AND FISCAL POLICIES FROM THE SAME VIEWPOINT, AND TO THE EXTENT CONSISTENT WITH OTHER OBJECTIVES OF FEDERAL POLICY, THESE MUST BE TAILORED TO FACILITATE THE AVAILABILITY OF CAPITAL TO PRIVATE ENTERPRISE IN THIS COUNTRY. SIMILARLY, THE PROCESS BY WHICH WE REGULATE SECURITIES TRANSACTIONS MUST BE REEXAMINED WITH A SIMILAR PURPOSE IN MIND. THOSE POLICIES AND PRACTICES WHICH WILL FACILITATE THE FLOW OF INSTITUTIONAL AND INDIVIDUAL SAVINGS INTO AMERICAN ENTERPRISE SHOULD BE FOSTERED AND

THOSE WHICH MIGHT RETARD THIS PROCESS SHOULD BE MODIFIED OR ABANDONED.

SUGGESTIONS HAVE BEEN MADE THAT MANY OF THE TRADITIONAL POLICIES OF THE SECURITIES AND EXCHANGE COMMISSION CONSTITUTE MORE OF A HINDRANCE THAN A HELP TO THE CAPITAL FORMATION PROCESS. IT IS SOMETIMES SUGGESTED THAT THE EXTENSIVE DISCLOSURE REQUIREMENTS WHICH HAVE DEVELOPED OVER A PERIOD OF FORTY YEARS MAKE THE RAISING OF MONEY MORE DIFFICULT THAN IT NEEDS TO BE, PARTICULARLY AS COMPARED WITH THE PROCESS IN OTHER COUNTRIES, SUCH AS EUROBOND OFFERINGS IN WESTERN EUROPE. IT IS SUGGESTED THAT IF WE WOULD CUT BACK THE QUALITY AND QUANTITY OF SUCH DISCLOSURE IT WOULD BE EASIER FOR AMERICAN ISSUERS TO RAISE THE NECESSARY CAPITAL FROM INVESTORS IN THIS COUNTRY. IT HAS ALSO BEEN SAID THAT PERHAPS OUR ENFORCEMENT ACTIVITIES, PARTICULARLY AS THEY ARE DIRECTED TO THE BROKER-DEALER COMMUNITY, SHOULD BE CURTAILED BECAUSE A NECESSARY CONSEQUENCE OF RIGOROUS ENFORCEMENT ACTIVITY IS AN UNDERMINING OF CONFIDENCE IN THE SECURITIES INDUSTRY, WITH THE RESULTING INCAPACITATION OF IT TO BE THE MEANS THROUGH WHICH SIGNIFICANT PARTS OF THE NATION'S CAPITAL NEEDS ARE SATISFIED. IT HAS BEEN SUGGESTED THAT PERHAPS WE SHOULD WINK AT CORPORATE TRANSGRESSIONS OF ACCEPTED MORAL AND EVEN LEGAL STANDARDS AND FOREGO THE NECESSITY OF DISCLOSURE OF SUCH MATTERS BECAUSE, BY COMPELLING DISCLOSURE, CONFIDENCE IN AMERICAN ENTERPRISE IS UNDERMINED, AND FROM THAT

WILL FOLLOW AN UNWILLINGNESS ON THE PART OF INVESTORS TO PUT THEIR SAVINGS AT RISK IN BUSINESSES MANAGED BY EXECUTIVES INDIFFERENT TO THE LAWS OF THIS COUNTRY AND THE COMMON DICTATES OF MORALITY. AND IT IS SUGGESTED THAT PERHAPS THE COMMISSION SHOULD BE LESS DILIGENT IN FERRETING OUT INSIDER TRADING LEST THE CONFIDENCE OF PEOPLE IN AMERICAN MANAGEMENTS BE UNDERMINED AND THE ENTREPRENEURS SO NECESSARY FOR PROGRESS IN THE AMERICAN ECONOMY GO UNREWARDED.

WITHOUT INTENDING TO CUT OFF DEBATE ON ALL THESE TERRIBLY IMPORTANT QUESTIONS, I WOULD SAY THAT THESE SUGGESTIONS AS THEY RELATE TO THE FIELD OF SECURITIES REGULATION ARE, FOR THE MOST PART, HOGWASH. THE DISCLOSURE POLICIES WHICH HAVE IMPLEMENTED THE MANDATES OF THE SECURITIES ACT OF 1933 AND THE SECURITIES EXCHANGE ACT OF 1934; THE RIGOROUS ENFORCEMENT OF THESE AND OTHER SECURITIES LAWS; THE COMPELLING OF DISCLOSURE BY MANAGEMENT EVEN WHEN IT EMBARRASSES: ALL THIS HAS BEEN ESSENTIAL TO THE DEVELOPMENT OF THE CAPITAL MARKETS IN THE UNITED STATES WHICH HAVE BEEN THE MOST EFFECTIVE IN THE HISTORY OF ANY COUNTRY IN GARNERING AND ALLOCATING CAPITAL. TO DESTROY OR DAMAGE ALL THAT HAS BEEN GAINED THROUGH THE FOUR DECADES OF EXPERIENCE AND EXPERIMENT AND HARD-WROUGHT ACHIEVEMENT BECAUSE WE FACE NEW PROBLEMS AND CHALLENGES WOULD, IN MY ESTIMATION, BE A DISGRACE AND RESULT IN HORRENDOUS LOSSES TO THE INTEGRITY OF OUR MARKETS AND, INSTEAD OF STRENGTHENING

OUR ABILITY TO FUND OUR CAPITAL NEEDS, WOULD SERIOUSLY UNDERMINE IT FOR DECADES TO COME.

THIS WOULD BE PARTICULARLY SO WERE WE TO SLACKEN THE INTENSITY OF OUR EFFORTS TO ELIMINATE FROM THE MARKETPLACE THE EVIL OF INSIDER TRADING. IN RECENT YEARS EVERY SURVEY OF INVESTORS HAS INDICATED AN OVERWHELMING CONCERN ON THE PART OF INDIVIDUALS ABOUT THE EXTENT TO WHICH THEY ARE ON A PARITY WITH LARGE INSTITUTIONAL INVESTORS. MOST INDIVIDUAL INVESTORS IN THIS COUNTRY ARE APPARENTLY CONVINCED THAT, VIS-A-VIS THE INSTITUTIONS AND THE LARGE INVESTORS, THEY ARE IN AN INFERIOR POSITION. PURPORTEDLY, THEY DO NOT HAVE THE SAME INFORMATION, EITHER IN QUANTITY OR QUALITY, THAT THESE OTHER INVESTORS HAVE; THEY HAVE LESS ACCESS TO CORPORATE SECRETS; THEY ARE SURE THEY ARE LESS ADVANTAGEOUSLY PLACED THAN THEIR INSTITUTIONAL AND LARGE INVESTOR CONFRERES. THE EXTENT TO WHICH THIS ATTITUDE IS GROUNDED IN HARSH EXPERIENCE OR CONSTITUTES FANTASY I AM NOT PREPARED TO SAY AT THIS MOMENT. SURELY, BASED UPON CASES WHICH HAVE COME TO THE PUBLIC'S ATTENTION, EITHER AS THE CONSEQUENCE OF PRIVATE LITIGATION OR COMMISSION INITIATED SUITS, THERE IS AT LEAST A MODICUM OF EVIDENCE TO SUPPORT THESE CONVICTIONS. WHILE I CERTAINLY WOULD NOT SUGGEST THAT CORPORATE LIFE IS HONEYCOMBED WITH CORRUPT USE OF INSIDE INFORMATION, NONETHELESS, I WOULD SUGGEST THAT THE NUMBER OF INSTANCES

IN WHICH DEMONSTRABLY INSIDERS HAVE USED UNDISCLOSED MATERIAL INFORMATION FOR THEIR OWN BENEFIT AND PROFIT IS SUFFICIENTLY LARGE TO JUSTIFY, TO A SIGNIFICANT EXTENT, THE CONVICTIONS OF THESE INDIVIDUAL SMALL INVESTORS. GIVEN THIS ATTITUDE ON THE PART OF SMALL INVESTORS, AND GIVEN FURTHER THE FACT THAT THERE APPEARS TO BE SOME FOUNDATION FOR SUCH A BELIEF, IT SEEMS TO ME THAT IT BEHOOVES ALL OF US WHO ARE CONCERNED WITH CAPITAL MARKETS ALSO TO BE CONCERNED WITH THE ELIMINATION TO THE FULLEST EXTENT POSSIBLE OF THE ABUSE OF INSIDE INFORMATION.

THE PRINCIPAL TOOL WITH WHICH WE HAVE SOUGHT TO CONTROL INSIDER TRADING HAS BEEN RULE 10B-5. WHILE SECTION 15(B), A CRUDE AND MECHANICAL TOOL DESIGNED TO INHIBIT THIS INFAMOUS PRACTICE - CRUDE AND MECHANICAL BECAUSE OF CONGRESS' BELIEF THAT IT WOULD BE DIFFICULT TO PROVE THE ACTUAL USE OF INSIDE INFORMATION - WAS ENACTED IN 1934, IT WAS NOT UNTIL 1942, WHEN RULE 10B-5 WAS ADOPTED, THAT THE MOVEMENT AGAINST IMPROPER INSIDER TRADING GAINED ITS MOST EFFECTIVE WEAPON. RULE 10B-5 HAS EXPANDED UNTIL SOME THINK IT HAS ENGULFED ALL OTHER ASPECTS OF SECURITIES LAW. THE REASONS FOR THIS EXPANSION - AND THEY ARE PARTICULARLY RELEVANT

WHEN DISCUSSING INSIDER TRADING HAVE BEEN WELL STATED BY ALAN BROMBERG:

> "PERHAPS THE PARAMOUNT REASON FOR THE 10B-5 TREND IS THE JUDICIAL AND ADMINISTRATIVE DISTASTE FOR SHARP PRACTICES. THIS IS PART OF A PREFERENCE FOR FAIR DEALING AND FIDUCIARY STANDARDS THAT IS EVIDENT IN OTHER FIELDS, TOO. MORE SPECIFICALLY, THERE IS AN EAGERNESS TO FOLLOW CONGRESS' OVERALL POLICIES OF INVESTOR PROTECTION, COUPLED WITH AN IMPATIENCE AT THE GAPS IN COVERAGE AND REMEDIES. IN PSYCHOLOGICAL TERMS THERE HAS BEEN A STRONG DRIVE TOWARDS CLOSURE. CLOSE BEHIND SEEMS TO BE A CONVICTION THAT RESTRICTIONS CONGRESS ORIGINALLY PLACED ON CIVIL ACTIONS ARE NEITHER NECESSARY NOR DESIRABLE; RATHER, THEY BECOME UNFORTUNATE OBSTACLES TO BE UNDERMINED OR CIRCUMVENTED. EQUAL DISSATISFACTION ARISES WITH THE SUBSTANTIVE PROCEDURAL AND GEOGRAPHIC LIMITATIONS ON STATE SAFEGUARDS FOR INVESTORS."

THE HISTORY OF RULE 10B-5 HAS BEEN ONE OF REPEATED EFFORTS TO RESTRAIN ITS EXPANSION. THESE EFFORTS, ALMOST WITHOUT EXCEPTION, WITH THE MOST NOTABLE EXCEPTION BEING THE BIRNBAUM DOCTRINE, HAVE BEEN UNSUCCESSFUL. THE RULE HAS BEEN EXPANDED VASTLY BEYOND THE IMAGININGS OF ITS ORIGINATORS AND IT CAN BE SAID WITH ACCURACY THAT IT HAS ALL BUT PREEMPTED FEDERAL SECURITIES LAW. ALL THE WHILE, IT HAS BEEN THE SUBJECT OF ENORMOUS CONTROVERSY AND EVERY EXPANSION OF IT HAS BEEN ACCOMPANIED BY HARSH OUTCRIES. THIS HAS BEEN PARTICULARLY TRUE AS RULE 10B-5 HAS TOUCHED INSIDER TRADING.

In 1961, the Commission handed down its decision in Cady, Roberts & Co., and immediately unleashed a torrent of criticism because of the alleged novelty of some of the propositions expressed in that case. For the first time, the concept of insider was expanded broadly to include more than officers, directors and large shareholders. In that case, one who fitted none of the categories, but one who did acquire his information from a director, was held subject to the same restrictions which previously had been imposed on officers, directors and large shareholders, and a responsibility to persons who were not shareholders at the time of the offending transaction was suggested. Also, for the first time the strictures of Rule 10b-5 were applied to exchange transactions. The mere filing of Texas Gulf Sulphur by the Commission, let alone the decision, triggered a new storm of protest. Again, the conception of "insider" was given a broad construction. Furthermore, novel tests of materiality were enunciated and applied and the entire scope and applicability of the rule was significantly expanded. The decisions of the District Court and the Court of Appeals for the Second Circuit only triggered further lamentations with respect to the "novelty" of these.

UNDERLYING RULE 10B-5, THESE CASES, AND THE EXPANSIVE READING WHICH COURTS AND THE COMMISSION HAVE GIVEN THE RULE, ARE IMPORTANT ECONOMIC CONSIDERATIONS AND SOUND MORAL PRINCIPLES. WITH REGARD TO THE FORMER, AS I INDICATED EARLIER, THE CAPITAL NEEDS OF THIS COUNTRY ARE INDEED ENORMOUS. MUCH OF THIS NEEDED CAPITAL MUST COME FROM SOURCES EXTERIOR TO CORPORATIONS, INCLUDING PARTICULARLY INDIVIDUAL SAVINGS. WE CAN EXPECT INDIVIDUALS TO PARTICIPATE IN THIS PROCESS ONLY IF THEY HAVE CONFIDENCE THAT THEY ARE NOT DISADVANTAGED IN THE GAME BY THE PRESENCE OF PLAYERS WITH SUPERIOR INFORMATION. PEOPLE WON'T PLAY POKER WHEN THEY THINK THE CARDS ARE MARKED AND ONE OF THE PLAYERS KNOWS THE CODE.

IN ADDITION TO ECONOMIC CONSIDERATIONS, IT SEEMS TO ME THAT OUR ETHICS AND MORALITY DEMAND TRANSLATION INTO LAW IN THIS AREA. ALL OF US KNOW THAT OUR LEGAL HISTORY HAS BEEN CHARACTERIZED IN LARGE MEASURE BY THE STEADY CONVERSION OF MORAL PRECEPTS INTO LEGAL COMMANDS. FOR INSTANCE, FEW OF US WOULD HAVE CONTESTED IN THE PAST THE IMMORALITY OF DISCRIMINATION IN EMPLOYMENT AND IN OTHER WAYS AGAINST A PERSON BECAUSE OF HIS OR HER COLOR OR SEX. IT TOOK MANY YEARS, BUT EVENTUALLY OUR ETHICAL CONVICTIONS WERE TRANSLATED INTO LEGAL MANDATES. I WOULD SUGGEST THAT THERE ARE FEW WHO WOULD DISPUTE THE IMMORALITY OF A PERSON VESTED WITH CORPORATE OFFICE, OR HAVING ACCESS TO CONFIDENTIAL CORPORATE INFORMATION, USING IT, AT THE EXPENSE OF THE GENERAL PUBLIC, TO FEATHER HIS OWN NEST AND

I WOULD SUGGEST THAT NO EXTENDED DISCOURSE IS NECESSARY TO JUSTIFY SUCH A MORAL CONVICTION. AS PROFESSOR LOSS QUOTED ONE OF HIS STUDENTS IN SPEAKING OF THIS, "I DON'T CARE" SHE SAID, "IT'S JUST NOT RIGHT".

WITHOUT ENTERING INTO A LENGTHY DISCUSSION OF NATURAL LAW I THINK MOST OF US KNOW WITHOUT QUIBBLE THAT INSIDER TRADING ON UNDISCLOSED INFORMATION JUST ISN'T RIGHT. IF I RECALL MY COLLEGE PHILOSOPHY, THE KANTIAN CATEGORICAL IMPERATIVE DEMANDED THAT, IN ASSESSING A MORAL PRECEPT, WE SHOULD IMAGINE IT UNIVERSALLY APPLICABLE AND ASSESS THE POTENTIAL CONSEQUENCES OF THAT. CAN YOU IMAGINE WHAT OUR ECONOMIC LIFE WOULD BE LIKE IF THERE WERE UNBRIDLED OPPORTUNITY ON THE PART OF INSIDERS TO UTILIZE THEIR INFORMATION IN THE MARKETPLACE? AN EXECUTIVE KNOWS THAT IN A WEEK HIS CORPORATION IS GOING TO ANNOUNCE A DRAMATIC BREAKTHROUGH IN THE SEARCH FOR A CANCER REMEDY SO HE GOES INTO THE MARKET IN A BIG WAY - BUYS OPTIONS, TAKES LARGE POSITIONS, PASSES THE WORD TO HIS FRIENDS, TELLS HIS BROTHER-IN-LAW AND HIS CONDUCT IS DUPLICATED BY EVERYONE IN THE COMPANY WHO HAS THE INFORMATION. A CORPORATION HAS SUFFERED A DISASTROUS DECLINE IN EARNINGS. DURING THE WEEK BEFORE THIS INFORMATION IS RELEASED, ALL THE OFFICERS AND DIRECTORS, AS WELL AS A NUMBER OF OTHER PEOPLE WITH ACCESS TO THE INFORMATION, DECIDE TO UNLOAD AND THEN COME BACK IN WHEN THE MARKET HAS REFLECTED THE ADVERSE DEVELOPMENT.

THIS SORT OF THING IS ABSOLUTELY UNTHINKABLE. IT WOULD, IN VERY SHORT ORDER, TURN OUR MARKETS INTO SHAMBLES, AND ANYONE WITH ANY SENSE

WOULD QUICKLY GET OUT OF THEM. THE LOSS WOULD BE THE NATION'S, FOR THE PARTICIPATION OF INDIVIDUALS AND OTHER INVESTORS IN THE MARKETPLACE IS ESSENTIAL IN THE SORT OF CAPITALISTIC ECONOMY THAT WE HAVE DEVELOPED.

THIS DEEP MORAL REVULSION HAS FOR FORTY YEARS NOW BEEN EXPRESSED IN STATUTES, COMMISSION RULES AND RULINGS AND COURT DECISIONS -- AND IT IS INDEED FORTUNATE THAT IT HAS BEEN. DURING THIS TIME WE HAVE STEADILY BROADENED THE DEFINITION OF THOSE TO WHOM THE PROHIBITIONS ARE APPLICABLE AND WE ALSO HAVE BROADENED OUR CONCEPTIONS OF WHAT INFORMATION IS SIGNIFICANT TO INVESTORS AND HENCE MUST BE TREATED AS MATERIAL FOR PURPOSES OF OUR STRICTURES.

PROHIBITIONS AGAINST INSIDER TRADING HAVE A VERY SIGNIFICANT IMPACT ON MARKETS IN ANOTHER WAY. BY DENYING INSIDERS THE PROFITS FROM USING INSIDE INFORMATION, UNQUESTIONABLY THE RELEASE AND DISSEMINATION OF MATERIAL INFORMATION BY ISSUERS IS SPEEDED UP, WITH OBVIOUS BENEFITS FOR EVERYONE. IMMEDIATE DISCLOSURE IS AN ESSENTIAL OF THE NOTION OF THE EFFICIENT MARKET, WHICH IS SO DEAR TO HEARTS OF THE ECONOMISTS. AN EFFICIENT MARKET POSITS THE PRESENCE IN THE MARKET OF ALL INFORMATION CONCERNING AN ISSUE THAT IS SIGNIFICANT IN MAKING AN INVESTMENT DECISION. IT ASSUMES PROMPT DISCLOSURE OF SUCH INFORMATION AND ITS THOROUGH DISSEMINATION, RESULTING IN A REFLECTION OF THE TOTALITY OF INFORMATION IN THE MARKET PRICE FOR THE SECURITY. IN A FULLY EFFICIENT MARKET THERE IS NO OPPORTUNITY FOR A PROFIT DERIVING FROM THE POSSESSION OF INFORMATION THAT IS NOT DISSEMINATED. RATHER,

PROFIT IN A TRANSACTION IN SUCH A MARKET MUST RESULT FROM BROAD MARKET MOVEMENTS (WITH THE SO-CALLED BETA COEFFICIENT INDICATING THE PRICE OF A PARTICULAR SECURITY VIS-A-VIS THE MARKET) OR FROM SUPERIOR ANALYSIS OR ASTUTE CONCLUSIONS DERIVING FROM THE INFORMATION THAT IS AVAILABLE TO EVERYONE (IT MIGHT BE NOTED THAT SOME MARKET THEORISTS SUGGEST THAT IN A TRULY EFFICIENT MARKET EVEN SUPERIOR ANALYSIS OR SOPHISTICATION MAY BE IRRELEVANT TO INVESTMENT RESULTS.) I WOULD SUGGEST THAT AS FULLY EFFICIENT A MARKETPLACE AS WE CAN ACHIEVE IS THE BEST MARKETPLACE FOR OUR SOCIETY AND THAT THE BARS AGAINST INSIDER TRADING HELP TO MAKE THE MARKETPLACE EFFICIENT.

SUCH A MARKET IS THE IDEAL FOR WHICH WE STRIVE. IT IS NOT A MARKET IN WHICH ALL INEQUALITIES AMONG INVESTORS ARE ELIMINATED. JUST AS, NOTWITHSTANDING OUR EGALITARIAN NOTIONS, WE HAVE NOT ACHIEVED, AND DO NOT EXPECT TO ACHIEVE, AND SHOULD NOT WANT TO ACHIEVE, AN ABSOLUTE EQUALITY OF POSITION AND SITUATION AMONG ALL PEOPLE, IT IS IMPOSSIBLE TO CONCEIVE OF ALL INVESTORS IN AN ABSOLUTELY EQUAL POSITION. THERE WILL BE DIFFERENCES OF INVESTMENT RESULTS DERIVING FROM DIFFERENCES IN PROFESSIONAL TRAINING, DIFFERENCES IN ASTUTENESS OF ANALYSIS, DIFFERENCES IN THE ABILITY TO UTILIZE ANALYTICAL TOOLS, IMMEDIACY OF OPPORTUNITY TO ACT UPON DISSEMINATED INFORMATION AND A HOST OF OTHER FACTORS. THERE WILL, AND I WOULD SUGGEST THERE SHOULD ALWAYS BE, OPPORTUNITY FOR PEOPLE TO PROFIT

FROM THEIR INGENUITY, THEIR SKILL, THEIR INSIGHTS, THEIR ANALYSES AND IT IS NOT THE PURPOSE OF ANY INSIDER TRADING RULE TO DENY THEM THE OPPORTUNITY TO DO SO. THE LEGITIMACY OF THIS DISTINCTION BETWEEN USING INSIDER INFORMATION AND BENEFITING FROM SUPERIOR INSIGHTS WAS SUGGESTED IN CADY, ROBERTS, WHERE THE COMMISSION SAID,"

> "...KNOWLEDGE OF THIS ACTION /A CUT IN THE DIVIDEND/ WAS NOT ARRIVED AT AS A RESULT OF PERCEPTIVE ANALYSIS OF GENERALLY KNOWN FACTS..."

NEEDLESS TO SAY, IN MANY INSTANCES IT IS EXTREMELY DIFFICULT TO DETERMINE WHETHER A DETERMINATION TO BUY OR SELL A SECURITY STEMMED FROM SUPERIOR ANALYSIS OR FROM THE POSSESSION OF INSIDE INFORMATION. INFORMATION ABOUT AN ISSUER IS MADE UP OF A VAST NUMBER OF DISCRETE PARTICLES. WHEN SOME OF THE PARTICLES ARE OF A PUBLIC NATURE AND SOME OF THEM HAVE BEEN SECURED IN VIOLATION OF INSIDER TRADING RULES, AND THEY ARE ALL SCRAMBLED TOGETHER, IT IS DIFFICULT TO MAKE JUDGMENTS WITH REGARD TO THE EXTENT TO WHICH CAUSALITY ATTACHED TO THE INFORMATION SECURED FROM INSIDE. WE CANNOT REACH INTO AN INVESTOR'S MIND AND CONCLUDE WITH ANY ASSURANCE WHAT IT WAS THAT CAUSED HIM TO TAKE AN ACTION. THE COMMISSION IN THE FABERGE CASE INTIMATED THAT WHENEVER AN INVESTOR HAS UNDISCLOSED MATERIAL INFORMATION AND THEREAFTER ENTERS INTO A TRANSACTION, THEN HE MAY BE IN VIOLATION OF THE INSIDER TRADING RULE. REGARDLESS OF WHETHER HIS ACTION CAN BE CAUSALLY MATCHED WITH HIS STATE OF MIND. SOME, IT MIGHT BE NOTED, HAVE SUGGESTED THAT SUCH A

TEMPORAL SEQUENCE SHOULD ONLY CREATE A PRESUMPTION OF IMPROPER USE SUBJECT TO REBUTTAL BY THE DEFENDANT.

NOTWITHSTANDING THE RELATIVELY LONG HISTORY OF OUR CONCERN WITH INSIDER TRADING IN THIS COUNTRY, IT IS EVIDENT THAT NOT ALL OF THE DILEMMAS AND PROBLEMS HAVE BEEN SOLVED. WE HAVE BROKEN WITH THE MECHANICAL CONVENTIONALITY THAT INSIDERS ARE TO BE EQUATED ONLY WITH OFFICERS, DIRECTORS AND 10% SHAREHOLDERS. WE NOW THINK OF INSIDERS MORE AS THOSE WITH ACCESS IN SOME WAY TO MATERIAL NON-PUBLIC INFORMATION AND WE EMBRACE WITHIN THE IDEA PERSONS WITH NO AFFILIATION WITH THE ISSUER WHO, FOR EXAMPLE, RECEIVE INFORMATION WHICH THEY HAVE REASON TO BELIEVE STEMS FROM AN INSIDE SOURCE AND HAS NOT BEEN PUBLICLY DISSEMINATED. THIS KIND OF AN EXTENSION OF THE CONCEPT OF INSIDER SEEMS TO ME TO BE ENTIRELY WARRANTED. WITHOUT SUCH A NOTION IT IS EASY TO IMAGINE A PRACTICE OF INSIDERS TRADING OFF INFORMATION, WHICH THEY COULD NOT USE DIRECTLY, TO EACH OTHER.

THE PROBLEM OF MATERIALITY CONTINUES TO TROUBLE MANY. THE COURTS AND THE COMMISSION HAVE ARTICULED VARIOUS TESTS OF MATERIALITY; THE MOST COMMONLY ACCEPTED NOW IS THIS: IS THIS INFORMATION SUCH THAT IT MIGHT AFFECT THE INVESTMENT JUDGMENT OF A REASONABLE INVESTOR (INCLUDING, AS INDICATED IN TEXAS GULF SULPHUR, SPECULATORS AS WELL AS LONG-TERM INVESTORS)? DESPITE THE SUBTLETIES HIDDEN WITHIN THESE TESTS, IN CASES INVOLVING INSIDER TRADING THE MATERIALITY OF THE UNDISCLOSED INFORMATION RARELY HAS BEEN DIFFICULT TO DISCERN. IN RECOGNITION OF THIS, PROFESSOR LOSS AND THOSE ASSOCIATED WITH HIM IN THE EFFORT TO CODIFY THE FEDERAL SECURITIES LAWS

HAVE REQUIRED THAT FOR LIABILITY FOR TRADING ON INSIDE INFORMATION, NOT ONLY MUST THE UNDISCLOSED FACT BE MATERIAL ("...A REASONABLE PERSON WOULD ATTACH IMPORTANCE TO IT UNDER THE CIRCUMSTANCES IN DETERMINING HIS COURSE OF ACTION..."), BUT IT MUST BE A "FACT OF SPECIAL SIGNIFICANCE" WHICH IS DEFINED IN THE PROPOSED CODE AS, AMONG OTHER THINGS, A FACT WHICH WOULD BE LIKELY, ON BEING MADE GENERALLY AVAILABLE, TO AFFECT THE MARKET PRICE OF A SECURITY TO A SIGNIFICANT EXTENT.

AND THEN THERE ARE THE RECURRING PROBLEMS OF DISSEMINATION: WHEN IS INFORMATION PUBLICLY AVAILABLE? WHAT OF THE SMALL COMPANY WHICH CANNOT CLAIM SPACE IN THE MAJOR FINANCIAL PUBLICATIONS FOR ITS NEWS? HOW MUCH TIME MUST ELAPSE BETWEEN THE TIME OF DISSEMINATION AND THE TRANSACTION? AND TO WHAT EXTENT MUST ONE INQUIRE CONCERNING WHETHER DISSEMINATION HAS OCCURRED?

THE PROBLEMS OF INSIDE INFORMATION AFFLICT ACUTELY THOSE IN THE SECURITIES INDUSTRY, PARTICULARLY ANALYSTS AND SECURITIES DEALERS WHO PERFORM A MULTIPLICITY OF FUNCTIONS, E.G., RETAIL BROKERAGE AND UNDERWRITING. THE ANALYST, IN ADDITION TO THE DIFFICULTIES OF DETERMINING MATERIALITY AND THE EXTENT OF DISSEMINATION, HAS THE ADDITIONAL PROBLEM OF DETERMINING WHEN, FOR EXAMPLE, AN EXECUTIVE'S NOD IN CONFIRMATION OF AN ESTIMATE ARRIVED AT ON THE BASIS OF PUBLIC INFORMATION MAKES HIM THE POSSESSOR OF INSIDE INFORMATION. THE COMMISSION RECOGNIZES THE DIFFICULTIES OF THE

ANALYST'S POSITION AND IS PRESENTLY WORKING TOWARD PUBLICATION OF A SET OF GUIDELINES - NOT, I EMPHASIZE, RULES - WHICH HOPEFULLY WILL AFFORD MORE GUIDANCE TO THE HONESTLY SEARCHING ANALYST THAN HE HAS HAD BEFORE.

THE DILEMMA OF THE SECURITIES DEALER WITH SEVERAL HATS IS DEMONSTRATED IN SLADE v. SHEARSON, HAMMILL AND CO., INC. IN THIS CASE, IT IS ALLEGED THAT SHEARSON, HAMMILL HAD RECOMMENDED A SECURITY TO A RETAIL CUSTOMER AT A TIME WHEN, BECAUSE OF ITS INVESTMENT BANKING RELATIONSHIP TO THE ISSUER, IT RECEIVED ADVERSE INFORMATION OF A MATERIAL NATURE. SHEARSON, HAMMILL HAS DEFENDED ON THE GROUNDS THAT IT HAD A CHINESE WALL BETWEEN ITS ACTIVITIES WHICH PREVENTED THE UNDERWRITING DEPARTMENT FROM COMMUNICATING INFORMATION TO THE RETAIL DEPARTMENT. THE DISTRICT COURT, PLAINLY CONCERNED ABOUT THE IMPACT A VERDICT FOR THE PLAINTIFF MIGHT HAVE ON THE STRUCTURE OF THE SECURITIES INDUSTRY, CERTIFIED THE BASIC QUESTION TO THE COURT OF APPEALS, BUT THAT COURT REMANDED THE MATTER TO THE DISTRICT COURT FOR TRIAL ON THE GROUND THAT IT WAS NOT APPROPRIATE TO DECIDE THE CERTIFIED QUESTION PRIOR TO TRIAL.

THE DILEMMAS CONFRONTING THE SECURITIES DEALER ARE EVIDENT. MUCH THE SAME PROBLEM CONFRONTS BANKS WHICH OFTEN SECURE UNDISCLOSED INFORMATION IN THEIR ROLES AS COMMERCIAL BANKERS WHILE THEIR TRUST

DEPARTMENTS MAY BE BUYING OR SELLING OR HOLDING SECURITIES OF THE SAME ISSUER; AT LEAST ONE MAJOR BANK HAS BEEN SUED, THE PLAINTIFF ALLEGING THAT THE TRUST DEPARTMENT RECEIVED INSIDE INFORMATION WHICH IT USED IN MAKING PORTFOLIO DECISIONS.

IT SEEMS TO ME THAT THIS PROBLEM, THE LIMITS OF THE "CHINESE WALL" THEORY AND THE MANNER IN WHICH BROKER-DEALERS MAY SAFEGUARD THEMSELVES FROM ASSERTIONS OF INSIDE INFORMATION ABUSE, MAY BE AMENABLE TO RULE-MAKING BY THE COMMISSION. THIS KIND OF PROBLEM IS NOT ATTENDED BY THE DIFFICULTIES WE ENCOUNTERED IN TRYING TO COMPRESS NOTIONS OF DIRECTOR'S RESPONSIBILITIES WITHIN THE CONFINES OF GUIDELINES, OR THE COMPLEXITIES OF TRYING TO DEAL WITH THE ENTIRE GAMUT OF INSIDER TRADING PROBLEMS. THE PROBLEM IS A SPECIALIZED, LIMITED ONE WHICH SHOULD BE AMENABLE TO SOME CLARIFICATION, IF NOT COMPLETE SOLUTION, THROUGH RULE-MAKING.

I COULD CONTINUE ENDLESSLY DISCUSSING THE DIFFICULTIES OF IMPLEMENTING THE BASIC POLICY WHICH REJECTS TRADING ON THE BASIS OF UNDISCLOSED INFORMATION. MY PURPOSE IN SUGGESTING A FEW OF THE PROBLEMS IS NOT TO CONVEY IN ANY WAY IMPATIENCE WITH THE MANNER IN WHICH THE LAW IS UNFOLDING OR ANY BELIEF THAT IT SHOULD BE FROZEN OR INHIBITED IN ITS DEVELOPMENT. THIS COMPLEXITY, THE UNFINISHED STATE OF THE LAW IN THIS AREA, SIMPLY REFLECTS THE RICH VARIETY OF OUR ECONOMIC LIFE AND PERHAPS ALSO, TO SOME EXTENT, THE DEXTERITY OF THOSE WHO WOULD TRY TO CIRCUMVENT THE RESTRAINTS WE HAVE ERECTED ON THIS CONDUCT.

THE PROGRESS WHICH HAS BEEN MADE IN SPIKING THE PRACTICE OF ILLEGAL INSIDER TRADING SHOULD BE A SOURCE OF PRIDE TO ANYONE CONCERNED WITH SOUND ADMINISTRATION OF SECURITIES LAW IN THIS COUNTRY. IT REFLECTS SOUND VALUES, SOUND MORAL CONVICTIONS, SOUND CONCEPTIONS OF NATIONAL ECONOMIC NEEDS AND POLICIES. THE BEST EVIDENCE THAT THE PATH WE CHOSE FORTY YEARS AGO IS A GOOD ONE, OF COURSE, IS THE EAGERNESS OF OTHER COUNTRIES CONCERNED WITH THEIR MARKETS TO EMULATE OUR EXPERIENCE AND LEARN FROM IT. IN FRANCE IMPROPER INSIDER TRADING SINCE 1970 HAS BEEN SUBJECT TO CRIMINAL PENALTIES AND SUCH HAS BEEN PROPOSED IN ENGLAND; IN GERMANY THEY ARE RELYING FOR THE MOMENT ON VOLUNTARY COMPLIANCE WITH STANDARDS THAT PROHIBIT IT.

IN THE FINAL ANALYSIS, INSIDER TRADING IS WRONG, DREADFULLY AND VICIOUSLY WRONG. IT UNDERMINES OUR MARKETS, IT CHEAPENS AND TARNISHES THE INTEGRITY OF OUR SYSTEM, AND HOPEFULLY, IF WE ARE VIGILANT ENOUGH, IT MAY INCREASINGLY IMPOVERISH THOSE WHO ENGAGE IN IT.