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Broader Issues Raised By Recent Insider Trading Cases

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This afternoon, I would like to describe briefly the SEC's efforts to inhibit insider trading - and then solicit your reactions to some broader questions raised by several recent cases involving graduates of leading business and law schools.

Five years ago, articles in leading publications stated that insider trading was so pervasive, nothing could be done about it. Many took such articles to be a license to engage in insider trading. If everyone else was doing it - and nothing could be done about it - why not?

A few academicians contended that insider trading was good for the market. That it moved prices in the "right" direction. But few shareholders felt it was good for them if the president of a company unloaded his shares on them, just before he announced bad news, or purchased their shares, just before he announced favorable news.

During the past five years, the Securities and Exchange Commission has brought 125 insider trading cases, as compared with 77 during the prior 47 years. The large increase is due principally to the increase in tender offers and to improved surveillance and enforcement systems. With the support of the business and financial community, the investing public, the Administration and Congress, the SEC's ability to expose and prosecute securities frauds has been greatly enhanced by:

- electronic market surveillance systems and transaction audit trails, that permit the quick identification of the sources of suspicious trading activities;
- the Insider Trading Sanctions Act of 1984, which permits heavy fines of inside traders;
- close coordination with the Justice Department, which imposes criminal sanctions on inside traders;
- and by growing cooperation from abroad.

The SEC's 1982 Accord with Switzerland removed the haven of the Swiss bank secrecy laws from inside traders. The SEC has since implemented additional cooperation agreements on enforcement matters with Canadian, Japanese and United Kingdom authorities. Others are in prospect. The logical extension of these bilateral agreements will be multilateral agreements with virtually all major markets.

The Ivan Boesky and many other cases demonstrate that it has become increasingly difficult for inside traders to hide - at home or abroad - and that those who engage in such activities are assuming enormous risks of imprisonment, heavy fines and civil suits, disbarment from the legal profession and the securities industry - and public disgrace. Insider trading has not been eradicated, but it has been inhibited and multimillions of dollars of profits Boesky and others have been siphoning off the market are now flowing through to the investing public.

A very disturbing area is the recent rash of insider trading cases against young men in their 20s and early 30s, who are graduates of leading business and law schools - the cream of the crop. It is notable that none have been young women, even though women have accounted for a growing portion of business and law school graduates during the past decade.

At any rate, ten recent graduates of Harvard, Stanford, Columbia, Wharton and other leading business and law schools are now convicted felons. Most will serve prison terms. They may be the tip of the iceberg - symptomatic of more serious problems in America today.

These men were very successful - earning six figure incomes, with promising careers at distinguished securities and law firms. Their insider trading profits have typically ranged from $20,000 to $50,000. A few realized substantially more - and others nothing - but they all misappropriated material nonpublic information from those who trusted them, or knowingly traded on such information.

Why were they willing to risk their brilliant futures and self-respect? While it may have been because of deep seated psychological reasons, other questions remain. Have the temptations become too great? Was it the challenge - or the excitement - of seeing if they could get away with it - if they could beat the system? Were they driven by peer pressures or rivalries to win a game in which the score has a dollar sign in front of it? Or has there been a change in moral attitudes in America since the end of World War II as a result of the dispersion of families, rising divorces, the permissiveness of the '60s and '70s, the Vietnam War and drugs? It was probably a combination of these factors, but what can be done about it?

Imprisonment is the most effective deterrent. However, some of these defendants have been required to provide 200 to 300 hours of community service. Would it be more efficacious for them to describe to the students at their alma maters and other schools, the devastating impact on their lives of their offenses?

As premier institutions in our educational system, should the graduate business and law schools attempt to change their images and curricula? Can the media help? The press emphasizes their graduates' incomes, rather than their contributions to society. The image of some schools is that they are training the next generation of millionaires - often characterized as financial schemers and manipulators - whereas most become very competent managers of people and resources for the benefit of society.

Graduate schools have courses on ethics, but do many students feel that you receive the benefits of ethical conduct in the hereafter - rather than the here-and-now? Are there courses that demonstrate that ethics pays? That those who go for edges, like high rollers in Las Vegas, are eventually wiped out?

I believe corporate executives, investment bankers and lawyers who do a good job for their customers and clients, employees, suppliers and communities, also do a better job for their shareholders, than those who attempt to take unfair advantage of these groups in their drive to maximize their next quarter's earnings.

Law and some business schools use the case method of teaching. Are there case studies of successful business men and women, investment bankers and lawyers - and of companies such as IBM, Johnson & Johnson and others - that demonstrate that the marketplace rewards quality, integrity and ethical conduct?

These are some of the questions to which I hope you will respond. The following related areas will be the subject of Congressional hearings in coming months. I will be glad to comment on any that are of interest. They include:

- leveraged buyouts and takeovers;
- the benefits and risks of the rapidly increasing internationalization of the securities markets and of computerized arbitrage and hedging activities;
- the need to simplify and rationalize the regulatory structures of the financial service industries;
- the SEC's electronic disclosure system, which will increase the fairness and efficiency of the securities markets by reducing from days to minutes, the dissemination of time-sensitive corporate information;
- and of course, insider trading.

Thank you.