



SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

August 3, 1987

The Honorable Donald W. Riegle
Chairman
Securities Subcommittee of the
Committee on Banking, Housing
and Urban Affairs
United States Senate
534 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Chairman Riegle:

As you requested during my testimony before the Subcommittee on June 19, 1987, I am transmitting, on behalf of the Commission, the enclosed legislative proposal to define and prohibit insider trading. The Commission will also be submitting, in advance of my testimony at the hearing scheduled for August 7, 1987, a memorandum describing the proposed legislation.

The enclosed legislative proposal reflects the views of the Commission, and does not necessarily represent the views of the President. As you requested, the Commission will not make this proposal available to the public prior to the hearing.

Questions concerning the proposed legislation can be directed to Cecile Srodes, Director of Legislative Affairs for the Commission, at (202) 272-2500.

Sincerely,

A handwritten signature in cursive script that reads "Charles C. Cox".

Charles C. Cox
Acting Chairman

Enclosure

A BILL

To amend the Securities Exchange Act of 1934.

1 *Be it enacted by the Senate and House of Representatives of the United States of*
2 *America in Congress assembled,*

3
4 **SECTION 1. SHORT TITLE.**

5
6 This Act may be cited as "The Insider Trading Act of 1987."
7

8 **SECTION 2. FINDINGS.**

9
10 (1) The fairness, efficiency and integrity of the nation's securities markets are impaired
11 when corporate insiders or other persons who obtain material nonpublic information relating to
12 an issuer or its securities wrongfully trade, or wrongfully cause the trading of, securities
13 while in possession of that information, or wrongfully communicate that information to others
14 who misuse it in connection with the purchase or sale of any security.
15

16 (2) The wrongful trading of securities is carried on to a substantial extent in interstate
17 and foreign commerce, and through the means and instrumentalities of such commerce. Even
18 when wrongful trading while in possession of material nonpublic information and wrongful
19 communication of such information are primarily intrastate in character, these activities
20 nonetheless have a direct effect on interstate and foreign commerce. Effective prohibitions
21 against such wrongful trading and communication are necessary to preserve the integrity of
22 the nation's markets and their ability to serve important domestic and international economic
23 functions, including capital formation.
24

25 (3) There is an important public interest in the prompt flow of information to the
26 securities markets.
27

28 (4) It is appropriate to establish exclusive statutory prohibitions that clarify what
29 conduct constitutes such wrongful trading and communication, and thereby reduce uncertainties
30 in the state of the law without otherwise affecting existing statutory prohibitions against
31 other manipulative, deceptive or fraudulent conduct.
32

33 **SECTION 3. INSIDER TRADING PROSCRIPTIONS.**

34
35 Chapter 78 of title 15, United States Code, is amended, by adding at the end of § 78p
36 the following new section:
37

38 **Section 16A. PROHIBITION AGAINST TRADING WHILE IN POSSESSION OF, AND**
39 **COMMUNICATING, MATERIAL NONPUBLIC INFORMATION**

40
41 (a) It shall be unlawful for any person, directly or indirectly, to purchase, sell, or cause the
42 purchase or sale of, any security while in possession of material nonpublic information
43 concerning the issuer or its securities, if such person knows or recklessly disregards that such
44 information has been obtained wrongfully or that such purchase or sale would constitute a
45 wrongful use of such information. For purposes of this Section, information is obtained or
46 used wrongfully if, directly or indirectly, it has been obtained by or as a result of, or its use
47 would constitute:
48

49 (1) theft, bribery, misrepresentation, or espionage through electronic or other means; or
50

1 (2) a breach of a duty to maintain such information in confidence or to refrain from
2 purchasing, selling, or causing the purchase or sale of, the security, which duty arises
3 from any fiduciary, contractual, employment, personal or other relationship with:

4
5 (A) the issuer of the security or its securityholders,

6
7 (B) any person planning or engaged in an acquisition or disposition of the issuer's
8 securities or assets,

9
10 (C) any government, or a political subdivision, agency or instrumentality of a
11 government,

12
13 (D) any person, or any self-regulatory organization, registered or required to be
14 registered with the Commission under any provision of the federal securities laws
15 (as that term is defined in Section 21(g) of this title),

16
17 (E) any person engaged in the business of gathering, analyzing, or disseminating
18 information concerning securities, the markets for securities, or the financial
19 condition of issuers,

20
21 (F) any other person that is a member of a class that the Commission designates,
22 by rule or regulation, where the Commission finds (i) that the activities of the
23 members of such class have a regular nexus to the operation of the nation's
24 securities markets, and (ii) that such designation is necessary or appropriate to
25 effectuate the purposes of this Section, or

26
27 (G) any other person who obtained such information as a result of a direct or
28 indirect confidential relationship with any of the persons or entities referred to in
29 paragraphs (A)-(F) above.

30
31 (b) It shall be unlawful for any person, whose purchase or sale of a security would violate
32 subsection (a) of this Section, to communicate, directly or indirectly, information that such
33 person knows or recklessly disregards is material and nonpublic to any other person who,
34 directly or indirectly, purchases, sells, or causes the purchase or sale of, such security or who
35 communicates the information to another person who makes or causes such a purchase or sale,
36 if such purchase or sale is reasonably foreseeable.

37
38 (c) (1) If any person has taken a substantial step or steps to commence, or has commenced,
39 a tender offer (the "offering person"), it shall be unlawful for any other person who is
40 in possession of material nonpublic information relating to such tender offer, which
41 information such other person knows or recklessly disregards has been acquired directly
42 or indirectly from (i) the offering person, (ii) the issuer of the securities sought or to be
43 sought by such tender offer, or (iii) any officer, director, partner or employee or any
44 other person acting on behalf of the offering person or such issuer, to purchase or sell
45 or cause to be purchased or sold any security of such issuer, except for sales to the
46 offering person.

47
48 (2) (A) It shall be unlawful for any person described in paragraph (2)(B) of this
49 subsection (c) to communicate, directly or indirectly, material nonpublic information
50 relating to a tender offer to any other person under circumstances in which it is
51 reasonably foreseeable that such communication is likely to result in a violation of

1 this Section, except that this paragraph shall not apply to a communication made in
2 good faith

3
4 (i) to the officers, directors, partners or employees of the offering person,
5 to its advisors or to other persons, involved in the planning, financing,
6 preparation or execution of such tender offer,

7
8 (ii) to the issuer whose securities are sought or to be sought by such tender
9 offer, to its officers, directors, partners, employees or advisors or to other
10 persons, involved in the planning, financing, preparation or execution of the
11 activities of the issuer with respect to such tender offer, or

12
13 (iii) to any person pursuant to a requirement of any statute or rule or
14 regulation promulgated thereunder.

15
16 (B) The persons referred to in paragraph (2)(A) of this subsection (c) are:

17
18 (i) the offering person or its officers, directors, partners, employees or
19 advisors;

20
21 (ii) the issuer of the securities sought or to be sought by such tender offer
22 or its officers, directors, partners, employees or advisors;

23
24 (iii) anyone acting on behalf of the persons described in paragraph (2)(B)(i)
25 or (2)(B)(ii) of this subsection; and

26
27 (iv) any person in possession of information relating to a tender offer which
28 information such person knows or recklessly disregards is material and
29 nonpublic and has been acquired directly or indirectly from any person
30 described in this paragraph (2)(B).

31
32 (d) (1) The Commission, by rule, regulation, or order, may exempt any person, security or
33 transaction, or any class thereof, from any or all of the provisions of this Section, upon
34 such terms and conditions as it deems necessary or appropriate, if the Commission
35 determines, by reason of the nature of such person, security, transaction, or class
36 thereof, or otherwise, that such action is not inconsistent with the purposes of this
37 Section.

38
39 (2) The prohibitions of subsections (a) and (c)(1) of this Section shall not apply to any
40 person who is other than a natural person and who sustains the burden of proving that:

41
42 (A) the individual(s) making the investment decision on behalf of such person to
43 purchase or sell the security, or to cause the purchase or sale of the security by or
44 on behalf of others, did not know the material nonpublic information; and

45
46 (B) such person had implemented one or a combination of policies and procedures,
47 reasonable under the circumstances, taking into consideration the nature of the
48 person's business, to ensure that individual(s) making investment decision(s) would
49 not violate subsection (a) of this Section, which policies and procedures may
50 include, but are not limited to, (i) those which restrict any purchase, sale and
51 causing any purchase or sale of any such security or (ii) those which prevent such
52 individual(s) from knowing such information.

1
2 (3) The prohibitions of subsections (b) and (c) of this Section shall not be construed as
3 making unlawful any communication made in a reasonable effort to make the information
4 public.

5
6 (4) The prohibitions of this Section shall not make unlawful any communication made:

7
8 (A) in the ordinary course of business by a person engaged in the business of
9 analyzing and disseminating information concerning securities, the markets for
10 securities, or the financial condition of issuers; or

11
12 (B) to a person engaged in the business of analyzing and disseminating information
13 concerning securities, the markets for securities, or the financial condition of
14 issuers, if such communication is not made for the personal benefit of the person
15 making the communication.

16
17 (5) The prohibitions of this Section shall not apply to any person who, while in
18 possession of material nonpublic information, acts on behalf of and with the authorization
19 of another person where the purchase, sale, or communication involved would be lawful if
20 done directly by such other person while in possession of such information.

21
22 (e) (1) Any person who violates subsection (a) or (c)(1) of this Section shall be liable in an
23 action in any court of competent jurisdiction to any person who, contemporaneously with
24 the purchase or sale of securities that forms the basis of such violation, has purchased
25 (where such violation is based on a sale of securities) or sold (where such violation is
26 based on a purchase of securities) securities of the same class. The total liability of any
27 person under this paragraph (1) shall not exceed the profit gained or loss avoided (within
28 the meaning of Section 21(d)(2)(C) of this title) as a result of such person's violations of
29 this Section.

30
31 (2) Any person (other than a person entitled to recovery under paragraph (1) of this
32 subsection) injured by a violation of this Section in connection with such person's
33 purchase or sale of securities may bring an action in any court of competent jurisdiction
34 to seek recovery of any damages caused by such violation, or for appropriate equitable
35 relief, or both.

36
37 (3) Any person who violates subsection (b) or (c)(2) of this Section shall be liable,
38 jointly and severally, with and to the same extent as any person who gained profits or
39 avoided losses (within the meaning of Section 21(d)(2)(C) of this title) as a result of
40 such violation of subsection (b) or (c)(2).

41
42 (4) No action may be brought under this subsection more than five years after the date
43 of the purchase or sale of securities that forms the basis of the violation.

44
45 **SECTION 4. AMENDMENTS TO THE INSIDER TRADING SANCTIONS ACT.**

46
47 Chapter 78 of title 15, United States Code, is amended, by deleting the words "in a manner
48 other than by communicating material nonpublic information" from the first sentence of
49 § 78u(d)(2)(B) and by striking the first two sentences of § 78u(d)(2)(A) and inserting in lieu
50 thereof the following:
51

1 Whenever it shall appear to the Commission that any person has violated Section
2 16A of this title or the rules or regulations thereunder in a transaction (i) on or through
3 the facilities of a national securities exchange or from or through a broker or dealer,
4 and (ii) which is not part of a public offering by an issuer of securities other than
5 standardized options, the Commission may bring an action in a United States district
6 court to seek, and the court shall have jurisdiction to impose, a civil penalty to be paid
7 by such person. The amount of such penalty shall be determined by the court in light of
8 the facts and circumstances, but shall not exceed three times the profit gained or loss
9 avoided as a result of the purchases or sales resulting from such violation, and shall be
10 payable into the Treasury of the United States.

11
12 **SECTION 5. AMENDMENT TO SECTION 20(d) OF THE SECURITIES EXCHANGE ACT.**

13
14 (a) Section 78t(d) of Chapter 78 of title 15, United States Code, is amended, by striking the
15 words

16
17 Whenever communicating, or purchasing or selling a security while in
18 possession of, material nonpublic information would violate, or result in liability to
19 any purchaser or seller of the security under any provision of this title, or any rule
20 or regulation thereunder, such conduct in connection with a purchase or sale of a

21
22 and inserting in lieu thereof the following:

23
24 Whenever communicating, or purchasing or selling a security while in
25 possession of, or causing the purchase or sale of a security while in possession of,
26 material nonpublic information would violate this Section, such conduct in
27 connection with a purchase or sale of a note, bond, debenture, evidence of
28 indebtedness or similar debt security of the issuer of such security (when such
29 information would be material with respect to such note, bond, debenture or similar
30 security), a security convertible into or exchangeable for such security, or a"

31
32 (b) The Securities Exchange Act of 1934 is amended by redesignating Section 20(d) as
33 Section 16A(f).

34
35 **SECTION 6. EFFECTIVE DATE.**

36
37 This Act shall take effect immediately upon enactment.
38