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Martin Goodlett

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SUBJECTIVE MATERIALITY AND THE OVER-THE-COUNTER DERIVATIVES MARKETS

INTRODUCTION

In July of 2010, the U.S. Securities and Exchange Commission (SEC) reached a settlement agreement with Goldman, Sachs & Co. (Goldman) after almost three months of negotiating and legal posturing. The deal's announcement marked one of the largest penalties in Wall Street's history, underscoring the dispute's significance both to the litigants and to the general investing public. As part of the settlement, Goldman agreed to pay $550 million, including $535 million in civil penalties. Although Goldman neither admitted nor denied wrongdoing, the firm acknowledged that it made a "mistake" by failing to disclose to investors that the third party responsible for selecting and packaging a reference portfolio of collateralized debt...
obligations (CDOs)\textsuperscript{5} was actively taking an adverse interest in the portfolio.\textsuperscript{6}

This highly publicized case quickly drew the public's attention and ire.\textsuperscript{7} Goldman, whether justly or not, had come to embody all that was wrong with Wall Street in the American public's collective conscience.\textsuperscript{8} The firm and its executives profited handsomely\textsuperscript{9} as most Americans struggled through the worst economic collapse since World War II.\textsuperscript{10} Recent homebuyers, previously fueled by cheap credit, faced foreclosures at a dizzying rate.\textsuperscript{11} Unemployment figures surged past historical averages.\textsuperscript{12} Complex, exotic financial instruments similar to those involved in the dispute between Goldman and the SEC were at the center of this economic whirlwind.\textsuperscript{13}

Upon announcing the Goldman settlement, Robert Khuzami, the SEC's director of enforcement, proudly stated that the agreement

\textsuperscript{5} A CDO is a type of derivative defined as "[a] structured finance instrument consisting of a bond or note backed by a pool of fixed-income assets." A DICTIIONARY OF FINANCE AND BANKING 86 (4th ed. 2008). A single CDO is typically comprised of several tranches, or classes, each with different risks and rights to the cash flow generated by the underlying pool of assets. See id. These underlying assets can include pools of mortgages, business loans, corporate bonds, or other derivative instruments. Raquel M. Gaspar & Thorsten Schmidt, On the Pricing of Collateralized Debt Obligations, in THE CREDIT DERIVATIVES HANDBOOK 229, 233 (Greg N. Gregoriou & Paul U. Ali eds., 2008).

\textsuperscript{6} Consent of Defendant Goldman, Sachs & Co., supra note 1, at 2.

\textsuperscript{7} See Alan Abelson, Wanna Bet?, BARRON'S, Apr. 26, 2010, at 7, 7.

\textsuperscript{8} See Stephen Davis & Jon Lukonnik, Real Story Behind Proxy Access Success, COMPLIANCE WK., Aug. 2010, at 50, 50.


\textsuperscript{11} See Carrick Mollenkamp, Subprime Resurfaces as Housing-Market Woe, WALL ST. J., July 9, 2009, at Cl.


\textsuperscript{13} FIN. CRISIS INQUIRY COMM'N, FINANCIAL CRISIS INQUIRY REPORT, at xxv (2011), available at http://www.gpoaccess.gov/fcic/fcic.pdf [hereinafter FCIC REPORT]. In its final report, the Financial Crisis Inquiry Commission stated that over-the-counter (OTC) derivative instruments such as credit default swaps and CDOs "lit and spread the flame of contagion and crisis." Id. at xxii. The use of these instruments created an opaque interconnectedness between "systemically important financial institutions," bringing about "cascading losses throughout the global financial system." Id. at xxv.
served to remind “Wall Street firms that they must deal fairly with clients, even if the product is complex or the investor sophisticated.”\textsuperscript{14} This proclamation echoes statements made by other prominent figures in the securities industry.\textsuperscript{15}

Admittedly, the assertions of Khuzami and others are correct. The U.S. Supreme Court has consistently held that determinations regarding the materiality of a statement or omission are governed by a single, objective test: the “reasonable investor” standard.\textsuperscript{16} Still, these comments seem to sidestep a more fundamental issue: Who is the reasonable investor? More specifically, do the expectations of, and demands placed on, this hypothetical investor change with his abilities and financial sophistication?

This Comment responds in the affirmative, at least with respect to over-the-counter (OTC) derivatives transactions.\textsuperscript{17} OTC derivatives markets are vastly different from the financial markets in existence during the drafting of the federal securities laws,\textsuperscript{18} and these differences necessitate a change in the judiciary’s approach to materiality. Allowing consideration of subjective factors would afford legal protection to those who need it while precluding imprudent OTC derivatives investors from using the Securities Acts as an insurance policy against their foolhardy decisions.\textsuperscript{19} It would also align the judiciary’s ex post analysis with that conducted ex ante by the contracting parties prior to entering into a transaction, creating stronger precedents for

\textsuperscript{14} Craig & Scannell, \textit{supra} note 2 (internal quotation marks omitted).


\textsuperscript{17} The term “derivative” covers a wide range of investment vehicles, but generally refers to a financial instrument with a payoff structure determined by the value of an underlying security, commodity, interest rate, or index. Fred D. Arditti, \textit{Derivatives}, at xiii (1996). Examples include futures, forward contracts, swaps, and options. Brian A. Eales & Moorad Choudhry, \textit{Derivative Instruments} 1 (2003). These investment vehicles allow investors to trade in some risk relating to the performance of a reference asset, a market price, or any other economic or natural phenomenon, often creating a completely independent trade in the reference asset’s risks or returns. Vinod Kothari, \textit{Credit Derivatives and Structured Credit Trading} 5 (rev. ed. 2009). The CDO involved in the Goldman dispute falls within this definition.

\textsuperscript{18} See \textit{FCIC Report}, \textit{supra} note 13, at xvi (“The financial system we examined bears little resemblance to that of our parents’ generation.”); Adam R. Waldman, Comment, \textit{OTC Derivatives & Systemic Risk: Innovative Finance or the Dance into the Abyss?}, 43 AM. U. L. REV. 1023, 1025 (1994) (stating that OTC derivatives have “radically altered the landscape of the global capital markets”).

\textsuperscript{19} See \textit{infra} notes 217–24 and accompanying text.
later courts and investors to follow. As a result of these benefits, the inclusion of a subjective component in materiality determinations would more faithfully uphold the principles inherent in the federal regulatory framework.

This Comment proceeds in four parts. Part II provides background information regarding OTC derivatives markets and the regulatory framework governing securities markets more generally. It examines the law as it currently stands, as well as its development, in an effort to elucidate the values underlying the current regime. Part III begins with a critique of the current objective standard of materiality and explores the issues that have arisen in the course of its application. It then advocates for the inclusion of a subjective component that accounts for the sophistication and capabilities of the parties to OTC derivatives transactions. Part IV applies the proposed standard, highlighting the benefits and drawbacks of a subjective standard. A brief conclusion follows in Part V.

II. Background

The derivatives market in which the Goldman dispute arose bears little resemblance to the traditional stock markets of the 1930s. In fact, OTC derivatives markets have little in common with the modern-day exchanges so often featured in the press. Unlike exchanges, OTC derivatives markets have no location and require no formal membership. Historically, this broad segment of the market has been largely unregulated. The SEC and the Commodity Futures Trading Commission could influence the OTC derivatives markets only indirectly, either by using "their power over the registered dealers and brokers" that also participate in the securities and futures markets or through regulating exchange-traded derivatives. A few large financial institutions dominate these markets, and the majority

20. See infra notes 213–14 and accompanying text.
21. See infra notes 25–168 and accompanying text.
22. See infra notes 169–208 and accompanying text.
23. See infra notes 209–35 and accompanying text.
24. See infra notes 236–53 and accompanying text.
26. Id.
27. Id. Although its effects are still being debated, the enactment of the Dodd-Frank Act certainly changes this. See Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (enacted).
of transactions involve a handful of firms. Participants in OTC transactions conduct bilateral negotiations, and the resultant contracts "are essentially private transactions." The nebulous structure of OTC derivatives markets creates different opportunities and risks than those of traditional exchanges. There is no "standardized" OTC derivative instrument; financial institutions tailor contracts to the needs of the given investor. The complexity spawned by such customization provides investors with the flexibility to manage many of the risks they face, but also imposes significant counterparty risk because there is no centralized clearinghouse backing the transactions. This counterparty risk is both compounded and masked by the dearth of reliable information concerning market activity. Despite the sparse, "sketchy" information available, it is undisputed that OTC derivatives markets have grown at a prolific pace. This growth has dramatically altered the structure of the financial markets and capitalism as a whole.

Even with the tectonic shift in the financial markets' structure, the regulatory framework has undergone little change. The remainder of this Part examines that framework, focusing primarily on three components: (1) federal statutes, (2) administrative rules, and (3) relevant case law. Examination of these individual pieces will both provide an understanding of the overarching structure of the current regime and elicit insights into the framework's philosophical underpinnings. But before looking at the substance of this regulatory framework, it is beneficial to look first at the historical context in

31. See id. at 325-26.
32. See id. at 332. Counterparty risk is "[t]he credit risk assumed when undertaking a transaction with another party that they will be unable or unwilling to honour their commitments." Peter Moles & Nicholas Terry, The Handbook of International Finance Terms 117 (1997). Counterparty risk is often a primary concern in OTC derivatives transactions, given the long duration and unsecured nature of many of these transactions. Waldman, supra note 18, at 1049.
33. See FCIC Report, supra note 13, at xx-xxi.
34. See Abken, supra note 30, at 328 chart 1 (containing information regarding "worldwide growth in notional principal for interest rate and currency swaps from 1987 to 1992").
35. See Edward Lipuma & Benjamin Lee, Financial Derivatives and the Globalization of Risk 161-62 (2004); see also Waldman, supra note 18, at 1025 (noting that OTC derivatives markets have "radically altered the landscape of the global capital markets").
which it developed for guidance as to the identity of the reasonable investor.

A. The Federal Securities Framework

Federal securities regulation emerged after a period of unprecedented economic distress. The nation was attempting to recover from the stock market crash of 1929 and struggling through the Great Depression. Before the crash’s onset, securities were regulated by state statutes—so-called “blue sky laws.” Under this regime, each state legislature enacted its own laws governing the issuance and trading of securities within its jurisdiction. The resulting patchwork of statutes varied not only in the classes of activities regulated, but also in the treatment of the targeted activities. Leading up to the stock market crash, the capital markets experienced a “surge of securities activity,” particularly by individuals “[t]empted by promises of ‘rags to riches’ transformations and easy credit.” Many throughout the country blamed the subsequent fall in stock prices on these speculators’ inattention to risk and on swindlers perpetrating frauds upon unwitting investors. The market’s precipitous drop served as proof of the states’ inability to address the challenges of the then-modern securities industry on their own; the increasingly interstate nature of business and the states’ limited resources undermined the efficacy of state-based regulation during difficult economic times. Soon after the crash, the call for federal action was sounded.

While the crash of 1929 crystallized the need for federal intervention, federal legislators were split as to the appropriate course of

38. Id.
39. See Louis Loss & Joel Seligman, Fundamentals of Securities Regulation 9–10 (5th ed. 2004). Generally, states adopted one of two types of blue sky laws. See Homer V. Cherrington, The Investor and the Securities Act 51 (1942). The first, and less popular, type was antifraud laws. States using this approach “refuse[d] to interfere with the flotation of any securities unless it ... appear[ed] that fraud ha[d] been or was about to be committed.” Id. at 52. The second, more restrictive type, called regulatory laws, allowed securities “to be sold in intrastate commerce only when there has been definite compliance with [the] law.” Id. at 52.
41. See id. at 52.
42. Investor’s Advocate, supra note 37.
44. Louis Loss, Securities Regulation 56–57 (1951).
45. See Soderquist, supra note 36, at 1 (“[The Securities Act] grew out of the 1929 market crash and Franklin Roosevelt’s 1932 campaign . . . .”).
action.\textsuperscript{46} Two dominant perspectives emerged: a direct, merit-based approach and an indirect, disclosure-based approach.\textsuperscript{47}

The direct approach, championed by William O. Douglas, would operate similarly to most states' blue sky laws.\textsuperscript{48} Under this approach government officials possess the authority to prevent companies from issuing public offerings that they deem "unfair, unjust, inequitable or oppressive." Proponents of this approach argued that mere disclosure would "fall[ ] far short of accomplishing its purposes"\textsuperscript{50} because investors would "either lack the training or intelligence to . . . find [the disclosed information] useful" or be so concerned with "speculative profit" that they would consider the information "irrelevant."\textsuperscript{51} These proponents also harbored concerns over the disparate burdens that a duty to disclose would impose.\textsuperscript{52} In their view, well-established corporations with widespread, diverse business operations would face greater difficulty in disclosing information than smaller, less established companies, which were more apt to swindle investors.\textsuperscript{53}

Despite these criticisms, a disclosure-based approach garnered significant support.\textsuperscript{54} Under this approach, government officials make no judgment as to the merits of a given security.\textsuperscript{55} The government's role is only to ensure that the issuer has provided the statutorily required information, thereby providing potential investors with an adequate basis from which to make an informed investment decision.\textsuperscript{56} Advocates lauded the disclosure-based system for its ability to dissuade businesses from undertaking dishonest practices previously con-

\begin{footnotes}
\item[46] Loss, supra note 44, at 76.
\item[47] See id. at 76-77.
\item[50] Loss, supra note 44, at 78.
\item[51] Id. at 79 (quoting William O. Douglas, Protecting the Investor, 23 Yale Rev. (N.S.) 521, 523-24 (1934)).
\item[52] See id.
\item[53] See id.
\item[54] Loss & Seligman, supra note 39, at 38-39.
\item[56] See Ernst & Ernst v. Hochfelder, 425 U.S. 185, 195 (1976) ("The Securities Act of 1933 was designed to provide investors with full disclosure of material information concerning public offerings of securities in commerce . . . ." (emphasis added) (citation omitted)); see also 15 U.S.C. § 77g (2006) (stating the information required in a security's registration statement); 15 U.S.C. § 781 (stating the registration requirement for securities).
\end{footnotes}
ducted away from the view of watchful eyes. As Justice Brandeis famously quipped, "Sunlight is said to be the best of disinfectants."

At the same time, proponents viewed the approach as "a minimalist form of government intervention" because investors retain the autonomy to determine how best to improve their position and are free to invest as they wished, no matter how foolish or improvident their decisions ultimately prove.

From these chief benefits would flow several corollaries. Proponents expected the additional information required under a disclosure regime to level the playing field between investors and companies issuing securities. This, in turn, was expected to instill investor confidence in the markets. Armed with additional information regarding business' prospects, investors would no longer need to rely on rumors or speculation to make investment decisions. Advocates of a disclosure-based approach therefore believed that transactions would better reflect the sum of information known regarding a security, which would also reduce the volatility of securities prices.

Hence, a disclosure-based system addressed the chief contributors of the 1929 crash and ultimately carried the day. The disclosure regime resulted in fairer, more efficient, and more stable capital markets. Companies raising capital through the markets shared in these benefits. The reciprocal benefits provided by a disclosure philosophy are captured in an SEC statement made in the course of one of its enforcement actions:

The importance of accurate and complete issuer disclosure to the integrity of the securities markets cannot be overemphasized. To the extent that investors cannot rely upon the accuracy and completeness of issuer statements, they will be less likely to invest,

58. Louis D. Brandeis, Other People's Money and How the Bankers Use It (2d ed. 1914).
59. Ripken, supra note 57, at 155.
60. Id. at 153.
61. Id. at 154; see also Ronald J. Colombo, Buy, Sell, or Hold? Analyst Fraud from Economic and Natural Law Perspectives, 73 Brook. L. Rev. 91, 120 (2007) ("Only upon such a restoration [of 'the ancient truths'], Roosevelt argued, could investor confidence, and thus capital markets, be resuscitated.").
63. Id.
64. Id.
65. See Easterbrook & Fischel, supra note 55, at 288 (stating that firms would voluntarily disclose information—to the benefit of both themselves and investors—in order to fund profitable projects in the absence of mandatory disclosure requirements).
thereby reducing the liquidity of the securities markets to the detriment of investors and issuers alike.  

Congress has incorporated disclosure requirements into many of the federal securities laws, including more recent legislation, and the disclosure paradigm has become a keystone of U.S. securities regulation. Due to materiality’s prominent position within this framework, the concept has far-reaching effects for both publicly traded corporations and investors alike.

1. The Securities Acts

The Securities Act of 1933 (1933 Act) marked the federal legislature’s first attempt to regulate the securities markets; Congress revisited its governance of the markets the following year with the Securities Exchange Act of 1934 (1934 Act). The Acts complement one another and can be viewed as interrelated, interdependent components of a single regulatory scheme. The 1933 Act governs the primary markets in which shares of securities are initially issued, generally requiring issuers to file a registration statement containing basic information regarding the company and the securities. The 1934 Act, on the other hand, focuses on the secondary markets where investors buy and sell those previously issued securities, generally im-


71. E.g., SODERQUIST, supra note 36, at 3 (referring to the Securities Exchange Act of 1934 as “the second part of the securities regulatory scheme that was contemplated as early as the 1932 Democratic campaign”); C. Steven Bradford, Following Dead Precedent: The Supreme Court’s Ill-Advised Rejection of Anticipatory Overruling, FORDHAM L. REV., Oct. 1990, at 39, 41; see also SEC v. Nat’l Sec., Inc., 393 U.S. 453, 468 (1969) (“The fact that there may well be some overlap [between the 1933 and 1934 Acts] is neither unusual nor unfortunate.”).


posing ongoing duties to report relevant information. Thus, the 1934 Act ensures that certain standards of fairness are maintained in securities markets after the shares are initially issued in accordance with the 1933 Act. Unsurprisingly, the Acts share many of the same themes, including a fundamental concern with the efficiency and fairness of the markets.

2. **Section 10(b) of the Securities Exchange Act of 1934**

While the 1933 Act marked a dramatic departure from the previous regulatory scheme, § 17 of the Act was particularly notable. As "the grandfather of all the SEC fraud provisions," § 17 broke ground as the first fraud provision "specifically tailored to the securities field." The section takes an expansive view of fraud, referring both to outright fraud as well as "material misstatements and half truths." Its reach extends beyond that of the state-enacted blue sky laws, which focused solely "on the direct relationship between specific buyers and sellers of securities," and instead seeks to address the general impact that securities fraud has on investor confidence and the market as a whole.

Congress pushed a step further by enacting § 10(b) of the 1934 Act, which empowers the SEC to prohibit and punish manipulative acts not explicitly mentioned in § 17 of the 1933 Act. Section § 10(b), considered a "catchall" provision, was designed to protect investors and promote the integrity of the securities markets by preventing fraud, manipulation, and deception in connection with the purchase or sale of a security. As the Supreme Court opined, "[I]t is hard to imagine that there ever is a buyer or seller who does not rely on mar-

74. See 15 U.S.C. § 78m (stating the periodic reporting requirements for issuers of securities); id. § 78l (stating the registration requirements of parties effecting security transactions on a national securities exchange).
77. *Loss & Seligman, supra* note 39, at 902 (internal quotation marks omitted).
78. *Id.* at 903. Prior to the enactment of the 1933 Act and § 17, the sole basis for federal prosecution was violation of the mail fraud statute. *Id.* at 901.
79. *Id.* at 903.
80. *Id.* at 919.
ket integrity." To accomplish the goals of § 10(b), the SEC has employed the provision as the “primary . . . mechanism for regulating securities fraud.”

Section 10(b) states:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or any facility of any national securities exchange—

. . . .

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

3. The Securities Exchange Commission and Rule 10b-5

The 1933 Act established a new statutory framework but left Congress needing a mechanism to enforce the new provisions. Congress first called upon the Federal Trade Commission to fulfill this role. But in light of the enactment of the 1934 Act—and the additional administrative burdens it entailed—Congress authorized the creation of the SEC.

The SEC has since sought to “to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.” These interrelated goals often form a symbiotic relationship, yet at times such broad objectives conflict with one another. It is therefore incumbent on the SEC to strike a delicate balance between these sometimes-competing interests.

The 1934 Act authorizes the SEC to develop and implement rules “as necessary or appropriate in the public interest.” Pursuant to this statutory authority, the SEC promulgated Rule 10b-5, which makes it

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85. Steinbuch, supra note 75, at 572.
88. 15 U.S.C. § 78d(a); see also LOSS & SELIGMAN, supra note 39, at 67.
89. Investor's Advocate, supra note 37.
90. Laura Simone Unger, View from the SEC—Promoting Fair and Efficient Markets as a Regulatory End, in Regulation of U.S. Equity Markets 59, 60 (Robert A. Schwartz ed., 2001) (“[I]nvestors are important to the market and the market is important to investors.”).
91. Id. (“[T]oo much regulation may . . . overly protect investors to the detriment of the marketplace.”).
unlawful to "make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading."\(^9\)

Rule 10b-5 was a direct response to the perceived inequity caused by a loophole within § 17 of the 1933 Act.\(^9\) Consequently, the Rule borrows much of its language from § 17,\(^9\) and courts have consistently interpreted the two provisions similarly.\(^9\) Rule 10b-5 has therefore taken an expansive view of fraud, and courts have applied the Rule to a wide variety of conduct.\(^9\) As the Court concluded in Superintendent of Insurance v. Bankers Life & Casualty Co., the Rule "prohibit[s] all fraudulent schemes in connection with the purchase or sale of securities, whether the artifices employed involve a garden type variety of fraud, or present a unique form of deception."\(^9\)

Given its breadth, the staggering quantity of litigation generated by Rule 10b-5 is unsurprising. Litigation under the Rule has increased since the Court first permitted investors, rather than the SEC, sue defendants directly.\(^9\) The contours of this implied right of action have waxed and waned over time. Once referred to as "a judicial oak

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94. In the course of one of its investigations, SEC staff members, looking to the language of the 1933 Act, interpreted § 17 as imposing disclosure duties upon only the seller. Sargent. supra note 73, at 4. Prompted by this inequity, the SEC put forth Rule 10b-5, thereby imposing disclosure duties on both parties. Id. The Commissioners quickly approved the Rule. The "debate" over the Rule consisted of Sumner Pike's single comment, "[W]e are against fraud aren't we?" Conference on Codification of the Federal Securities Laws, 22 Bus. Law. 793, 922 (1967) (statement of Milton V. Freeman).
96. See SEC v. Shanahan, 646 F.3d 536, 541 (8th Cir. 2011); SEC v. Wolfson, 539 F.3d 1249, 1256 (10th Cir. 2008). But see Aaron v. SEC, 446 U.S. 680 (1980) (holding that scienter is not required to prove a violation under § 17(a)(2) or § 17(a)(3) of the 1933 Act); Touche Ross & Co. v. Redington, 442 U.S. 560 (1979) (rejecting a private right of action for violations of § 17(a) of the 1934 Act).
97. See, e.g., United States v. Carpenter, 791 F.2d 1024 (2d Cir. 1986) (involving the misappropriation of insider information); Mobil Corp. v. Marathon Oil Co., 669 F.2d 366 (6th Cir. 1981) (involving unlawful manipulative practices in connection with a tender offer); Schlick v. Penn-Dixie Cement Corp., 507 F.2d 374 (2d Cir. 1974) (involving claims arising in connection with a merger).
which has grown from little more than a legislative acorn,”

more recent Supreme Court decisions have whittled away at the breadth of Rule 10b-5’s implied private right of action.

Generally, plaintiffs—whether the SEC or individual investors—must prove six elements to prevail under Rule 10b-5: (1) a material misrepresentation or omission; (2) scienter; (3) a connection with the purchase or sale of a security; (4) reliance on the material misrepresentation or omission, also known as transaction causation; (5) economic loss; and (6) loss causation.

B. Materiality Defined

While each element of a Rule 10b-5 claim raises complex issues, the requirement that a misstatement or omission be material has proved particularly troublesome. At its core, the concept of materiality is a simple one. Despite its theoretical simplicity, however, courts and practitioners have found the concept “slippery” and “elusive” when put into practice. The numerous attempts by courts and regulators to fashion a practical test or working definition have largely failed. The following discussion outlines the most prominent of those attempts and describes the resulting confusion.

1. TSC Industries, Inc. v. Northway, Inc.

The seminal case regarding the concept of materiality in securities regulation is TSC Industries, Inc. v. Northway, Inc. Northway, a corporation holding shares in TSC Industries, alleged that TSC’s proxy statement failed to adequately state the degree of an acquiring company’s control over TSC and the favorability of the terms of a proposed merger. Northway claimed that its interests were effec-

101. See, e.g., Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc., 552 U.S. 148 (2008) (holding that § 10(b)’s implied right of action does not extend to aiders and abettors); see also W. Taylor Marshall, Note, ‘Round and ‘Round We Go: The Supreme Court Again Limits the Circumstances in Which Federal Courts May Hold Secondary Actors Liable Under Section 10(B) and SEC Rule 10B-5, 31 U. Ark. Little Rock L. Rev. 197, 198 (2008) (“Beginning with the Rehnquist Court in 1972, the Supreme Court has systematically narrowed the reach of liability under section 10(b) and SEC Rule 10b-5.”).
104. Id. (citing SEC v. Bausch & Lomb Inc., 565 F.2d 8, 10 (2d Cir. 1977)).
106. Id. at 441.
tively liquidated, and it filed suit under § 14(a) of the 1934 Act and its correlative regulations.107

The Supreme Court ruled in favor of TSC, finding none of the omissions to be misleading as a matter of law.108 In doing so, the Court unanimously recognized the issue of materiality "as a mixed question of law and fact"109 that turns on the importance a reasonable person would attach to the misrepresented or omitted fact.110 The more difficult issue concerned the proper threshold for determining when a statement or omission became sufficiently material to allow for liability.111 The Court concluded that information becomes sufficiently material only when, under all the circumstances, its disclosure would raise a "substantial likelihood" that "the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder" or "would have been viewed by the reasonable investor as having significantly altered the total mix of information made available."112

The Court reached its conclusion "in view of the prophylactic purpose" of the rule at issue,113 focusing on the role materiality plays as "a critical gatekeeper"114 in filtering out irrelevant information in the decision process.115 The Court drew a sharp distinction between the quantity and quality of information disclosed,116 noting the potential for corporations to avoid liability by "bury[ing] the shareholders in an

107. Id. The regulations require proxy solicitations to include disclosure of all material facts and prohibit false or misleading statements regarding any material fact. 17 C.F.R. § 240.14a-3 (2011); 17 C.F.R. § 240.14a-9 (2011).
108. TSC Indus., Inc., 426 U.S. at 452–53.
109. Id. at 450.
110. Id. at 445.
111. See id. at 445. The Court noted that there was universal agreement that an objective view of materiality is required. Id. However, lower courts had reached differing conclusions regarding the proper threshold for determining materiality. Compare List v. Fashion Park, Inc., 340 F.2d 457, 462 (2d Cir. 1965) ("The basic test of 'materiality,' on the other hand, is whether a reasonable man would attach importance [to the fact misrepresented] in determining his choice of action in the transaction in question." (alteration in original) (internal quotation marks omitted)), with Northway, Inc. v. TSC Indus., Inc., 512 F.2d 324, 330 (7th Cir. 1975) (holding that the proper test of materiality "includes all facts which a reasonable shareholder might consider important" (emphasis added)).
112. TSC Indus., Inc., 426 U.S. at 449 (internal quotation marks omitted).
113. Id. at 448.
115. Miller, supra note 114, at 368; see also TSC Indus., Inc., 426 U.S. at 448–49.
116. See TSC Indus., Inc., 426 U.S. at 448.
avalanche of trivial information—a result that is hardly conducive to informed decisionmaking.” \(^{117}\)

After setting the threshold, the Court went on to stress the fact-specific nature of the inquiry and explained that the underlying facts are often only the beginning of the analysis. \(^{118}\) It noted that disputes may often hinge upon the inferences that a reasonable shareholder might draw from those facts and that the “delicate assessments” of inferences are best left to the trier of fact. \(^{119}\)

2. Basic Inc. v. Levinson

The Supreme Court revisited the concept of materiality in *Basic Inc. v. Levinson*, this time in the context of preliminary merger discussions. \(^{120}\) The plaintiffs alleged that Basic’s management publicly denied participating in ongoing merger discussions while actively taking part in such negotiations. \(^{121}\) The plaintiffs sold their shares after the management’s denials but before the announcement of the eventual merger. \(^{122}\) They then filed a class action suit under § 10(b) and Rule 10b-5 to recover damages resulting from the lower prices they received from their sales. \(^{123}\)

The Supreme Court’s ensuing analysis focused on two issues. First, it explicitly extended the *TSC Industries* standard of materiality to fraud suits filed under § 10(b) and Rule 10b-5. \(^{124}\) Keeping in line with that decision, the Court again emphasized the fact-sensitive nature of materiality determinations. \(^{125}\) Carrying this logic forward, the Court reasoned that designating a single fact as determinative “must necessarily be overinclusive or underinclusive.” \(^{126}\) It therefore eschewed the bright-line rule urged by Basic’s counsel and held that materiality determinations must be made “in the light of all the circumstances.” \(^{127}\)

While the Court recognized the difficulties of conducting such an all-

\(^{117}\) *Id.* at 448-49

\(^{118}\) *Id.* at 450.

\(^{119}\) *Id.*

\(^{120}\) Basic Inc. v. Levinson, 485 U.S. 224 (1988). The forward-looking, speculative nature of mergers complicates the analysis of a statement’s materiality. *See id.* at 232. These finer points of materiality fall beyond the scope of this Comment.

\(^{121}\) *Id.* at 227-28.

\(^{122}\) *Id.* at 228.

\(^{123}\) *Id.*

\(^{124}\) *Id.* at 232 (“We now expressly adopt the *TSC Industries* standard of materiality for the § 10(b) and Rule 10b-5 context.”).

\(^{125}\) *Id.* at 240.

\(^{126}\) *Basic Inc.*, 485 U.S. at 236.

\(^{127}\) *Id.* The Supreme Court recently reaffirmed this approach in *Matrixx Initiatives, Inc. v. Siracusano*, rejecting the defendant’s contention that reports of adverse events associated with a pharmaceutical company’s products are material only when provided in sufficient number to
encompassing analysis, it nevertheless stated that "ease of application alone is not an excuse for ignoring the purposes of the Securities Acts and Congress' policy decisions."\textsuperscript{128}

Second, the Supreme Court upheld the rebuttable presumption of reliance supported by the fraud-on-the-market theory.\textsuperscript{129} In reaching this conclusion, the Court relied heavily on practical considerations, such as the nature of then-modern securities markets,\textsuperscript{130} the unique difficulties of proving reliance in nondisclosure cases,\textsuperscript{131} judicial economy,\textsuperscript{132} and common sense.\textsuperscript{133} Once invoked, the presumption removes the plaintiff's burden to establish actual reliance and places the burden on the defendant to present evidence affirmatively overcoming the presumption to avoid liability.\textsuperscript{134}

3. Later Interpretations of Materiality

The apparent simplicity of these landmark cases masks the complexities lurking beneath the surface.\textsuperscript{135} As a result, both scholars and practitioners have scorned the cases not so much for what they said, but for what they did not.\textsuperscript{136} Case law after Basic has embraced con-
flicting views of materiality. Court determinations have been unpredictable, leaving many to argue that they are based on “subjective conjecture” rather than objective facts.137

a. Interaction Between Rule 10b-5’s Elements

Part of the confusion stems from the interplay between the elements of claims arising under Rule 10b-5. Particularly relevant is the interaction between the defendant’s duty to disclose (materiality) and the plaintiff’s duty to make use of that disclosure. These are, to be sure, distinct elements that implicate different policy considerations; however, some courts have interpreted the two elements in conjunction with one another.138

Of particular interest is the courts’ treatment of reliance, which “provides the requisite causal connection between a defendant’s misrepresentation and a plaintiff’s injury.”139 Most jurisdictions seek to determine whether a plaintiff’s reliance on a misstatement was “reasonable”140 or “justifiable.”141 A plaintiff’s carelessness must typically rise to a level constituting “recklessness” to fail this test.142 Similar to materiality, reasonable-reliance determinations must “be made on a case-by-case basis based on all of the surrounding circumstances.”143 Courts have offered a number of relevant factors to consider when making these determinations, but unlike materiality determinations,

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137. E.g., Sauer, supra note 103, at 319.
138. See Makor Issues & Rights, Ltd. v. Tellabs, Inc., 437 F.3d 588, 596 (7th Cir. 2006) (“The crux of materiality is whether, in context, an investor would reasonably rely on the defendant’s statement as one reflecting a consequential fact about the company.”), vacated on other grounds, 551 U.S. 308 (2007), remanded to 513 F.3d 702 (7th Cir. 2008); List v. Fashion Park, Inc., 340 F.2d 457, 462-63 (2d Cir. 1965) (noting the disagreement and confusion “concerning the meaning and applicability of ‘reliance’ and ‘materiality’”). For an interesting analysis of this interplay, see Stefan J. Padfield, Immaterial Lies: Condoning Deceit in the Name of Securities Regulation, 61 Case W. Res. L. Rev. 143 (2010).
140. See, e.g., AES Corp. v. Dow Chem. Co., 325 F.3d 174, 178 (3d Cir. 2003) (“The ‘reasonable reliance’ element of a Rule 10b-5 claim requires . . . a demonstration that the plaintiff exercised the diligence that a reasonable person under all of the circumstances would have exercised to protect his own interests.”).
142. See Brown, 991 F.2d at 1032.
143. AES Corp., 325 F.3d at 179.
the plaintiff’s financial sophistication and expertise is almost always included.144

However, not all jurisdictions follow this majority rule. For example, the U.S. Court of Appeals for the Seventh Circuit has—in at least one situation—disavowed justifiable reliance as an independent element of a Rule 10b-5 claim, viewing it instead as “no more than the combination of a material misstatement (or omission) and causation.”145 This approach appears to take a much more subjective view of reliance than the majority’s reasonable-reliance rubric, and it precludes recovery when “the investor knows enough so that the lie or omission still leaves him cognizant of the risk.”146

The U.S. Court of Appeals for the Fifth Circuit takes yet a different tack. Concerned with consistency in application, it has established a separate “due diligence” element for private Rule 10b-5 actions that explicitly adopts a subjective lens.147 Under this approach, a plaintiff’s conduct is evaluated for recklessness using a reasonable investor with the plaintiff’s attributes as the benchmark.148 Although these divergent perspectives suggest that the issue of reliance may be as fractious as materiality, virtually all jurisdictions—even those taking an objective view of reliance—account for a plaintiff’s resources and sophistication.

b. Interaction Between Elements and Evidence

Also adding to the confusion over the proper conception of materiality are issues regarding the type of evidence required to prove a Rule 10b-5 violation. The proof required to establish an element of an alleged violation is generally distinct from the element’s definition, yet these two concepts have seemingly blurred in some instances.149 Justice Alito, then-judge for the U.S. Court of Appeals for the Third Circuit, stated that “the concept of materiality translates into information that alters the price of the firm’s stock.”150 For this reason, courts

144. E.g., Banca Cremi, S.A. v. Alex, Brown & Sons, Inc., 132 F.3d 1017, 1028 (4th Cir. 1997); Brown, 991 F.2d at 1032; Molecular Technology Corp. v. Valentine, 925 F.2d 910, 918 (6th Cir. 1991); Zobrist, 708 F.2d at 1516.
146. Teamsters Local 282 Pension Trust Fund v. Angelos, 762 F.2d 522, 530 (7th Cir. 1985).
148. Id.
149. See Herman v. T & S Commodities, Inc., 592 F. Supp. 1406, 1416 (S.D.N.Y. 1984) (holding that a piece of information was material because of the market reaction elicited by its disclosure).
150. Oran v. Stafford, 226 F.3d 275, 282 (3d Cir. 2000) (quoting In re Burlington Coat Factory Sec. Litig., 114 F.3d 1410, 1425 (3d Cir. 1997)). Like the fraud-on-the-market theory employed
and litigants have looked to the market's reaction as persuasive evidence of the materiality of a given piece of information.\textsuperscript{151}

This objective approach looks beyond the litigants at bar and considers the view of the market as a whole. Given the dominant role of institutional investors in modern securities markets,\textsuperscript{152} some might argue that the objective approach necessarily incorporates the views of sophisticated investors. In many circumstances, however, this technique is unavailing due to practical difficulties that may preclude its use.\textsuperscript{153} Courts have therefore relied on other presumptions and procedural tools to supplement their analyses.\textsuperscript{154} Often times, these tools have provided conflicting guidance without articulating a coherent legal principle to distinguish cases or their treatment.

For example, in \textit{SEC v. Shapiro}, the U.S. Court of Appeals for the Second Circuit held undisclosed information to be material because the defendant, a financially sophisticated investor accused of illegally trading on inside information, invested soon after receiving the allegedly material information.\textsuperscript{155} In another case, \textit{SEC v. Mayhew}, the Second Circuit stated that a major consideration in determining the

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\textsuperscript{151} See, e.g., \textit{Oran}, 226 F.3d at 282.


\textsuperscript{153} See \textit{Sauer}, \textit{supra} note 103, at 324–25. Evidence of the market's reaction may be unavailable or difficult to interpret due to the timeliness or form of the disclosure. \textit{Id.} at 324. Additionally, the dynamics of the market may render it difficult or impossible to isolate the effect of the relevant disclosure from the "background noise" of the market. \textit{Id.} at 325. Furthermore, this category of evidence is only available ex post and is therefore of no assistance in determining whether or not to disclose information ex ante. \textit{Lee}, \textit{supra} note 115, at 664.

\textsuperscript{154} See, e.g., \textit{SEC v. Mayhew}, 121 F.3d 44, 52 (2d Cir. 1997) (finding materiality because of the importance attached to the information by the defendant); \textit{SEC v. Shapiro}, 494 F.2d 1301, 1307 (2d Cir. 1974) (same).

\textsuperscript{155} \textit{Shapiro}, 494 F.2d at 1307 ("But we need not merely speculate as to how a reasonable investor might have received this information. The behavior of appellant, his partner Shapiro, and others who knew of the merger, all of whom were sophisticated investors, demonstrates empirically that the information was material.").
materiality of information "is the importance attached to it by those who knew about it." While these notions may make intuitive sense, seeking to uncover the defendant's interpretation of the information through his actions adds a subjective aspect to materiality.

But not all cases consider such subjective factors; the Supreme Court's acceptance of the fraud-on-the-market theory in Basic Inc. is a prime example. Prior to the rebuttable presumption of reliance supported by the fraud-on-the-market theory, plaintiffs were forced to prove actual, subjective reliance on the alleged misrepresentation or omission. Acceptance of the fraud-on-the-market theory waives this requirement. Thus, once a plaintiff raises the presumption of reliance, both reliance and materiality become completely objective inquiries.

c. Staff Accounting Bulletin No. 99

Perhaps sensing the confusion of judges, attorneys, and executives across the nation, the SEC released Staff Accounting Bulletin No. 99 (SAB No. 99) in 1999. Despite only mimicking the standard accounting and auditing procedures already prevalent at the time, the SEC's pronouncement has become critical to the analysis of qualita-

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156. Mayhew, 121 F.3d at 52. Even this method is not a perfect guide to determine objective materiality. For example, under the "mosaic theory," a relatively insignificant fact may become material by way of the investor's extensive knowledge or familiarity with the security. See Elkind v. Liggett & Myers, Inc., 635 F.2d 156, 165 (2d Cir. 1980).

157. See Basic Inc. v. Levinson, 485 U.S. 224, 245 (1988) (upholding the presumption of reliance supported by the fraud-on-the-market theory employed by the district court).

158. See Guerra v. Teradyne Inc., No. 01-11789-NG, 2004 U.S. Dist. LEXIS 28548, at *13 n.3 (D. Mass. Jan. 16, 2004) ("There is no longer any requirement that 'reliance' be directly pleaded in a 'fraud on the market' claim . . ."); Rand v. Monsanto Co., No. 85 C 9087, 1989 U.S. Dist. LEXIS 2936, at *14 (N.D. Ill. Mar. 22, 1989) ("It is no longer the law that a plaintiff must show actual reliance on fraudulent statements in order to prevail under the fraud-on-the-market theory . . ."). Even before the Supreme Court accepted the presumption of reliance in Basic Inc., it had previously waived specific proof of reliance when there was an omission of a material fact by one with a duty to disclose. Affiliated Ute Citizens of Utah v. United States, 406 U.S. 128, 153–54 (1972).

159. See Basic Inc., 485 U.S. at 245.


162. See id. at 45,152 n.14 (stating that SAB No. 99 "is not intended to change current law or guidance in the accounting literature").
tive materiality. Similar to the Basic decision, it cautions against exclusive reliance on quantitative measurements or bright-line tests when making materiality determinations, even stating that potential market reaction to a disclosure is "too blunt an instrument to be depended on." According to SAB No. 99, materiality is too nuanced a concept to "be reduced to a numerical formula" and must "take into account all the considerations that enter into an experienced human judgment." A misstatement could have a larger impact on an investor's decision-making process than its quantitatively small size would indicate because of qualitative factors not captured by numerical calculations. For example, a relatively minor misstatement may mask sales trends or conceal problems with loan covenants regarding a company's financial condition. Finally, SAB No. 99 states that management's intent does not necessarily make a statement material, but "may provide significant evidence of [the statement's] materiality."  

III. Analysis

The tension in defining materiality highlights an area of the law that remains, for lack of a better description, in a state of "disarray." The reasoning and dispositions of cases have been inconsistent and have failed to articulate a cohesive framework to analyze future cases. Critics deride "objective" determinations of materiality as "exercise[s] in subjective projection by the trier of fact." This Comment advocates for the consideration of the parties' sophistication in materiality determinations in the OTC derivatives markets. This subjective approach would provide disclosing parties much-needed guidance regarding the disclosure of information and would provide courts with a cogent framework for analyzing issues while supporting the goals of the Securities Acts.

163. Sauer, supra note 103, at 336. Unlike quantitative materiality, which utilizes benchmarks of assets, earnings, and liabilities, a qualitative standard of materiality measures disclosure decisions based on amorphous factors such as quality, kind, essential character, or conduct. Fedders, supra note 136, at 41.


165. Id. at 45,151.

166. Id. at 45,152 ("Qualitative factors may cause misstatements of quantitatively small amounts to be material.").

167. Id.

168. Id.


170. Sauer, supra note 103, at 321.
This Part begins with a brief hypothetical that demonstrates the pitfalls of a purely objective standard of materiality. It first examines a key assumption underlying the objective standard, concluding that such a justification is insufficient to preclude an inquiry of subjective considerations. The second section analyzes the issues arising from case law addressing the issue of materiality. The third section proposes the inclusion of a subjective element in materiality determinations arising from OTC derivatives transactions, allowing courts to consider the financial sophistication and resources of the transacting parties. This Part concludes by analogizing the proposed materiality standard to trust law's "prudent investor" rule.

A. Materiality in Theory

Using materiality to delineate information that must be disclosed from information that need not be disclosed is well reasoned and has a firm basis in economics.\(^{171}\) Distinguishing between material and non-material information increases efficiency by reducing contracting parties' transaction costs.\(^{172}\) Assuming that an issuer is better positioned to know its own general affairs and future prospects, requiring it to disclose material information obviates the need for investors to incur higher costs to obtain this information.\(^{173}\) Furthermore, limiting the disclosure requirement to only material information reduces the costs to both the investor and the issuer.\(^{174}\) The investor saves the time and cost of sifting through piles of inconsequential information; the issuer avoids the costs of compiling or disseminating information of little or no marginal benefit to investors.

An abstract conception of materiality, while sound in theory, can pose problems when applied to concrete cases. The drawbacks of such an approach may be best illustrated by the following example: Consider two equity investors, one implementing a value-based investment strategy\(^{175}\) and the other implementing a growth-oriented in-

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\(^{171}\) But see Easterbrook & Fischel, supra note 55, at 280–83 (describing the likely functioning of financial markets without disclosure requirements).


\(^{173}\) Easterbrook & Fischel, supra note 55, at 280 (“Firms that promise to make disclosures for [the purpose of reducing the cost of holding the stock] will prosper relative to others, because their investors will incur relatively lower costs and can be more passive with safety.”).


\(^{175}\) Value investors generally seek to invest in "cheap" companies valued at a discount to their true worth. See Frank K. Reilly & Keith C. Brown, Investment Analysis and Port-
vestment strategy.\textsuperscript{176} Because these investors use different criteria to make investment decisions, one investor may legitimately assign greater importance to a particular piece of information than the other investor. This leaves open the possibility that one investor will deem the information material, while the other does not. Assuming that there can only be one standard of materiality, as the reasonable investor standard does, a court may be forced to determine which investor’s assignment is correct. The strict objectivity of the reasonable investor standard, however, is unresponsive to this dilemma.\textsuperscript{177} Simply presuming both investors to be reasonable does not provide a principled basis for reconciling the differences between these investors’ viewpoints.\textsuperscript{178}

\textbf{B. Investors’ Informational Needs}

Fundamental to the reasonable investor standard’s coherence is an implicit assumption that all investors are identical—or should be treated as such. As the Second Circuit stated in \textit{SEC v. Texas Gulf Sulfur Co.}, “Speculators and chartists of Wall and Bay Streets are also ‘reasonable’ investors entitled to the same legal protection afforded conservative traders.”\textsuperscript{179} Other courts have offered similar sentiments.\textsuperscript{180} This position seems rooted in the notion of fundamental

\textsuperscript{176} Growth-oriented investors generally seek to invest in companies expected to grow at a rate exceeding that of the general market. See \textit{Lawrence J. Gitman & Michael D. Joehnk, Fundamentals of Investing} 202 (1981). They are focused primarily on a company’s earnings and its economic determinants. \textit{Reilly \& Brown, supra} note 175, at 909. Attractive companies are generally in the earlier stages of their life cycle and are often quite profitable. See \textit{Francis, supra} note 175, at 570–72 (explaining the general arc of a company’s life using the life-cycle theory). Because these companies need to finance their future growth, earnings are typically reinvested in the company rather than paid to shareholders. \textit{Nancy L. Jacob \& R. Richardson Pettit, Investments} 418 (2d ed. 1988).

\textsuperscript{177} See \textit{Sauer, supra} note 103, at 321 (stating that the “reasonable investor” standard offers “no guidance as to how to obtain the views of that hypothetical being”).

\textsuperscript{178} See \textit{id.} (“Absent clear and often unavailable evidence as to how actual investors evaluated the information at issue, defining the reasonable investor becomes an exercise in subjective projection by the trier of fact.”).

\textsuperscript{179} \textit{SEC v. Tex. Gulf Sulphur Co.}, 401 F.2d 833, 849 (2d Cir. 1968).

fairness and the jurisprudential principle that like cases should be treated alike. While the conclusion drawn from the nebulous concept of equality has enjoyed widespread acceptance, its underlying justification is unpersuasive when applied to OTC derivatives markets.

There is no need to assume that investors are identical or have the same informational needs. As one scholar noted, "[I]nvestors are not homogeneous." It is widely acknowledged "that the range of potentially material information is somewhat broader in the voting than in the investment context." Differences in circumstances need not be drastic to highlight the rule's shortcomings. The relative importance of a single piece of information may change based on the investor's investment strategy or the disclosing entity's industry, market sector, or position in its life cycle. Not only are these distinctions limitless, they are also fluid and may change over time. Materiality, much like beauty, lies in the eye of the beholder.

This suggests that the Court's implicit premise that a single standard of materiality must govern all securities transactions should be rejected. Indeed, both Congress and the courts have found room to draw distinctions between investors in other areas of securities law. Examples can be found in the Court's interpretation of § 4(2) of the 1933 Act and in the treatment of accredited investors and qualified institutional buyers.

1. Private Offerings

Section 4(2) of the 1933 Act exempts "transactions by any issuer not involving any public offering" from its general registration requirements. Because the Act fails to provide guidance in defining a

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185. See infra notes 188-203 and accompanying text.
187. See 17 C.F.R. § 230.501(a) (2011) (defining an accredited investor); id. § 230.144A(a) (defining a qualified institutional buyer).
"public offering," courts have interpreted the section with an eye toward the provision's statutory purpose. In SEC v. Ralston Purina Co., the Supreme Court stated that the availability of § 4(2)'s exemption ultimately turns "on whether the particular class of persons affected needs the protection of the Act." Accordingly, it focused "on the need of the offerees for the protections afforded by registration." Transactions involving "those who are shown to be able to fend for themselves" fall beyond the boundaries of a public offering and are exempted from the attendant registration requirements. The Ralston Purina Court cited investor sophistication and access to information as two factors to consider when determining whether a plaintiff is able to fend for herself.

Subsequent cases have clarified the appropriate role of investor sophistication in this context. For example, the U.S. Court of Appeals for the Fifth Circuit held that general sophistication is necessary but insufficient by itself to justify exemption. The U.S. Court of Appeals for the Fourth Circuit has similarly held that

sophistication is not a substitute for access to the kind of information which registration would disclose. . . . A purchaser of unregistered stock must be shown to have been in a position to acquire [detailed knowledge of the company and its affairs to make possible an informed investment decision] about the issuer.

2. Accredited Investors and Qualified Institutional Buyers

"Accredited investor" and "qualified institutional buyer" provisions also draw distinctions based on financial sophistication. Although individual investors may qualify by meeting certain net worth or income

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189. E.g., Garfield v. Strain, 320 F.2d 116, 119 (10th Cir. 1963).
192. Id. at 127.
193. Id. at 125.
194. See id. at 125-26.
196. Hill York Corp., 448 F.2d at 690; Mason v. Marshall, 412 F. Supp. 294, 300 (N.D. Tex. 1974) ("[T]he exemption is not dependent on the sophistication of the offerees but whether they had access to all of the information which a registration statement would have provided.").
197. United States v. Custer Channel Wing Corp., 376 F.2d 675, 678 (4th Cir. 1967) (citations omitted) (internal quotation marks omitted).
requirements,198 accredited investors are typically sophisticated financial institutions.199 Accredited investors operate in the financial markets with fewer restrictions than ordinary investors, but they also operate with diminished protections.200 Federal regulations presume these investors possess sufficient financial knowledge and business experience to adequately evaluate the risks and merits of prospective investments without legal intervention.

The requirements to be considered a qualified institutional buyer are even more restrictive than those for an accredited investor.201 To be a qualified institutional buyer, an entity must be of a specific type and own and invest at least $100 million in securities on a discretionary basis.202 Once an entity becomes a qualified institutional buyer, it has greater access to capital and the trading markets, and it may participate in transactions unavailable to ordinary investors.203

The logic behind these statutory exceptions is apparent—these investors are able to fend for themselves and therefore do not require statutory protection to effectively guard their interests. The exceptions demonstrate the willingness of Congress and the judiciary to recognize differences between investors on the basis of their sophistication, discrediting the courts' insistence that all investors are entitled to the same legal protection. Although these exceptions may seem insignificant in relation to the total number of participants in the financial markets, their underlying reasoning is far from trivial and carries equal force in the context of materiality determinations.

The exceptions do, however, raise questions regarding the appropriate conception of investor sophistication. Investors may qualify as accredited investors or qualified institutional buyers based solely on

198. "Any natural person whose individual net worth, or joint net worth with that person's spouse" exceeds $1,000,000 at the time of purchase is considered an accredited investor. 17 C.F.R. § 230.501(a)(5) (2011). "Any natural person who had an individual income in excess of $200,000 . . . or joint income with that person's spouse in excess of $300,000 in each of [the two most recent years]" would qualify as an accredited investor. Id. § 230.501(a)(6).
199. See id. § 230.501(a)(1)–(8) (listing banks, registered brokers and dealers, insurance companies, investment companies, certain governmental or private employee-benefit plans, and some business trusts or partnerships as entities that may qualify as accredited investors).
200. Regulations provide a safe harbor for Section 4(2)'s registration requirements so long as the unregistered securities are offered to thirty-five or fewer unaccredited investors. Id. § 230.506(b)(2)(i). No corresponding limit is posed on similar sales to accredited investors. Additionally, if an issuer sells stock to unaccredited purchasers, it must provide information, such as audited financial statements, to the purchaser. Id. § 230.502(b)(1).
201. See id. § 230.144A(a)(1) (defining qualified institutional buyer).
202. Id. § 230.144A(a)(1)(i).
203. See id. § 230.144A(d). Qualified institutional buyers may purchase shares of unregistered securities if the offer is made only to qualified institutional buyers or those reasonably thought by the offeror to be qualified institutional buyers. Id. § 230.144A(d)(1).
their indicia of sophistication, rather than their actual level of sophistication. Such investors thereby gain their statutory sophistication simply by virtue of their wealth.

Thus, there are two possible methods to account for investor sophistication. The strict, rule-based approach displayed by the accredited investor and qualified institutional buyer provisions is easy to administer and creates easily discernable guidelines demarcating the boundaries of sophistication. This allows parties to better structure their conduct in light of their expected treatment by the law. However, this indirect approach runs contrary to the principles of Basic and SAB No. 99; namely, that any boundary, even if tightly drawn, would likely be both overinclusive and underinclusive. When put into practice, it would afford protection to investors who do not need it and deny it to those who do.

The direct approach used in Ralston Purina—which looks to the investors' actual sophistication—may better reflect the dynamics of financial transactions and more faithfully uphold the intent of Congress. This approach, however, may reduce the ability of parties to foresee the expected legal consequences of their actions and plan accordingly. The fine-grain analysis may also require substantial administrative and judicial resources.

C. The Inclusion of Subjective Considerations

The purely objective standard suffers from pitfalls when put into practice. Case law concerning materiality has been wildly inconsistent. At least one commentator has attributed the doctrinal confusion to courts' manipulation of materiality. According to this argument, judges use materiality as a "safety valve" to alleviate administrative concerns and discourage claims they deem as nonmeritorious, rather than to define the scope of conduct giving rise to liability. This Comment credits that broad contention, but takes issue with a much narrower point. It submits that the doctrinal inconsistency is borne not from the inclusion of policy concerns, but from the lack of a framework with which to evaluate such considerations. This point is explored in the following subsections.

204. See 17 C.F.R. § 230.501(a) (stating the requirements to be considered an accredited investor); id. § 230.144A(a) (stating the requirements to be considered a qualified institutional buyer).
205. Basic Inc. v. Levinson, 485 U.S. 224, 236 (1988); accord SAB No. 99, supra note 162, at 45.151 (cautioning against exclusive reliance on bright-line rules).
206. See supra notes 105–159 and accompanying text.
207. Padfield, supra note 138, at 146–47.
208. Id. at 147.
1. A Stronger Positive Impact

Courts have routinely looked to policy considerations when interpreting the securities laws, often doing so conspicuously and explicitly.209 This alone gives no reason for pause. The problem, at least in relation to materiality, is that courts have no framework with which to incorporate such policy concerns in their analyses. Judges are left to make materiality determinations using little more than their personal beliefs, many of which may not comport with the principles of the Securities Acts. The lack of coherence in the resulting case law should come as no surprise. A simple, straightforward solution is to establish guideposts to which courts can orient their analyses. Allowing courts to consider the financial sophistication and resources of the transacting parties in OTC derivates transactions would provide such guidance.

The only “guidance” the current test provides to courts is to consider the information within the “totality of the circumstances.” Such decisions are notoriously difficult to make,210 primarily because, as one court candidly admitted, “no one knows what moves or does not move the mythical ‘average prudent investor.’”211 Consequently, materiality determinations are often of such an ad hoc, haphazard nature that they provide little guidance to future courts and have limited precedential value for later decisions.212

Including a subjective component to materiality would obviate the need to divine characteristics of the hypothetical “reasonable investor” and would provide a concrete factor for courts to consider: the characteristics of the investor receiving or in need of the information. This would constrain the unbridled discretion of a court in applying a totality of the circumstances analysis. No longer would judges, animated only by their personal biases or viewpoints, be able to preclude a trier of fact from considering the importance of the misrepresented or omitted information.213 Instead, its analysis would be limited to the facts presented to the court. At the same time, future

212. Sauer, supra note 103, at 319.
213. Some rightly find judges’ ability to keep materiality determinations from juries particularly troubling, given the Supreme Court’s emphasis on the fact-sensitive nature of materiality determinations.
courts could be confident that past materiality determinations were based solely on legitimate considerations, thereby increasing their precedential value.

But courts are not the only parties to reap the benefits of the additional guidance that including a subjective component would provide. Executives and corporate counsel, faced with the daunting decision of whether or not to disclose information, also struggle to grasp the concept of materiality. With the inclusion of a subjective standard, such parties could inform their decisions with meaningful precedents set by past materiality determinations, which would likely bring a degree of certainty to predictions regarding the legal implications of their disclosure decisions. To the extent that a situation involves novel circumstances, corporate counsel would be comforted by the fact that their ex ante analysis will closely mirror that undertaken by the court ex post. When making their respective materiality determinations, both parties would be looking to the plaintiff's characteristics, thereby helping counsel navigate through uncharted waters.

2. Administrative Concerns

Courts and investors could likely reap these benefits at little additional expense. Admittedly, facts concerning a plaintiff's resources and financial expertise would undoubtedly be made relevant to materiality determinations under a subjective approach, which could potentially increase the costs of discovery and expend judicial resources when used in trials. Many of these same facts, however, are already considered in connection with the other elements of a Rule 10b-5 claim, particularly that of reliance. Virtually all courts—even those not using the majority's reasonable- or justifiable-reliance rubric—have explicitly acknowledged that a plaintiff's "sophistication and expertise" are factors to consider when determining whether gauging a plaintiff's reliance on an alleged misrepresentation. It is therefore


215. A party would have to assess the sophistication of its counterpart before availing itself of the reduced disclosure requirement under a subjective standard. This inquiry would likely come at some cost to the investor. Under the standard proposed by this Comment, the investor could still forego this analysis and have its disclosure decisions subjected to the current objective standard. See discussion infra Part III.D. More to the point, Basic stands for the proposition that Congress's clearly manifested policy decisions trump concerns over judicial administration.

216. E.g., Teamsters Local 282 Pension Trust Fund v. Angelos, 762 F.2d 522, 530 (7th Cir. 1985); G. A. Thompson & Co. v. Partridge, 636 F.2d 945, 955 (5th Cir. 1981).
unlikely that a subjective formulation of materiality would significantly expand the scope of discovery or issues contested at trial by courts in these jurisdictions. Thus, concern of potentially increasing the duration or cost of securities litigation is likely overblown.

3. **Subjective Materiality in OTC Derivatives Markets**

The OTC derivatives markets, which foster the trading of customizable instruments through negotiation, seem to be an appropriate forum for the inclusion of a subjective component. Because of the limited number of parties involved in a transaction, investors may feasibly engage in a more tailored analysis of their counterparty's sophistication. The same cannot be said of traditional disclosure settings, such as proxy solicitations, when disclosures are simultaneously distributed to millions of investors.

The prevalence of sophisticated, institutional investors also counsels in favor of including a subject component of materiality in OTC derivatives markets transactions. Courts are clearly reticent to leave defenseless investors without the protection afforded by the Securities Acts, as shown by courts holding that the presence of a single unsophisticated offeree precludes the protection of § 4(2)'s exemption.\(^{217}\) It may well be true that the Securities Acts protect "[l]arge as well as small investors,"\(^{218}\) but this concern for the fundamental fairness of the markets carries with it an important qualification: the protections of the Securities Acts will be available to investors only so long as they need them. The Acts exhibit Congress's desire "to protect investors who do not have access to inside information and who are not in a position to protect themselves from fraud."\(^{219}\) Financial expertise bears directly on an investor's need for such protection, and the majority of OTC derivatives investors possess the resources to conduct thorough due diligence of potential risks without governmental intervention.

This is not to say that the composition and characteristics of OTC derivatives markets fundamentally alter the policy values embodied in

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217. See SEC v. Universal Major Indus. Corp., [1975–1976 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,229 at 98,211 ("[D]efendant failed to establish that all of those who purchased UMI common stock or received stock for value belonged to a class of persons who could `fend' for themselves."); SEC v. Murphy, 626 F.2d 633, 645 (9th Cir. 1980) ("The party claiming the exemption must show that it is met not only with respect to each purchaser, but also with respect to each offeree." (citing Lively v. Hirschfeld, 440 F.2d 631, 633 (10th Cir. 1971))).


the Securities Acts; rather, the relative absence of unsophisticated investors may alter the application of such policy considerations. As a general proposition, courts have routinely stated that a fundamental purpose of their enactment was "to substitute a philosophy of full disclosure for the philosophy of caveat emptor."220 Yet, President Franklin D. Roosevelt's message to Congress provides a more complete articulation of the nuanced motivations prompting the enactment of the Securities Acts:

This proposal adds to the ancient rule of caveat emptor, the further doctrine, "Let the seller also beware." It puts the burden of telling the whole truth on the seller. It should give impetus to honest dealing in securities and thereby bring back public confidence.

The purpose of the legislation I suggest is to protect the public with the least possible interference to honest business.221

These comments suggest that obligations rest with both parties to a transaction, placing recipients and disclosing parties on level ground only with respect to facts.222 This was done, however, to provide an equal footing from which parties may arrive at independent conclusions regarding a security's attractiveness.223

One investor's failure to adequately consider the risks of a security does not implicate the interests protected by the Securities Acts. As the Ninth Circuit stated, "The purpose of the [1934] Act is to protect the innocent investor, not one who loses his innocence and then waits to see how his investment turns out before he decides to invoke the provisions of the Act."224 The best way to distinguish between these two hypothetical investors is to look to the parties' sophistication and the resources they employed or were capable of employing in making their investment decision.

221. 77 CONG. REC. 937 (1933) (message from President Franklin D. Roosevelt).
222. See 17 C.F.R. § 240.10b-5 (2011) ("It shall be unlawful for any person . . . to make any untrue statement of a material fact or to omit to state a material fact . . . ." (emphasis added)).
223. From an economic perspective, the stock market may be viewed as a pricing mechanism, allowing shareholders to accurately assess the value of the shares they own. Louis Lowenstein, Pruning Deadwood in Hostile Takeovers: A Proposal for Legislation, 83 COLUM. L. REV. 249, 254 (1983). The different perspectives, and the conclusions that they produce, may better reflect all information in the market than a single viewpoint held by all investors. See Rana Foroohar, Uncertainty? Don't Be So Sure, TIME, Oct. 31, 2011, at 28. Capturing these perspectives would improve the functioning of the market and better allow shareholders to determine the value of their investment.
D. The Prudent Investor Rule: A Working Example

This Comment proposes a framework for materiality determinations in OTC derivatives markets analogous to trust law’s prudent investor rule, which requires trustees to “manage the funds of the trust as a prudent investor would.” The Restatement (Third) of Trusts measures trustees objectively while still taking into account a trustee’s characteristics and abilities. Additionally, those with “a degree of skill greater than that of an individual of ordinary intelligence” must make use of those extraordinary skills.

The standard of materiality advocated in this Comment would impose a similar framework for disclosure decisions in the OTC derivatives markets. The objective standard limits the amount of disclosure required, regardless of the counterparty’s actual financial sophistication. Recipients of disclosures are encouraged to undertake the appropriate due diligence before making investment decisions because the failure to do so will preclude recovery. If strictly applied by courts, the current approach allows sophisticated institutional investors with greater resources and expertise to recover for failing to make use of skills that exceed those of the ordinary investor, thereby discouraging the full utilization of their expertise. The proposed standard would relieve defendants from liability when plaintiffs (the recipients of disclosures) fail to perform due diligence commensurate with their sophistication and expertise.

225. See Restatement (Third) of Trusts § 90 (2007). The genesis of the prudent investor rule comes from dicta in Harvard College v. Amory, an 1830 decision from the Supreme Judicial Court of Massachusetts. See 26 Mass. (9 Pick.) 446, 461 (1830); see also Paul G. Haskell, The Prudent Person Rule for Trustee Investment and Modern Portfolio Theory, 69 N.C. L. Rev. 87, 88 (1990). The prudent investor rule has undergone a shift toward a more liberal, fact-specific standard with the publication of the Restatement (Third) of Trusts. See Edward C. Halbach, Jr., Trust Investment Law in the Third Restatement, 77 Iowa L. Rev. 1151, 1155 (1992) (stating that the “modest reformulation” of the prudent investor rule in the Restatement (Third) was meant to return Harvard College’s “intended generality and flexibility”).


227. See id. § 90 cmt. d.

228. Id.; see also Shriners Hosps. for Crippled Children v. Gardiner, 733 P.2d 1110, 1112 (Ariz. 1987) (“The standard of care required, however, is measured objectively. The trustee must be reasonable in her delegation.” (citation omitted)).

229. Restatement (Third) of Trusts § 90 cmt. d (2007); see also Coberly v. Superior Court of L.A. Cnty., 42 Cal. Rptr. 64, 67 (Dist. Ct. App. 1965) (“Trustees are bound to use such talents as they possess.”)

Comparing the reasonable investor rule of securities law with the prudent investor rule of trust law leads to a paradoxical result. As the law currently stands, a financially sophisticated plaintiff alleging a failure to disclose material information in an arms-length transaction—where no fiduciary duty exists between parties—is more likely to recover than an unsophisticated beneficiary claiming violations by a trustee. The law has no problem requiring a trustee to make reasonable use of his talents, but fails to require the same of investors seeking the protection of the Securities Acts.

Admittedly, the additional duties imposed by the Restatement (Third) are rooted in the nature of the trustee’s fiduciary relationship with the beneficiary. However, the Restatement’s position is also buttressed by “sound policy.” Encouraging investors to make full use of their abilities in assessing the risks they undertake surely falls within the bounds of sound policy, especially when considering the systemic risks created by OTC derivatives products. The drafters of the Securities Acts, having just gone through the 1929 crash, showed tremendous concern for the efficiency and stability of the financial markets. The most recent financial crisis should provide the judiciary the same acute awareness.

Finally, trust law’s updated prudent investor rule also demonstrates that a newer, liberalized standard is workable. The National Conference of Commissioners on Uniform State Laws, building from the principles enshrined in the Restatement (Third), drafted a modernized Uniform Prudent Investor Act (UPIA). The updated UPIA adopts the two-tiered framework discussed above, and thus far, over forty states have enacted the UPIA in whole or significant part. This widespread acceptance lends support to the standard that this Comment proposes for materiality determinations in disputes arising from OTC derivatives markets.

IV. Impact

The litigation involving Goldman is unlikely to be an isolated event. Not long after Goldman reached its settlement agreement with the SEC, Citigroup Inc. “agreed to pay $75 million to settle SEC charges

231. See Restatement (Third) of Trusts § 90 cmt. d (2007).
232. Id.
233. Kristen N. Johnson, Things Fall Apart: Regulating the Credit Default Swap Commons, 82 Colo. L. Rev. 167, 190 (2011).
of understating its subprime exposure in response to investors.”

A wave of possible litigation related to allegedly fraudulent business practices has loomed large in the wake of the most recent financial crisis. As famed investor Warren Buffett stated, “It’s only when the tide goes out that you learn who’s been swimming naked.”

One of the largest issuers of mortgage-backed CDOs during the financial meltdown was Deutsche Bank (Deutsche). Much like Goldman, Deutsche sold the mortgage-backed CDOs it created to some of its clients while advising others to bet against the housing market and doing the same with its own accounts. One client taking issue with this practice was M&T Bank Corp. (M&T), which purchased $82 million of CDOs from Deutsche in March 2007. Little more than a year later, the value of M&T’s investment had dropped by more than ninety-five percent. In response to its losses, M&T filed suit under multiple theories, alleging that Deutsche wrongfully stated that the bonds’ “underlying structures [were] built to withstand adverse conditions.” It also alleged that Deutsche was aware of the issues with its underwriting standards and had withheld that information from the credit-rating agencies. Deutsche, however, maintained that it had clearly warned that the underlying assets to which the CDOs were referenced were of poor quality.

Deutsche’s alleged conduct, if proved at trial, could constitute at least two violations of federal securities laws; its assurances of the soundness and safety of the CDOs’ underlying portfolio could be a material misrepresentation, and its failure to inform M&T of its deteriorated underwriting standards could be a material omission. Assuming that the court accepted M&T’s allegations, it would then delve into the materiality of the information.

Taking an objective view of Deutsche’s misrepresentation, the information would almost certainly be material. The risk undertaken in

237. See Hodgson & Nissen, supra note 3.
239. See Mollenkamp & Ng, supra note 236.
240. Id.
242. Id.
243. Id.
244. Id.
245. Id. at *10 (Sup. Ct. Apr. 7, 2009).
246. Id. at *11.
247. Id. at *13.
exchange for potential profits lies at the heart of any investment decision. It would therefore be reasonable for an investor to use an assessment of the risk made by the party responsible for creating the investment product to guide his course of action. In the language of *TSC Industries* and *Basic*, such assurances would likely be viewed "as having significantly altered the total mix of information made available."247

The result is less clear under a subjective approach and would likely depend on any other information made available at the time the contract was entered. The plaintiff's complaint notes the "overwhelming emphasis" Deutche's preliminary circular placed on the rating agency's assessment of the portfolio's relative safety and low risk.248 Assuming the agency's findings were accurately described in the circular and were arrived at independently, the alleged misrepresentations could be immaterial. If M&T had access to the relevant information regarding the underlying portfolio of mortgages, it would be more difficult to argue that the independent ratings altered the total mix of information available to M&T. The company would have been able to arrive at its own conclusion regarding the value and prospects of the portfolio, just as Deutsche did. M&T's failure to adequately engage in this analysis may preclude it from recovering under a subjective analysis. If this information were not available to M&T, it would have an easier time demonstrating that the ratings included in the circular significantly altered the mix of available information.

This example highlights the need for a fully developed factual record. It also demonstrates one possible drawback of a subjective approach. Looking to the total mix of information made available to the specific plaintiff may still require courts to assess some inferences created by the facts. Even extensive discovery may fail to uncover all of the information relevant to a plaintiff's investment process and the factors weighed in making its decision. Courts, given the benefit of hindsight, may overstate the effectiveness of due diligence in uncovering all of the information to make an informed investment decision, just as the signs of the impending financial crisis were easily visible in retrospect.

Using a subjective lens to analyze the SEC's dispute with Goldman discussed at the beginning of this Comment further highlights this point. There, the key misrepresentation revolved around the role of

the third party selecting a CDO's reference portfolio. Goldman described this third party as independent, while in actuality it was taking the short side of the transaction, betting directly against the portfolio it was creating.

Goldman's strongest legal arguments are likely those advanced in the media after the SEC's announcement of the case. First, the plaintiffs, as sophisticated investors, had to be aware that another party was taking a position opposite from its own. The identity of this party would likely be irrelevant because anyone willing to take such a position would have a different assessment of the underlying portfolio's prospects. Second, the plaintiffs were never precluded from conducting their own assessment of the investment's risks and should therefore bear the risk of failing to properly do so. It is unclear whether these arguments would be sufficient to avoid liability without full discovery.

The plaintiffs would likely rely on the nonqualitative aspects of the transaction to advance their position, claiming that they had no means by which to discover the true role of the third party selecting the portfolio. Given the opaqueness of the OTC derivatives market, these claims may have merit. The plaintiffs would likely further allege that they would not have entered into the contract had they known the true role of the third party. It remains unclear how a court would view this argument under a subjective approach. However, a purely objective approach would likely produce a similarly unclear result. Absent prior dealings involving similarly structured transactions or explicit statements made by Goldman regarding the CDO's structure, there would likely be little evidence to persuade the court one way or the other. Because of Goldman's settlement agreement, the court's treatment of this argument will remain a mystery. Indeed, this may be Goldman's preferred result, given the number of Goldman clients that would likely build their cases off an SEC victory at trial.

While predicting the outcome in materiality determinations remains a difficult task, the consideration of subjective factors provides investors and the courts with a construct to frame their analysis. The benefits of including a subjective component, however, go beyond these individual disputes. Future investors of OTC derivatives would be

249. Complaint, supra note 1, at 2.
250. Id.
251. See Craig & Scannell, supra note 2.
253. See Jones et al., supra note 252.
able to rely upon past determinations concerning a particular counterparty (assuming that the party’s resources or sophistication did not change) and, further, would be able to analogize to other disputes, as is commonly done under the common law. As this body of case law develops, structure and certainty would replace the ambiguity so prevalent in materiality determinations currently.

V. CONCLUSION

The period leading up to the most recent financial crisis bears striking resemblance to the period leading up to the Great Depression. Almost eighty years ago, the changing dynamics of the securities markets prompted Congress to dramatically reshape the regulatory framework and enact the Securities Acts. A similar, albeit more modest, adjustment is now needed to adequately address the newfound prominence of the OTC derivatives markets.

The objective conception of materiality has spurred much litigation but little clarity. The preceding analysis explains a fallacious premise underlying the Court’s resolution of these cases and demonstrates the mental gymnastics in which courts must engage to envision the “reasonable investor.” This process is further complicated by the other elements of a Rule 10b-5 claim and has resulted in unpredictability.

Adopting a subjective approach within the unique nature and dynamics of OTC derivatives transactions would allow courts to avoid at least some of these issues by assessing the importance of information in relation to the total mix of information to the plaintiff, rather than the reasonable investor. Such an approach would satisfy the economic underpinnings of the disclosure regime and more faithfully uphold the motivating principles of the Securities Acts. It would also limit courts’ discretion in making materiality determinations to an analysis that more closely mirrors that conducted by parties to OTC derivatives transactions. As a result, judicial determinations would therefore serve as more meaningful precedent and provide guidance to future
investors in OTC derivatives markets. Just as important, the inclusion of a subjective component would help bring some much-needed coherency to the courts’ materiality jurisprudence.

Martin Goodlett*