

C L I F F O R D
C H A N C E



A horizontal band of abstract circular light trails in various colors (blue, green, yellow, orange) against a dark blue background, centered horizontally across the slide.

HEIGHTENED INSIDER TRADING SCRUTINY AND RISK MITIGANTS IN THE CURRENT PANDEMIC CONDITIONS

MAY 6, 2020

OVERVIEW

- Heightened Insider Trading Risk Caused by the Pandemic
- U.S. Enforcement Fundamentals – Insider Trading and Related Laws
- Hypothetical Scenarios
- Risk Mitigants

ENFORCEMENT FOCUS DURING THE PANDEMIC

“Given these unique circumstances, a greater number of people may have access to material nonpublic information than in less challenging times. Trading . . . on the basis of inside information may violate the antifraud provisions of the federal securities laws.”

STEPHANIE AVAKIAN AND STEVEN PEIKIN, CO-DIRECTORS OF THE SEC DIVISION OF ENFORCEMENT, MARCH 23, 2020

“U.S. Probes Whether Traders Profited Off Tips on Russia at OPEC+: CFTC said to examine suspicious wagers involving oil future”

BLOOMBERG, APRIL 22, 2020

“Every U.S. Attorney’s Office is . . . directed to prioritize the detection, investigation, and prosecution of all criminal conduct related to the current pandemic.”

WILLIAM BARR, UNITED STATES ATTORNEY GENERAL, MARCH 16, 2020

HEIGHTENED INSIDER TRADING RISK

Greater potential for misuse of inside information

- New sources of price-sensitive information
- Increased criticality of information and increased volatility result in large price effects
- New sources of information may not be accustomed to handling confidential, price-sensitive information

Insider-trading controls are strained

- Work-from-home orders make Compliance's job harder
- New information sources need to be vetted

Easing of regulatory requirements also heightens risk

- CFTC has eased voice-recording requirements for certain registrants
- SEC has relaxed some time periods for earnings reports

HEIGHTENED ENFORCEMENT RISK

EXPANSION OF SCOPE OF INSIDER TRADING LIABILITY SINCE 2008

New statutes have expanded the scope of insider-trading liability

- Commodity Exchange Act – Dodd-Frank revisions make insider trading applicable to new products
- STOCK Act – Prohibits employees of the executive and legislative branches from trading on government information

Old statutes are being applied to insider trading in novel ways

- Sarbanes Oxley Insider Trading – Different statute with less stringent requirements than traditional securities insider trading
- New York State Martin Act – State anti-fraud law used to push the boundaries of insider-trading liability
- Securities Insider Trading – Increased enforcement focus on expert networks

ENFORCEMENT FUNDAMENTALS

INSIDER TRADING

Fraud-based offense

- **Elements:**
 - Trading on the basis of material non-public information
 - Obtained in breach of a duty, or via deception or other fraud
- Potentially applies to:**
- Any person located in the U.S.;
 - Any person anywhere in the world involved with trading on U.S. markets

Covered Instruments	
Securities Laws	Commodities Laws
<ul style="list-style-type: none">• Securities• Government securities• Single-stock futures• Narrow-basket indices	<ul style="list-style-type: none">• Futures• Swaps• Broad-based stock indices• Commodities in interstate commerce

MATERIAL NON-PUBLIC INFORMATION (MNPI)

Material:

- There must be a substantial likelihood that a reasonable investor would consider the information important in making an investment decision
- Reliability of source and specificity of information both impact materiality

Non-public:

- Not generally accessible to all potential investors using ordinary means of discovery
- Selective disclosure (i.e. to investment analysts, on conference call, or e-mail) may not render information public.

Disclosure of material, non-public information will be insider trading only IF accompanied by...

BREACH OF DUTY IN RESPECT OF MNPI

Breach of duty to shareholders:

- **Classical Theory**: Focuses on trading by true corporate insiders or temporary/constructive insiders (e.g., underwriters, lawyers, accountants).

Breach of duty to the source of the information:

- **Misappropriation Theory**: Expands insider trading liability to non-insiders, who traded with knowing possession of material non-public information in breach of a fiduciary or similar *duty of trust and confidence*. e.g.,
 - Duty owed by employee to employer
 - Duty owed by portfolio managers to the portfolio
 - STOCK Act duties
 - Duties of confidentiality owed by scientists conducting drug trials
 - Ad hoc duties created by contract, employment policies, statements, conduct, etc.

US INSIDER TRADING

TIPPER / TIPPEE LIABILITY

A tipper is anyone who:

- Discloses material non-public information;
- Knowing that the information was obtained in breach of a duty;
- In return for a "personal benefit"—broadly defined

A tippee is anyone who:

- Trades;
- While in knowing possession of material non-public information; and
- Knows or should know that
- the tipper's disclosure of material non-public information was in violation of a duty of confidence; and
- the tipper divulged the information in exchange for a benefit

OTHER RELEVANT LAWS

Trading on MNPI can violate other federal criminal statutes with less stringent elements

- Wire fraud
- Sarbanes-Oxley insider trading
- Conversion

New York's Martin Act

- Applies to anyone transacting in securities or commodities in New York, or with a counterparty in New York
- “Insider Trading 2.0” may require those with superior information to disclose the information or abstain from trading

SCENARIO

FX TRADER

Jane is an asset manager who trades spot FX, currency futures and equities for several portfolios. Jane intends to purchase a large quantity of CHF for Portfolio A on the spot market.

- Can Jane trade CHF futures for Portfolio A in advance of the large spot trade, in order to take advantage of the price movement in CHF futures that the spot trade will cause?
- Can Jane trade futures for her own proprietary account ahead of executing Portfolio A's spot trade, so that she can profit from the price movement?
- Assume Jane needs to purchase stocks for Portfolio A today, and also needs to purchase stock options for Portfolio B. She knows that whichever trade she makes first will impact the price of the trade for the other portfolio. Can she make both trades?

SCENARIO

POLITICAL INTELLIGENCE

Bob trades at InvestCo, a hedge fund, which has recently engaged ABC, a political intelligence company, to provide information regarding government stimulus efforts. Bob receives an e-mail from an ABC analyst regarding a stimulus bill being debated in Congress. The e-mail predicts that Congress will pass a much larger stimulus package than had previously been reported. Bob believes that the analyst's information is likely accurate.

- Can Bob trade on this information?
- Bob learns that the analyst's husband is an aide to Senate Majority Leader Mitch McConnell. What should Bob ask the ABC analyst to determine whether or not he can trade?

SCENARIO

NEW COVID-19 DRUG

Fred, a trader at InvestCo, is working from home. Fred's wife Alice, a chemical engineer for ChemCo, is also working from home. Fred overhears that ChemCo has just signed a contract with PharmaCo to provide components for PharmaCo's ground-breaking new COVID-19 drug. Fred knows that Alice's specialty is working with platinum polymers. He reasons that if Alice is on the call, the new drug must contain platinum polymers.

- Can Fred trade shares of ChemCo?
- Can Fred trade shares of PharmaCo?
- Can Fred trade physical platinum or platinum futures?
- Fred knows that InvestCo regularly trades platinum. What should he do?

RISK MITIGANTS

REDUCING LIKELIHOOD OF INVESTIGATION

Conduct MNPI-related risk assessment

- Are new trading strategies / new markets being vetted?
- Do MNPI policies cover all sources of COVID-relevant information?
- Are existing information barriers sufficient?

Conduct assessment of documentation policies and procedures

Assess risk from expert networks

- Do the agreements prohibit confidential information?
- Are your communications controls sufficient?
- Are experts appropriately vetted?

Consider need for supplemental training on insider-trading risk

Ensure whistleblower portals are fully accessible online

RISK MITIGANTS

REDUCING DURATION OF INVESTIGATION

Understand focus of inquiry

Conduct internal investigation

- Be quick and be thorough
- Preserve attorney-client privilege

Avoid “process” violations

- Assume the regulator knows more than you
- Vet responses provided by the business
- Be precise and be accurate

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Steve Gatti is a partner in Clifford Chance's Financial Services Regulatory Group and head of the US securities regulation practice. His practice concentrates on securities enforcement and counseling, with a focus on broker-dealer and investment management regulation, and issues unique to cross-border, multi-national financial services clients.

Steve represents US and international financial institutions, including broker-dealers, banks, and investment advisers in regulatory, enforcement, and commercial matters.

Steve's practice includes strategic counseling on financial markets and trading regulation, anti-money laundering compliance, investment management compliance, broker-dealer regulation, trading systems, distribution and marketing issues, new products, privacy, transactions in the financial institutions sector, and Dodd-Frank. He also represents institutions and individuals in examinations, investigations, and enforcement matters before the U.S. Securities and Exchange Commission (SEC), the Financial Industry Regulatory Authority (FINRA), the US Commodity Futures Trading Commission (CFTC) and other self-regulatory organizations as well as state regulatory authorities. Steve also has years of experience conducting internal investigations involving potential securities law violations and financial fraud, and in conducting internal compliance audits.

Steve received a BA in 1990 from The College of William & Mary and a JD *with honors* in 1995 from The George Washington University Law School. Prior to attending law school, Steve was an exchange floor clerk with an NYSE specialist trading unit. He has recently been named one of Washington's Top Securities Lawyers by *The Washingtonian* magazine and is recognized as a leading regulatory enforcement lawyer in Chambers USA and Legal 500 USA 2018.

Steve is resident in the firm's Washington, DC office and is a member of the District of Columbia Bar, the State of New Jersey Bar and the State of Maryland Bar.

Representative engagements include:

- Conducted comprehensive internal compliance reviews of the extraterritorial application of U.S. financial regulation to non-U.S. business of major multi-national banks

- Established U.S.-registered investment adviser and broker-dealer subsidiaries for leading international financial services providers, including drafting relevant policies, procedures, and manuals
- Advised international banks on restructuring prime brokerage, ISDA, and securities lending arrangements
- Represented US and non-US financial services companies in connection with acquisitions and sales of US regulated institutions
- Represented leading Asian, Nordic, and European investment banks in SEC and FINRA investigations of their cross-border trading and compliance practices
- Advised leading international bank on privacy and data protection law requirements under regulations implementing the Gramm Leach Bliley Act, the Red Flag rules and other applicable state and federal laws
- Conducted global internal compliance audit, including insider trading review, of leading multi-national hedge fund manager
- Represented leading online broker-dealer in FINRA OATS and DMA enforcement actions
- Represented leading broker-dealer market intermediary in SEC short sale enforcement action
- Advised several leading financial institutions on privacy and data protection requirements applicable to asset sales and restructuring
- Represented bulge-bracket firm in connection with FINRA investigation of mutual fund sales and distribution practices

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Robert E. Rice, a partner in Clifford Chance's Litigation & Dispute Resolution practice, has 25 years of white-collar experience in Government and the private sector. Over the course of his career, Bob, a seasoned trial and appellate lawyer, has been at the forefront of many high-stakes regulatory enforcement matters and criminal prosecutions.

Bob represents financial institutions, asset management firms, public companies and individual clients in regulatory and criminal matters as well as in parallel civil litigation and internal investigations.

Before joining Clifford Chance, Bob's prior roles included serving as Chief Counsel to United States Securities and Exchange Commission Chair Mary Jo White, as Head of the Litigation and Regulatory Investigations Practice Group at a major global financial institution, and as an Assistant United States Attorney in the United States Attorney's Office for the Southern District of New York.

As Chief Counsel to SEC Chair White from 2013 to 2015, Bob provided advice and counsel on a broad range of regulatory matters across the SEC's divisions and offices, focusing on enforcement actions, policy and strategy; compliance examinations and inspections of broker-dealers, investment advisers and other SEC registrants; and cross-border coordination with regulatory agencies around the world.

Before his time at the SEC, Bob was, from 2004 to 2013, a Managing Director and senior in-house lawyer at a global financial institution.

While there, he led a team of in-house lawyers in developing and implementing strategies to manage legal and reputational risk associated with a global docket of complex regulatory investigations and enforcement actions, criminal investigations and prosecutions, litigation and corporate governance matters. Bob also served for almost a decade as a federal prosecutor in the United States Attorney's Office for the Southern District of New York, ultimately becoming a Deputy Chief of its Criminal Division. During his tenure in that office, Bob investigated and prosecuted a broad range of federal crimes, including bank fraud, money laundering, public corruption, RICO and securities fraud.

Bob is a JD graduate of St. John's University School of Law, where he was the Managing Editor of the Law Review.

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David Yeres, who has over 35 years experience in government and private practice with Commodity Exchange Act matters, heads the Clifford Chance US commodities and derivatives enforcement practice.

David was counsel to the Chairman of the Commodity Futures Trading Commission, the federal regulatory agency for commodity futures and options trading, and served on the Commission's Financial Products Advisory Committee. He was also the Deputy Associate Attorney General of the United States as well as a federal criminal prosecutor. He is the former chairman of the New York State Bar Association Committee on Commodities Law.

David, who has been in private practice since 1983, has represented, among others, trading companies, banks, and funds with regard to related internal investigations and contentious matters, as well as the dealing or trading in a wide range of physical and financial commodities transactions. He has advised domestic and international clients on the development and operation of various financial products including funds and other structured vehicles that utilize derivative transactions, securities and foreign exchange as well as commodities. David served as an adjunct professor of Commodity Exchange Act regulation at the Fordham Law School and is widely acknowledged as expert in the Commodity Futures Trading Commission's regulation and enforcement program.

Representative experience includes:

- Representing a Canada-based international financial institution in class action lawsuit alleging manipulation of the \$12 trillion market for debt securities issued by the US Treasury
- Representing a Chinese multinational banking company in a class action lawsuit alleging manipulation of platinum and palladium futures and options prices
- Representing a major financial institution in connection with numerous class actions and regulatory investigations alleging manipulation of LIBOR
- Representing a major US financial institution in connection with remediation of certain foreign exchange trading practices
- Representing a major international trading organization in connection with an investigation of alleged unlawful trading of energy futures contracts
- Representing a joint venture in connection with investigations by CFTC and NYAG of foreign exchange market-related misconduct
- Representing a Middle Eastern bank in connection with a CFTC investigation of certain financial futures and swaps trading activities
- Representing a Latin American bank in connection with an investigation of a US futures exchange into alleged "spoofing" of an energy market

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Prior to joining Clifford Chance, Benjamin interned at the New England Legal Foundation, where he assisted in authoring briefs for the United States Court of Appeals for the First Circuit and the Supreme Courts of Massachusetts, New Hampshire and Maine.

Benjamin received a JD from the New York University School of Law and a BA in philosophy from the University of Georgia. He is admitted to practice in New York.

Recent experience includes:

- Defeated all DOJ FCPA charges against Lawrence Hoskins at trial, with remaining money laundering counts resulting in a 15-month sentence that is currently under appeal
- Representing a financial institution in connection with an investigation by the CME into its trading of energy futures
- Representing a major US financial institution in connection with remediation of its foreign exchange trading practices
- Representing a joint venture in connection with investigations by CFTC and NYAG of foreign exchange market-related misconduct
- Representing a major financial institution in regulatory investigations alleging manipulation of LIBOR, and in subsequent implementation of settlement undertakings

Benjamin Peacock is a senior associate in Clifford Chance's Litigation & Dispute Resolution practice in New York. He represents clients in cross-border criminal and regulatory investigations and complex commercial litigation and arbitration.

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