Fordham Compliance Programs, Corporate Law Center, and StoneTurn present

COMPLIANCE TALKS

Behind the Crime
The Inside Story of Tipper X

Monday, October 15, 2018
6 – 6:30 p.m., Check-in
6 – 8 p.m., Program
8 – 9 p.m., Light Reception

CLE COURSE MATERIALS

“The secret witness at the center of the biggest insider trading case in a generation.”
The New York Times

StoneTurn

FORDHAM UNIVERSITY
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CLE Materials

Panel 1: Behind the Crime: The Inside Story of Tipper X


Peter J. Henning. Making Up Insider Trading Law As You Go Along. (View in document)
The Inside Scoop on Insider Trading Prevention: Ten Ideas for Compliance Training Sessions

By Tom Hardin

“[XYZ] hedge fund has agreed to pay $[x] million to settle claims by U.S. securities regulators that it failed to maintain policies to prevent misuse of inside information about three months after two of its partners were hit with criminal insider trading charges.”

The above recent headline is a compliance officer’s worst nightmare.

As someone charged criminally for insider trading in 2009 and sentenced in 2015, I’ve made it my life’s mission today to assist compliance officers in the training of investment staff by creating awareness of the behaviors which led to my decision to cross the line and the life-altering penalties that resulted from going down the proverbial slippery slope. More than just “scared straight,” my goal is to educate on what exactly I was thinking at the time as a young analyst -- the extremely faulty rationalizations -- and how compliance professionals today can keep their investment staff and employers from suffering the same fate.

Dirks v SEC laid out tipper-tippee liability in 1983 and insider trading has been the bread and butter of the SEC’s enforcement program ever since. More recently, the regulator has invested resources into being more proactive about detecting suspicious trading. Today, the Market Abuse Unit’s Analysis and Detection Center uses data analysis tools to detect suspicious patterns such as improbably successful trading across different securities over time (see August 2017’s SEC v Rivas et al).

On the criminal side, without a federal statute defining the law, jurisprudence of insider trading law has been periodically tweaked among the various appeal decisions in federal district courts depending on which judges are on the panel. It seems what is viewed as “good law” today is “bad law” tomorrow and is enough to make a compliance officer’s head spin, especially for someone without a legal background.

In August 2017, the Martoma majority decision in the Second Circuit, while upholding Mathew Martoma’s 2014 conviction, did expand the discretion enjoyed by prosecutors and SEC lawyers in these cases by pushing back on the elements of December 2014’s Newman decision with regard to “meaningfully close personal relationship.” Numerous Big Law briefs have been circulated with nuanced discussions of what it all means and my goal is to not repeat any of that but to provide some practical advice from my former analyst perspective for compliance professionals today to use in their training sessions with investment staff. I aim to avoid any discussion of the legal nuance of “gift,” “knowledge of benefit,” or “closeness of relationship” because, as a former investment analyst, I do not want investment staff engaged in what I did and term “isolated decision making”: where an analyst or trader makes a decision on a trade either thinking that they understand the nuance of the law or rationalize that they “won’t get caught.”

I have had the privilege of serving as a guest speaker for forty investment managers in 2017. Below are ten insights gathered from my own experience as a former analyst as well as feedback from clients on best practices.

1) Investment staff who think they may be in possession of material non-public information (MNPI) must escalate their questions/concerns to compliance. They must never think they are wise enough to draw the line when they think they might have MNPI. I found it perverse in December 2014 when the mainstream media headlines read “Hedge Funds Cheer Newman Decision” implying that some firms are trying to play it close to the line. You never want your analysts to be thinking about whether their relationship to the tipper is sufficiently close or whether the value received by the person who tipped you was significant enough to form the basis of a claim. All of these facts will be assessed in hindsight in a political and judicial environment they can’t control and may be very different from today. If they have MNPI, trading in the particular security is restricted until the MNPI becomes public. Period. Regardless of what is viewed by Big Law as “bad law” or “good law” in the current month.

Compliance professionals should also reach out to outside counsel to walk through specific research fact patterns. On occasion, I receive questions in my training sessions from analysts regarding the nuance of “material” versus “immaterial” information in their research processes. Again, they need to understand that they should not be making these determinations on their own. Even just a fifteen-minute conversation between the CCO, analyst and outside counsel can establish that you are seeking an expert’s opinion on a specific fact pattern of research and, because insider trading is a fraud-based claim, can prove that you did not have intent to deceive if later questioned by the regulator. The main point is to have a clear line of escalation from the research process to compliance.

About the Author

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MAKING UP INSIDER TRADING LAW AS YOU GO ALONG

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MAKING UP INSIDER TRADING LAW AS YOU GO ALONG

PETER J. HENNING

“I dunno. I’m making this up as I go along.” Indiana Jones.1

1. Introduction

We look for coherence in the law, especially when it can result in a prison sentence or substantial monetary penalties for a violation. Statutes give us some comfort that a legislative body has thought about the reason certain conduct is designated as wrongful, and why the moral opprobrium of the community should be visited on offenders.2 At least that is what we hope would happen. But when the law develops in a different way, through ad hoc judicial decisions and administrative regulations, along with legislative inaction to correct or redirect its application, then there is a fear that traditional notions of due process and fair notice have not been adequately addressed. Those concerns have not had an impact, however, in the world of securities fraud for one of its prime areas: insider trading. Rather than rational legal development along a relatively clear statutory path, we continue to see that the law is for the most part made up as we go along by the courts, including the Supreme Court, and the Securities and Exchange Commission.3

If that sounds like a criticism, it is not intended as one. Instead, insider trading law’s haphazard development has resulted in a reasonably stable set of rules that can be applied predictably to most instances of trading on confidential information.4 That may be about as much as we can expect from a white-collar

[footnotes]

2 See Miriam H. Baer, Insider Trading’s Legality Problem, 127 YALE L.J. FORUM 129, 133 (2017) (“[W]hen we deal with criminal law, we expect statutes to play the starring role in legal analysis. For other types of offenses, criminal law more or less satisfies this expectation.”).
3 This is similar to the argument of Professor Bainbridge that insider trading law is “instructive case study in how a legal regime exhibiting path dependent features went awry, detaching itself from both statutory and policy moorings.” Stephen M. Bainbridge, Insider Trading Regulation: The Path Dependent Choice Between Property Rights and Securities Fraud, 52 SMU L. Rev. 1589, 1589 (1999). His claim was “that path dependence provides a pedagogically useful metaphor, in that it focuses our attention on those aspects of the prohibition's evolution that led it astray,” so that “[a]s the prohibition has evolved, the federal securities laws have become an increasingly poor fit within which to confine insider trading. Id. at 1590. Whether or not one concludes that insider trading law has gone “awry,” I certainly agree with the point that “the path dependence metaphor counsels tinkering with the prohibition, but not sweeping change.” Id. at 591.
4 See Peter J. Henning, What’s So Bad About Insider Trading Law?, 70 BUS. LAW. 751, 757 (2015) (“Since the SEC first initiated an administrative proceeding over fifty years ago to sanction a broker for trading on confidential corporate information, the federal law of insider trading has grown into a reasonably well-defined prohibition, even with questions about its scope around the periphery. Some uncertainty in the law should not be surprising, given that the violation is not a creature of statute but instead more a common law offense developed through a series of judicial decisions.”); but see Baer, supra note __, at 143 (“[O]ne would vastly prefer a reflective, all-in-one consideration of insider trading law’s possible iterations (subject, of course, to updating and amendment), than make do with the path-dependence and uncertainty that arises out of a piecemeal approach.”).
crime that has changed as the markets evolve. What is lacking is any expression of congressional policy about why trading on material non-public information is a violation, or what should be its parameters. Scholars have struggled to explain what types of trading ought to be prohibited, why the law developed as it did, and whether use of confidential information by those outside a company should be treated the same as the classic situation of a corporate manager trading in the company's shares for personal gain.\(^5\)

Regardless of the lack of a clear policy for what should be considered a violation of the law, the Supreme Court’s decision in *Salman v. United States*\(^6\) in 2016 shows that the justices are for the most part satisfied with how the prohibition is administered, even with no overarching theory of what should – or should not – constitute a violation. The very simplicity of the Court’s analysis in *Salman* belies any apprehension that the justices are dissatisfied with insider trading law, even if some might view the decision as a missed opportunity to rewrite the law.\(^7\) The decision left some questions unanswered, such as how much is needed to show the requisite benefit conferred on a tipper for inside information, but those are better left to the lower courts to flesh out as the circumstances demand.

In this Essay, I discuss how the *Salman* decision is a further reflection of two interrelated points. First, insider trading law is comprised of rules that seem to work in the cases before the courts and then fleshed out over time to deal with circumstances that appear to come within a broad prohibition on profiting unfairly from access to confidential information.\(^8\) Whether described as theft, fraud, or embezzlement, the law created by the Supreme Court and SEC designates it as

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5 See, e.g., Kenneth R. Davis, *Insider Trading Flaw: Toward A Fraud-on-the-Market Theory and Beyond*, 66 AM. U. L. REV. 51, 53 (2016) (“Since its inception, the law of insider trading has perplexed the legal community. Scholars have criticized the law for its lack of clarity and over-complexity. Such criticisms are understandable. Insider trading law is a dysfunctional hodge-podge of rules that make little intuitive sense. The problem arises in part because no U.S. statute defines insider trading.”); Thomas Lee Hazen, *Identifying the Duty Prohibiting Outsider Trading on Material Nonpublic Information*, 61 HASTINGS L.J. 881, 883 (2010) (“The absence of a clear definition of insider trading under federal securities law has led to hundreds of decisions grappling with the issue. Many of these decisions are confusing and inconsistent with one another.”); Donald C. Langevoort & G. Mitu Gulati, *The Muddled Duty to Disclose Under Rule 10b-5*, 57 VAND. L. REV. 1639, 1646 (2004) (“We suspect that many modern judges are uncomfortable with property-based duties to disclose under Rule 10b-5, and most of the muddles in the law are the product of this discomfort. At base, the cause of the discomfort is the difficulty of determining optimal disclosure rules.”).

6 137 S. Ct. 420 (2016).

7 See Eric C. Chaffee, *The Supreme Court As Museum Curator: Securities Regulation and the Roberts Court*, 67 CASE W. RES. L. REV. 847, 863 (2017) (“*Salman v. United States* offered the Roberts Court an opportunity to remake federal securities regulation in the area of insider trading, and once again the Court chose to preserve the status quo created by existing precedent.”); Donna M. Nagy, *Beyond Dirks: Gratuitous Tipping and Insider Trading*, 42 J. CORP. L. 1, 55 (2016) (“[A] choice by the *Salman* Court to narrowly address the central issue of gratuitous tipping or to follow a path that merely clarifies joint tipper-tippee liability would be a lost opportunity.”); Baer, supra note __, at 148 (“[T]he Supreme Court’s decision in *Salman* reflects a missed opportunity, albeit an opportunity the Court could not have taken advantage of very easily.”).

8 See Henning, supra note __, at 757 (“Only in the last thirty years has insider trading become a priority for the SEC and federal prosecutors, which means its development has come through numerous judicial decisions. The growth of the law has occurred largely in fits and starts, rather than through a clear progression reflecting a coherent conception of the many aspects that make up a violation.”).
wrong because . . . well, it just is. Second, when a decision goes against the government’s view of what should be subject to the prohibition, then it will seek to reverse it through rulemaking and by arguing in the courts for a more favorable analysis. The defining principle of insider trading law seems to be that when you make it up as you go along but don’t like the outcome in a particular case, just do your best to make sure the law drifts back to the way you wanted it in the first place—a common law crime if there ever was one.

2. The Origins of Insider Trading Law

The prohibition on insider trading is based on the application of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5. The development of Rule 10b-5 shows how the law has been the product of making it up as you go along. As recounted many times, it was drafted quickly in 1942, with much of it copied from Section 17(a) of the Securities Act of 1933, to address a situation in which a corporate officer was buying up stock in his company while telling shareholders it was doing badly when in fact its earnings were increasing. After the SEC attorneys hopped on a train to Washington and circulated a draft of the rule to the Commissioners, it was approved with only one comment: “Well, we are against fraud, aren’t we?” Of course we are, and so a rule made up almost on the spot has

See Remarks of Milton Freeman, Conference on Codification of the Federal Securities Laws, 22 BUS. LAW. 793, 922 (1967);
become the basis for multiple criminal prosecutions and civil enforcement actions every year. Not only that, but the courts have allowed private investors to use it to pursue fraud claims against companies and their directors, resulting in hundreds of lawsuits every year against many of the largest companies. As Justice Rehnquist once noted, “When we deal with private actions under Rule 10b-5, we deal with a judicial oak which has grown from little more than a legislative acorn.”

Anyone who has ever dealt with securities fraud knows well that neither Section 10(b) nor Rule 10b-5 make any mention, even implicitly, about trading on material nonpublic information. Instead, the prohibition is a creature of judicial and administrative construction. How the law developed is attributable, at least in part, to the visceral appeal of the cases that reached the Supreme Court that would support a narrower view at first, and then a broader interpretation.

The genesis of the insider trading prohibition under Rule 10b-5 was In the Matter of Cady, Roberts & Co., a SEC administrative decision in 1961 involving a broker tipped by a corporate director about a reduction in the company's dividend that led the broker to sell shares. The violation was brazen, to say the least, and in finding a violation, the SEC's opinion stated that an “insider must disclose material facts which are known to them by virtue of their position but which are not known to persons with whom they deal and which, if known, would affect their investment judgment.” Trading on such information “constitutes a violation of the anti-fraud provisions,” specifically Rule 10b-5. As Professor Langevoort pointed out, the decision was the result of a push by the SEC's chairman, William Cary, to remake insider trading law to overturn a thirty-year-old state court decision holding that open-market securities trading while in possession of inside information was not fraudulent.

said anything except Sumner Pike who said, “Well,” he said, “we are against fraud, aren’t we?” That is how it happened.

14 See Ernst & Ernst v. Hochfelder, 425 U.S. 185, 196 (1976) (“Although § 10(b) does not by its terms create an express civil remedy for its violation, and there is no indication that Congress, or the Commission when adopting Rule 10b-5, contemplated such a remedy, the existence of a private cause of action for violations of the statute and the Rule is now well established.”).
15 Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 737 (1975). Calling it a “legislative acorn” may be overestimating the scope of the congressional enactment, but the metaphor remains a useful one.
17 Id. at 911.
18 Id.
We are told that when William Cary became Chairman of the SEC in 1961, he had only a short policy agenda. One item on it, however, was to overturn the Supreme Judicial Court of Massachusetts’s decision in Goodwin v. Aggasiz, which had held thirty years earlier that open-market insider trading was not actionable as common law fraud. Cary soon wrote the Commission's opinion in an administrative broker-dealer disciplinary proceeding, In re Cady, Roberts & Co., that for the first time treated exchange-based insider trading as federal securities fraud. He thus set in motion the modern law of insider trading.

Id. at 1319.
A few years later, the SEC brought its first civil enforcement action in federal court for insider trading against a group of defendants working for the Texas Gulf Sulphur Company who traded ahead of the release of news about a major ore strike in Canada. They took advantage of a privileged position to make quick, risk-free profits, conduct that would never receive a judicial imprimatur. The United States Court of Appeals for the Second Circuit upheld the claim that the trading violated Rule 10b-5 in SEC v. Texas Gulf Sulphur Co.,\(^20\) holding that “anyone in possession of material inside information must either disclose it to the investing public, or, if he is disabled from disclosing it in order to protect a corporate confidence, or he chooses not to do so, must abstain from trading in or recommending the securities concerned while such inside information remains undisclosed.”\(^21\) Trading based on the possession of valuable information is not necessarily fraudulent in other contexts, but the Second Circuit took the lead in adopting a rule the SEC and federal prosecutors would find most accommodating to their desire to pursue a wide variety of cases. Professor Bainbridge rightfully points out that the Second Circuit’s equal-access rule “rests on a foundation of sand”\(^22\) because there was neither judicial precedent nor congressional policy to support such a broad prohibition, but what a sandcastle the courts and the SEC have built since then.

3. Chiarella and O’Hagan

Since Texas Gulf Sulphur, the Supreme Court has issued a grand total of four decisions setting the parameters of insider trading, relying on its own understanding of what should be prohibited because there is simply no congressional direction available to divine how the law should apply.\(^23\) For a prohibition generating so many prosecutions and civil enforcement actions, not to mention headlines and even a movie featuring it,\(^24\) it is a bit surprising that it has not drawn more attention from the justices. The first case, Chiarella v. United States,\(^25\) involved a sympathetic defendant, and resulted in a narrower reading of the scope of the prohibition than the SEC and federal prosecutors wanted. As Professor Pritchard noted, the author of the opinion, Justice Powell, “worried that prohibitions against insider trading could chill incentives for analysts and other market professionals to uncover information about publicly traded companies.”\(^26\) But even his formidable presence did not ultimately deter federal prosecutors and the SEC

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\(^{20}\) 401 F.2d 833 (2d Cir. 1968) (en banc).

\(^{21}\) Id. at 848.


\(^{23}\) A fifth case, Carpenter v. United States, 484 U.S. 19 (1987), made it to the Supreme Court on the issue of whether the misappropriation theory came within Section 10(b) and Rule 10b-5, but the justices were evenly divided on the issue and did not address it further in the case. Id. at 24.

\(^{24}\) See WALL STREET (Twentieth Century Fox 1987). Please avoid the sequel, however.

\(^{25}\) 445 U.S. 222.

from getting the expansive view they wanted, ultimately using a case involving a
greedy lawyer that led – not surprisingly – to a more favorable theory of liability.

A. The Classic Theory

Chiarella established the basic requirement that the trader breach a fiduciary
duty, or other duty of trust and confidence, in disclosing inside information for the
purpose of trading. This was the first criminal prosecution for insider trading, and
the charges were filed after the defendant, Vincent Chiarella, settled with the SEC by
paying back about $30,000 in profits. Working at a financial printer in New York,
Chiarella deciphered the names of the target companies in filings prepared on behalf
of the offerors. Justice Powell’s majority opinion expressed the basic proposition
that “Section 10(b) is aptly described as a catchall provision, but what it catches
must be fraud”28 – thereby clearly tying the proscription to the common law fraud
offense that requires proof of a misstatement or omission of a material fact. That
meant “[w]hen an allegation of fraud is based upon nondisclosure, there can be no
fraud absent a duty to speak,” so that “liability is premised upon a duty to disclose
arising from a relationship of trust and confidence between parties to a
transaction.”29

The Court found the duty only flowed to the shareholders of the company
whose securities were traded, and because Chiarella traded in the shares of the
targets of potential takeovers, he did not have any legal obligation to disclose the
nonpublic information he had unearthed before trading. Out the window went
Texas Gulf Sulphur’s expansive view that only required possession of confidential
information to violate Rule 10b-5. Instead, the focus became whether there was “an
affirmative duty to disclose” information before trading on it,30 which tied insider
trading to state law fiduciary duties, at least initially.

Of course, the parity-of-information rule espoused in Texas Gulf Sulphur
would not die quite so easily. Shortly after Chiarella, the SEC adopted Rule 14e-331
to prohibit trading by someone who receives information about a tender offer for a
security once a substantial step is taken toward that transaction. The prohibition is
triggered by possession of confidential information, and there is no mention of any
breach of a duty of trust and confidence in obtaining the information or trading on
it.32 The SEC specifically rejected the argument that Chiarella limited its rulemaking

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27 Id. at 224.
28 Id. at 234-35.
29 Id. at 230.
30 Id. at 231.
31 17 C.F.R. § 240.14e-3.
32 The release accompanying Rule 14e-3 states:
Rule 14e-3(a) establishes a “disclose or abstain from trading” rule under the Williams Act. A
person who is in possession of material information that relates to a tender offer by another
person which information he knows or has reason to know is nonpublic and which he also knows
or has reason to know was acquired directly or indirectly from a person who has taken a
substantial step or steps to commence or has commenced a tender offer (hereinafter also referred
to as the “offering person”), the issuer whose securities are subject to the tender offer or any
officer, director, partner or employee or any other person acting on behalf of the offering person
authority by defining the scope of all insider trading, stating that “the decision did not suggest any limitation on the Commission’s authority under Section 14(e) to adopt a rule regulating trading while in possession of material, nonpublic information relating to a tender offer.”\(^{33}\) It is always nice when an agency thumbs its nose at the Supreme Court, especially after having its preferred interpretation of the law rejected.

But Rule 14e-3 only reaches a narrow slice of the insider trading universe, covering deals in which a tender offer might be made but not a merger or sale of assets that can also cause a company’s price to spike. Nor does it touch on trading on a broad range of corporate information that can affect the stock price, like earnings or product development. In announcing the adoption of the rule, the SEC also mentioned another means to hold individuals liable to skirt the edge of \textit{Chiarella:} the misappropriation theory. Chief Justice Burger’s dissent in that case argued Rule 10b-5 incorporated the principle that “a person who has misappropriated nonpublic information has an absolute duty to disclose that information or to refrain from trading.”\(^{34}\) The majority rejected that approach, explaining that the theory had not been presented to the jury so it could not be a basis to uphold the conviction.\(^{35}\) Not rejecting it squarely created an opening for the SEC and federal prosecutors to offer it as a means to avoid the strictures of \textit{Chiarella}. The release accompanying Rule 14e-3, issued less than six months after the Supreme Court’s ruling, noted that the agency “continues to believe that such conduct undermines the integrity of, and investor confidence in, the securities markets, and that persons who unlawfully obtain or misappropriate material, nonpublic information violate Rule 10b-5 when they trade on such information.”\(^{36}\)
B. The Misappropriation Theory

Perhaps still smarting from Chiarella’s rejection of the possession theory of liability endorsed in Texas Gulf Sulphur, the Second Circuit explicitly adopted the misappropriation theory in United States v. Newman a year later in a case in which prosecutors crafted their indictment to avoid the Supreme Court’s requirement that only someone who owed a duty directly to the shareholders of the company whose securities were traded could commit insider trading. The defendants were investment bankers who traded and leaked information about pending mergers and acquisitions, buying shares in the target companies. This clearly fell outside Chiarella, but the appeals court held that under the misappropriation theory their “conduct as alleged in the indictment could be found to constitute a criminal violation of section 10(b) and Rule 10b-5 despite the fact that neither the investment banks nor their clients was at the time a purchaser or seller of the target company securities in any transaction with any of the defendants.”

So it was not just the SEC thumbring its nose at Chiarella in Rule 14e-3, so too did the Second Circuit. In the end, they were vindicated because the Supreme Court – ten years after Justice Powell’s retirement – heartily endorsed the misappropriation theory in 1997 in United States v. O’Hagan. The defendant, James O’Hagan, was a well-regarded lawyer in Minneapolis who also happened to take information about a potential tender offer his firm was advising on to make over $4 million in profits from buying stock and options in the target – money he apparently could use to try to coverup an earlier embezzlement from client accounts. Trading in the securities of the target, however, and not those of the client, meant he could only be prosecuted under the misappropriation theory, along with violating of Rule 14e-3. The Eighth Circuit overturned his conviction, holding that misappropriation was an impermissible extension of insider trading liability because the theory did not involve any “deception” as required by Section 10(b) after Chiarella.

The government could not have asked for a more amenable case to argue for the misappropriation theory: a miscreant lawyer arguing that he should get to keep millions of dollars derived from a theft of confidential client information that he used to turn a quick profit. Perhaps seeing the error of its ways in Justice Powell’s limited approach to liability in Chiarella, the majority stated that “it makes scant

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37 664 F.2d 12 (2d Cir. 1981).
38 Id. at 15 (“In preparing the indictment, the Government attempted to remedy a deficiency that led to the Supreme Court’s reversal of a conviction in Chiarella v. United States”) (citation omitted).
39 Id. at 16.
41 See id. at 649 n.2 (“O’Hagan was convicted of theft in state court, sentenced to 30 months’ imprisonment, and fined.”).
42 United States v. O’Hagan, 92 F.3d 612, 617 (8th Cir. 1996), rev’d, 521 U.S. 642 (1997) (“we hold that § 10(b) liability cannot be based on the misappropriation theory. We reach this conclusion because, contrary to § 10(b)’s explicit requirements, the misappropriation theory does not require “deception,” and, even assuming that it does, it renders nugatory the requirement that the “deception” be “in connection with the purchase or sale of any security.”).
sense to hold a lawyer like O’Hagan a § 10(b) violator if he works for a law firm representing the target of a tender offer, but not if he works for a law firm representing the bidder. The text of the statute requires no such result.” Righting a past wrong is certainly a worthy reason for a decision, but one would be hard pressed to find any citations to the usual legal precedents in the majority opinion to justify the result. The primary sources to support its analysis are the government’s brief and a law review article written over ten years earlier. What the Supreme Court took in its restrictive approach in Chiarella, it largely gave back in O’Hagan. And then the Court gave the government even more by putting the seal of approval to Rule 14e-3, accepting a form of the possession theory of liability for tender offers.

Whatever harm Chiarella might have caused to the insider trading enforcement regime was finally obviated in O’Hagan. But the Supreme Court still tied a violation to a breach of a duty, a more difficult element to prove than mere possession of confidential information. But the SEC and federal prosecutors could hardly complain because tying the prohibition to fraud meant that some aspect of fiduciary duty would be part of a case.

4. Dirks and Salman

The law of tipping was the product of the Supreme Court’s decision in Dirks v. SEC, announced three years after Chiarella. Unlike the other cases to reach the Court, which were all criminal prosecutions, this was an administrative proceeding. The respondent was Raymond Dirks, a stock analyst who received information about financial shenanigans from an employee of Equity Funding Corporation, a financial conglomerate. The employee said that the company was engaging in fraud that included the creation of bogus insurance policies, information Dirks confirmed and tried to expose by contacting the media. At the same time, he told brokers at his firm about the issues at the company, leading them to sell Equity Funding shares in their client accounts. The SEC found that Dirks engaged in insider trading because he received a tip from a corporate insider and passed it on to brokers, resulting in a sale of shares before the stock collapsed. Today, he would be celebrated as a whistleblower, a term not in vogue at that time, but instead Dirks found himself on the wrong end of an enforcement action.

A. Dirks v. SEC

Extending the duty analysis from Chiarella, the Court, again per Justice Powell, held that “a tippee assumes a fiduciary duty to the shareholders of a corporation not to trade on material nonpublic information only when the insider

43 Id. at 659.
44 See, e.g., id. at 653-54 (“We agree with the Government that misappropriation, as just defined, satisfies § 10(b)’s requirement that chargeable conduct involve a ‘deceptive device or contrivance’ used “in connection with” the purchase or sale of securities. We observe, first, that misappropriators, as the Government describes them, deal in deception. A fiduciary who ‘[pretends] loyalty to the principal while secretly converting the principal's information for personal gain,’ Brief for United States 17, ‘dupes’ or defrauds the principal. See Aldave, Misappropriation: A General Theory of Liability for Trading on Nonpublic Information, 13 Hofstra L.Rev. 101, 119 (1984).”).
has breached his fiduciary duty to the shareholders by disclosing the information to the tippee and the tippee knows or should know that there has been a breach.”

To establish the breach, the tipper must receive “a direct or indirect personal benefit from the disclosure, such as a pecuniary gain or a reputational benefit that will translate into future earnings.” That sounds like a bribe or kickback, but Justice Powell modified this further by explaining that the relationship between the two can also suggest “a quid pro quo from the latter,” including “when an insider makes a gift of confidential information to a trading relative or friend. The tip and trade resemble trading by the insider himself followed by a gift of the profits to the recipient.”

So in tipping cases, the key was finding a sufficient benefit flowing between the source and the trader, based on their relationship that could include personal connections that did not reflect any formal business connection. But that element was sorely missing, and the Court easily reversed the finding of a violation, extolling the virtues of what Dirks and other stock analysts do in ferreting out information and passing it along to investors.

To show just how sympathetic his position was, the Solicitor General’s Office did not support the SEC’s position, even filing an amicus brief against the agency – a rare occurrence in which the two leading enforcers of the insider trading prohibition are on opposite sides.

Despite the reversal, the kind of back-of-the-envelope legal analysis in Dirks that required looking for some ill-defined benefit, at least when there wasn’t a bag of cash, gave the SEC and federal prosecutors flexibility to use evidence of a wide range of personal connections to establish unlawful tipping. Personal connections ranging from an Alcoholics Anonymous sponsor to golfing buddies in which no money changed hands were enough to establish the benefit for the quid pro quo requirement. But not without a few bumps in the road, of course.

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46 Id. at 660.
47 Id. at 663.
48 Id. at 664.
49 See id. at 658 n.18 ("Despite the unusualness of Dirks' 'find,' the central role that he played in uncovering the fraud at Equity Funding, and that analysts in general can play in revealing information that corporations may have reason to withhold from the public, is an important one. Dirks' careful investigation brought to light a massive fraud at the corporation. And until the Equity Funding fraud was exposed, the information in the trading market was grossly inaccurate. But for Dirks' efforts, the fraud might well have gone undetected longer.").
50 See Pritchard, supra note __, at 935 ("On petition for certiorari, the Solicitor General authorized the SEC to file an opposition to the petition, but refused to join the SEC's position. The Solicitor General took the position that information obtained by Dirks could not be considered confidential . . .").
52 See Sarah Baumgartel, Privileging Professional Insider Trading, 51 GA. L. REV. 71, 72 (2016) (“Beyond fiduciary obligations, beyond employers and employees, beyond principals and agents, modern insider trading enforcement is premised on the idea that personal relationships, such as friendship, can give rise to legally-enforceable duties of loyalty and confidentiality.”).
53 See, e.g., United States v. Bray, 853 F.3d 18, 27 (1st Cir. 2017) (“O'Neill claimed that he and 'Bubba' were 'good friends' who, at the time of the Wainwright tip, had known each other for fifteen years. The two men often socialized with each other at the club, dined with each other at local bars and restaurants, and even took each other's counsel."); United States v. McPhail, 831 F.3d 1, 3–4 (1st Cir. 2016) ("beginning in July 2009, unbeknownst to Santamaria, McPhail began passing along the upshot of the information he received in these conversations to a set
The Second Circuit took a bit more restrictive view of the type of relationship that could be the basis for the duty of trust and confidence needed for an illegal tip in *United States v. Chestman*. The defendants were the husband of a member of a family that owned a supermarket chain and his stock broker, and the husband learned from his wife that the company would be acquired in a tender offer. Family members were admonished to keep the information quiet, but the husband told the broker, who bought shares in different accounts that included one for the husband. Sitting en banc, the Second Circuit found that there was no fiduciary duty between a husband and wife to support a conviction under Rule 10b-5. It stated, "Although spouses certainly may by their conduct become fiduciaries, the marriage relationship alone does not impose fiduciary status." Nor would giving confidential information with an admonishment not to disclose or trade on it be enough, because "entrusting confidential information to another does not, without more, create the necessary relationship and its correlative duty to maintain the confidence." Instead, for relationships that fall outside those recognized by the law, like the lawyer-client relationship, establishing the duty for tipping liability requires showing "[a] fiduciary relationship [that] involves discretionary authority and dependency: One person depends on another—the fiduciary—to serve his interests." Much like it did after the *Chiarella* decision, the SEC resorted to its rulemaking authority to expand the definition of the requisite duty for insider trading. In 2000, it adopted Rule 10b5-2 to clarify the scope of the prohibition. The rule provides that a duty of trust and confidence exists "whenever a person agrees to maintain information in confidence," when there is a "history, pattern, or practice of sharing confidences" such that an expectation of confidentiality arises, or when information is received from a family member. Of course, the SEC would never say it was contradicting federal judges, so its release noted that the rule provided "more of a bright-line test for certain enumerated close family relationships" that would make it easier for courts by avoiding any need to examine the details of personal relationships. One is reminded of the old adage, "I'm from..."
Making Up Insider Trading Law As You Go Along

the government and I'm here to help.” The lower courts have upheld Rule 10b5-2 as a permissible exercise of the SEC’s authority, even though it gives a broader definition of the requisite duty than found by the Supreme Court and Second Circuit in Chiarella and Chestman. Moreover, Justice Scalia expressed a contrary view that an administrative agency should not be able to define the parameters of a crime in its regulations, but whether that proves to be a problem has not yet arisen.

B. **Salman v. United States**

Although Chestman caused a bit of trouble for the SEC, the Second Circuit caused more of a stir in 2014 when it adopted a restrictive requirement for proving the benefit to the tipper in United States v. Newman. The case involved two downstream tippees well removed from the initial source of the confidential information. The circuit court stated that when the connection involves only a casual connection then the government must show “a meaningfully close personal relationship that generates an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature.”

Read broadly, that requirement would make life much more difficult for the SEC and federal prosecutors because there are any number of cases, especially ones involving family relationships, that might not have proof of something more tangible than the warm feeling one gets from giving a gift.

So to straighten things out, the Supreme Court granted review in Salman v. United States, a case with facts almost as accommodating to the government as those in O’Hagan that fell within the core of the prohibition on tipping inside information, resulting in an outcome that was easy to predict. The tipper, Maher

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61 See United States v. McPhail, 831 F.3d 1, 7 (1st Cir. 2016) (“Evidence of a ‘history, pattern, or practice of sharing confidences’ between the insider and the misappropriator is nothing more than evidence that a relationship of trust and confidence arose by implication. We see no indication in O’Hagan or Chiarella that these traditional principles are somehow inapplicable when the relationship in question arises outside of a strict, formal business setting.”); United States v. McGee, 763 F.3d 304, 313 (3d Cir. 2015) (“Rule 10b5-2(b)(2) is valid and entitled to Chevron deference because it (1) has not been congressionally or judicially foreclosed, and (2) is based on a permissible reading of § 10(b).”).

62 See Whitman v. United States, 135 S. Ct. 352, 353 (2014) (Scalia, J., dissenting from denial of cert.) (“With deference to agency interpretations of statutory provisions to which criminal prohibitions are attached, federal administrators can in effect create (and uncreate) new crimes at will, so long as they do not roam beyond ambiguities that the laws contain.”). In his usual way, Justice Scalia questioned the motivations for this approach, stating that “I doubt the Government’s pretensions to deference. They collide with the norm that legislatures, not executive officers, define crimes.” Id.

63 773 F.3d 438 (2d Cir. 2014).

64 Id. at 452.

65 137 S. Ct. 420 (2016).

66 See Jill E. Fisch, *Family Ties: Salman and the Scope of Insider Trading*, 69 STAN. L. REV. ONLINE 46, 52 (2016) (“The conduct in *Salman* falls within the core of illegal tipping as defined by the Court in *Dirks*. Like *Dirks*, *Salman* leaves the outer limits of when a gift involves a personal benefit unclear, recognizing merely that an insider receives a personal benefit when he gives confidential information to a trading friend or relative. Cases involving family members are the easy insider trading cases because, for the reasons set out above, a court can reasonably infer the insider’s personal benefit from the mere fact of the family relationship.”); A.C. Pritchard, *The SEC, Administrative Usurpation, and Insider Trading*, 69 STAN. L. REV. ONLINE 55, 59 (2016) (“*Salman* is an easy case on the merits. The inference that a tipper receives an indirect personal benefit when he passes information to his brother, or (indirectly) his brother-in-law, as occurred in *Salman*, is a natural one.”).
Kara, was an investment banker who gave information to his younger brother, Michael Kara, who in turn passed it to Bassam Salman, whose sister was marrying Maher and had been befriended by Michael. The testimony at trial fit the script for a familial tipping case perfectly, with the brothers – who pleaded guilty and were cooperating – stating they had a “very close relationship” in which Maher loved Michael “very much,” and shared the confidential information so that Michael could trade on it.\textsuperscript{67}

In a unanimous opinion by Justice Alito, the Court gave short shrift to Salman’s that there was no tangible benefit exchanged among the family members, stating that “[w]e adhere to\textsuperscript{68} Dirks, which easily resolves the narrow issue presented here.” Turning to\textsuperscript{69} Newman’s statement about the proof necessary to show the benefit, it too received a swift rejection: “To the extent the Second Circuit held that the tipper must also receive something of a ‘pecuniary or similarly valuable nature’ in exchange for a gift to family or friends, we agree with the Ninth Circuit that this requirement is inconsistent with\textsuperscript{70} Dirks.”

For all the hand-wringer that Salman might result in significant changes to insider trading law, it turns out to be an uninteresting case that adds little to the law of insider trading.\textsuperscript{71} The most important aspect of the decision is not what it says, which is pedestrian, but instead that it shows the justices view the prohibition as both well established and sufficiently clear to pass constitutional muster. The Court rejected Salman’s vagueness argument, finding that “Dirks created a simple and clear “guiding principle” for determining tippee liability . . . .”\textsuperscript{72} Thus, there is no reason for lower courts to experiment with creating limitations to make it more difficult to pursue violations because the law outlined in\textsuperscript{73} Chiarella, Dirks, and O’Hagan gives sufficient enough guidance for juries to make the credibility assessments needed to assess liability.

The Second Circuit took its cue on interpreting the scope of the prohibition in\textsuperscript{74} United States v. Martoma,\textsuperscript{75} finding that even the sliver of Newman that remained was no longer good law after Salman. One part of Newman not addressed directly was the requirement of a “meaningfully close personal relationship” when the benefit to the tipper was a gift between trading friends. In Martoma, the Second Circuit held that the “logic” of Salman also abrogated that element for insider trading, so that all the government must prove is that the tipper expected the tippee to trade on the information, and that giving it resembles handing over the profits as if the tipper traded and then gave away the money.\textsuperscript{76}

\textsuperscript{67} Id. at 424.
\textsuperscript{68} Id. at 427.
\textsuperscript{69} Id. at 428.
\textsuperscript{70} Austin J. Green, (Beyond) Family Ties: Remote Tippees in A Post-Salman Era, 85 FORDHAM L. REV. 2769, 2771 (2017) (“Salman was the Supreme Court’s first insider trading case in almost two decades, but it did little to address recent issues within insider trading jurisprudence.”).
\textsuperscript{71} Id.
\textsuperscript{72} 2017 WL 3611518 (2d Cir. Aug. 23, 2017).
\textsuperscript{73} Id. at *8 (“If the insider discloses inside information ‘with the expectation that [the recipient] would trade on it,’ and the disclosure ‘resemble[s] trading by the insider followed by a gift of the profits to the recipient,’ he
fuzzy feeling from giving a gift now shifts to proving the expectation of trading by the tippee, a seemingly broad expansion of insider trading that will be welcomed by prosecutors and the SEC who no longer have to search for evidence of a close relationship.

5. Conclusion

Will we have to await another two decades for an insider trading case to make it back to the Supreme Court? The problem created by Newman's benefit analysis was the product of the Second Circuit looking for a limiting principle to keep prosecutors from being overly aggressive in pursuing downstream tippees. The circuit court referenced the government's “overreliance” on dicta from prior cases that highlighted “the doctrinal novelty of its recent insider trading prosecutions, which are increasingly targeted at remote tippees many levels removed from corporate insiders.” Changing the Dirks gift analysis was a step too far, however, and it may be that the only way for a case to make it to the Supreme Court in the future will be for a lower court to cut back on the prohibition in a way that substantially restricts proof of an element of the offense. Tinkering is no doubt permissible, and the Second Circuit's decision in Martoma shows that it was willing to pull back from creating an additional hurdle to proving a violation.

For an area of the law that is the product of judicial creation, with a little help from the SEC in its rulemaking, the Supreme Court seems rather satisfied with how it has turned out – or at least is apathetic with where things stand, as shown by the superficial approach taken in Salman. Congress could step in to adopt a clear prohibition, although that is unlikely after Salman and Martoma. There is no real political impetus in that direction, and there will not be any pressure to enact a statutory prohibition without a case making it appear that Wall Street scions can trade on their favored position too much to their advantage. The probable outcome would be a broader rule, mimicking the possession theory first adopted in Texas Gulf Sulphur.

personally benefits for the reasons described in Dirks and Salman.” (quoting Salman v. United States, 137 S. Ct. 420, 427-28 (2016)).

75 See Pritchard, supra note __ at 62 (“For better or worse, the Court is likely stuck managing the common law of insider trading under Rule 10b-5.”).
76 See Henning, supra note __, at 766–67 (“There has never been any indication from Capitol Hill that the insider trading prohibition should be restricted, and indeed it has been embraced. There is almost no chance Congress will tinker with the law to authorize some types of trading on confidential information that could be seen as favoring Wall Street and large hedge funds, even if academics could show that it also somehow benefited small investors. Indeed, the push is much more likely to be in the direction of a broader prohibition rather than a narrowly tailored approach that authorizes some use of confidential information.”).
77 See James Walsh, "Look Then to Be Well Edified, When the Fool Delivereth the Madman": Insider-Trading Regulation After Salman v. United States, 67 CASE W. RES. L. REV. 979, 996 (2017) (“[T]he time has come for the federal government to take a hardline stance on insider trading, because there's no telling how many more Newman's are waiting in the wings of appellate courts, and how many insiders are out there seeking ‘recognition’ and industry status as players with reliable information.”).
So when you make it up as you go along, sometimes you can be happy with the result. And the current status of insider trading law is one that is largely amenable to the desires of the SEC and prosecutors. To those who might be clamoring for some clarification of the law, whether by Congress or the SEC, the political reality is that such legislation is unlikely to be enacted unless there is a need to reverse a judicial decision that makes it considerably more difficult to pursue insider trading. Absent that, the message from *Salman* is clear: just leave well enough alone.

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78 See, e.g., Austin, supra note __, at 2798 (proposing SEC adopt Rule 10b5-D creating a safe harbor for hedge fund managers who disclose information within two days of trading); Bruce W. Klaw, *Why Now Is the Time to Statutorily Ban Insider Trading Under the Equality of Access Theory*, 7 WM. & MARY BUS. L. REV. 275, 345 (2016) (“Now is the time to adopt a new statutory provision that finally defines ‘insider trading.’”).
It’s important also not make an analyst feel guilty for coming to you with their concerns regarding MNPI. You do not want the analyst to close down and be disincentivized to go to you in the future. The CCO should make sure that all employees feel that they can come to him or her and I believe should sit close to the investment staff, with your office ideally near the trading floor and the door always open.

2) The current “hot areas” of enforcement for investment managers are always changing and what’s in the spotlight today (political consultants) may not necessarily be the hot topic of future inducements or enforcement actions (semi-private data sets)? The market is always three steps ahead of enforcement, but that is actually to the analyst’s detriment, because new things that they are doing will feel like “everyone is doing it” so it “should be fine” – think political/healthcare consultants in the recent Visium and Deerfield cases. Keep in mind that, regardless of the decisions in Newman, Salman or Martoma, there’s also the SEC, which has a much lower burden of proof – requiring only a preponderance of evidence to prove insider trading. Just because someone is within the lines of what is considered current “good law” in terms of “gift” or “knowledge of benefit”, he or she could still be subject to an enforcement action by the SEC. If that enforcement action is brought, the manager’s assets under management are going to be threatened or disappear altogether.

Today, there are a lot of potential issues with respect to data sets and data scraping, where firms are coming into possession of semi-private data in the research process. Whether that information is obtained in breach of a duty can be a tough call. From what I’ve seen, compliance is frequently under pressure from analysts to permit a data source on the basis that other firms are using that source. These data sources and providers often involve numerous areas of law, including computer privacy, securities law, even Federal Aviation Administration laws (e.g., if a manager is engaging a drone operator). I would recommend that any CCO analyzing these service providers take a closer look and bring in outside experts when needed.

3) Place limits on expert networks such as limiting the number of calls per expert to a handful. After a handful, an analyst will have established a relationship with the expert, and the risk of receiving MNPI increases. Another way to limit the risks inherent to expert networks is to chaperone calls. I feel that unannounced chaperoning is good, although some will debate this. To me, if I don’t know whether compliance is on the call, I am going to always be above board. Also, work with your investment staff to rank their highest risk sources of MNPI so that you know where to focus your time.

4) Investment firms need to have specific policies in place that apply to consulting firms employing political intelligence analysts. A firm’s policies and procedures for engaging outside consultants should not be focused solely on expert network firms. As noted in the SEC’s settlement with Deerfield Management (8/21/17):

Deerfield distinguished expert network firms from research firms. Deerfield imposed compliance requirements when its employees interacted with experts and expert network firms, but did not adopt similar safeguards for dealings with research firms.

From my former seat analyzing the telecom sector, I can say with certainty that research calls with political consultants often venture into gray areas. For example, the former government employees will comment on whether they think a certain commissioner or staff will act a certain way. They love being “right,” so it’s up to the analyst to judge whether it’s a prediction based on past behavior or at risk of actual knowledge.

On the criminal side, the prosecution has also expanded its menu of fraud statutes when targeting investment firm professionals in these cases. In addition to filing charges alleging securities fraud, prosecutors are also including charges under wire fraud and stealing property of the U.S. government (18 U.S. Code § 641). Consequently, while they may not prevail in a case for securities fraud, they’ve hedged themselves to a degree with these other fraud statutes.

In my view, healthcare consultants are a massive risk. Some of these firms host conferences and updates in DC quite often. They are very niche specific with their experts on staff. They actively recruit former staff and have to refresh consultants often since DC changes rapidly. That means it’s hard to have quality control over the integrity of the individuals these firms are bringing on as consultants (i.e. Blaszczak in the Deerfield case).

One of the other big areas of risk is clinical trials. The best practices that I have observed in my discussions with firms is a policy of not being able to talk to anyone who is a lead investigator on a drug trial. But, there’s always the risk that a smaller contributor (i.e. conducting a smaller part of the trial) may not really be contributing to the analyst’s mosaic but in fact has MNPI. Again, reiterate the point in training of your investment staff to escalate these questions to you and not engage in isolated decision making.

5) Analysts should be very thoughtful when wording emails. I’ve observed that some firms are better than others about training their employees to consider how an email would look out of context. Regulators have the benefit of hindsight when bringing investigations. We’ve also recently seen an increased focused of the SEC’s OCIE in understanding how investment advisers use various electronic communication mediums. Even if you’re not doing anything illicit, using locker room language in an email could be a red flag during a later regulatory examination. They also need to understand that if they are communicating with people who are using a casual communication style, that they are exposing themselves to risk due to the individuals communicating this way. “How would this email look in three years out of context?” should always be considered. I’ve also found it quite effective during training sessions for the CCO to highlight poor examples of emails and/or IMs sent from their investment staff.

6) Compliance professionals need to be aware of who the firm’s analysts talk to the most. In my presentations, I point out that you are the average of the five people with whom you surround yourself and the mistakes that I made in building my investor peer network. Compliance officers can use email archiving to ferret out the five investors each of their analysts talk to most. Cases in the past have started from one investor talking to another in a group of investors or traders, so understanding the relationships between a firm’s analysts and other investor’s is key.

7) What is the “tone at the middle” at your firm? Regulators and investors frequently focus on – rightfully so – tone at the top. As was seen with Deerfield, however, just as important is the tone at the middle. That case involved three members of the investment staff and analysts and traders can have somewhat tribal subculture at a firm. While a firm can have
a great tone at the top, the analyst subculture can still be its undoing. The CCO should understand these subcultures, especially in larger organizations.

8) It is important to stress that every member of your firm is on the compliance team. Compliance can’t be everywhere all of the time with the investment team. Your traders and analysts are responsible for being the guardian of their own integrity and being vigilant for indications that they might be succumbing to any rationalization undermining it. Also stress if they make a mistake, own it before it gets worse – the cover-up is ALWAYS worse than the crime.

On the behavior side, making investment staff aware of some of the rationalizations and psychological traps that pull people over the line – into unethical or even illegal activity – can be helpful. Examples of psychological traps include (i) small steps, (ii) reduction words and the idea of (iii) faceless victims. With me, I received MNPI from another investor and then placed four small trades where I told myself these positions were “immaterial” because of their size. The reduction word “immaterial” was my self-talk to try and minimize my illegal behavior. Also, with insider trading, a common rationalization is that it’s a victimless crime. Another trap is the thought that “everyone is doing it” – the so-called false consensus effect. During training sessions, I believe a CCO should introduce the psychological traps that can ensnare even the most well-meaning employees. Although everyone may want to behave ethically, you’re only ethical up to the situation and circumstances you’re in at the time.

9) Each quarter, take one or two analysts aside and go through their biggest positions. Who are they talking to? How are they getting information? Not only does it get the compliance officer comfortable with the positions and have the potential to ferret out important information, it also acclimates the investment staff to speaking about their positions. During presence exams, the SEC will often speak directly with investment staff, so it is important that analysts, staff and management are all comfortable speaking about their positions and that they’re not doing it for the first time during an exam. It may be even more important now that we know one SEC regional office is conducting unannounced visits to investment managers, not giving them time to “dress up” their compliance policies or prep analysts before the questions start.

10) The prohibition on trading while in possession of MNPI effectively shuts down the possibility of using the original analysis until after the MNPI has become public. Mistakes with handling MNPI can be made in the research process. In fact, one of my past clients shared with me the story of a young analyst and his largest position in the portfolio. He had his five thesis points, airtight analysis and then received MNPI on an unchaperoned research call with an industry contact. Instead of raising his hand and going to the CCO, he chose to ignore the MNPI as he rationalized it wasn’t part of his original thesis. This all came to light after an inquiry from the regulator and the analyst is now on leave from the firm. While enforcement actions will continue to be brought against the obvious bad actors, I believe it is situations like these that are most common and of highest concern. The analyst most likely did not have any intent to break the law but engaged here in “isolated decision making” and ultimately put the firm and himself in harm’s way. Analysts must own up if a mistake is made so that they are protected and the firm is protected. Again, the cover-up is much worse than the crime.

For the investment team, it is important to emphasize some of the nuance here in training sessions: receiving MNPI immediately prohibits further trading in the stock, even if: i) the MNPI would not in itself have led to the decision to trade, ii) even if the MNPI was irrelevant to the decision to trade, iii) even if the individual had already started to undertake the trade when he/she received MNPI and iv) even if the decision was made to trade before receiving the MNPI.

Summary

As was originally noted in Dirks, the job of an analyst is to “ferret out and analyze information.” Through the investment research process, a thorough analyst will come into possession of MNPI multiple times in their careers. It is not time to panic, ignore, rationalize or “cover up” in these situations. A well-trained analyst will know exactly what to do.

Thank you again for the opportunity to turn past career-ending decisions into an opportunity today to add a voice to the compliance discussion.