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Insider Trading, MNPI and Related Internal Controls: A Renewed Focus by SEC

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Over the past few years, the SEC has brought fewer insider trading and Material Non-Public Information (MNPI)-related cases compared to historical numbers. We expect to see a reversal of that trend in 2022.

The SEC has provided some hints of its renewed focus on insider trading. First, even though the overall number of insider trading cases was down last year, the SEC brought two "first of kind" cases involving MNPI. The SEC successfully defeated a motion to dismiss its first "shadow trading" insider trading case – charging an individual with trading in the securities of an issuer based on MNPI he had obtained regarding another issuer. And the SEC brought its first case against an alternative data provider when it charged App Annie and its founder with making fraudulent misrepresentations in connection with its use of confidential information.

Second, the SEC has made trading by corporate insiders a regulatory priority. In December 2021, the SEC announced proposed amendments to Exchange Act Rule 10b5-1, which provides affirmative defenses for corporate insiders and companies to buy and sell company stock pursuant to trading plans adopted in good faith and before becoming aware of MNPI. The proposed amendments would add new conditions to the existing affirmative defense under Rule 10b5-1 (1)(c) to address perceived abusive practices associated with the existing rule. Typically, enforcement actions track stated regulatory priorities. We expect a renewed investigative focus on whether insiders have engaged in "gaming" their 10b5-1 trading plans, for example, by adjusting them while in possession of MNPI regarding the company.

Third, over the past two years, we have witnessed SEC examinations of fund managers that are highly focused on MNPI issues. For example, the exam staff has requested voluminous sets of emails and text messages, and has conducted interviews of traders and analysts as to those communications, similar to enforcement investigations. Firms that use alternative data sets have also been subject to targeted exams relating to their policies and procedures for onboarding and monitoring data vendors (*see* App Annie).

Examiners are highly focused on whether MNPI judgment calls have been adequately analyzed, documented, and cleared with legal/compliance as necessary—in other words, is the fund manager enforcing policies and procedures reasonably designed to prevent the misuse of MNPI under Section 204A of the Advisers Act? Where deficiencies are found, the SEC has brought stand-alone enforcement actions focused on 204A compliance violations, even in the absence of insider trading charges.

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