

May 2, 2013

U.S. Insider Trading Enforcement Goes Global

Introduction

A recent inquiry into potential insider trading in Switzerland ahead of the acquisition of H.J. Heinz Company has drawn attention to the role of U.S. regulators in policing suspicious trading activities that take place outside of the United States. While the Heinz matter has attracted significant media attention, it is only the latest in a string of similar cross-border inquiries and enforcement actions undertaken recently by the U.S. Securities and Exchange Commission (SEC). As these matters demonstrate, the SEC has in recent years shown an increasing willingness to pursue insider trading enforcement actions with substantial international dimensions. In the words of former SEC Enforcement Chief Robert Khuzami, "offshore trading is not off-limits to U.S. law enforcement."¹

Historically, many of the SEC's insider trading cases with international angles were simply the outgrowth of cases that were primarily domestic in nature. In recent years, however, a number of the SEC's insider trading matters have involved significant overseas conduct (e.g., foreign traders operating through foreign accounts) and consequently a high number of foreign defendants. In many of these matters, the jurisdictional nexus between the suspicious conduct and the U.S. market is increasingly attenuated (including at least one recent example in which the sole basis appears to have been that a particular

securities transaction was cleared through a U.S. brokerage account). While individuals or firms who choose to litigate insider trading cases against the SEC may be able to raise defenses to the SEC's arguably extraterritorial exercise of its jurisdiction under certain factual scenarios, the mere prospect of an SEC investigation – including significant legal costs and corresponding reputational impact – should cause internationally active firms to take note of the breadth and intensity of the SEC's focus on cross-border insider trading matters.

As a result of this shifting enforcement paradigm, internationally active market participants would be well-advised to assure that their policies and procedures on insider trading track the most conservative set of laws to which they are subject (in many cases, those of the United States), and that their legal and compliance functions are well integrated with a firm's trading operations such that they are positioned to understand new and evolving ways in which a firm receives and shares information. Such firms also should take proactive steps to prepare an internal blueprint for how to respond to potential insider trading issues when they arise, whether in the form of a whistleblower complaint, an internal surveillance issue or a formal inquiry from the SEC or other regulators.

Recent International Insider Trading Enforcement Actions

A review of recent insider trading enforcement actions underscores the degree to which those matters with global implications now make up a significant part of the SEC's docket.

One of the most significant recent insider trading matters, SEC v. Tiger Asia Management et al., involved trades in Chinese bank stocks that were executed on the Hong Kong Stock Exchange (**HKSE**) at the direction of Sung Kook "Bill" Hwang, the founder and portfolio manager of U.S.-based Tiger Asia Management and Tiger Asia Partners (collectively, **Tiger Asia**).² According to the SEC's complaint, the former head trader for Tiger Asia was approached by placement agents in the United States offering a private placement of Chinese bank stocks.³ After agreeing to be "wall-crossed," the trader obtained information regarding the private placements, including price levels.⁴ Allegedly acting on this information, Mr. Hwang directed the trader to open a short position in the Chinese bank stocks on the HKSE.⁵ Tiger Asia also allegedly engaged in market manipulation by submitting losing trades in securities of Chinese bank stocks on the HKSE, in order to manipulate the price of such securities at month's end, which had the effect of artificially inflating Tiger Asia Management's management fees.⁶ Tiger Asia's overseas activities resulted in parallel criminal and civil actions by the U.S. Department of Justice and the SEC, respectively. Tiger Asia Management ultimately agreed to pay a combined USD60m in disgorgement and penalties, including USD44m to settle the SEC's civil action and USD16m forfeited in connection with the criminal action. Tiger Asia Partners pled guilty to a single criminal charge and was sentenced to one year of probation.

Whereas the Tiger Asia matter involved substantial conduct in both the United States and abroad, a number of other recent insider trading matters involve conduct that is almost exclusively offshore (i.e., trades placed in overseas accounts by foreign traders). The Heinz inquiry noted above, SEC v. Certain Unknown Traders in the Securities of H.J. Heinz Company, involves suspicious trading in Switzerland by unknown foreign traders ahead of the public announcement that H.J. Heinz Company would be acquired by Berkshire Hathaway and 3G Capital. The day before the acquisition was announced, traders using an account in Zurich associated with Goldman Sachs purchased out-of-the-money call options in Heinz stock at a cost of USD90,000. As a result of Heinz share price increases following the announcement, the value of these holdings ballooned to USD1.8m. The very next day, the SEC obtained an order in U.S. federal court, the effect of which was to freeze the Swiss account.

Acting without knowledge of any concrete link to conduct within the United States (other than the fact that Heinz securities were traded on a U.S. exchange), and without knowing the identities or nationalities of the traders involved, the SEC was able to effect an account freeze in Switzerland. The SEC apparently was able to obtain an order freezing assets in the omnibus account through which the trading occurred – notwithstanding the fact that the account is located in Zurich – because it was held at a subsidiary of Goldman Sachs, a U.S. institution over which the U.S. court clearly had jurisdiction and the ability to impose sanctions for failure to obey a U.S. court order.⁷ While the SEC has encountered issues in other cases obtaining evidence sufficient to proceed beyond the initial asset-

freeze, the SEC's "shoot first" approach continues to be a strong signal to internationally active firms who are forced to incur substantial legal expenses in investigating and defending SEC cases, regardless of whether the SEC ultimately has sufficient evidence to proceed with its case beyond an initial asset freeze.

The Heinz matter also demonstrates that the SEC's ability to identify suspicious trading activity – in this case, high volume options trading in an account with no meaningful prior history of such trading – extends well beyond U.S. borders. Whether derived from the SEC's own market surveillance or from the cooperation of foreign financial regulatory agencies, the result is an unmistakable expansion of the SEC's ability to respond to potentially suspicious trading from Zurich to Hong Kong and beyond.

Nor is the Heinz matter an outlier. Two other recent enforcement actions follow the same essential fact pattern. SEC v. Compania Internacional Financia, S.A., et al., involved the acquisition of U.S.-based Arch Chemicals, Inc. by the Swiss-based Lonza Group.⁸ Before the acquisition was announced, three other Swiss entities purchased millions of shares of Arch. These purchases were conducted primarily through accounts based in the United Kingdom. Once the acquisition was announced, the Swiss entities sold their Arch holdings, realizing millions in profits. Within days of the alleged insider trading, the SEC obtained asset freezes and other emergency relief against all three Swiss respondents. In seeking emergency relief, the SEC specifically noted that the defendants were foreign entities who placed their trades in overseas accounts.

Another recent matter, SEC v. Well Advantage Limited and Certain Unknown Traders, appears to have an even more tenuous connection to the U.S. market.⁹ This matter involved the activities of Well Advantage (**Well**), a company incorporated in the British Virgin Islands and headquartered in Hong Kong. According to the SEC's complaint, Well is indirectly owned by Zhang Zhi Rong, a Hong Kong businessman with close ties to China National Offshore Oil Corporation (**CNOOC**). In July 2012, CNOOC announced that it had agreed to acquire Nexen, an

energy company based in Canada. Prior to the announcement, Well and a number of other traders stockpiled Nexen shares, which were liquidated shortly after the announcement. The SEC obtained a series of emergency court orders in the Well Advantage matter, ultimately freezing a total of USD44m in assets relating to the case. The SEC alleged that each of the entities purchased the Nexen stock based on nonpublic information, and that the trading patterns associated with the purchases of Nexen shares were consistent with insider trading. As in the Heinz matter, the SEC took its initial action within days of the announcement of the Nexen deal, and less than 24 hours after Well sold off its position.

Like many other recent cases, certain aspects of the Well Advantage matter have only a limited nexus with the U.S. In the case of Well itself, the trades were made using accounts based in the United States and held at Citigroup Global Markets (**Citigroup**) or UBS Securities LLC (**UBS**), which acted as Well's prime broker.¹⁰ To freeze Well's assets, therefore, the SEC simply obtained a court order directing Citigroup and UBS to freeze assets located in domestic accounts.¹¹ However, certain of the "unknown traders" named as defendants in the SEC action executed their trades through an omnibus account located in Singapore and held by a subsidiary of Citigroup.¹² With respect to these trades, the SEC was able to obtain an order directing Citigroup, a U.S. institution, to freeze the assets held overseas by its subsidiary.¹³ Still other "unknown traders" named as SEC defendants executed their trades through an omnibus account located in Singapore and held by Phillip Securities, a Singapore-based brokerage firm with a single U.S. affiliate, the Chicago-based Phillip Futures Inc.¹⁴ While Phillip Securities is not a U.S.-based firm, it did clear the trades in Nexen securities in the U.S., using an account at Pershing LLC. Acting quickly to prevent the proceeds from being repatriated to Singapore, the SEC obtained an order freezing Phillip Securities' account at Pershing.¹⁵

Since obtaining the initial asset freezes in the Well matter, the SEC has been successful in identifying several of the unknown traders, and has obtained settlements involving significant civil penalties. For example, the SEC identified

certain of the beneficial owners of securities in the Phillip Securities account who agreed to settle the SEC charges against them for a total of USD3.3m.¹⁶

Cross-Border Cooperation in Insider Trading Enforcement Actions

In pursuing international insider trading matters, the SEC has relied heavily on cross-border cooperation from foreign securities regulators in identifying and obtaining evidence of potential misconduct that resides overseas. Whether in the context of information-sharing to pursue parallel investigations in more than one jurisdiction or simply through the production of materials by a foreign regulator to the SEC under the auspices of a bilateral or multilateral memorandum of understanding (MOU), the SEC has proven itself quite adept at forging cooperative relationships with many of its overseas counterparts which have resulted in real, tangible cooperation and assistance.

In SEC v. Arnold McClellan and Annabel McClellan, the SEC alleged that the wife of a former Deloitte tax partner passed inside information that she had gained through her husband's work to relatives in the United Kingdom and that those relatives allegedly traded on that information (including advance notice of at least seven confidential acquisitions planned by Deloitte clients) and also tipped colleagues at a London-based derivatives firm, who also traded on that information.¹⁷

The McClellan matter involved parallel investigations conducted by the Financial Services Authority in the United Kingdom (now, the Financial Conduct Authority) and the SEC, Department of Justice, and Federal Bureau of Investigation in the U.S. Ms. McClellan ultimately settled the SEC's civil charges, agreeing to pay a USD1m penalty, and pled guilty to one count of obstructing the SEC's

investigation, after which she was sentenced to 11 months in prison. In the United Kingdom, the relatives (a husband and wife) who had received and traded on the basis of inside information were sentenced to 4 years and 10 months, respectively.

In addition to the cooperation reflected by the McClellan matter in parallel investigations, the SEC has repeatedly (and increasingly) acknowledged, in its litigation press releases, having received substantial assistance from other regulators in circumstances in which it does not appear as though those foreign regulators were pursuing their own domestic investigations. Rather, these matters demonstrate the extent to which the SEC has been successful in obtaining international assistance from foreign regulators solely on the basis of a request under an applicable MOU – with the expectation that the SEC will reciprocate that assistance as circumstances merit.

The recent case, SEC v. Richard Bruce Moore, illustrates how both types of cross-border cooperation can exist within the same matter. In this case, the SEC charged a Toronto-based investment banker with insider trading ahead of the pending acquisition of a UK-based company by the Canada Pension Plan Investment Board.¹⁸ In its complaint, the SEC alleged that Moore traded ADRs of the target company in the U.S. through a brokerage account in the Channel Islands as well as common shares of the target company

in London. In announcing the settlement, a senior official in the SEC's Division of Enforcement stated: "[i]n today's interconnected markets, the cooperative relationships among securities regulators mean that those who choose to engage in international insider trading should expect to face consequences across the globe."¹⁹ Importantly, the SEC's litigation press release specifically acknowledged the cooperation and assistance of the Ontario Securities Commission (who had conducted a parallel investigation in Canada) as well as the Jersey Financial Services Commission (who apparently had not conducted its own parallel investigation). Such public acknowledgment of international cooperation is not an anomaly. Indeed, in other recent cases the SEC has credited a significant number of foreign regulators with providing similar cooperation, including the French Autorité Des Marchés Financiers,²⁰ the New Zealand Securities Commission,²¹ the Australia Securities and Investments Commission,²² the Swiss Financial Market Supervisory Authority,²³ the Cyprus Securities and Exchange Commission,²⁴ the British Virgin Islands Financial Services Commission,²⁵ the Israel

Securities Authority,²⁶ the Hong Kong Securities and Futures Commission,²⁷ and the Italian Commissione Nazionale per le Società e la Borsa,²⁸ among others.

It is worth noting the ongoing litigation involving the SEC and the China affiliates of each of the Big Four accounting firms in the U.S. (plus another large U.S. accounting firm) in which the SEC is seeking to force those firms to turn over audit work papers and other materials relating to their audits of China-based companies that are under separate investigation by the SEC for potential accounting fraud relating to so-called "reverse mergers." While that litigation has important implications on the interplay between the SEC's aggressive efforts to obtain evidence located abroad and the ability of firms to invoke local, domestic requirements as a defense against production of requested materials, the SEC's ongoing ability to gather evidence overseas on a regulator-to-regulator basis, particularly during the investigative stages of its cases, will continue unabated.

Conclusion and Recommendations

The SEC's aggressive approach to enforcing insider trading laws globally has important implications for internationally active market participants. To address this development, firms should consider taking the following steps to either develop a comprehensive cross-border compliance program in the first instance or incorporate appropriate enhancements to existing programs in an effort to mitigate the risk of cross-border regulatory scrutiny:

- First, firms should ensure that their policies and procedures track the highest legal standard against which their conduct may be judged which, in many cases, may be that of the United States. Internal procedures should seek to ensure that legal and

compliance functions are well integrated with a firm's trading operations such that they are positioned to understand new and evolving ways in which a firm receives and shares information, both internally and with third parties. Policies and procedures also should address the circumstances in which internal information barriers are necessary or appropriate as well as specific procedures for involving legal and compliance in determining whether the firm has received material non-public or "price sensitive" information and, as such, should restrict itself from trading in the relevant securities.

- Second, firms should adopt or enhance comprehensive training programs to ensure that a firm's employees are familiar with their compliance roles and responsibilities, particularly with respect to the handling and sharing of material non-public or "price sensitive" information. Among other things, training programs should explore the current global enforcement environment, the standards against which firm and individual employee conduct will be judged as well as the internal mechanisms available to employees to report any compliance concerns or potential violations. Specifically, firms should consider training on internal ethics/whistleblower hotlines and their relationship to the SEC's new whistleblower program, which has seen a significant uptick in whistleblower complaints originating from outside the United States.²⁹ The point of incorporating these items into compliance training is to ensure that employees understand that the incentives of the SEC whistleblower program are such that potential whistleblowers are incentivized to report any potential concerns first through internal reporting mechanisms prior to raising the issue externally to the SEC or other regulators (i.e., primarily because one of the factors to be applied by the SEC in determining the amount of any whistleblower award is whether the individual first reported through available internal channels).
- Next, firms should take care to develop tailored protocols for ongoing compliance monitoring and surveillance of trading activity to identify and address insider trading and other risks. These monitoring procedures should be risk-based, taking into account the nature and degree of information to which different categories of employees may have access, and must be flexible enough to permit adjustments and enhancements based on the evolution of how information is received and disseminated within an organization and with third parties. Firms also should dedicate sufficient resources to internal legal and compliance departments so as to make compliance monitoring a legitimate, meaningful process that is fully supported by senior business leaders and credible to domestic and foreign regulators alike.
- Firms should proactively develop an internal playbook for responding to a potential insider trading problem *before* an issue is detected. As the recent matters discussed above demonstrate, time is often of the essence once an issue has captured the regulatory interest of the SEC or other regulators around the world. As a result, firms should develop a process for conducting internal reviews on a cross-border basis in order to gather relevant facts expeditiously and consider how best to mitigate regulatory risk both domestically and internationally. This means that firms should undertake a robust mapping exercise to understand where documents and information, like e-mails and other electronic data, are stored based on the geographic location of its employees and computer systems and consider whether there might be any potential complexities in gathering and reviewing that information (e.g., data privacy concerns) on a cross-border basis. Ultimately, if an issue identified internally is of a sufficient magnitude that makes self-reporting either necessary or advisable, internationally active firms will need to consider carefully how best to self-report potential violations and how best to navigate the real possibility of having to self-report to a number of different regulators around the world.
- Finally, firms should be prepared for how they will respond to a cross-border regulatory investigation, whether in the form of an SEC subpoena (or, an asset freeze order from a foreign court) by carefully analyzing the intersection of a foreign request or court order with local banking, privacy, and consumer protection laws in the various jurisdictions in which they operate. While such

issues must be considered on a fact-specific basis, firms that think about the steps they will take to respond to these issues *before* they arise will be far better positioned to handle them when they occur than those who put off consideration of such cross-border complexities until a problem arises.

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Endnotes

¹ SEC Press Release 2012-264, *Hedge Fund Manager to Pay \$44 Million for Illegal Trading in Chinese Bank Stocks*, December 12, 2012.

² See generally *SEC v. Tiger Asia Management LLC et al.*, 12-cv-7601-DMC (S.D.N.Y.), Complaint, Dec. 12, 2012.

³ *Id.* at 5.

⁴ *Id.*

⁵ *Id.*

⁶ *Id.* at 11-12.

⁷ See *SEC v. Unknown Traders in the Securities of H.J. Heinz Company*, 1:13-cv-01080-JSR (S.D.N.Y.), Order to Show Cause and Order Freezing Assets and Granting Other Relief, at 4-5, Feb. 15, 2013.

⁸ See *SEC v. Compania Internacional Financiera S.A. et al.*, 11-cv-04904-JPO (S.D.N.Y.), Complaint, July 15, 2011.

⁹ See *SEC v. Well Advantage Limited, et al.*, 1:12-cv-05786-RJS (S.D.N.Y.), Plaintiff Securities and Exchange Commission's Memorandum of Law in Support of Its *Ex Parte* Emergency Application For an Order to Show Cause, Asset Freeze and Other Relief ("Well SEC Memorandum").

¹⁰ Well SEC Memorandum at 4-5, July 27, 2012.

¹¹ See *SEC v. Well Advantage Limited, et al.*, 1:12-cv-05786-RJS (S.D.N.Y.), Order to Show Cause and Order Freezing Assets and Granting Other Relief (**Well Freeze Order**) at 7.

¹² See Well SEC Memorandum at 6.

¹³ See Well Freeze Order at 7.

¹⁴ See Well SEC Memorandum at 6.

¹⁵ See Well Freeze Order at 7.

¹⁶ See *SEC v. Well Advantage Ltd. et al.*, Lit. Rel. No. 22663, April 1, 2013.

¹⁷ See generally *SEC v. Arnold McClellan and Annabel McClellan*, 1:10-cv-5412-JCS (N.D.Ca.), Complaint, Nov. 30, 2010.

¹⁸ *SEC v. Richard Bruce Moore*, 13-cv-2514 (S.D.N.Y.), Complaint, April 16, 2013.

¹⁹ SEC Press Release 2013-62, *SEC Charges Canada-Based Investment Banker with Insider Trading*, April 16, 2013.

²⁰ See *SEC v. Dr. Yves M. Benhamou*, SEC Lit. Rel. No. 21721, Nov. 2, 2010.

²¹ See *SEC v. Thomas C. Conradt, et al.*, SEC Lit. Rel. No. 22581, Dec. 26, 2012.

²² *Id.*

²³ See *SEC v. Quorne Limited and Michael Sarkesian*, SEC Lit. Rel. No.

²⁴ *Id.*

²⁵ *Id.*

²⁶ See *SEC v. Aragon Capital Advisors, LLC, et al.*, SEC Lit. Rel. No. 22322, Apr. 6, 2012.

²⁷ See *SEC v. Kan King Wong et al.*, SEC Lit. Rel. No. 20447, Feb. 5, 2008.

²⁸ *SEC v. Cristian De Colli*, SEC Lit. Rel. No. 20819, Dec. 2, 2008.

²⁹ For more information, see Jeffrey A. Lehtman, *Cross-Border Implications of the SEC Whistleblower Report*, Law360, Nov. 15, 2012, available at <http://www.law360.com/articles/395744/cross-border-implications-of-the-sec-whistleblower-report>.

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