SEC Settles with Research Firm over Mishandling of Insider Information

Political Intelligence Firm, Marwood Group, Fined $375,000 by SEC, Admits Fault and Agrees to Implement Remedial Measures

SUMMARY

On November 24, 2015, the Securities and Exchange Commission announced that it had entered into a settlement order with Marwood Group Research LLC, a so-called “political intelligence firm,” in connection with the mishandling of information that potentially constituted material non-public information (“MNPI”), Marwood agreed to admit to violations of Section 15(g) of the Securities and Exchange Act of 1934 and Section 204A of the Investment Advisers Act of 1940, to pay a $375,000 penalty, and to take specified remedial actions.

The SEC made the following specific findings of fact to support the settlement order:

- Marwood encouraged its employees to communicate with and maintain relationships with government employees in order to develop written reports, which would then be distributed to hedge funds and other securities market participants, concerning likely outcomes of future government actions.
- Marwood had written policies and procedures that prohibited the dissemination of MNPI and required any potential such information received from any source to be brought to the attention of the firm’s chief compliance officer (“CCO”).
- In two instances in 2010, Marwood research employees did not follow the CCO escalation procedure or otherwise quarantine information received from sources at federal government agencies that potentially constituted MNPI, and Marwood subsequently distributed written reports containing that information to hundreds of its clients.

The SEC concluded that Marwood’s interactions with government agents created a substantial risk that MNPI would be obtained and misused, that Marwood’s policies were not reasonably tailored to its business, and that Marwood failed to reasonably enforce the policies that it did have in place.
BACKGROUND
Marwood, a political intelligence firm, is a broker-dealer registered with the SEC and an investment adviser registered with the State of New York. Marwood researches and analyzes legislative and regulatory changes that have the potential to affect the share price of a public company’s stock or stocks within a particular market sector and communicates its analyses in research notes to its clients. The SEC settlement order notes that to enhance its analysis of future government regulatory events, Marwood encouraged its analysts to maintain contacts and seek information from federal employees. The SEC’s stipulation of facts also noted that Marwood’s hiring decisions would consider, in part, a prospective employee’s professional experience at a particular agency as well as contacts within the government.

The SEC notified Marwood of its investigation regarding Marwood’s handling of potential MNPI in December 2014 and announced the settlement of this matter on November 24, 2015.¹

THE SETTLEMENT
The violations of the Exchange Act and the Advisers Act² arose from Marwood’s treatment of information received in 2010 from the Centers for Medicare and Medicaid Services (“CMS”) relating to Medicare coverage of Provenge, an immunotherapy treatment, and the Food and Drug Administration (“FDA”) relating to its approval for sale in the United States of Bydureon, an injectable diabetes drug. During this period, Marwood had in place written policies and procedures concerning the use and dissemination of inside information, including MNPI, as well as policies and procedures providing for a review process over the preparation and publication of its research notes.

- In the case of Provenge, the SEC settlement order notes that a Marwood associate contacted a member of CMS’s staff regarding its analyses for determining Medicare coverage of Provenge. The SEC found that the information that the Marwood analyst obtained from the CMS contact, in the context in which it was conveyed, presented a substantial risk that it could be MNPI; despite that fact, no Marwood employees took steps to present the information to the CCO for further review, in violation of existing Marwood policies. Marwood subsequently published a research note on this topic to hundreds of Marwood clients and predicted CMS’s continued coverage and reimbursement of Provenge’s use for on-label purposes.

- With Bydureon, Marwood retained a former high-ranking FDA official as a consultant to assist with its analysis of Bydureon’s approval, and the consultant communicated information learned from a contact at the FDA regarding the Bydureon approval process. The SEC determined that


² Section 15(g) of the Exchange Act requires broker-dealers to establish, maintain, and enforce written policies and procedures reasonably designed, taking into consideration the nature of such broker’s or dealer’s business, to prevent the misuse in violation of this title, or the rules or regulations thereunder, of MNPI. Similarly, Section 204A of the Advisers Act requires investment advisers to establish, maintain, and enforce written policies and procedures to prevent the misuse, in violation of the Advisers Act or the Exchange Act and the rules or regulations thereunder, of MNPI.
there was substantial risk that this information too was MNPI, but no Marwood employees took any steps to quarantine the information received from the consultant or to escalate the matter to the CCO. Marwood subsequently informed its clients that there was an internal debate at the FDA concerning the safety of Bydureon and that there was an under-appreciated risk in the market that the application could be denied.

The SEC found that Marwood did not have a written policy or procedure that reasonably ensured that the CCO was provided with sufficient information to assess whether a research note may have been influenced by improperly obtained MNPI or to evaluate independently other Marwood employees’ assessments that any information they had received from a government employee was not MNPI. The SEC concluded that Marwood’s policies and procedures amounted to line employees and managers self-assessing whether the information was MNPI and that, under existing law, these were insufficient safeguards for broker-dealers regularly in contact with persons in possession of MNPI.\(^3\)

Marwood admitted to the facts set forth in the settlement order and acknowledged that its conduct violated Section 15(g) of the Exchange Act and Section 204A of the Advisers Act. Marwood also agreed to pay a $375,000 penalty and retain an independent compliance consultant to review its compliance procedures and report back to the SEC within 180 days. Marwood has committed to implement all recommendations of the compliance consultant except for recommendations that Marwood considers to be unduly burdensome, in which case it will notify the SEC and propose an alternative mechanism to achieve the same objective or purpose.

**IMPLICATIONS AND COMPLIANCE CONSIDERATIONS**

This settlement demonstrates the SEC’s willingness to prosecute potential insider trading-related activity that is beyond traditional tipper and tippee conduct and beyond the scope of the traditional SEC Rule 10b-5 anti-fraud provisions.

The SEC’s focus on the research firm’s failure to protect insider information reflects recent developments. As we have previously discussed, the Second Circuit’s holding in *U.S. v. Newman* confirmed that in tipper-tippee cases the personal benefit received by the tipper in exchange for the disclosure of non-public information must be of “some consequence,” not just friendship, and that a tippee cannot be convicted unless the tippee knew of the personal benefit received by the insider in exchange for the disclosure. *Newman* effectively increased the evidentiary burden to prove insider trading under SEC Rule 10b-5,\(^4\) and therefore narrowed the scope of factual scenarios that may subject a market participant to

\(^3\) *See In re Gintel Asset Mgmt., Inc., Advisers Act Rel. No. 2079 (November 8, 2002); In re Deprince, Race & Zollo, Inc., Advisers Act Rel. No. 2035 (June 12, 2002); In re Guy P. Wyser-Pratte, Advisers Act Rel. No. IA-1943 (May 2, 2001); In re Certain Market Making Activities on Nasdaq, Exchange Act Rel. No. 40910 (January 11, 1999).*

insider trading liability. The stipulation of facts in the Marwood settlement order suggest that there may not have been a sufficient factual basis to establish liability on the part of Marwood for insider trading, particularly under Newman. The SEC appears to acknowledge that background, noting in the settlement order that there is no required finding of an underlying insider trading violation or any other violation of the Exchange Act in order to find a violation of the rules requiring the protection of insider information.5

In light of this settlement, broker-dealers and investment advisers should review their policies and procedures for protecting MNPI, including the application and enforcement of existing policies and procedures.

It is also noteworthy that the settlement is narrowly tailored to the policies and procedures of SEC registered broker-dealers and investment advisers subject to the Advisers Act. In particular, the settlement order does not address whether any of Marwood’s clients or subscribers might have risked violating SEC Rule 10b-5 based on the receipt of the Marwood research reports in conjunction with subsequent trading activity. The settlement order also does not directly conclude whether the information received from CMS and FDA was in fact MNPI, either when received by Marwood, or when included in the research reports.

Similarly, the settlement order does not speak to whether any party involved may have been exposed to potential liability under the Stop Trading on Congressional Knowledge Act, or STOCK Act.6 Of relevance to Marwood’s case, the STOCK Act states that no executive branch employee may use nonpublic information derived from such person’s position as an executive branch employee or gained from the performance of such person’s official responsibilities as a means for making a private profit. The SEC did not discuss whether the communications at issue from the CMS or the FDA would constitute nonpublic information derived from such person’s position, although the SEC has previously sought to enforce a similar STOCK Act provision for Congressional members and employees.7 Nonetheless, we note that the settlement order reinforces the need for clients of, and subscribers to, reports issued by firms like Marwood to review their own policies and procedures in connection with onboarding new research vendors and the scope of permitted interactions between research vendors and firm employees.

Finally, we note that Congress has given the Commodity Futures Trading Commission and the Federal Trade Commission anti-fraud authority that substantially mirrors the language of SEC Rule 10b-5. While largely untested by the regulators themselves, these provisions are likely to prohibit the use of MNPI in

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7 S&C’s memo on the SEC’s enforcement of a STOCK ACT provision in connection with CMS disclosure is available at https://www.sullcrom.com/siteFiles/Publications/SC_Publication_The_STOCK_Act.pdf.
situations that do not include securities transactions. Because these agencies have indicated that they will be instructed by (although not necessarily governed by) the SEC’s own analysis of the scope of Rule 10b-5 in determining whether an insider trading related violation has occurred, any SEC order addressing MNPI or potential MNPI may be persuasive precedent, and trading firms should ensure that any MNPI policies and procedures are tailored to cover not only SEC issues, but also the MNPI implications of the statutes and regulations of other regulators, such as the CFTC and FTC.
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