Securities Law—Potential Expansion of Liability Theories Under the Martin Act

New York State Attorney General and BlackRock Settle Investigation into BlackRock’s Analyst Survey Program, Signaling Potential Expansion of Martin Act Liability Under “Insider Trading 2.0” Theory

SUMMARY

On January 8, 2014, the New York State Attorney General and BlackRock, Inc. entered into a settlement agreement by which BlackRock agreed to end its Wall Street research analyst survey program. The Attorney General alleged that BlackRock’s practice of systematically surveying and aggregating information from analysts gave BlackRock an unfair advantage in predicting future analyst opinions, in violation of the Martin Act and the New York Executive Law. Because the Attorney General did not contend that BlackRock obtained any material non-public information, or that the information was provided by analysts in breach of any duty to their employers, the allegations by the Attorney General signal a potential expansion of liability under New York State law.

The BlackRock settlement comes on the heels of an industry-wide probe into the alleged procurement by sophisticated investors of early access to potentially market-moving information, a practice that the Attorney General dubbed “Insider Trading 2.0.” BlackRock neither admitted nor denied the Attorney General’s findings but consented to remedial measures including permanent, worldwide discontinuance of the survey program and continued cooperation with ongoing related investigations. The agreement did not impose a fine or penalty.

BACKGROUND

BlackRock’s survey program was developed in 2003 by Barclays Global Investors (“BGI”), which BlackRock acquired in 2009. The program involved surveys of Wall Street research analysts on a
monthly or quarterly basis that asked the analysts to ascribe numeric scores to attributes—such as management, competitive position, and earnings—of the companies they covered. The quantitative investment arm of BlackRock’s BGI subsidiary then derived “signals,” or quantitative return forecasts, from aggregated survey response data and incorporated the signals into trading models. The Attorney General found that BGI’s quantitative investment arm engaged in securities transactions based, in part, on signals derived from the survey program.

Participation in the survey program was conditioned on an analyst’s agreement to base answers entirely on his or her “public stance,” i.e., information that the analyst would disclose to other clients. Each survey also contained an introduction “highlight[ing] the fact that [BlackRock was] only interested in public information.” The analysts’ employers expressly consented to the analysts’ participation in the program.

**INVESTIGATION FINDINGS AND CONCLUSIONS**

The Attorney General alleged that information contained in research analyst reports is “generally considered to be market moving” and noted that brokerage firms and analysts are not allowed to disclose research reports selectively prior to the reports’ publication. BlackRock has maintained that the survey program simply quantified publicly available information expressed by analysts in reports and other forums such as speeches and interviews. Citing internal documents, including a document stating that “[t]he purpose of the survey is to get ahead of analysts’ actions,” the Attorney General rejected BlackRock’s argument. He alleged instead that the program’s design “allowed it to capture more than previously published analyst views, including non-public analyst sentiment that could be used to trade ahead of the market reaction to upcoming analyst reports.”

The Attorney General deemed suspect both the timing of the surveys’ distribution and specific questions contained in the surveys. Because BlackRock frequently received survey responses weeks after an analyst’s most recent report, the Attorney General alleged an elevated risk that the resulting survey data would reflect developments post-dating any public expression of the analyst’s opinion. The Attorney General also alleged that certain survey questions tended to reveal opinions that were not likely to be published in reports, such as a question requesting the analyst’s assessment, “[e]xcluding transactions actually announced,” of the likelihood that a covered company would be acquired in a merger.

Additionally, the Attorney General alleged that BGI’s quantitative investment arm “leveraged BlackRock’s massive market position to help ensure that brokerage firms would respond to the survey program” and “directly rewarded” participating analysts with high ratings in industry rankings.

The Attorney General concluded that the survey program violated the Martin Act, which imposes civil and criminal liability for securities fraud conducted “within or from” New York, and § 63(12) of the New York Executive Law, which authorizes the Attorney General to prosecute “persistent fraud or illegality in the carrying on, conducting or transaction of business.” BlackRock neither admitted nor denied the Attorney
General's findings but agreed to (i) discontinue the analyst survey program worldwide and cease acting on information already obtained through the program, (ii) cooperate with the Attorney General in connection with related investigations, (iii) implement policies prohibiting violations of the settlement's terms, and (iv) reimburse the State of New York $400,000 to cover the costs of the investigation.  

**IMPLICATIONS**

The BlackRock settlement reflects the Attorney General's apparent effort to expand the scope of Martin Act liability to reach beyond the federal standard for insider trading. Traditionally, the New York State law insider trading standard tracked the federal standard, which provides that liability attaches only (i) “when a corporate insider trades in the securities of his corporation on the basis of material, nonpublic information” or (ii) when a person trades on the basis of confidential information “misappropriate[d] . . . for securities trading purposes, in breach of a duty owed to the source of the information,” if the trader knows or should know that the information was obtained improperly.

In his settlement with BlackRock, the Attorney General notably did not allege that any information obtained by BlackRock was material or that participating analysts provided the information in breach of any duty. Rather, the Attorney General focused on the potential risk that analysts may have disclosed nonpublic opinions—a risk exacerbated by BlackRock's market position. This approach suggests that the Attorney General may view the Martin Act to reach beyond the traditional insider trading standard and encompass methods of obtaining information that create a significant risk of insider trading, even where there is no evidence of historic improper conduct.

In recent years, both the DOJ and the SEC have not only embraced broad interpretations of materiality, but also suggested that aggressive insider trading enforcement is necessary to create a so-called “level playing field” among investors. This trend creates additional uncertainty for sophisticated investors who seek to obtain information in a manner that is not otherwise unlawful, but that can be characterized by enforcement authorities as creating an “unfair” informational advantage or that creates a significant risk of obtaining inside information.

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ENDNOTES


2. The findings of the Attorney General's investigation appear to apply uniformly to the survey program as it existed both before and after BlackRock's acquisition of BGI. See, e.g., Assurance of Discontinuance Pursuant to Executive Law § 63(15), In the Matter of the Investigation of BlackRock, Inc., Assurance No. 14-007 (Jan. 8, 2014) [hereinafter BlackRock Assurance], ¶ 43.

3. Id. ¶¶ 9–10; 14.

4. Id. ¶¶ 8; 15–17.

5. Id. ¶¶ 8; 18–20.

6. Id. ¶ 5–6.

7. Id. ¶ 18; 23–27.

8. Id. ¶ 22.

9. Id. ¶ 28–32.

10. Id. ¶ 33–38.

11. Id. ¶ 39–41.


13. See N.Y. Exec. Law § 63(12); BlackRock Assurance ¶ 45.


16. See, e.g., BlackRock Assurance ¶ 44 ("The survey program’s design allowed it to receive information not necessarily disclosed in analysts' previously published research reports . . . .").

17. See id. ¶ 8 (noting brokerage firms’ consent to employees’ participation in the program).

18. See SEC ENFORCEMENT ACTIONS: INSIDER TRADING CASES, https://www.sec.gov/spotlight/insidertrading/cases.shtml (last visited Jan. 21, 2014) (noting that insider trading "undermin[es] the level playing field that is fundamental to the integrity and fair functioning of the capital markets").
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