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US MANAGERS AWAIT A CRUCIAL SUPREME COURT INSIDER TRADING DECISION



JUDGMENT DAY:

US MANAGERS AWAIT A CRUCIAL DECISION ON INSIDER TRADING AS THE US SUPREME COURT IS SET TO RULE ON *SALMAN V UNITED STATES* IN THE COMING MONTHS

BY SAM DALE



The US Supreme Court is set to hear its first significant insider trading case in three decades and its judgment could potentially overhaul the concept of criminal liability in insider trading cases.

On January 20, the Supreme Court agreed to hear an appeal in the case of *Salman v United States* from the Ninth Circuit Court of Appeals.

While a date has not yet been set, insiders expect oral evidence to be heard this summer and a decision to be handed down in the autumn.

There is no statutory definition of insider trading and prosecutors have struggled to gain convictions.

“The law of insider trading is notoriously murky. It is built upon SEC standards and federal case law that have evolved over the years, and as the cases *Newman* and *Salman* exemplify, the law is both complicated and ill-defined,” says Milo Marsden, partner at law firm Dorsey.

The *Salman* case could bring clarity. It involves Bassam Salman’s conviction for conspiracy and insider trading.

The tipper was Maher Kara, an employee of Citigroup’s healthcare investment banking group. In 2004, Maher had

begun discussing aspects of his job with his older brother Michael Kara. From late 2004 to 2007, Maher regularly disclosed to Michael inside information concerning upcoming mergers and acquisitions by Citigroup clients.

Meanwhile, Maher Kara became engaged to Salman’s sister. The two families grew close, and Michael Kara and Salman became friends. Michael began sharing the Citigroup information with Salman, who traded on it in an account held in the name of another relative.

Salman was convicted of trading on the confidential information, making a profit of around \$1.7m. He is appealing by relying on a previous decision in *United States v Newman*.

Newman ruling

The *Newman* judgment rocked the hedge fund world when two managers had their convictions for insider trading overturned in a ruling that redefined tippee liability.

In December 2014, the Second Circuit ruled in favour of former Diamondback Capital portfolio manager Todd Newman and Level Global Investors trader Anthony Chiasson. The court said to convict for insider trading, it must be proven that the tipper received a benefit and the

tippee knew about the benefit. It also found proof of a personal benefit can't be satisfied through a friendship.

In October 2015, the Supreme Court denied US Solicitor General Donald Verrilli's petition to revisit the Second Circuit decision.

For hedge funds, *Newman* drastically narrows the definition of insider trading.

Regulatory blow

It was a major blow to the Securities and Exchange Commission and US Attorney for the Southern District of New York. SEC chief litigation counsel Matthew Solomon described the case as a "very negative legal development" and suggested it affected the regulator's case against SAC Capital founder Steve Cohen.

In January, Cohen, now chief executive of Point72 Capital Management, was banned from managing external money until 1 January 2018 for failing to supervise funds properly. In 2014, SAC traders were convicted of securities fraud.

Lawyers criticised the ban on Cohen as too short and Solomon laid part of the blame with *Newman*.

In October, SAC Capital trader Michael Steinberg saw his three-and-a-half year jail term overturned along with six other managers in the wake of the decision in *Newman*. It also constrained judges in the Second Court, which is seen as the leading authority on financial cases.

On July 6 last year, a judge in the Ninth Court used the opportunity to provide a dissenting opinion on *Newman* and apply wider insider trading tippee liability. The conflicting opinions meant it was inevitable the Supreme Court would have to take on the case.

Regulators are now hoping *Newman* can be dismissed and the law returned to pre-December 2014 with narrow tippee liability reinstated.

The court has three options. It could overturn *Newman* and return to a situation as if it had never happened. It could affirm *Newman* and embed the narrow definition of tippee liability in US law. Or it could dodge the issue and affirm or appeal the case without setting wider rules.

"*Salman* is poised to change the landscape, depending upon which way the Supreme Court rules," says Erin Koeppel, partner at K&L Gates. "People want certainty but I am not sure that will happen."

Lawyers say the *Salman* case is "much cleaner" than *Newman* as the key issue is whether personal benefit can be established by tipping within families without any direct financial benefit.

David Miller, partner at Morgan Lewis, says the *Salman* case could settle issues of tipping liability under insider trading law. Miller has previously served for five years as an Assistant US Attorney in the Southern District of New York where he prosecuted insider trading cases. He also sat on the Securities and Commodities Fraud Task Force.

"Whether the court affirms or reverses, it will be significant because the court is likely to weigh in on what

Newman and personal benefit means," he says. "This will have substantial ramifications for future enforcement and regulatory action in insider trading. Many of the insider trading cases in the last decade relate to tipping liability."

The death of Supreme Court associate justice Antonin Scalia in February has also potentially changed the dynamics of the case.

With a Republican Senate refusing to even hold confirmation hearings with any Supreme Court nominee made by President Obama, it seems likely the court will remain with just eight justices for months.

"Scalia was known for being a strict interpretationist and his views were pretty black and white on issues like this," says one financial crime litigator. "Without him to guide the discussion among justices and oral argument then it is a different court."

In the meantime, lawyers are telling hedge funds not to relax insider trading controls on the basis of *Newman*.

Next steps

SEC head of enforcement Andrew Cerensey has said the regulator will not think about creating its own definition of insider trading until after the case. And Congress is waiting too. Last year, Connecticut Congressman Jim Himes tabled legislation that would overturn the *Newman* decision but he has struggled with a deadlocked Congress.

In October, Himes told sister publication *HFMWeek* the decision by the Supreme Court not to hear the *Newman* case was "the final nail in the coffin of operating without a clear insider trading statute... Market confidence is critical and the Appellant Court and Supreme Court's decisions raise some real uncertainties about market integrity," he says.

Campaigners have long called for insider trading to be defined by statute rather than case law but there are complications. "People were calling for a statutory definition of 'insider trading' even before *Newman* and *Salman*," says Koeppel. "These cases are so fact-specific that it may be difficult to come up with a statute to address appropriately all different scenarios," says Nicole Baker, partner at K&L Gates.

It's hoped that political conditions after the elections in November could be more favourable for action "It is possible we could see some proposed legislation depending on what the court rules," says Miller.

"There has been a push, particularly post-*Newman*, for some kind of legislative action. The *Newman* case has had a significant impact on the prosecution of remote tippees. The *Salman* decision could clarify or limit *Newman's* holding." ■



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