

Ensuring Nonpublic Info Stays Private Amid SEC Crackdown

By **Teresa Goody Guillén, Alexandra Karambelas and Jamie Reiner** (April 22, 2024)

The new flexible work environment created in the post-pandemic years poses unique challenges for companies and individuals who work outside a traditional office. The U.S. Securities and Exchange Commission knows this and is actively enforcing the securities laws if violations result.

Trading on Material Nonpublic Information

In two recent high-profile cases, the SEC announced charges against individuals who traded on material nonpublic information, or MNPI, obtained from partners or spouses while working from home.

In February, the SEC charged Tyler Loudon for allegedly trading on MNPI he acquired from his wife while the two were working from home.[1] In a press release, the SEC alleged that Loudon "took advantage of his remote working conditions" to obtain the MNPI from his wife's work materials, making \$1.76 million in profits from insider trading.

Loudon's wife was a mergers and acquisitions manager at BP PLC. The complaint details that Loudon overheard many of her work-related conversations about a BP acquisition of TravelCenters of America Inc. in early 2023, and without his wife's knowledge, he purchased 46,450 shares of TravelCenters stock before the announcement of the merger.

In a similar case, in June 2023, the SEC brought charges against Jordan Meadow, a registered representative for a New York-based broker-dealer, and Steven Teixeira, the chief compliance officer of an international payment-processing company.[2]

The SEC alleged that the two men traded based on MNPI that Teixeira accessed from his girlfriend's laptop while the two were working at home. Specifically, the complaint alleges that Teixeira retrieved nonpublic information on possible upcoming mergers and acquisitions of public companies from the laptop of his girlfriend, who was employed at a New York-based investment bank.

Allegedly, Teixeira used the information to purchase options on different issuers ahead of the announcement of a deal and then told his friends, including Meadow. Teixeira allegedly made \$28,600 in profits, with Meadow bringing in more than \$730,000. Meadow also allegedly passed the information along to his brokerage customers, which resulted in millions of dollars in profit for them and hundreds of thousands of dollars in commissions for Meadow.

In a parallel action, the U.S. District Court for the Southern District of New York is criminally charging Meadow and Teixeira.



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Notably, the use of increasingly sophisticated data analytics has allowed the SEC to detect potential insider trading violations with greater speed and efficiency.

The commission has been highlighting its data analytics capabilities over the past year, particularly in the unprecedented enforcement action and parallel indictment of Terren Peizer for insider trading based on a Rule 10b5-1 plan in March 2023,[3] and the commission announcing charges against 13 individuals the same day for insider trading.[4]

These cases illustrate that the SEC is increasing the sophistication of their enforcement efforts by utilizing advanced data analytics tools.

Off-Channel Communications

Exposure to MNPI is not the only potential hazard in the work-from-home era.

As hybrid and remote work appear to be here to stay, the SEC's continued focus on off-channel communications and the use of personal devices shows no signs of stopping.

The commission brought a plethora of charges arising from off-channel communications violations in 2023, including multimillion-dollar settlements with HSBC and Scotia Capital[5] and 10 broker-dealers in August 2023.[6] In the announcement accompanying those enforcement actions, the SEC emphasized that by failing to maintain and preserve these records, the firms likely "deprived the Commission of these off-channel communications in various SEC investigations."

More recently, the SEC announced charges against Senvest Management LLC for alleged "widespread and longstanding failures to maintain and preserve certain electronic communications." [7] As a result, the firm agreed to pay a \$6.5 million penalty and retain a compliance consultant in order to conduct a review of the company's personal device and electronic communications policies.

These enforcement actions were brought pursuant to long-standing SEC books and records requirements regulating the maintenance and preservation of documents. Specifically, Section 17(a)(1) of the Securities Exchange Act of 1934 and Rule 17a-4 require that broker-dealers preserve all communications received and sent relating to a firm's business. Similarly, Section 204 of and Rule 204-2(a)(7) under the Investment Advisers Act of 1940 require registered investment advisers to retain certain specific categories of business-related communications.

Mitigating Risk in the Work-From-Home Era

While flexible work environments and the convenience of personal devices can be beneficial, companies must consider the potential compliance pitfalls that accompany remote work and off-channel communications.

It is imperative that companies and individuals take steps to ensure MNPI remains confidential while they are working outside the office.

Specifically, while individuals are working from home, meetings should be conducted in private. If privacy is limited, they should consider the best practices of wearing headphones; using room partitions or dividers, privacy computer and phone screens, and strong passwords; and being mindful to always lock devices when not in use.

Employees should be trained on their duties to ensure that material nonpublic information remains confidential, and on how to ensure confidentiality. Further, when working from home, it is important for individuals to remind those who may be near during confidential conversations that they may overhear confidential information, but they should not share or act on the information.

Employees should also be trained regarding off-channel communications, and companies should evaluate what degree of control they have over the personal devices of their employees if such devices are used for business purposes.

It is also important to ensure that all employees, including senior employees, are abiding by these policies. In their enforcement efforts, the SEC has focused on senior employees and their off-channel communications, suggesting that the commission might view violations by senior personnel as an implication that the firm has widespread problems.

Companies would be well advised to adopt robust policies governing the protection of MNPI and the use of personal devices. Existing policies should be reviewed and updated by outside counsel to account for the unique challenges posed by remote work. Any program should meet applicable regulatory requirements, emphasize practicality, reflect the business needs of the corporation, and evidence meaningful training and enforcement.

The identification of potentially relevant documents and communications — including chats, instant messages and texts — can cause numerous technical and practical challenges, particularly when the need for preservation and collection arises.

Conclusion

In the age of remote work, companies and individuals have an added responsibility to ensure that MNPI remains confidential, especially when employees are working outside the traditional office.

As the use of sophisticated data analytics allows the SEC to change the way they track trading patterns, we can expect existing cases to gain speed and new actions to be initiated swiftly.

Further, as employees continue to use personal devices for business communications, the SEC will likely continue its aggressive enforcement of recordkeeping requirements to limit off-channel communications.

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[1] <https://www.sec.gov/news/press-release/2024-24>.

[2] <https://www.sec.gov/news/press-release/2023-124>.

[3] <https://www.bakerlaw.com/insights/doj-brings-first-ever-indictment-for-insider-trading-based-on-use-of-a-rule-10b5-1-plan/>.

[4] <https://www.sec.gov/news/statement/20230629>.

[5] <https://www.bakerlaw.com/insights/sec-and-cftc-continue-crackdown-on-financial-firms-over-off-channel-communications/>.

[6] <https://www.bakerlaw.com/insights/sec-and-cftc-show-no-signs-of-slowing-down-enforcement-actions-for-financial-firms-use-of-off-channel-communications/>.

[7] <https://www.sec.gov/news/press-release/2024-44>.