

Client Update

SEC Settles Action Concerning Adequacy of Policies to Prevent Dissemination of Material Nonpublic Information

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On November 24, 2015, the Securities and Exchange Commission (the “SEC”) announced a settled action against Marwood Group Research LLC (“Marwood”), a political intelligence firm, for its failure in 2010 to adopt adequate policies that would prevent the dissemination to Marwood’s clients of potential material, nonpublic information (“MPNI”) obtained from government employees.¹ Marwood admitted to violations of Section 15(g) of the Securities Exchange Act² and Section 204A of the Investment Advisers Act³ and agreed to pay a \$375,000 penalty. The settled action underscores the SEC’s continued focus on insider trading and should serve to remind financial firms to be vigilant in ensuring that their compliance policies and procedures are both adequately robust and carefully monitored.

SEC ORDER

Marwood is a political intelligence firm registered with the SEC as a broker-dealer and with New York State as an investment adviser. Its business includes

¹ In the Matter of Marwood Group Research, LLC, Adm. Proc. File No. 3-16970 (Nov. 24, 2015).

² Section 15(g) of the Exchange Act requires every registered broker or dealer 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 . . . of material nonpublic information by such broker or dealer or any person associated with such broker or dealer.”

³ Section 204A of the Advisers Act requires an investment adviser to “establish, maintain, and enforce written policies and procedures reasonably designed, taking into consideration the nature of such investment adviser’s business, to prevent the misuse . . . of material nonpublic information by such investment adviser or any person associated with such investment adviser.”

providing hedge funds and other members of the financial sector with “research notes” (e.g., reports and updates) about regulatory and legislative issues, including a predictive opinion of the potential outcomes of future governmental actions. The SEC alleged that in 2010, to enhance Marwood’s ability to collect and draft information for its research notes, the firm encouraged analysts to maintain relationships with and seek information from government contacts. Some of the information obtained from government employees, according to the SEC’s allegations, “presented a substantial risk that it could be MNPI.”

At the time, Marwood had written policies and procedures prohibiting the dissemination of MNPI, which was broadly defined in the policy as including “any pending but not yet publicly proposed or approved action by a regulatory or other government agency.” The policies and procedures also outlined a review process by which Marwood’s research notes were to be reviewed and approved by a licensed supervisory principal as well as submission to the compliance department. The policies also provided that if Marwood employees had any doubt about whether information constituted MNPI, they were to refrain from using the information and promptly contact the compliance department. The SEC, however, found Marwood’s policies and procedures were inadequately designed to prevent the inappropriate dissemination of MNPI, particularly given the nature of Marwood’s business as a political intelligence firm. Specifically, the SEC criticized Marwood’s policy for “not expressly requir[ing] the compliance department to be advised as to the source of the information included in the research note or about communications with government sources, if any.”

In determining to accept the offer of settlement, the SEC considered the voluntary and proactive steps taken by Marwood in 2013 and 2014 to make its compliance policies more robust. In addition to requiring Marwood to admit to wrongdoing, the settlement requires Marwood to employ an independent compliance consultant to review its policies and procedures for compliance with Section 15(g) of the Exchange Act and Section 204A of the Advisers Act.

CONCLUSION

The SEC’s enforcement action against Marwood highlights the need for state-registered investment advisers and exempt reporting advisers, as well as SEC registered investment advisers, to adopt and maintain policies and procedures that are reasonably designed to prevent the misuse of MNPI. In addition, investment advisers, broker-dealers and other financial industry participants should carefully review their policies and procedures regarding MNPI and confirm that those policies are adequately tailored to address the specific risks of their business. Employees should be well-informed regarding their firm’s policies

and procedures around MNPI, particularly if the firm engages the services of political intelligence businesses or other expert network services.

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Please do not hesitate to contact us with any questions.