



March 2020

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COVID-19 Series: Review of Internal Controls Especially Important as the SEC Indicates Increased Scrutiny of Potential Insider Trading During COVID-19 Crisis

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On March 23, 2020, the SEC's Division of Enforcement issued a public statement emphasizing the importance of maintaining market integrity and following corporate controls and procedures designed to prevent the misuse of material nonpublic information during the COVID-19 crisis.¹ The SEC specifically highlighted its concerns about incentives to trade illegally on nonpublic information during these difficult times, noting that "corporate insiders are regularly learning new material nonpublic information that may hold an even greater value than under normal circumstances." Further, the SEC wrote that "a greater number of people may have access to material nonpublic information than in less challenging times."

Importantly, the SEC underscored its expectation that public companies and regulated entities (including broker-dealers, investment advisers, and other registrants) take active steps with their internal controls and disclosure procedures to keep material nonpublic information confidential and protect against the improper dissemination and use of such information, minimizing the potential for illegal trading.

It is clear from this release that the SEC intends to maintain, if not increase, its focus on insider trading actions, particularly in the context of COVID-19.

The COVID-19 pandemic has created a particularly challenging environment with respect to potential insider trading, primarily for two reasons: (1) many employees are working remotely and (2) many employees have access to COVID-19-related material nonpublic information, particularly due to the way the virus is impacting business operations. The SEC's statement puts companies, broker-dealers, investment advisers, and other regulated entities on notice to review and assess their internal disclosure controls and procedures to account for the unusual risks posed by the COVID-19 crisis.

As a result, we advise entities to consider:

1. Reviewing their internal policies and procedures to ensure that they are sufficiently specific in addressing COVID-19-related insider trading and extend, as applicable, to directors, officers, employees, consultants, and other outside professionals;



2. Revising internal policies and procedures as necessary to ensure that the definition of “confidential information” includes not only “company information” but also “government decisions”;
3. Evaluating relationships with government entities and carefully assessing whether any information obtained from those relationships is nonpublic and/or pre-decision information that could create insider trading liability if traded on;
4. Regularly assessing the effectiveness of internal controls as the COVID-19 crisis continues, making modifications as appropriate;
5. Temporarily imposing blackout periods for trading or enhancing pre-clearance procedures during this time;
6. Providing written guidance to all officers, directors, and employees that emphasizes the importance of their obligations to keep material nonpublic information that they may have access to confidential, particularly as more people work from home and share electronic devices with family members, roommates, and others; and
7. Continuing regular compliance training via video conferencing or other means to address the specific risks posed by the COVID-19 pandemic and the expected increased scrutiny on trading during this time.

Ultimately, companies, broker-dealers, investment advisers, hedge funds, and other regulated entities should be especially careful during this time and remind directors, officers, employees, and consultants that trading in a company’s securities on the basis of insider information, including certain COVID-19-related information, may violate the antifraud provisions of the federal securities laws. Robust compliance and internal controls, including reminders and training on the permissible handling of material nonpublic information and monitoring of employee communications, are critical.

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¹ Stephanie Avakian & Steven Peikin, SEC Division of Enforcement, *Statement from Stephanie Avakian and Steven Peikin, Co-Directors of the SEC’s Division of Enforcement, Regarding Market Integrity* (Mar. 23, 2020), <https://www.sec.gov/news/public-statement/statement-enforcement-co-directors-market-integrity>.

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