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## *PH COVID-19 Client Alert Series: Remote Technology Issues During COVID-19 Crisis Pose Heightened Insider Trading Risks*

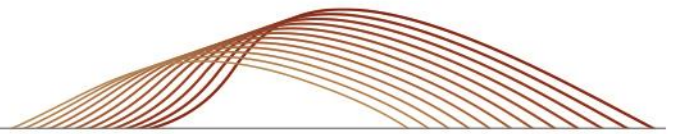
By [Kenneth M. Breen](#), [Phara A. Guberman](#) & [Amanda L. Pober](#)

As recently discussed in the March 27, 2020 Alert “Review of Internal Controls Especially Important as the SEC Indicates Increased Scrutiny of Potential Insider Trading During COVID-19 Crisis,” the U.S. Securities and Exchange Commission (“SEC”) intends to increase its focus on insider trading actions particularly in the context of COVID-19. As a result, financial institutions and other regulated entities should review and assess their internal disclosure controls and procedures to ensure nonpublic material information is adequately protected and the risks of illegal trading are minimized.

One particular challenge financial institutions are facing in the remote working environment due to the COVID-19 crisis is complying with rules and regulations requiring that trading-related telephone calls be recorded. With a greater number of people regularly learning and possibly sharing new material nonpublic information, remote working environments are threatening the ability of financial institutions and other entities to record trading-related calls. These entities may be at increased risks for insider trading and market manipulation investigations, particularly where the U.S. Department of Justice (“DOJ”) and SEC have already indicated that they intend to devote increased resources to examining potential insider trading activities during the pandemic.<sup>1</sup>

In the United States, under Rule 17a-4(b)(4) of the Securities Exchange Act of 1934, all regulated entities are required to retain records of all communications, including digital communications, that relate to their “business as such.”<sup>2</sup> FINRA Regulatory Notice 11-39 explains that determining whether a communication must be retained depends upon its content only; the retention requirement is not affected by the type of device or technology used to transmit the communication.<sup>3</sup>

Regulators such as the U.S. Commodities Futures Trading Commission (“CFTC”), U.K. Financial Conduct Authority (“FCA”), and the European Securities and Markets Authority (“ESMA”) specifically require certain market participants to record telephone conversations when conducting trades. The CFTC rule, for example, applies to futures commission merchants, large introducing brokers, retail foreign exchange dealers, and commodity trading advisors that are members of a designated contract market or swap execution facility.<sup>4</sup>



In adopting this rule to require certain market participants to record and maintain certain oral communications, the CFTC noted:

Requiring the recording and retention of oral communications will serve as a disincentive for covered entities to make fraudulent or misleading communications to their customers over the telephone and could serve as a meaningful deterrent against violations such as trading ahead of customer orders by providing a record of the time that a customer's telephone order is received.<sup>5</sup>

Phone recordings from trading desks are often critical to the prosecution in bringing criminal cases for insider trading and market manipulation.<sup>6</sup> The CFTC rule requiring the recording of telephone communications applies to both firm-provided and personal devices. The CFTC noted that “[i]t would be contrary to the objectives of ensuring market integrity and customer protection to allow circumvention of the rule simply by communicating on a personal device lacking recording capability. To be clear, covered persons must ensure that covered communications do not occur on personal phones that lack recording capability.”<sup>7</sup>

Certain financial institutions and other regulated entities have technologies to allow phone recordings even for remote work. For example, some traders' office phones are installed with software that redirects incoming calls to traders' mobile phones and records the conversation. Other entities employ services that allow banks and other financial institutions to add a recording-compliant business number to a trader's mobile phone to ensure that electronic records are kept when traders are working outside the office.

Even with these technological advances, however, the number of traders working remotely due to the pandemic is unprecedented. We can expect that remote recording capabilities may be malfunctioning. Technical glitches in recording phone calls have caused regulatory headaches for companies in the past. For example, in 2019, the CFTC ordered a subsidiary of an international investment bank to pay a \$1M fine after it was unable to turnover certain recordings during an investigation after its recording system failed to resume recording for 20 days after a system reboot, which the CFTC alleged impeded its investigation.<sup>8</sup>

Therefore, it is especially important during this time that financial institutions and other regulated entities evaluate their current recording technologies and recording policies and ensure that all necessary employees are aware of and complying with applicable recording rules, including on their personal devices as they work offsite.

Recognizing challenges facing market participants as a result of the COVID-19 pandemic and social distancing requirements, the CFTC recently provided relief to certain market participants who are covered by its phone recording rule, including futures commission merchants and introducing brokers, swap dealers, retail foreign exchange dealers, and floor brokers, from compliance with CFTC regulations requiring the recording of oral communications.<sup>9</sup> Specifically, the CFTC noted that through June 30, 2020, it will not take enforcement action against market participants for failure to comply with requirements to make and keep records of oral communications “if the personnel required to use recorded lines are required by the registrant's written business continuity plan to be absent from their normal business site” *provided* that: (1) a written record of the oral communication, including the date, time, persons participating, and subject matter of communication is created and maintained; and (2) the registrant takes affirmative steps to collect and adequately maintain any written materials created, including handwritten notes, transcripts, or summaries.<sup>10</sup>



U.K. entities have also acknowledged these technological difficulties posed by the COVID-19 crisis. The FCA recently said that firms should continue to record calls, but that in scenarios where it is not possible to do so, firms should “consider what steps they could take to mitigate outstanding risks if they are unable to comply with their obligations to record voice communications. This could include enhanced monitoring, or retrospective review once the situation has been resolved” and noted that firms should also “continue to take all steps to prevent market abuse risks.”<sup>11</sup> ESMA has said traders can take handwritten notes of phone calls as a temporary alternative.<sup>12</sup>

The task of manually recording calls is burdensome and ripe for both errors and market abuse. As set forth above, phone recordings have often been the basis for insider trading and market manipulation investigations, and civil and criminal charges. As the CFTC noted in implementing its rule, phone recordings are generally a disincentive for such activities. Without recordings, there is essentially an honor system being implemented for traders. As we know, regulators will be particularly focused on potential insider trading activities during the COVID-19 pandemic. It is especially important for financial institutions and other entities to review internal controls and compliance procedures regarding trading activities, offer reminders to employees regarding such protocols, and consider expanding, even if only temporarily, internal controls to best protect against insider trading risks. The CFTC has noted that, as a matter of course, it considers good-faith compliance with policies and procedures reasonably designed to comply with the oral communications recording rule as a mitigating factor when exercising its discretion in enforcement actions for violation of the rule.<sup>13</sup>

Even with certain regulator exceptions to recording oral communications during the COVID-19 pandemic, the SEC nonetheless has strict record-keeping and document retention requirements that need to be maintained. Accordingly, we recommend that financial institutions and other regulated entities consider the following best practices:

- For handwritten notes of calls, include: (1) the date and time of the call; (2) location where the call was held; (3) the names of all clients or traders who participated on the call, as well as their locations; and (4) any quotes, solicited bids, offers, and trade instructions, including the prices at which trades were struck. Document retention policies should be implemented and circulated that specifically address the retention of handwritten notes. This is a control not only for insider trading risks, but also because phone recordings are often used to resolve client disputes regarding errors related to the purchase or sale of securities. These notes will be important should litigation arise.
- While trades are increasingly being conducted electronically, we understand that traders sometimes need to use phone calls to trade large blocks of stock or to buy and sell securities in markets that are less liquid or do not offer transparent pricing. To the extent possible, entities should encourage the use of mobile trading apps that obviate the need for phone calls and will create a digital record.
- Entities should provide written guidance and reminders regarding their internal policies against potential insider trading, including, but not limited to their obligations to keep material nonpublic information that they may have access to confidential and to record trading-related calls to the extent possible. As “stay-at-home” orders continue, entities should regularly provide remote video training to employees, officers, and directors on compliance procedures, including any enhanced procedures during this time, to address the expected increased scrutiny on trading during this time.



Further, with traders working remotely, regulated entities should also consider implementing new protocols to limit access to material nonpublic information, including upcoming trades, client orders, and other confidential data. Regulated entities should consider strongly suggesting the following for a defined group of employees:

- Establish a designated area in your home that affords privacy and keeps confidential information protected from others who you may share a home with;
- Use privacy screens to protect confidential information on your computer;
- Lock your computer when you are away from your work area;
- Use a company-issued computer rather than a personal device, if available;
- Never save data to a personal device;
- Connect to your company network via secure VPN; and
- Do not use public printing services to print confidential documents.

The COVID-19 pandemic has created a particularly challenging environment with respect to potential insider trading as many employees work remotely, with increased scrutiny of trading activity expected from regulators across the world. It is particularly important that during this time, financial institutions and other regulated entities ensure that they review and assess their recording capabilities and technology policies to minimize the risks of illegal trading, and consider enhancing their internal controls, even temporarily.



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- <sup>1</sup> See 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>; Attorney General William Barr, Office of the Attorney General, Memorandum for All United States Attorneys Regarding COVID-19 – Department of Justice Priorities (Mar. 16, 2020), <https://www.justice.gov/aq/page/file/1258676/download>.
  - <sup>2</sup> 17 CFR § 240.17a-4(b)(4).
  - <sup>3</sup> FINRA, Regulatory Notice 11-89, *Social Media Websites and the Use of Personal Devices for Business Communications: Guidance on Social Networking Websites and Business Communications*, at 3 (Aug. 2011), <https://www.finra.org/sites/default/files/NoticeDocument/p124186.pdf>.
  - <sup>4</sup> 17 CFR § 1.35.
  - <sup>5</sup> Adaptation of Regulations to Incorporate Swaps—Records of Transactions—Final Rules, 77 Fed. Reg. 75,523, 75,528, Comm. Fut. L. Rep. P 32493, 2012 WL 12347068 (Dec. 21, 2012).
  - <sup>6</sup> See, e.g., *United States v. Afriyie*, No. 16-CR-377 (S.D.N.Y.) (jury found defendant guilty of securities fraud and wire fraud for committing insider trading; evidence included recorded calls between defendant and his broker); *United States v. Siva, et al.*, 17-CR-503 (S.D.N.Y.) (former stock broker pleaded guilty to insider trading scheme based on confidential information misappropriated from investment bank; evidence included telephone recordings); *United States v. Smith, et al.*, No. 19-CR-669 (N.D. Ill.) (precious metals traders charged with scheme to manipulate market for precious metals futures contracts and fraud market participants; certain deceptive orders placed through telephone calls to floor brokers).
  - <sup>7</sup> Adaptation of Regulations to Incorporate Swaps—Records of Transactions—Final Rules, 77 Fed. Reg. 75,523, 75,528, Comm. Fut. L. Rep. P 32493, 2012 WL 12347068 (Dec. 21, 2012).
  - <sup>8</sup> Kristin Broughton, CFTC Fines Goldman Sachs \$1 Million for Failing to Record Calls, *The Wall Street Journal* (Nov. 26, 2019), <https://www.wsj.com/articles/cftc-fines-goldman-sachs-1-million-for-failing-to-record-calls-11574810565>.
  - <sup>9</sup> CFTC Press Release 8132-20, CFTC Provides Relief to Market Participants in Response to COVID-19 (March 17, 2020), <https://www.cftc.gov/PressRoom/PressReleases/8132-20>.
  - <sup>10</sup> See, e.g., Letter from Joshua B. Sterling, Director, Division of Swap Dealer & Intermediary Oversight, CFTC regarding “No-Action Positions for Swap Dealers to Facilitate Physical Separation of Personnel in response to the COVID-19 Pandemic,” CFTC Letter No. 20-06 (Mar. 17, 2020), <https://www.cftc.gov/csl/20-06/download>.
  - <sup>11</sup> Financial Conduct Authority, FCA information for firms on coronavirus (COVID-19) response (Mar. 17, 2020), <https://www.fca.org.uk/firms/information-firms-coronavirus-COVID-19-response>.
  - <sup>12</sup> ESMA, Public Statement: COVID-19: Clarification of issues related to the application of MiFID II requirements on the recording of telephone conversations (Mar. 20, 2020), [https://www.esma.europa.eu/sites/default/files/library/esma35-43-2348\\_esma\\_statement\\_on\\_covid-19\\_telephone\\_recording.pdf](https://www.esma.europa.eu/sites/default/files/library/esma35-43-2348_esma_statement_on_covid-19_telephone_recording.pdf).
  - <sup>13</sup> Adaptation of Regulations to Incorporate Swaps—Records of Transactions—Final Rules, 77 Fed. Reg. 75,523, 75,528, Comm. Fut. L. Rep. P 32493, 2012 WL 12347068 (Dec. 21, 2012).

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