

[Securities Regulation Daily Wrap Up, TOP STORY—House again passes insider trading definition bill, separately creates COVID-19 fraud working group, \(May 18, 2021\)](#)

Securities Regulation Daily Wrap Up

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The insider trading bill would codify the law of illegal insider trading in a single federal statute and also would give the Commission six months to make conforming amendments to Exchange Act Rule 10b5-1 regarding the requirements for insiders' trading plans.

The House once again passed a bill to statutorily define illegal insider trading and thus clarify a body of law that historically has been a judge-made body of law. The second attempt to move the insider trading bill from the House to the Senate perhaps lacked the drama of the vote taken in the last Congress, which passed the bill with overwhelming bipartisan support, but the latest floor debate did briefly re-expose a fault line over whether Congress or the courts should decide what constitutes illegal insider trading. In other business, the House also passed a bill that would have the SEC and the Consumer Financial Protection Bureau (CFPB) work together to combat COVID-19 fraud perpetrated against investors and consumers. The insider trading bill was considered *en bloc* with other COVID-19-themed bills that required recorded votes, and the entire bundle of bills passed by a vote of 350-75. The SEC-CFPB working group bill passed by voice vote.

Insider trading definition. The Insider Trading Prohibition Act ([H.R. 2655](#)), sponsored by Rep. Jim Himes (D-Conn), would create a statutory definition of insider trading that is intended to clarify federal securities fraud liability in light of multiple decisions by the U.S. Court of Appeals for the Second Circuit and recent opinions by the U.S. Supreme Court that, in part, had reaffirmed the Supreme Court's *Dirks* opinion and, in part, clarified the scope of the Second Circuit's decisions. A statutory definition of insider trading may help to inform the public regarding what is and is not considered unlawful securities trading. A similar version of the Himes bill passed the House during the last Congress by a [vote](#) of 410-13 (See, [H.R. 2534](#); House Rep. [No. 116-219](#); House Rules Committee [comparative draft](#)).

Democratic floor manager Rep. Emanuel Cleaver (D-Mo) said the bill was long overdue and would help eliminate uncertainty about who is potentially liable for insider trading. According to Republican floor manager Rep. French Hill (R-Ark), stopping and punishing illegal insider trading is a top priority for House Republicans and the task of codifying existing law into a single statute without expanding or contracting current law is a serious one. Representative Hill also noted that the new base text of the bill includes an amendment by Rep. Patrick McHenry (R-NC), Ranking Member of the House Financial Services Committee, regarding the materiality and personal benefit requirements that had been added to the bill when the House considered it in the last Congress (See [prior coverage](#) in *Securities Regulation Daily* regarding the various amendments then proposed).

Representative Himes described the bill as landmark legislation that puts the definition of illegal insider trading back in the hands of Congress, rather than in the hands of unelected judges, thus exposing the only observable fault line between some Democrats and some Republicans. The counter argument came from Rep. Bill Huizenga (R-Mich), who said the bill was a positive development and that insider trading is a nonpartisan issue, but who also cited the concerns of past SEC Chairs Mary Jo White and Jay Clayton regarding the potential confusion that may result from a singular statutory definition of illegal insider trading, which he said could be both overbroad and too narrow. According to Rep. Huizenga, the Senate in the last Congress ignored the bill because there is no actual problem to solve. That argument begs the question of whether things will be different this time now that Democrats hold a slight edge in the Senate.

The latest version of the bill would provide that it is unlawful for a person to buy, sell, enter into, or cause the purchase or sale of a security (including security-based swaps) while aware of material, nonpublic information (MNPI) relating to the security or any non-public information that has or would reasonably be expected to have a material effect on the market price of the security, if the person knows, or recklessly disregards, that the information was obtained wrongfully, or that the purchase or sale would be a wrongful use of the information.

The bill also prohibits the wrongful communication of MNPI where a person, whose own purchase or sale of a security would violate the general ban on insider trading, wrongfully communicates MNPI relating to the security that has or would reasonably be expected to have a material effect on the market price of the security to another person who: (1) buys or sells a security to which the communication relates; or (2) communicates the information to another person who makes or causes a purchase or sale of a security while aware of the information; and (3) the purchase or sale while aware of the information was reasonably foreseeable.

Under the bill's proposed standard, trading while aware of MNPI or communicating MNPI would be wrongful only if such acts fell into one of several categories: (1) theft, bribery, misrepresentation, or espionage; (2) the violation of federal laws regarding computer data, intellectual property, or computer privacy; (3) unauthorized and deceptive takings (e.g., conversion or misappropriation); or (4) breach of fiduciary duty.

Some of these categories could expand the types of acts that may result in insider trading liability to acts that may not currently be within the general antifraud authority of Exchange Act Section 10(b). Presumably, this would make it easier to bring charges against persons who engage in theft, computer hacking, and related offences.

With respect to breach of fiduciary duty, the bill explains that this phrase refers to the breach of any fiduciary duty, a breach of a confidentiality agreement, a breach of contract, a breach of any code of conduct or ethics policy, or a breach of any other personal or other relationship of trust and confidence. Moreover, the breach must be done for a direct or indirect personal benefit, which would include pecuniary gain, reputational benefit, or a gift of confidential information to a trading relative or friend. This language would mirror some of the language used by the Supreme Court in its *Dirks* opinion.

The bill also includes a knowledge requirement. As a result, a person trading while aware of MNPI need not know specifically how the information was obtained or communicated, or whether any personal benefit was paid or promised to anyone in the chain of communication, provided that the person who traded while aware of the information (or who communicated the information) was aware, consciously avoided being aware, or recklessly disregarded that the information was wrongfully obtained, improperly used, or wrongfully communicated.

The bill would provide for derivative liability, but it also provides for non-liability for any controlling person or employer who did not participate in or induce acts that would violate the ban on insider trading. Moreover, the insider trading ban proposed in the bill would not apply to a person who acts at the specific direction of, and solely for the account of, another person whose securities trading or communication of MNPI would be lawful. Moreover, the SEC would have authority to grant exemptions from the new insider trading ban.

However, the bill would provide an affirmative defense for persons who enter into Exchange Act Rule 10b5-1 trading plans. A separate provision in the bill would require the SEC to review and make conforming amendments to Rule 10b5-1 within six months after enactment.

COVID-19 investor fraud. The House also passed by voice vote the COVID-19 Fraud Prevention Act ([H.R. 2959](#)), sponsored by Rep. Cynthia Axne (D-Iowa). Under the bill, the CFPB and the SEC are directed to jointly establish the Consumer and Investor Fraud Working Group within 30 days of enactment. The working group would have several purposes: (1) provide resources by which the CFPB and the SEC can help consumers and investors to avoid fraud related to the COVID-19 pandemic; (2) provide legal aid and other resources to consumers and investors who have been adversely impacted by COVID-19 fraud; and (3) address other topics the working group determines are appropriate.

The working group would have to report to Congress on a quarterly basis. The working group, however, would sunset on December 31, 2022. Unlike some bills creating advisory committees, there is no provision in the bill to allow the CFPB director and the SEC chair to extend the working group beyond the sunset date.

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