



## *The COVID-19 Pandemic and Insider Trading*

Market shocks have historically led to investigations of insider trading. The COVID-19 pandemic has already done so: allegations have been made against four U.S. senators for insider trading based on material nonpublic information related to the pandemic. On March 23, 2020, the SEC’s Division of Enforcement issued a statement warning about the risks of insider trading posed by the COVID-19 pandemic<sup>1</sup>. The statement makes clear the SEC’s concerns about the need for public companies and regulated entities to do everything possible to minimize the potential for improper trading during the COVID-19 crisis.

Insider trading is the trading of securities based on material nonpublic information. Information is “material” if there is a substantial likelihood a reasonable shareholder would consider the information important in making a decision to buy or sell the company’s securities. Information is “nonpublic” if it has not been disseminated in a manner making it available to investors generally.

Given the dynamic circumstances created by the pandemic and the government’s response, a greater number of people may have access to material nonpublic information than in less challenging times. This information may hold an even greater value than under normal circumstances. The statement from the SEC’s Division of Enforcement notes this “may particularly be the case” if COVID-19 impacts the timely filing of earnings reports or other SEC disclosures—which would provide additional opportunities for insiders to profit from material nonpublic information about an issuer’s operations and financial condition.

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<sup>1</sup> <https://www.sec.gov/news/public-statement/statement-enforcement-co-directors-market-integrity>

There are myriad potential sources of insider trading during the COVID-19 pandemic. The insiders of any company facing disruption and adverse trends may be tempted to sell shares in the company before the extent of the problems becomes known. An obvious example is nonpublic information held by a pharmaceutical company regarding the success or failure of a drug trial for a COVID-19 vaccine. This type of information would certainly move the market for the company's shares and could be extremely tempting for an insider to use before it is known by the investing public. Similarly, material nonpublic information related to the pandemic could also include the development of tracking and testing technologies, awards of government contracts, changes in healthcare reimbursement rates, or governmental actions that could significantly benefit a certain company, industry, sector or type of investment.

The SEC Division of Enforcement's statement makes it clear that it is committing "substantial resources" to ensure investors are not victims of fraud or illegal practices, including insider trading, and that it is committed to maintaining public confidence in the fairness and integrity of the markets. Corporate insiders should expect to see increased enforcement in the future and proceed accordingly.

## What should you do?

Individuals with access to material nonpublic information – including, but not limited to, directors, officers, employees, consultants and other outside professionals – should be mindful of their obligations to keep this information confidential and to comply with prohibitions on illegal securities trading. Public companies should be mindful of their established disclosure controls and procedures, insider trading prohibitions, codes of ethics, as well as Regulation Fair Disclosure and selective disclosure prohibitions. Likewise, broker-dealers, investment advisers and other registrants must comply with the policies and procedures designed to prevent the use of material nonpublic information.

## D&O coverage for insider trading claims

A company's directors and officers (D&O) liability policy may provide some coverage in connection with an insider trading claim. The policy may pay for the costs of responding to SEC inquiries and defending against potential civil and criminal actions. However, policyholders should be mindful that most D&O policies contain language defining covered "loss" to exclude amounts that are uninsurable by law. Insurers often rely on this language to preclude coverage for the payment of restitution or the disgorgement of "ill-gotten gains" in insider trading claims. Policyholders should also be aware that D&O policies exclude coverage for "personal profit" to which the insured was not legally entitled. Policyholders should work with their brokers to negotiate the broadest language possible with respect to these exclusions in order to provide protection when insider trading claims are asserted. Policyholders should also be vigilant in providing notice to their insurers of SEC subpoenas and investigations as well as traditional claims and suits.