U.S. Agencies Step Up Insider Trading Enforcement Against Foreign Nationals, Particularly Chinese Traders

06.13.2017 | UPDATES

Investigations and enforcement actions by the U.S. Securities and Exchange Commission (SEC) and U.S. Department of Justice (DOJ) targeting potential illegal insider trading by foreign nationals, particularly by those in China, are increasing significantly. Combating illegal insider trading has been a priority, at least for the SEC, since the 1980s. However, the current focus on non-U.S. traders by both the SEC (civil enforcement) and DOJ (criminal prosecution) aligns with President Trump's stated goal of taking steps to combat foreign actors that take advantage of U.S. businesses. The new administration's outward-looking enforcement philosophy also is being exhibited through a heightened focus on cybercrimes and trade secret theft.

However, while the need for prosecution is obvious in some instances, such as a recent action against Chinese nationals who traded on confidential information obtained from hacking the computer systems of U.S. law firms, it is less so in others. In fact, ordinary retail stock traders residing outside the United States are seeing aggressive enforcement efforts, including actions based on nothing more than a foreign national “suspiciously” making a significant profit in a short period of time before an acquisition was announced.

As we discuss below, U.S. regulators sometimes view such foreign traders as easy targets, especially those with U.S. bank and brokerage accounts subject to quick seizure, because the traders often do not put up a fight even though many legal defenses may be available to them.

Recent Actions Against Non-U.S. Traders

The U.S. government has defeated most jurisdictional challenges regarding the prosecution of foreign nationals for securities claims. Essentially, it only needs to demonstrate minimum contacts that are satisfied when transactions take place on U.S. exchanges or involve accounts or funds in the United States. This means that neither the trader nor the company's stock being traded needs to be based in the United States. At the same time, the SEC is taking action to improve cooperation with foreign regulators, which is an additional concern for foreign traders. For example, earlier this year, the SEC announced its formal agreement with the Securities and Futures Commission of Hong Kong (SFC) "as part of the SEC's long-term strategy to enhance the oversight of regulated entities that operate across national borders," and which certainly will lead to more sharing of information related to enforcement activities.

While foreign insider trading defendants once were a rarity, they now are commonplace and are being seen nearly as frequently as domestic trader cases. This change appears to be due both to the government's international focus and the SEC’s substantially increased use of data analytics to identify suspicious trading patterns. Consider the following recent actions:

- In February 2017, the SEC and DOJ worked together to obtain an emergency freeze order over brokerage accounts controlled by Shaohua (Michael) Yin, a citizen of China who worked with a Hong Kong-based investment adviser. Yin is alleged to have used five U.S.-based brokerage accounts in the names of Chinese nationals to reap profits of about $29 million as a result of the acquisition of DreamWorks Animation by Comcast Corporation. An SEC official stated, “Our action today shows that the SEC will not hesitate to freeze the assets of foreign traders when they use our markets to conduct illegal activity.”

Notably, however, the SEC's complaint contained no information about what material inside-information Yin supposedly possessed about the deal or how he obtained it. Rather, the SEC was able to obtain the asset freeze purely based on suspicious facts related to the account holders and the timing and amounts of the trades.

- Also, in February 2017, the SEC obtained an emergency court order to freeze the assets of unknown traders using brokerage accounts in Singapore and England to reap more than $3.6 million in potentially illegal trading profits in advance of the announcement that Japan-based Softbank Group Corp. agreed to acquire Fortress Investment Group, LLC.

Once again, the SEC's complaint was not based on specific facts reflecting the traders' possession or use of inside information, but it was based on only the suspicious nature of the transactions within days of the public announcement.

- In December 2016, the SEC and DOJ took parallel actions against three Chinese national traders who allegedly made $3 million from trading based on confidential information learned from hacking into a law firm's computer network.

- In June 2016, a resident of China who worked as a consultant to two China-based private equity firms paid nearly $800,000 to settle SEC insider-trading claims based on information allegedly learned about the acquisition of a U.S. company.
What Is Illegal Insider Trading?

In a nutshell, illegal insider trading is the buying or selling of a security in breach of a either a fiduciary duty or other relationship of trust and confidence while in possession of *material, non-public* information about the security, including situations where the information has been misappropriated.

Violations may extend beyond the actual traders to those who "tipped" the information. Some potential defenses to insider-trading liability are obvious from this definition, such as the trader or tipper possesses or supplies "material" information, or even if the information was material, the trader did not breach any duty or confidence or misappropriate the information.

Both the SEC and DOJ have jurisdiction to enforce the insider-trading laws, often but not always working in tandem. The sanctions they may obtain are similar, such as the disgorgement of profits (or amounts equal to losses avoided) and money penalties/fines. Of course, DOJ’s ability to prosecute criminally is the biggest stick, with the maximum prison sentence for an insider-trading violation now being 20 years.

Given this severe risk, very often it is advisable for those under investigation to remain outside of the United States to reduce the risk of arrest and incarceration. As we discuss below, however, one need not be physically present in the United States to contest charges or to negotiate a settlement.

Non-U.S. Traders Often Are Viewed as Easier Targets

The reality is that regulators often see foreign traders as easier targets. There are several reasons for this, but a dominant factor is that foreign individuals are less likely to put up a fight. Even though they understandably will not come to the United States to contest charges or negotiate, they also are less likely even to engage a U.S. lawyer to do so. As a result, the government often can convince judges to freeze bank and brokerage accounts, real estate and other U.S. assets very quickly (and later seize those assets) and often without providing substantial proof of liability because the allegations are not contested. While foreign traders may be able to avoid criminal incarceration by not being physically present in the United States, often that is an undesirable result because they have businesses, family and assets in the United States and wish to return or visit.

Insider Trading Cases Are Defensible and Government’s Burden of Proof Is Substantial

Many traders do not understand that the U.S. government faces a rigorous test to prove illegal insider trading, and there may be many legal defenses available to them. Moreover, even where liability is likely, there often are legal and factual arguments to be made, including those that may limit the amount of disgorgement and money penalties the government can obtain, and to negotiate other acceptable settlement terms.

Consider the following situation where, with the assistance of U.S. legal counsel, foreign traders were able to put an end to the SEC’s insider trading investigations:

- A Hong Kong trader with U.S. brokerage accounts and substantial U.S. family connections was contacted by the SEC regarding stock trading in a company in advance of its acquisition, which saw the trader realize over $1 million in profits. The trader refused to come to the United States to provide testimony, but counsel negotiated an agreement with the SEC whereby the trader’s profits would be voluntarily frozen in the U.S. brokerage account while the SEC completed its investigation, provided, however, that the monies could be moved after seven days’ written notice to the SEC, thereby giving the SEC an opportunity to obtain a freeze order if warranted. After one year of investigation, the trader’s counsel notified the SEC that the funds were going to be transferred after seven days unless action was taken. The SEC did not take action within that time, and the trader promptly transferred the funds out of the United States.

- A China-based trader with U.S. brokerage accounts, real estate and family was subpoenaed by the SEC regarding trading in a U.S. company’s stock in advance of its acquisition by a Chinese company, which resulted in over $2 million in trading profits. Utilizing U.S. counsel, the trader was able to demonstrate to the SEC that information regarding the forthcoming acquisition—non-public in the United States—had been widely discussed on Chinese language message boards and therefore was public information. The SEC promptly closed its investigation. If the trader had not demonstrated to the SEC that the information had been made public in China, the SEC most certainly would have obtained a freeze order and seized the brokerage accounts and other assets.

Conclusion

These recent insider-trading prosecutions, the Trump administration’s enforcement priorities and focus on foreign actors, and the SEC’s increased use of data analytics all combine to create a substantially increased risk for foreign securities traders. As a result, such traders need to understand the U.S. securities enforcement landscape and potential defenses available to them should the SEC (and DOJ) come knocking.
Sean Prosser and Rick Liu are members of Perkins Coie's White Collar & Investigations practice and regularly represent clients before the SEC and the DOJ. Perkins Coie has offices across the United States and internationally in Taiwan, Shanghai and Beijing.

© 2017 Perkins Coie LLP

RELATED SERVICES

PRACTICES

• White Collar & Investigations
• Securities Litigation
• International Transactions & Trade
• Corporate & Securities
• Corporate Finance
• Public Companies

© 2019 Perkins Coie LLP