

Morgan Lewis

webcast

**Working with Expert Consultants:
Procedures for Controlling Material
Non-Public Information (MNPI)**

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Agenda

- 10b-5 and MNPI
 - The “Mosaic Theory”
- The Role of “Expert Networks”
- Due Diligence and Agreements
- Remaining Alert
- What to Do in Case of A Search Warrant
- Soft Dollars and Best Execution

Elements of a 10b-5 Enforcement Action

- Section 10b of the Exchange Act and Rule 10b5 prohibit manipulative or deceptive devices in transacting in securities
- Rule 10b5-1 describes insider trading in this way
 - The purchase or sale of a security
 - On the basis of material non-public information
 - About that security or issuer
 - In breach of a duty of trust or confidence owed directly, indirectly or derivatively to the issuer or any other person who is the source of the MNPI
- “on the basis of” means while aware of

MNPI and Mosaics

- Material information is information that a reasonable person would want to know in making an investment decision
- Non-public means it has not yet been effectively communicated to the market place, i.e., is available to the general investing public
- Analysts may use non-public pieces of immaterial information to develop a material mosaic
- A skilled analyst with knowledge of a company and an industry may piece together seemingly immaterial data together with publicly available information into a mosaic that reveals material non-public information

The Role of Expert Networks

- Find, engage, and manage experts across a broad range of industries and disciplines
- Role is to provide expertise or research data in a manner that does not convey MNPI illegally
- Many, but not all, such firms provide training to their experts and have compliance programs
 - In-house legal and compliance personnel
 - Terms and conditions for consultants
 - No public company employees
 - Do not call list

Conducting Due Diligence

- Do firm's consultants have other employment?
- Are industry contacts:
 - Introduced?
 - Paid?
- What is firm's work product, and how delivered?
- Does the firm have written policies and procedures concerning MNPI and consultants?
- Does the firm offer mandatory compliance training for consultants?
- Does the firm or its employees or consultants allow trading in the companies about which they provide research?
- Are employees of public companies contacted?

Agreements with Expert Networks

- Specific representations
 - Match to due diligence
 - Public companies do not prohibit their employees from consulting as industry contacts
 - Information provided by industry contacts doesn't violate any obligations to the contact's employer or other contract obligations
 - No litigation or investigations related to information/research provided
 - Investor does not want, and consultants will not divulge, MNPI
 - Consultants understand that the investor intends to trade based on the information
 - Confidentiality of relationship
 - Prompt notification of any changes to accuracy of representations

Remaining Alert

- As with all information received, portfolio managers and analysts must evaluate information they receive from an expert consultant to determine whether it is MNPI
- This regulatory obligation cannot be delegated
- Recommended follow-up:
 - Remind employees that consultants must pass a compliance review before they are approved for use
 - Educate employees as to MNPI issues and remind them to escalate any possible issues to legal or compliance
 - Consider surveillance of firm's communications with consultants
 - Refresh due diligence periodically

Soft Dollars and Best Execution

- Concealment as evidence of intent
 - If normally paid with hard dollars, why is something soft dollared?
- Do you disclose that research from affiliated expert networks affects broker-selection on your ADV?

Search Warrants

- Warrant is written court order authorizing law enforcement agents to search specific premises and seize specific types of property
- Warrant is issued only upon finding by court that there is probable cause to believe that a crime has been committed and that evidence of the crime is located at premises
- You will not be able to stop the execution of a search warrant, but you can limit the harm and disruption if you are prepared

Search Warrants—Be Prepared!


- Make sure employees (including security guards) know whom to contact in the event of the arrival of law enforcement agents
- Having a plan in place will help protect you by:
 - Ensuring that agents limit search to areas/items authorized by warrant
 - Ensuring that employees know how to respond to agents
 - Minimizing panic and chaos
 - Ensuring that no one engages in conduct that could be considered obstructive

Search Warrants—What You Can Do

- Obtain a copy of the warrant and understand its scope
- Alert in-house counsel immediately; contact outside criminal counsel and have counsel speak with lead agent and/or prosecutor
- Ask agents to wait until counsel is on premises; they have no obligation to wait
- Ask to obtain copies of essential documents; agents have no obligation to allow copying
- Follow the agents as they search and keep detailed written record of where they search and what items are seized
- Make sure that privileged materials are identified as such and try to prevent their seizure
- Contact company public affairs department and tell them of search; advise that they not comment or confirm anything in response to press inquiries
- Obtain a signed inventory of the items seized

Search Warrants—Advice to Employees

- Agents will use search as opportunity to interview employees
- Employees may not be instructed not to speak with agents
- However, employees may be advised:
 - They have no obligation to grant an interview; it is voluntary and can be declined or postponed
 - They are entitled to have counsel present during an interview
 - They can halt an interview at any time
 - They have no obligation to make or sign any written statement
 - They should not consent to extend the search to areas or items not included in the warrant
 - They have no obligation to sign a receipt for any item, including the inventory
 - Agents lack authority to grant immunity and do not have an obligation to be completely truthful



Please note that any advice contained in this communication is not intended or written to be used, and should not be used, as legal advice.

Questions?

Thank you for your participation.

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