House passes insider trading bill

May 25, 2021

The House of Representatives has passed a bill on a bipartisan basis that would be the first statute directly banning insider trading in the securities markets. The bill largely would preserve current case law, but would expand the scope of insider trading by prohibiting trades based on information obtained by theft or computer hacking. The House passed an identical bill in late 2019 that did not receive a Senate vote, but Senate action may be more likely under current Democratic control.

Insider Trading Prohibition Act

On May 18, 2021, the U.S. House of Representatives passed the **Insider Trading Prohibition Act** (H.R. 2655, 117th Cong.) by a 350-75 vote. The bill is identical to the bill **passed by the House in December 2019** (H.R. 2534, 116th Cong.). Although the bill contains only a few expansions of current law, it nevertheless would reflect a significant structural change to the federal securities laws by adopting a statutory ban on insider trading, which historically has been defined by judicial decisions and SEC regulations.[1]

The bill, consistent with current law, would prohibit a person from trading "while aware of material, nonpublic information" ("MNPI") if the trader knows "that such information has been obtained wrongfully" or that the trade "would constitute a wrongful use of [that] information." The bill also would ban tipping—described as "wrongfully" communicating MNPI—if the tipper's own trading would be prohibited and if the tippee engages in trades based on that MNPI. The tippee also would be prohibited from tipping another trader if it is "reasonably foreseeable" that the person would trade.[2]

Changes to insider trading law under the bill

Current case law prohibits insider trading if MNPI is obtained in breach of a duty. The bill would expand the prohibition to a broader set of circumstances in which a trader obtains MNPI "wrongfully." Breach of a duty would remain one method of obtaining information wrongfully, but there would be others: theft, bribery, misrepresentation, espionage, violations of certain federal law, conversion, misappropriation, or unauthorized taking of MNPI. Perhaps the most significant impact would be to cover hacking for MNPI without regard to whether the hacking method involved "deceptive" conduct, which the Second Circuit held is required under current law.[3]

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[1] In 2010, the CFTC was granted authority by the Dodd-Frank Wall Street Reform and Consumer Protection Act to promulgate rules and regulations relating to insider trading. *See* 7 U.S.C § 6c(a)(6) (2018). The CFTC has since promulgated Rule 180.1, similar to Section 10b-5 of the Securities Exchange Act of 1934.

[2] The Act also authorizes the Securities and Exchange Commission to "exempt" any person, security, or transaction from the prohibition.

[3] *S.E.C. v. Dorozhko*, 574 F.3d 42 (2d. Cir. 2009). *See generally* Preet Bharara & Robert R. Jackson Jr., *Insider Trading Laws Haven't Kept Up With the Crooks*, N.Y. TIMES (Oct. 9, 2018), *available at* **https://www.sec.gov/news/speech/jackson-insider-trading-laws-havent-kept-crooks** ("Or what if a hacker finds his way into a corporate computer system and trades on the sensitive information he uncovers? Will that hacker face charges of insider trading? This time, the answer depends on whether the information was obtained through sufficiently 'deceptive' practices, like misrepresenting one's identity to gain access to information, rather than just mere theft, like exploiting a weakness in computer code.").

In addition to preserving a breach of duty as one way to obtain MNPI wrongfully, the bill would continue to require that the source of MNPI receive a "personal benefit" to establish a breach of duty. The bill defines "personal benefit" as "a direct or indirect personal benefit (including pecuniary gain, reputational benefit, or a gift of confidential information to a trading relative or friend)." The personal benefit requirement has been the subject of extensive litigation that seems likely to continue if the bill is adopted into law.[4] However, the bill would somewhat simplify, in the context of a remote tippee, the current requirement that the tippee *knew* or should have known the fact that the tipper received a personal benefit.[5] Under the bill, the tippee would not need to know the "specific means by which the information was obtained or communicated, or whether any personal benefit was paid or promised by or to any person in the chain or communication." It would be sufficient if the tippee "was aware, consciously avoided being aware, or recklessly disregarded that such information was wrongfully obtained, improperly used, or wrongfully communicated."

In sum, the bill preserves much of current insider trading law, includes an expansion to different types of "wrongfully" obtained MNPI, and maintains the requirement of a personal benefit to prove breach of a duty. The most significant change would be structural—enactment of a statute expressly addressing insider trading instead of relying on judicial decisions and SEC regulations. We will monitor any Senate action on the bill.

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[4] *Salman v. United States*, 137 S. Ct. 420 (2016); *Dirks v. SEC*, 463 U.S. 646 (1983); *United States v. Martoma*, 894 F.3d 64 (2d Cir. 2018); *United States v. Newman*, 773 F.3d 438 (2d Cir. 2014), *abrogated by Salman v. United States*, 137 S. Ct. 420 (2016).

[5] *Newman*, 773 F.3d at 447–448 (holding that "a tippee is liable only if he knows or should have known of the breach" and "[t]hus, without establishing that the tippee knows of the personal benefit received by the insider in exchange for the disclosure, the Government cannot meet its burden of showing that the tippee knew of a breach"); *see also Salman*, 137 S. Ct. at 425 n.1.