

Government Enforcers Focused on Coronavirus-related Actions

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Key Points:

- Market participants should review and assess their compliance procedures to prevent and detect insider trading risks associated with COVID-19.
- Companies should increase their vigilance regarding cybersecurity threats such as phishing emails and malicious websites relating to coronavirus.
- Investors should be wary of potential stock manipulation schemes related to fake COVID-19 claims.

Enforcers across the federal government are focused on fraud risks related to the COVID-19 pandemic and resulting market turmoil. Below is a summary of recent public statements and enforcement actions by regulatory and criminal authorities arising out of the COVID-19 pandemic. Investment advisers, broker-dealers and other regulated entities, as well as public companies, should be mindful of these rapidly emerging trends to protect themselves from fraudulent activity by others and to reduce the risk of misconduct within their own organizations.

U.S. Securities and Exchange Commission

On March 23, the co-Directors of the U.S. Securities and Exchange Commission (SEC) Division of Enforcement released a [statement regarding COVID-19's impact on market integrity](#). The SEC appears particularly focused on insider trading related to the coronavirus. As the Directors warned in their statement:

[I]n these dynamic circumstances, corporate insiders are regularly learning new material nonpublic information that may hold an even greater value than under normal circumstances. This may particularly be the case if earnings reports or required SEC disclosure filings are delayed due to COVID-19. Given these unique circumstances, a greater number of people may have access to material nonpublic information than in less challenging times. Those with such access—including, for example, directors, officers, employees, and consultants and other outside professionals—should be mindful of their obligations to keep this information confidential and to

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comply with the prohibitions on illegal securities trading.

In their statement, the Directors warned public companies and investment advisers to be mindful of their regulatory obligations to protect against the improper dissemination and misuse of material nonpublic information. Investment advisers and broker-dealers have such an obligation under Section 204A of the Investment Advisers Act and Section 15(g) of the Securities Exchange Act, which require registered entities to establish, maintain and enforce written policies and procedures that are reasonably designed to prevent the misuse of material nonpublic information. From a public company perspective, management should be focused on its obligations under Regulation FD when engaging with investors during this volatile period. In addition, public companies may wish to remind their directors, officers and employees about the company's insider trading policies and the importance of adhering to those policies.

Separately, we believe that the SEC will also focus on potential insider trading based on material nonpublic information about regulatory developments related to the pandemic, which could be inappropriately disclosed to investors by government officials or others. The SEC and Department of Justice (DOJ) have pursued similar cases in the past relying on the Stop Trading on Congressional Knowledge (STOCK) Act, which specifically addresses insider trading based on government information and on criminal fraud statutes that have been construed to have a broader reach than Section 10(b) of the Exchange Act. (For further information, see our prior alert on [United States v. Blaszcak, where the Second Circuit upheld a broad interpretation of criminal fraud statutes in an insider trading case involving "political intelligence."](#)) There have been several recent high-profile media reports regarding members of Congress selling securities around the time they received briefings on COVID-19, and this may attract the SEC's attention. In addition to investigating potentially suspicious trading by government officials, the SEC may inquire whether similar information has been disclosed to institutional investors, who could use it for trading purposes. While there may be some delay in SEC investigations and enforcement because regulators (like everyone else) are working remotely at the moment, we think it is likely, over time, that the SEC will investigate COVID-19 related insider trading cases.

Apart from insider trading, the SEC has warned investors to be on alert for coronavirus-related investment scams. On February 4, the SEC's Office of Investor Education and Advocacy [issued an alert](#) urging investors to be wary of fraudulent "pump-and-dump" schemes claiming that products or services of publicly-traded companies could prevent, detect or cure coronavirus. The SEC has already taken actions to prevent these types of schemes. For example, on February 7, the SEC temporarily suspended trading in the securities of Aethlon Medical, Inc. because of concerns regarding the accuracy and adequacy of information disseminated by third-party promoters regarding the viability of the company's product to treat coronavirus. Similarly, the SEC suspended trading on March 25 in the securities of Zoom Technologies, Inc., due in part to concerns that investors were confusing this issuer with the similarly-named NASDAQ-listed issuer that provides communication services. In announcing the suspension, the SEC noted the NASDAQ-listed issuer's communication services are being used by many during the ongoing pandemic and that the issuer has seen a recent rise in its share price.

The SEC has also taken measures to ensure that its operations will continue during the pending crisis. The agency has transitioned to a full telework setup with limited exceptions. The [SEC's Office of Compliance Inspections and Examinations \(OCIE\)](#)

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has switched to conducting its examinations off-site through correspondence, unless it is “absolutely necessary to be on-site.” Anecdotally, we have seen activity continue in OCIE “desk” examinations and, via telephone and email, in Enforcement investigations that were underway before the current public health crisis.

Commodity Futures Trading Commission

The Commodity Futures Trading Commission (CFTC) has similarly shifted its resources in response to COVID-19. On March 17, 2020, CFTC Chairman Heath Tarbert outlined five main objectives:

1. Increasing monitoring of derivative markets and their participants.
2. Using the CFTC’s regulatory framework to promote orderly and liquid markets.
3. Responding swiftly to changing conditions with practical, targeted relief.
4. Communicating consistently and transparently with all stakeholders.
5. Maintaining the CFTC’s commitment to advancing strategic policy goals.

Chairman Tarbert also announced that the CFTC is focused on surveying the markets for potential misconduct related to COVID-19. We expect the CFTC will focus on its traditional priorities, including market manipulation and fraud schemes relating to futures and derivatives trading. The CFTC, like the SEC, will also likely be surveilling for potential insider trading, but in futures markets as opposed to equities markets. Since the passage of the Dodd-Frank Act, the CFTC has the authority to bring insider trading cases based on futures trading. The CFTC also has the same authority as the SEC to bring insider trading cases based on government information via the STOCK Act.

Finally, as part of its regulatory framework, the CFTC is encouraging market participants to communicate with the agency regarding requests for regulatory relief in light of the current public health crisis.

Department of Justice

Last week, Attorney General Barr directed all U.S. Attorneys’ Offices to **prioritize the investigation and prosecution of coronavirus-related fraud schemes**. Consistent with this instruction, the DOJ has mandated that each U.S. Attorney appoint a Coronavirus Fraud Coordinator to serve as the legal counsel for the federal district on matters related to the virus, direct the prosecution of coronavirus-related crimes and conduct outreach and awareness. The DOJ has suggested that it intends to prosecute behavior along the following lines:

1. Phishing emails from entities posing as the World Health Organization or the Centers for Disease Control and Prevention.
2. Malicious websites and apps that appear to share coronavirus-related information to gain and lock access to devices until payment is received.
3. Medical providers obtaining patient information for COVID-19 testing and then using that information to fraudulently bill for other tests and procedures.
4. Individuals and businesses selling fake cures for COVID-19 online and engaging in other forms of fraud.

5. Seeking donations fraudulently for illegitimate or non-existent charitable organizations.

The DOJ filed its first enforcement action related to coronavirus fraud on March 21, 2020. The government sought and obtained a temporary restraining order against the operators of the website “coronavirusmedicalkit.com” who were engaging in a wire fraud scheme by offering non-existent COVID-19 vaccines. This will likely count as the first of many criminal prosecutions arising out of the COVID-19 pandemic. As the U.S. Attorney for the Eastern District of New York, Richard Donoghue, warned in a separate statement: “Any individual or company despicably seeking to enrich themselves by taking advantage of the Coronavirus emergency facing our country will face the full force of the U.S. Justice Department, and I expect they will not be happy with the outcome.”

U.S. Treasury Financial Crimes Enforcement Network

The U.S. Treasury Financial Crimes Enforcement Network (“FinCEN”) has advised financial institutions to be on guard for fraud related to COVID-19. FinCEN has noted the following trends:

1. Imposter Scams: Bad actors are attempting to solicit donations, steal personal information or distribute malware by impersonating government agencies (e.g., Centers for Disease Control and Prevention), international organizations (e.g., World Health Organization) or health care organizations.
2. Investment Scams: promotions that falsely claim that the products or services of publicly traded companies can prevent, detect or cure coronavirus.
3. Product Scams: The U.S. Federal Trade Commission and U.S. Food and Drug Administration have issued public statements and warning letters to companies selling unapproved or misbranded products that make false health claims pertaining to COVID-19. Additionally, FinCEN has received reports regarding fraudulent marketing of COVID-19-related supplies, such as certain facemasks.
4. Insider Trading: FinCEN has received reports regarding suspected COVID-19-related insider trading.

In response to these actions, FinCEN is encouraging financial institutions to report any potential frauds through its suspicious report template. FinCEN announced that it will continue to monitor the situation and will release updated information for financial institutions.

Conclusion

Beyond the grave public health risks associated with the COVID-19 pandemic, the virus has created new opportunities for fraud and other misconduct in financial markets. In response, market participants should undertake the following steps: (1) review and assess compliance procedures to prevent and detect insider trading; (2) alert employees to increase their vigilance in relation to cybersecurity threats such as phishing emails or malicious websites; and (3) carefully scrutinize any purported claims regarding companies and coronavirus tests or cures to avoid falling victim to pump-and-dump investment scams.

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