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Former Wells Fargo Employees Charged With Insider Trading On Analyst Research Reports

Perhaps signaling new scrutiny on what has been described as the "netherworld" of Wall Street, the Securities and Exchange Commission has charged two former Wells Fargo employees with violating federal securities laws by using knowledge of nonpublic impending analyst upgrades or downgrades in certain securities to generate more than $100,000 in illicit gains. Gregory T. Bolan, Jr., 37, and Joseph C. Ruggieri, 35, are charged with violations of Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder. Notably, the Commission has chosen to file the action as administrative proceeding, and is seeking injunctive relief, disgorgement of ill-gotten gains, and the imposition of civil monetary penalties. Due to the highly expedited nature of administrative proceedings, an evidentiary hearing must take place within 60 days.

The Allegations

In an Order Instituting Administrative Proceedings, the Commission alleges that Bolan, a former analyst in Wells Fargo's research department, repeatedly tipped Ruggieri and an unnamed deceased individual of impending upgrades and downgrades to various securities he covered in the health care industry. Bolan was widely followed and respected in the health care sector, and his ratings had the ability to significantly influence the short-term price direction of various securities. Ruggieri was a senior trader of health care securities at Wells Fargo,and was responsible not only for entering customer orders but also for placing principal trades for Wells Fargo's account. After Bolan's tip of an impending upgrade or downgrade, Ruggieri would then purchase or sell short the relevant company's stock ahead of the announcement.

The Commission alleged a pattern of insider trading in which Bolan, after authoring a draft of a report upgrading or downgrading a stock, would then communicate with Ruggieri prior to the publication of the report. Ruggieri was then able to place the relevant purchase or sell order in the underlying security, and the Commission alleges that he was able to realize gains ranging from $266 to over $40,000 as a result. Because a trader's investment performance was directly tied to his annual compensation, the trades benefited both Wells Fargo and Ruggieri. In total, Ruggieri's trades netted over $117,000 in gross profits in his trading account.

But Is It Insider Trading?

The past several years have seen an unprecedented campaign by civil and criminal authorities to combat insider trading, with the U.S. Attorney's Office for the Southern District of New York obtaining nearly 90 convictions in a row before the first acquittal this past July. However, nearly all of these convictions revolved around an intricate and massive network of freely flowing nonpublic information that had permeated sectors of Wall Street. Perhaps the most well known perpetrator was Raj Rajaratnam, the once high-flying hedge fund trader who is currently serving an 11-year prison sentence - incidentally, the longest insider trading sentence in history.

Here, the government is entering an area in which, unlike its previous campaign against hedge funds, there is not a long and established string of legal victories. There will not only be new players, but also an expected rigorous discourse over whether the actions by Bolan and Ruggieri were even insider trading. In order to constitute insider trading, the person disclosing the non-public information, known as the tipper, must do so in violation of a fiduciary duty. Stated another way, there is no affirmative duty to disclose when trading in securities from the mere possession of nonpublic information; rather, the duty arises from the existence of a fiduciary relationship. The Supreme Court has explained that:

The test is whether the insider personally will benefit, directly or indirectly, from his disclosure.

Here, there was no situation where a hedge-fund bigwig such as Rajaratnam was able to obtain and trade on secret earnings data or acquisition information from a company insider that clearly had a fiduciary duty to refrain from disclosing that information. Instead, a Wells Fargo research analyst who undeniably was not an insider and lacked any fiduciary duty allegedly provided that information to a Wells Fargo trader, who then used that information to enrich his employer's account and ultimately, himself. There is no question that Bolan violated some Wells Fargo internal policy or regulation against disclosing that kind of information; however, as Peter Henning of Dealbook so aptly put it,

violation of an internal policy does not turn this case into an insider trading issue, unless there was a special benefit provided by the recipients to get him to release the information.

No doubt aware of this, the Commission devotes two paragraphs in its Order to argue that Bolan did benefit from tipping Ruggieri and the unnamed trader:

35. Bolan benefited from his tipping of Ruggieri and Trader A by virtue of his friendships with Ruggieri and Trader A. After Bolan resigned from Wells Fargo, Ruggieri gave Bolan the keys to his apartment so that he could use it when interviewing for positions in New York. In March 2011, Bolan asked the head of equity sales at Wells Fargo whether there were any job openings for Trader A, referring to him as a "trusted friend."

36. Additionally, Ruggieri, and his managers at Wells Fargo, provided positive feedback to Bolan's managers at Wells Fargo. This feedback helped Bolan to be promoted from vice president to director at Wells Fargo. In fact, in Bolan's director nomination form, Bolan's manager stated "Greg is among the best analysts in the department in terms of his dialogue with trading. We consistently hear from trading that Greg provides great information flow to the desk and they are able to monetize his efforts. They often hold [him] out as the standard."

The extent and existence of such a duty will likely be a key focus going forward.

Interesting Similarities Between Allegations At Lehman Brothers In 2005

The Commission's allegations raise interesting parallels to a 2012 feature story in the *New York Times* that recounted allegations from a former Lehman Brothers employee of similar conduct back in

2005 that ultimately never resulted in any charges. The former analyst, Ted Parmigiani, recounted a story of disclosing to Lehman employees via an internal "squawk box" that he planned to publish a market-moving report on the shares of Amkor Technology within the hour. However, by the time he released the

report, the market had already shot up - presumably as Lehman traders were tipped off and passed the information to hedge-fund clients. According to Parmigiani, this was not an isolated occurrence; rather, he pointed to dozens of instances in which Lehman's proprietary trading desk and favored clients positioned themselves accordingly before such information was made public. The Commission ultimately disclosed that it had investigated each of Parmigiani's allegations, including over 10,000 internal emails, and declined to bring charges.

Commission's Use of Administrative Proceedings

Another notable takeaway in the Commission's announcement is the choice to use administrative proceedings as the forum to litigate the charges. While use of the in-house proceedings have been quite rare in insider trading cases, the Commission hinted earlier this summer that it planned to use administrative proceedings to bring more insider trading cases. Compared to proceedings brought in federal district court, which is the widely used avenue by the Commission to bring enforcement actions, administrative actions typically lack many procedural protections available in federal court, including discovery and the use of an impartial jury. However, the Commission must sacrifice its ability to seek so-called "three-times fines" - civil monetary penalties of up to three times the profit gained or loss avoided.

Isolated Occurrence Or New Focus By Regulators?

With the government's previous focus on insider trading in the hedge fund arena likely winding down, it begs the question as to whether the civil charges against Bolan and Ruggieri are an isolated occurrence or instead suggest that regulators intend to further examine the relationship between Wall Street research departments and not only other internal departments but also outside clients. Regulators have championed their fight against insider trading on the basis of market integrity and fairness, with the Commission claiming that:

[O]ne of the main reasons that capital is available in such quantities in the U.S. markets is basically that the investor trusts the U.S. markets to be fair. Fairness is a major issue.

It certainly would be naive to think that the conduct alleged at Wells Fargo was an isolated occurrence, but it is likely that further prosecution of such cases will be put on hold while regulators are able to test the legal soundness of their theories.

At this point, criminal charges have not been filed against either individual. The Commission indicated that Wells Fargo has agreed to place an amount equal to the alleged profits reaped in its principal account aside for possible future disgorgement.