

SEC Enforcement Case Summary Hedge Fund Manager Charged with Failures Related to Receipt of MNPI

On December 20, 2024, the SEC charged a registered investment adviser and hedge fund manager, Silver Point Capital L.P., with failing to establish, implement, and enforce written policies and procedures reasonably designed to prevent the misuse of material nonpublic information (**MNPI**) relating to its participation on creditors' committees. This case follows other similar enforcement cases in 2024 based on similar facts. (See Marathon Asset Management, L.P. and Sound Point Capital Management.)

According to the SEC's complaint, one of Silver Point's core strategies was to invest in bankrupt or distressed entities that were struggling to make payments on debt they had issued. As part of this strategy, and because of the nature of its business, a long-time Silver Point consultant, a now-deceased former bankruptcy lawyer, Chaim Fortgang, participated on creditors' committees of those distressed companies on Silver Point's behalf. However, the SEC alleged, the firm failed to enforce policies and procedures that were reasonably designed to address the specific risks associated with the consultant's receipt of MNPI as a result of his participation on creditors' committees.

The SEC noted that Silver Point was organized in two sides, a "public side" and "private side." The public side actively bought and sold the debt of the distressed entity. The private side participated as a creditor/investor in confidential negotiations over how the distressed entity could repay its debt, often receiving MNPI in those negotiations. To prevent leakage of MNPI from its private side to its public side, Silver Point purported to rely on an information barrier between the two sides. However, the SEC alleged that such policies and procedures were not reasonably designed in light of the firm's business model and the information barrier was not effectively implemented to prevent the misuse of MNPI by the consultant who served as the firm's private side representative in confidential negotiations.

The information barrier policy applied to all "Silver Point directors, officers, partners, employees, temporary employees and any other affiliated persons designated by [the Compliance department] (which may include consultants, independent contractors and certain other persons)." It required that Silver Point's Legal and Compliance Department ("Compliance") designate each of these covered individuals as either public, private, or administrative, which then determined the level of surveillance and other oversight warranted by Compliance to prevent the leakage of MNPI. For example, certain communications between public and private employees were subject to enhanced monitoring, surveillance, and logging requirements by Compliance. The central requirement of the barrier policy was that any private side employee who wanted to communicate with a public side employee (or vice versa) about any investment-related matter (i.e., not strictly personal or administrative) must first inform Compliance. Such preapproval was required regardless of whether the private side possessed "Confidential Information," which included, but was not limited to, MNPI. Such a communication between the public and private sides was referred to as a "wall crossing."

Silver Point's information barrier policy also required Compliance to maintain a "watch list" and a "restricted list" to track the firm's investments and levels of knowledge. Compliance placed an issuer on the restricted list when the public side learned MNPI about that issuer. Silver Point was prohibited from trading in securities of issuers on the restricted list. The watch list, on the other hand, included issuers about which only the private side had Confidential Information. This list was only accessible to Compliance because, as is explained in the barrier policy, "the very fact that Private Employees are working on a particular financing or other transaction may constitute [MNPI]."

However, the SEC order noted that Silver Point's policy did not clearly require that consultants like Fortgang, who regularly sat on creditors' committees and received MNPI, be subject to the same oversight and controls as private side employees who also sat on creditors' committees and received MNPI. Instead, Silver Point's barrier policy was ambiguous—stating only that consultants like Fortgang may be designated as private employees, without providing any criteria for Compliance to use to determine when to do so. Based on Fortgang's role and his routine access to MNPI on Silver Point's behalf, the SEC noted that he should have been designated by Compliance as a private employee for purposes of applying the barrier policy to him. However, Silver Point failed to treat or designate him as such, notwithstanding his express agreement to be bound by the barrier policy. By not designating Fortgang as a public or private employee, Silver Point allowed Fortgang to operate in a loophole, effectively exempting him from the public/private barriers that were crucial to ensuring that Silver Point did not misuse MNPI.

According to the SEC, Silver Point did not consistently preapprove and, where appropriate, monitor and log Fortgang's calls and in-person communications with the public side. Nor did Silver Point conduct email surveillance, periodic email check-ins, or trainings for Fortgang as it did for private side employees. SEC alleged that these failures created a substantial risk of MNPI leakage from Fortgang to the public side, and therefore a risk of illegal insider trading by Silver Point. Fortgang was permitted to move unimpeded throughout the office, specifically including spaces where public side employees worked—even sit next to the traders while they placed trades—without any oversight by Compliance, in contravention of the information barrier policy.

These risks materialized when Silver Point purchased over \$260 million of Puerto Rico bonds, and generated profits of over \$29 million, over the same period while Fortgang was in possession of MNPI about the same Puerto Rico bonds as a result of participation as a member of a creditors committee appointed by a bankruptcy court in confidential mediation sessions, following a 2015 financial collapse resulting in a default on a significant amount of debt. During this period, the SEC noted that Fortgang had numerous calls and shared information freely with public side employees without preapproval or any monitoring by Compliance pursuant to the information barrier policy. The SEC case noted that other hedge funds involved in the mediation flatly prohibited their employees from trading in Puerto Rico bonds when they had MNPI from the mediation.

The SEC has demanded a jury trial in the litigated case, which is ongoing.

See Summary - <https://www.sec.gov/newsroom/press-releases/2024-209>