

**SEC ACTION INDICATES INCREASED ENFORCEMENT  
INVESTIGATIONS INTO HEDGE FUNDS AND DERIVATIVES**

Yesterday it was reported that the Securities and Exchange Commission brought the first insider trading case relating to credit default swaps – against a hedge fund manager.<sup>1</sup> The SEC alleges in the case that a bond salesman tipped off a hedge fund manager when the salesman learned of the restructuring of a bond offering that was expected to increase the price of credit default swaps covering those bonds.<sup>2</sup> Using this inside information, the hedge fund manager then allegedly purchased credit default swaps covering the bonds and later closed out the swap positions at a gain. This appears to be one of the investigations mentioned recently by SEC Chairman Mary Schapiro when she said the SEC is pursuing about 150 investigations involving hedge funds and up to 50 involving credit default swaps and other derivatives.<sup>3</sup>

What is noteworthy about the case and the statement by Chairman Schapiro is that the SEC appears intent on initiating enforcement investigations in far more diverse areas of the securities markets than has been the case in recent years. Articulating an aggressive theme on this topic, a senior official with the SEC's New York Regional Office was reported yesterday as saying, "We need to be policing even the most complex markets to ensure that all investors, regardless of their supposed-sophistication, have a fair shake. We have to be every bit as sophisticated."<sup>4</sup>

Hedge fund and other private fund managers, as well as others in the securities markets who are involved with derivative instruments, should prepare for increased scrutiny by the SEC and its staff. Members of Willkie Farr & Gallagher's securities enforcement practice within the Litigation Department and members of the Asset Management Group have considerable experience in the types of issues at the center of the SEC's initiatives. For example, we have represented numerous hedge fund managers and other clients in connection with enforcement investigations and examinations involving allegations of insider trading and market manipulation, as well as the use by these clients of complicated securities products.

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<sup>1</sup> Liz Rappaport, *As SEC Steps Up Vigilance, It's Policing Some New Beats*, THE WALL STREET JOURNAL, at C1 (May 7, 2009) ("*May 7 Wall Street Journal Article*").

<sup>2</sup> *SEC Files First Credit Default Swap Insider Trading Case*, SEC Litigation Release No. 21023 (May 5, 2009).

<sup>3</sup> Chairman Mary L. Schapiro, *Speech by SEC Chairman: Address to the Society of American Business Editors and Writers* (April 27, 2009).

<sup>4</sup> *See May 7 Wall Street Journal Article.*

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If you have any questions regarding this alert, please contact the Willkie Farr & Gallagher attorney with whom you regularly work.

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