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Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Why A Rare SEC Dismissal May Not Reflect A New Approach

By **Andrew Dean and Greg Burton** (March 14, 2025, 4:52 PM EDT)

On March 6, the U.S. Securities and Exchange Commission staff informed the U.S. District Court for the District of Connecticut that, pending a commission vote, the SEC planned to seek dismissal of the charges against Silver Point Capital, a registered investment adviser, for allegedly having insufficient information barriers to guard against the misuse of material nonpublic information.


Andrew Dean


Greg Burton

At first blush, the dismissal in SEC v. Silver Point is a fairly remarkable reversal of a litigated enforcement action and could portend a lighter approach in this space. But a deeper look suggests that may not be the case.

Background Facts

On Dec. 20, 2024, the SEC filed a complaint in the District of Connecticut charging Silver Point with violations of Sections 204A and 206(4) of the Investment Advisers Act, as well as Rule 206(4)-7 thereunder.[1] Section 204A requires that investment advisers adopt policies to prevent the misuse of material nonpublic information, or MNPI, while Section 206(4) and Rule 206(4)-7 thereunder require advisers to adopt and implement the policies and procedures necessary to avoid violations of the act.

Like many advisers in the restructuring space, Silver Point both actively bought and sold the debt of distressed entities, which the complaint referred to as the "public side," and often received MNPI while participating as a creditor/investor, including in ad hoc creditor committees, in confidential negotiations over how distressed entities could repay debt, which the complaint referred to as the "private side." To guard against the misuse of MNPI on its public side that came from its private side, Silver Point relied on an information barrier between the two sides.

The SEC's allegations centered on Silver Point's retention of a bankruptcy attorney, now deceased, who had served on creditors committees for certain distressed companies in which Silver Point had invested. The SEC alleged that Silver Point's policies failed to clearly require that individuals in the attorney's position be subject to the oversight necessary to protect the information barrier between the public and private divisions, and that its existing policies were not enforced as to the attorney.

In particular, the SEC focused on the attorney's role on an ad hoc creditor committee relating to the commonwealth of Puerto Rico's bankruptcy process. The SEC alleged that in that role, the attorney

frequently came into possession of MNPI relating to Puerto Rico bonds, that he had unmonitored conversations with public-side traders while in possession of MNPI, and that Silver Point purchased $260 million in Puerto Rico bonds during the same period.

However, although the complaint alleged that the attorney had "hundreds of opportunities to improperly share MNPI with the public side," the SEC acknowledged it was "impossible to know" whether he had ever actually done so.

In its answer, filed on Feb. 18, Silver Point argued that the attorney's role was legal in nature — that is, that he was neither a public nor a private employee of the business — and that the attorney's contractual and ethical obligations sufficed to protect against the transmission of MNPI. It asserted that its compliance function had no reason to monitor the attorney's activities, since he served as counsel to the business.

On March 6 — less than three months after filing its complaint — the SEC filed a joint motion to stay the proceedings, stating that the parties had agreed to dismiss the case with prejudice pending a vote of the commission. The SEC offered no other explanation for the planned dismissal, while Silver Point issued a statement asserting that the SEC's claims had "absolutely no basis" and that "the SEC should never have filed this action."

Notably, the court has not yet addressed the substance of the SEC's case, and there are no substantive motions pending.

Takeaways

The pending dismissal likely does not reflect a new approach to Section 204A.

Market participants evaluating what the dismissal means for their operations should not read too much into the SEC staff's decision to seek a dismissal — at least not yet.

First, in the months before it charged Silver Point, the SEC broadly supported several significant Section 204A cases where there were no underlying insider trading allegations.

In an enforcement action taken against Sound Point Capital Management LP, a 4-1 commission vote on Section 204A,[2] the SEC's order found that Sound Point (1) managed collateralized loan obligations and traded both its own CLOs and CLOs managed by third parties, and (2) had a credit business for which it often participated in lender groups or creditor committees.[3]

As a result of the credit business, Sound Point came into possession of MNPI regarding companies whose loans were held in the CLOs that it traded. In July 2019, Sound Point began conducting pretrade compliance reviews of the potential impact of this kind of MNPI, but did not adopt a written policy for these reviews until July 2022. And it had no written policies or procedures concerning the potential impact of MNPI on the loans of third-party managed CLOs until June 2024.

In an enforcement action against Marathon Asset Management LP, a 5-0 commission vote on Section 204A, the SEC's order found that one of Marathon's core strategies had been to invest in distressed corporate bonds and other similar debt.[4] This strategy, and the nature of its business, meant that it regularly participated on ad hoc creditor committees in which participants received MNPI about distressed entities.

The SEC found that Marathon had failed to establish, maintain, and enforce policies and procedures that were reasonably designed to address the specific risks associated with receiving and identifying potential MNPI as a result of its participation on creditor committees.

The SEC's general support of Section 204A charges makes sense. Section 204A is a federal statute passed by Congress, not a rule approved by a prior SEC with which subsequent commissions may disagree.

Congress determined that information barriers are needed, given the unique role that investment advisers play in the markets, and thus passed Section 204A. To that end, the commission has vindicated that policy objective by bringing stand-alone Section 204A cases, although Silver Point is the first litigated stand-alone Section 204A case.

So notwithstanding the pending commission authorization — it is hard to imagine the staff told the court it planned to dismiss the case without understanding the commission's position — and court dismissal, these prior settlements are still good law on Section 204A and instructive for investment advisers to have reasonably designed and implemented policies and procedures.

Second, the facts of the litigated Silver Point action are bespoke and represent a fact pattern with substantial litigation risk, which could help explain the result.

For example, as the defendant argued in its answer, the attorney involved actively practiced law, rendered legal advice under privilege and had functionally served as outside counsel. This meant that in addition to his contractual obligations to comply with MNPI-related policies, the attorney was bound by ethical duties to avoid improperly sharing MNPI.

As a consequence, Silver Point argued it would not have been reasonable to believe that the Advisers Act required it to "chaperone" the attorney — as otherwise provided for in its policies — and "re-assess [his] judgment" regarding the proper treatment of MNPI.

The case here is further complicated by the fact that the attorney central to the SEC's allegations is now deceased. This has significant evidentiary import in this case, where many of the specific events the SEC cites as alleged procedural failures are in-person meetings or phone calls, rather than written communications.

Finally, the SEC's complaint here rested solely on alleged deficiencies relating to Silver Point's compliance policies and procedures.

The SEC and the defendant appear to agree that the SEC's investigation found no evidence of insider trading based on MNPI, and the SEC did not charge Silver Point or any individuals with insider trading. Cases in which the SEC alleges only shortcomings related to policies and procedures, without any instances in which the policy failures actually led to other violations of the securities laws, may often be more difficult to litigate.

Viewed in light of all these factors, the staff's decision to seek dismissal may represent a different evaluation of litigation risk and a desire to conserve litigation resources.

The SEC's pending dismissal of this matter is otherwise extraordinary.

While market participants shouldn't take too much comfort that the anticipated dismissal reflects a shift in the SEC's approach to Section 204A, such a dismissal is remarkable to the extent that it reflects a noteworthy and perhaps novel repudiation of a decision made during the prior commission.

The SEC's dismissal of complaints in the crypto space can be viewed as a shift in policy thinking by the commission. But the anticipated dismissal of this complaint does not appear to be for similar reasons.

While there may be significant litigation risk, it is the rare example — outside of the crypto context — of a new commission moving to dismiss an enforcement action from the prior commission where nothing about the case appears to have changed, e.g., there have been no apparent changes in the facts or law, and no dispositive motions.

While it is impossible to know the exact reasoning behind the SEC's actions without an official explanation, which may be forthcoming, for the reasons discussed above, investment advisers should not read too much into the pending dismissal.

Andrew Dean is a partner at Weil Gotshal & Manges LLP. He was formerly a co-chief of the SEC Enforcement Division's Asset Management Unit.

Greg Burton is an associate at the firm.

Disclosure: Andrew Dean worked on the Sound Point case while he was at the SEC.

[1] Complaint in SEC v. Silver Point Capital, L.P., 24-cv-2018 (D. Conn.), dated Dec. 20, 2024.

[2] Commission votes for settled actions are available on the SEC's website; the votes are not available for litigating matters. See https://www.sec.gov/about/commission-votes/annual/commission-votes-ap-2024.xml.

[3] See Order, In re Sound Point Cap. Mgmt., LP, Rel. No. 6666 (Aug. 26, 2024).

[4] See Order, In re Marathon Asset Mgmt., L.P., Rel. No. 6737 (Sept. 30, 2024).