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SEC Sues Deutsche Bank Worker in First Credit-Default Swap Case

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By David Scheer

May 5 (Bloomberg) -- U.S. regulators, targeting insider trading in credit-default swaps for the first time, accused a Deutsche Bank AG salesman of illegally feeding information on a bond sale to a hedge-fund money manager.

Jon-Paul Rorech, 36, a bond and credit-default swap salesman at Deutsche Bank Securities, passed information on the pending sale to former Millennium Partners LP money manager **Renato Negrin**, 45, who bought swaps to reap a $1.2 million profit when the 2006 deal was announced, the Securities and Exchange Commission said in a statement today. The agency wants them to forfeit "unlawful" gains and pay unspecified fines.

"The SEC is clearly determined to assert its jurisdiction over trading in credit-default swaps, even though they're not traditionally seen as publicly traded securities," said **Russell Ryan**, a former SEC enforcement lawyer now at King & Spalding in Washington. "The SEC presumably put a lot of thought into this and realized the risk that it could get a bad precedent here."

Prices on credit-default swaps, which insure investors against bond defaults, have surged before transactions including corporate takeovers in recent years, fueling speculation that traders are abusing inside information. The SEC has said since at least 2007 that it's examining the trades. Today's suit may test its ability to impose sanctions.

The SEC's suit focuses on efforts by Dutch media company VNU Group BV, later renamed Nielsen Co., to restructure its debt in 2006.

'Level Playing Field'

"There must be a level playing field with even the most sophisticated financial instruments," **James Clarkson**, acting director of the SEC's New York office, said in the statement. "CDS may still be obscure to the average individual investor, but there is nothing obscure about fraudulently trading with an unfair advantage."

Lawyers for Rorech and Negrin denied the accusations. The agency's complaint at federal court in Manhattan doesn't accuse Frankfurt-based Deutsche Bank or New York-based Millennium of wrongdoing.

"Mr. Rorech did not commit insider trading or any other violation of the securities laws," said his attorney, **Richard Strassberg** of Goodwin Procter LLP in New York. "He was simply doing his job trying to help the bank and its client, VNU, sell a high-yield bond deal."

Jurisdictional Dispute

Negrin "flatly denies the charges, and he intends to contest them," said **Lawrence Iason** of Morvillo, Abramowitz, Grand, Iason, Anello & Bohrer, P.C. in New York. "We are confident he will be vindicated."

Iason said the SEC lacks the legal authority to bring the case because the underlying Dutch bonds aren't subject to the U.S. regulator's oversight. He also said his client didn't receive illicit inside information. "I don't think there's jurisdiction and I don't think there's insider trading here," Iason said.

Credit-default swaps are financial instruments based on bonds and loans that are used to speculate on a company's ability to repay debt. The contracts, typically expiring after five years, pay if a borrower fails to meet obligations.

Federal Reserve Chairman **Ben S. Bernanke** urged regulators in 2007 to take action to prevent abusive trading in credit- default swaps from undermining investor confidence. The agency now has more than 50 open inquiries involving the swaps and other derivatives, SEC Chairman **Mary Schapiro** said April 27.

"The SEC has been banging this drum for years," and more cases may follow, said **Christopher Clark**, a former federal prosecutor now at Dewey & LeBoeuf LLP. "If the enforcement action is successful, it's going to have the effect of making people more careful and of beefing up compliance programs."

'Listening to Silence'

To help entice investors, VNU explored selling bonds that would be covered by credit-default swaps already trading in the market, the SEC said. Deutsche Bank's New York securities unit led efforts to create the additional tranche, which could spur demand for the swaps and drive up their price.

Days before the offering, Rorech and Negrin repeatedly arranged to switch from recorded telephone lines to talk privately on mobile phones, according to the SEC's complaint.

During one recorded conversation, Negrin asked Rorech for some way to "handicap" whether VNU would issue bonds that the SEC said could drive up swap prices, according to the agency's complaint.

"You're listening to my silence, right?" Rorech answered, according to the agency. "OK, I'll call you back," Negrin replied. They spoke for three minutes on mobile phones immediately afterward.

'Zero Tolerance'

About a week before the sale was announced, Negrin placed two orders for swaps on behalf of a hedge fund advised by Millennium, according to the complaint. He sold the instruments the day the deal the deal became public.

Millennium, which manages about $11 billion, agreed to set profits sought by the SEC in escrow until the suit is resolved, the regulator said.

"We have a zero tolerance policy toward insider trading and Millennium requires every employee to certify annually that they are aware of and in compliance with our policies," Millennium founder **Israel Englander** said in a statement today.

Deutsche Bank "will continue to look into this matter closely in cooperation with the SEC," spokeswoman **Michele Allison** said.

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