Paul, Weiss

Client Memorandum

September 25, 2025

Second Circuit Limits Insider Trading Liability for Prime Brokers

On September 16, 2025, the U.S. Court of Appeals for the Second Circuit affirmed the dismissal of insider trading claims against Morgan Stanley and Goldman Sachs (the "Banks") following the March 2021 collapse of Archegos Capital Management. Plaintiffs—investors in seven public companies (the "Issuers") in which Archegos held highly leveraged positions through brokerage services provided by the Banks—alleged that the Banks received advance warning of Archegos's imminent collapse and sold off their positions in the Issuers, leaving retail investors holding the bag. The Second Circuit held that plaintiffs did not plead an insider trading claim under the "classical theory" because Archegos did not owe a fiduciary duty to the Issuers, nor did plaintiffs satisfy the "misappropriation theory" because the Banks did not owe a fiduciary duty to Archegos. Plaintiffs also failed to plead particular facts that the Banks tipped material nonpublic information ("MNPI") to certain preferred customers. The decision confirms the limits on insider trading risk for prime brokers and banks providing brokerage services to arm's-length counterparties, even when facing complex, rapid unwind events.

Background

Archegos built up large, highly leveraged positions in the Issuers using total return swaps and margin lending services provided by prime brokers, including the Banks. Under these arrangements, the Banks purchased the underlying stock and paid Archegos appreciation in the stock price and dividends in exchange for fees, allowing Archegos to receive the benefit of stock ownership without actually purchasing the stock. Archegos beneficially owned between 30% to 70% of each Issuer's stock. The arrangements further provided that, if the Issuers' stock value decreased, the Banks could issue a margin call to Archegos to cover the decline. To offset their market exposure, the Banks also purchased, on their own and for themselves, the same volume of Issuers' shares.

In March 2021, as the prices of the Issuers' stocks declined, the Banks issued margin calls that Archegos was unable to meet. Plaintiffs alleged that, after Archegos informed the Banks that it could not cover its obligations and requested a standstill, the Banks refused and quickly sold off their Archegos-related positions—both the shares held in connection with the swaps and their own proprietary shares—before the broader market became aware of Archegos's financial distress.

Plaintiffs filed putative class actions in the Southern District of New York, alleging that the Banks engaged in insider trading in violation of Section 10(b) of the Exchange Act and SEC Rule 10b-5, as well as Sections 20A and 20(a) of the Exchange Act, by selling their positions based on MNPI about Archegos's impending collapse. Plaintiffs alleged that the Banks avoided billions of dollars in losses at the expense of ordinary investors who were unaware of Archegos's financial distress. The district court dismissed the claims, finding that plaintiffs had not adequately alleged the existence of a fiduciary duty or sufficient facts to support claims of insider trading. Plaintiffs appealed.

The Second Circuit's Decision

A three-judge panel of the Second Circuit affirmed the dismissal in a unanimous opinion written by Judge Maria Araújo Kahn. The Second Circuit held that the plaintiffs failed to plausibly allege insider trading under the classical theory because "Archegos did not owe a fiduciary or fiduciary-like duty to the Issuers and, thus, [the Banks] are not liable as Archegos' tippees." The court rejected plaintiffs' argument that Archegos's large swap exposures made it a controlling shareholder and constructive insider of the Issuers, explaining that "an entity does not become a corporate insider based solely on its beneficial ownership of stock" because it lacks power to "vote its shares, influence corporate decisions, or access internal corporate documents."

The court also held that plaintiffs failed to adequately plead the misappropriation theory of insider trading because the Banks never "agreed to serve as Archegos' fiduciaries." Rather, the Banks simply "offered Archegos various brokerage services" through contracts negotiated at arm's length that entitled the Banks "to sell their Archegos-related positions upon Archegos' default." The court stressed that "a fiduciary duty cannot be imposed unilaterally by entrusting a person with confidential information." The court also rejected plaintiffs' argument that the Banks tipped MNPI to certain "preferred clients" because the complaint lacked particularized facts about the "content and circumstances of such tips."

Implications

The Second Circuit's decision offers welcome clarity for prime brokers, banks and other market participants navigating complex unwind scenarios. The ruling confirms that large swap exposures alone do not confer insider status or create a fiduciary duty for purposes of insider trading liability. The ruling also underscores that prime brokers exercising arm's-length negotiated rights to protect their own interests do not assume fiduciary obligations to their counterparties, limiting insider trading risk. To further mitigate risk, firms should consider whether to expressly disclaim fiduciary duties in brokerage agreements, carefully document any confidentiality commitments and maintain robust controls around information-sharing during block trades and unwind events. Finally, the ruling reinforces that tipping claims must be supported by specific, particularized facts, not mere inferences from trading patterns or market events. At bottom, the decision provides a strong foundation for defending against civil insider trading claims where no fiduciary duty exists and factual allegations are lacking.

* * *

This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

Alison R. Benedon
+1-212-373-2009
abenedon@paulweiss.com

Susanna M. Buergel
+1-212-373-3553
sbuergel@paulweiss.com

Kristina A. Bunting
+1-212-373-3503
kbunting@paulweiss.com

Geoffrey R. Chepiga
+1-212-373-3421
gchepiga@paulweiss.com

Andrew J. Ehrlich
+1-212-373-3166
aehrlich@paulweiss.com

Harris Fischman
+1-212-373-3306
hfischman@paulweiss.com

David P. Friedman
+1-212-373-3935
dfriedman@paulweiss.com

Joshua Hill Jr.
+1-628-432-5123
jhill@paulweiss.com

Daniel J. Kramer
+1-212-373-3020
dkramer@paulweiss.com

Gregory F. Laufer
+1-212-373-3441
glaufer@paulweiss.com

Lorin L. Reisner
+1-212-373-3250
lreisner@paulweiss.com

Audra J. Soloway
+1-212-373-3289
asoloway@paulweiss.com

Richard C. Tarlowe
+1-212-373-3035
rtarlowe@paulweiss.com

Daniel S. Sinnreich
+1-212-373-2540
dsinnreich@paulweiss.com

Securities Litigation & Enforcement Practice Management Associate Emily M. Miller and associate Thomas B. Bounds contributed to this Client Memorandum.