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REGULATORY NEWS & COMPLIANCE BEST PRACTICES

Strategies to combat the perennial demon of insider trading

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Last week a Canadian attorney apparently committed suicide rather than face insider trading charges. The **SEC** also barred a former **Goldman Sachs** rep for feeding his brother confidential information about a **Safeco** deal that produced $152,000 in ill-gotten gains. And there was the much-publicized arrest last month of hedge fund titan **Raj Rajaratnam** (**IA Watch**, Oct. 16, 2009) on similar charges - yet another case that once again brings to the fore this recurring compliance issue.

"I think types of regulatory cases such as insider trading run on a cycle. It appears like we may be entering the more active end of the cycle for insider trading," says former regulator and now partner at **Katten Muchin Rosenman** in New York **Gary Distell**.

Most CCOs have some tests to detect possible insider trading. Why not employ one that came from an SEC examiner? **Michelle Kennedy**, president of **Compass Compliance Services** in Greenwood, S.C., grabbed this one during a past exam:

Sort your firm's blotter by date and then by security and account. Look for purchases and sales of the same security within 2-3 days that produced a large profit margin. This is an ideal test for your annual review, says Kennedy.

The **SEC** often conducts multiple tests with a firm's blotter data, including directed-trading, wrap arrangements, client-objective and front running, she adds.

Here are some more actions you could consider:

- Periodically bring in an outside lawyer who has experience with insider trading cases to talk with staff. This is one tactic a New York CCO employs. The lawyer reminds staff about the do's and don'ts of insider trading, talks about recent enforcement cases and answers questions.
- Provide staff with an annual attestation that probes their relationships with others in the industry. Another New York CCO hands new employees the attestation, as well as each year giving it to all staff to sign.
- Review trades in personal accounts. One staffer at **Investment Advisors** of Birmingham, Ala., looks over confirmations as they come in. The firm's IT department built a report that automatically flags a rep who places a personal trade and examines their customer trades the day before, during and after the trade "to see if there's anything that might not look right," says CCO **Suzette Foster**. The firm also may peruse press releases related to the stocks

Insider trading is "one of the easiest things for regulator's to catch," says Distell. Cases get tougher when they involve multiple leaks from several people over time, such as allegedly occurred in the Rajaratnam case, he says.

Other best practices steps you should consider is to regularly train staff on your firm's policies and procedures regarding insider trading, personal trading and use of confidential information. Remind people they should not trade on information resulting from a confidentiality agreement, says Distell.

Monitor news reports, material announcements from companies and compare these against your firm's large positions. "Look for patterns of trades before [public] announcements," says Distell.

The biggest mistake compliance staff make in this area is not following a trail of suspicion until its end, he adds. When you're monitoring e-mails, if you come upon questionable discussions, at least ask the recipient to explain the context of the message, says Distell.