

Swapping best practices for keeping an eye on the trading desk

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Are you one of those people who doesn't quite feel alive until you've had that first cup of coffee in the morning? Traders can be the same way, which can affect their errors.

Look for patterns in error rates and you may find a trader who's not a morning person and thus prone to problems early in the day - or one who feels fatigued as the afternoon grows long, finds **Craig Watanabe**, COO of **Penniall & Associates** (\$274M in AUM) in Pasadena, Calif. He recommends you create a trade error report that includes the date, time, error responsibility, description of the error, profit/loss and supervisory review. Put these data into an Excel spreadsheet to make your analysis easier. Should you find a trader who's engine stalls in the morning light, perhaps his schedule should be adjusted.

Testing trading according to guidelines

The test **Steven Yadegari**, CCO at **Cramer Rosenthal McGlynn** (\$11.8B in AUM) in New York, uses to gauge whether trades stay within client guidelines begins with grabbing a large cross section of client accounts and checking the relevant governing documents. For instance, SMA accounts play off of the advisory agreement, mutual fund holdings depend upon the prospectus and hedge funds run off of their PPMs. He judges whether each account continues to fit within their applicable guidelines or restrictions.

The firm's trading software assists. For instance, say a client wishes to limit 5% of his account to cash. As his account's share of cash approaches that threshold, traders are made aware of a "warning bell." Another one sounds if a trade actually exceeds the 5% limit. Yadegari adds to his review by periodically checking actual trades and making sure the limits input into the software match the governing documents.

There are numerous tests you can deploy to check on trading issues. For instance, favoritism (do some clients pay less for the same security on the same day?), trading of securities on your restricted or watch list and whether certain clients are consistently favored in cross transactions, says **Victoria Hogan**, president, **NorthPoint Compliance** in Red Bank, N.J. She shares with you her [primer on how to conduct trade blotter reviews](http://www.iawatch.com/ArticleView.aspx?Article=09015cf2801588aa), which is available at <http://www.iawatch.com/ArticleView.aspx?Article=09015cf2801588aa>.

One test she believes many CCOs miss has to do with whether trade prices match broker fee schedules. Too often RIAs aren't even aware of the fee schedule, which would not look good to **SEC** examiners, she cautions.

While brokers may overcharge clients small amounts per trade, the money adds up - and the cash belongs to your clients, she says. The test is simple. Compare actual trade costs against the broker's published fees.

As with all trading anomalies, if you detect unusual patterns, ask the trader or PM and document their response. You may have to take some issues to upper management and introduce corrective measures, says Hogan.

Be sure the data in your trade blotter corresponds with your best ex meetings and approved broker list, advises **Michelle Kennedy**, president of **Compass Compliance Services** in Greenwood, S.C. SEC examiners will plow through the blotter and cross-reference what they find with your best ex

meetings. She urges two tests: (1) Try to retrieve trade ticket information from a few months ago (some trading software makes this difficult) and (2) review wrap accounts to be sure no commissions are posted.

Other ideas from peers and regulators include:

- Periodically scrutinizing execution costs across broker-dealers.
- Asking B-Ds for an itemized list of what your clients and your firm are receiving for its soft dollars. Compliance or another department not connected with research, trading or portfolio management should look over the list to be sure the services fit within the [soft dollars safe harbor](#) ([IA Watch](#), May 17, 2010).
- Demanding a daily exceptions report taken from the previous day's trading that indicates the PM's allocation decisions. The CCO could question the PM about any irregularities.