



## Combating Insider Trading: What Works

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**Editor's Note:** [John F. Savarese](#) is a partner in the Litigation Department of Wachtell, Lipton, Rosen & Katz. This post is based on a Wachtell Lipton client memorandum by Mr. Savarese, [Lawrence B. Pedowitz](#), [David Gruenstein](#), [Ralph M. Levene](#), [Wayne M. Carlin](#) and [Amanda N. Persaud](#).

Last year's headlines were filled with announcements of major new insider trading prosecutions. The DOJ and SEC have promised there will be more such cases to come in 2010, including through the use of more aggressive investigative techniques such as wiretaps and wired informants. The question is what can a firm practically do to stop insider trading, and if the risk of improper trading cannot be entirely eliminated, how to protect the firm and its constituencies?

Most responsible firms of sufficient size — hedge funds, investment advisors, broker-dealers and banks — have adopted and implemented written policies and procedures that are fairly standard. These written policies are helpful in educating people about the bright lines, but, as typical policies candidly recognize, they cannot cover every situation. In today's world — which reflects an exponential expansion of the sources of information, as well as the means and speed of communication and the webs of relationships among trading professionals, consultants, advisors and corporate insiders — situations can arise where the lines are less than bright.

In this memorandum, we outline some measures that can make a genuine difference when implementing compliance policies and procedures. It is, of course, critically important for firms to continue reinforcing the message that clearly improper conduct will not be tolerated. But firms could also significantly enhance their compliance environment by devoting more time to developing detailed guidance for employees concerning the range of conduct that borders the often blurry and uncertain lines that arise in everyday business. It is important that firms maintain a current understanding of how traders are actually gathering information and pursuing trading strategies. This approach can help prevent a disconnect between a firm's compliance procedures and the day-to-day business practices that can put the entire firm in peril.

We thus suggest the following:

- first of all, it is necessary to drill down sufficiently to gain an understanding of the actual information-gathering techniques and trading strategies that are being employed throughout the firm's various trading and investing operations; the firm should have an up-to-date understanding of what its business practices are in this critical area and information should be gathered from investment professionals in a manner sufficient to spot the kinds of issues that arise in the course of their business;
- this effort will enable the firm to evaluate whether these techniques and strategies present legal and reputational risks and to conduct training that is not abstract and general, but instead tailored to the real-world challenges and issues faced by the various trading desks or investment operations within the firm; this kind of tailored training will allow employees to develop a better understanding of the sometimes unclear line between fair, thoughtful and well-informed investment and trading strategies, on the one hand, and the misuse of material non-public information on the other;
- such training should sensitize employees and supervisors sufficiently so that they know when to raise issues and seek additional advice and input before taking any action;
- these kinds of training sessions should be reinforced through mandatory attendance, record-keeping and annual certifications to document that training has been completed and that compliance has been agreed upon — in other words, the formal pieces of paper do matter but are most effective when part of an integrated approach where legal and compliance personnel understand how the business actually operates and where the investment professionals are taught how to spot issues;
- consideration should be given to shortening written compliance materials (or creating easily consulted summaries) and presenting them in a format that facilitates training;
- firms should revisit their insider trading policies and training with an eye to the communications and social media revolution of recent years, in recognition that many employees now carry on much more extensive communications with many more people and with far less reflection than was ever the case in the past — which multiplies the opportunities and risks for personnel to engage in potentially inappropriate communications;

- information technology and other compliance resources should be deployed wisely to conduct surveillance and monitoring that helps the firm to evaluate compliance; and
- finally, a firm's senior management should clearly and periodically reinforce the "tone from the top" message that individual investment professionals should not take chances with the firm's reputation, and, when there is any question, should escalate situations that present legal and reputational risk to appropriate levels within the firm so that decisions can be made on a fully informed and collective basis.

Detecting and punishing insider trading will continue to be a key enforcement priority for prosecutors and regulators. Existing compliance programs should be reviewed in light of today's level of risk and the realities (sometimes not fully appreciated by all firms) of how their business is actually conducted. It is critical (1) to implement a compliance program that reflects how the firm actually does business, (2) to periodically reassess the program in light of potentially changing business practices and trading strategies, and (3) to maximize the ability of the firm to contain any problem that may nonetheless arise so that it does not threaten the firm's future.

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