

# Broker-Dealer Beat: Brokerage Firm's Deficient Insider Trading Procedures

**September 2014**

The SEC recently settled an enforcement action against brokerage firm Monness, Crespi, Hardt & Co. ("MCH") for deficient insider trading procedures. This case is an important reminder of some key elements of effective insider trading policies and procedures.

Important take-aways from this matter include:

1. A finding of deficient procedures under Section 15(g) of the Exchange Act does not require an underlying insider trading violation;
2. A firm's insider trading procedures should cover each activity or program where there is the risk of misuse of material, nonpublic information; and
3. The mere establishment of policies and procedures alone is not sufficient to prevent or detect the misuse of material, nonpublic information; firms must follow their procedures and implement an adequate surveillance system to monitor compliance and enforcement.

MCH is a registered broker-dealer and equity research firm. The Securities and Exchange Commission found that from 2006 to 2012, MCH failed to enforce two of its written compliance procedures: (a) the requirements to place issuers that were the subject of an upcoming research report on a restricted list and obtain firm approval to trade any restricted securities; and (b) the requirement that employees submit personal securities trading reports. Without such reports or a comprehensive restricted list, MCH could not adequately review employee trading for research front running or other misuse of material, nonpublic information.

Additionally, MCH lacked policies and procedures covering its "Corporate Access" and "Idea Dinner" programs. The Corporate Access program provided issuer management written access to investors through non-investment banking road shows and other investor access events. The "Idea Dinner" program consisted of dinners at which MCH personnel and current and prospective investor clients shared ideas and information on market, sector and company specific topics. These dinners were sometimes attended by MCH analysts.

MCH did not have procedures that specifically addressed the risks associated with its Corporate Access and Idea Dinner programs. For example, there was no policy preventing an analyst from proposing a trading recommendation on a security that was the subject of an upcoming research report. Similarly, there were no procedures or controls to assure that MCH's analysts were not divulging material, nonpublic information learned at one of these events. Nor did MCH monitor analysts' presentations, conduct trading reviews around these events or conduct reviews to determine if ratings or target price changes or material disclosures by the issuers took place shortly after an MCH analyst took part in these events.

Concluding that MCH failed to adequately establish, enforce and maintain written policies and procedures reasonably designed, given the nature of its business, to prevent the misuse of material, nonpublic information, the Commission found that MCH willfully violated Section 15(g) of the Securities Exchange Act of 1934. MCH was ordered to cease and desist from violating Section 15(g), censured, and ordered to pay a \$150,000 civil monetary penalty.