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Tips to avoid getting tipped

How to protect yourself from risks of insider trading

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The Ontario Securities Commission (OSC) recently announced sanctions following its decision in the case of a former trader who used insider information from a legal assistant at a law firm advising on merger transactions.

The ex-trader was fined $300,000 and ordered to pay $128,000 in disgorgement and $47,500 in costs. He also was barred from trading for 15 years. The legal assistant settled with the OSC and received a two-year ban from trading in securities.

This is not the only trader case in Canada in which registrants were penalized and had their careers in the securities industry come to an abrupt end.

Despite only a handful of cases reaching regulators' hearing rooms or the courts each year, regulators across the country continue to make insider trading and insider tipping a prime target of their oversight. They use sophisticated software to monitor for insider trading and regularly investigate registrants on potential tipping violations.

When a dealer becomes aware of an inquiry into one of its advisors, it does its own investigation. If there are concerns about the advisor's conduct, the dealer rarely waits for the conclusion of the regulator's investigation before separating itself from the accused. To put it bluntly, registrants — who are merely subject to these allegations — are often fired.

Here are some tips to avoid being called onto the carpet to explain your trades and, if your trades are called into question, how to prepare your answers to prove that you did not trade on insider information and should not be the subject of career-ending allegations.

Do your own research

Advisors sell their knowledge and expertise when recommending any securities. You are expected to be well-read on companies and their senior executives to understand the securities you recommend to clients.

A research file (including electronic files) on the companies you recommend to clients can be shown to a regulator in the event of an investigation. This file will support how you came to recommend certain securities to clients in order to satisfy the regulator that it was not from an insider tip.

Don’t rush

You may be tempted to rush to trade when you receive information that seems valuable about a company or security. Resist this temptation.

Take your time to ensure that the information you have received is not insider information. If it seems like an insider tip, complete your diligence by confirming the information as well as the source of the information.

What if the source of the information is unknown?

You should also do your own investigation into the nature and source of the information you receive before you act on it. This is necessary to ensure that the information is not coming from an insider, even if the person providing the information is not him or herself an insider.

If a friend or colleague has offered an observation about a company or has provided you with information, you should track down the source of the information and determine for yourself if it is legitimate and public. Failing to do so may expose you to the risk that, somewhere down the line, an insider was the source of the information.

Even if you are several steps down the communication line, you could still be subject to insider trading allegations and be found guilty of insider trading.

You are the company you keep

Certain industry participants may operate too close to the regulatory line, while others may step over it. Be careful about with whom you share investment analysis, research, and information. Simply having emails or phone records showing communication with someone who tends to cross the line may be sufficient to implicate you and your business.

Information obtained from your dealer

Dealers have internal policies about the information they share with advisors. If information in a dealer document is marked for internal use only, do not share it with clients. You should be aware of your dealer’s policies and protocols and receive regular training on what steps need to be taken concerning information that is not to be shared with clients.

Contact your compliance department

If you want to recommend a stock to clients based on information you have received but are having difficulty nailing down the source, bring the concern to your compliance department before you trade. Compliance professionals will guide you through the protocol and assist you with your next steps.

Contact with insiders

Advisors have regular access to company insiders. Before you trade, it is crucial to ensure that the information they provide has, in fact, been publicly disclosed.

If there is even a slight chance that the information you received could be non-public, you must not pass it on to anyone. If you mention it to anyone and they trade on information that turns out to be non-public, you could be investigated for tipping. This could be career-ending.

If during your diligence or at any other time you become aware that information appears to be an insider tip, be sure to inform your compliance department.

Conclusion

If you're in doubt about information you've received, check with the person who gave it to you to find out where you can find it publicly. If you're still in doubt, check with your compliance department to ensure that all policies and procedures are followed.

Caution and diligence in your business will pay dividends. While you may be tempted to move quickly to trade on information, recent cases and sanctions should be enough warning that the costs can outweigh the benefits.

Regulators are committed to protecting the public and the markets against insider tipping. Advisors who want to avoid being the subject of investigations can follow these tips to ensure they manage their business in a compliant manner, protecting their reputations, licences, and livelihoods.