



EYEING EVERY TRADE

Just several hours after the market reopened on September 17, the first day of trading following the September 11 attacks, the Exchange's Market Surveillance division was tackling a daunting task—determining whether anyone had profited through trades based on prior knowledge of the events that were to come. The Security Exchange Commission's (SEC) Division of Enforcement had asked the NYSE for help with this investigation, and the Exchange immediately responded, convening a special task force of 25 employees. Their mission? To investigate trading activity and review short interest in 47 listed issues—mainly the airline, lodging, insurance, brokerage and defense industries—in the week before the attacks, and certain buying activity immediately after.

The task force began by reviewing each security and examining who bought and sold and at what quantity and price. With the NYSE's proprietary surveillance systems, analysts were able to home in on large short-sale orders, large sales of individual securities whose prices depreciated before the attacks, and large purchases in stocks that appreciated afterward. The team then combined the trade data for all 47 targeted stocks and reviewed them collectively, focusing on accounts that traded multiple securities and individuals who traded through multiple accounts. Using systems software, it quickly reviewed and evaluated trades—considering characteristics provided by the U.S. Treasury Department and the Federal Bureau of Investigation (FBI). In total, the task force reviewed more than 500,000 records representing more than 1 billion shares, made 1,098 trading-information requests to 36 member firms, and turned the results over to the SEC—all before Thanksgiving.

PREPARING FOR SUCCESS

Meanwhile, the NYSE's Member Firm Regulation division was reaching out to brokerage firms to establish new lines of contact with those that had lost records and had been dislocated in the disaster. The NYSE ensured member firms received information being released by the U.S. Treasury, including names of suspected terrorists. The NYSE's technology arm, the Securities Industry Automation Corp., was testing the lines to make sure the firms could still submit trading information electroni-

cally. At the same time, the Exchange's Enforcement division embarked on a massive effort to reconstruct its records and temporarily house the 140 staff members displaced from the World Trade Center.

The entire financial community worked hand in hand—the Exchange and the regulatory arms of all U.S. financial markets, the SEC and the brokerage community—throughout the whole process. “The cooperation, especially from the NYSE and the broker-dealer community, was tremendous,” explains Joseph Cella, chief of the office of Market Surveillance in the SEC's Enforcement division, and the principal point person for all the U.S. markets during the course of the investigation. “It was a process of gathering a lot of information in a very short period. We were in touch with the NYSE daily about emerging developments.”

NYSE MARKET SURVEILLANCE BLENDS PEOPLE AND TECHNOLOGY TO ENSURE FAIR AND ORDERLY MARKETS

Key to this surveillance operation is a team of experienced analysts. While NYSE investigations generally start with a computer alert or complaint, the analytical process involves extensive document analysis and on-the-record testimony from specialists, floor brokers, traders, member-firm employees and others. Sophisticated surveillance systems enable analysts to handle each year a combined more than 500 cases of suspected insider trading, market manipulation and other violations of Exchange rules and federal securities laws. “Our systems perform pattern-detection and data-mining functions, and analysts focus on the creative, evaluative and instinctual aspects of their job,” says Aldo Martinez, vice president of one of the NYSE's Market Trading Analysis units.

For example, while the NYSE's Stock Watch system searches in real time for unusual trading patterns and alerts NYSE staff to possible abuses, other surveillance systems monitor for intraday patterns of

MARKET WATCHDOG

This investigation was one of the largest ever for the NYSE's Market Surveillance division, the “watchdog” of all trading taking place on the NYSE. It monitors all transactions in real time and afterward in investigations of possible trading abuses. The division, along with Member Firm Regulation and Enforcement, is part of the NYSE Regulatory Group, whose employees—accounting for a third of the Exchange's workforce—examine, surveil and enforce rules designed to protect the integrity of the NYSE marketplace and the interests of all market participants.

violative trading over time, or scrutinize chat-room discussions about listed stocks that have been flagged for review. “Our online trading systems surveil all trading on the Exchange and store that data historically,” explains Regina Mysliwiec, NYSE senior vice president of Market Surveillance. “We not only see a day of high activity, or what we might consider aberrational trading, but if we see a news or research report that indicates a major change in a company's fortune, we can go back and look for spikes in trading before the announcement or release of information.”

Market Surveillance can take informal disciplinary action against those under the NYSE's jurisdiction: its members, member firms and their employees. Matters warranting formal action are referred to the NYSE's Enforcement division, and cases outside the NYSE's jurisdiction are referred to the SEC. Last year, the SEC instituted 14 enforcement actions following NYSE insider-trading referrals with total profit disgorgement, fines and penalties of \$14 million.

TAKING ACTION

Most recently, the SEC acknowledged the NYSE for its assistance in an insider-trading case against a CEO and his Mexico-based company. The complaint alleges that upon being tipped by a director of a company that was to be acquired in June 1999, the CEO fraudulently bought 50,000 shares of that company through a brokerage account in his own company's name, at a cost of \$1.81 million. After the merger was announced a week later, the complaint alleges he sold the shares, realizing illegal profits of more than \$776,000. This past February, the CEO and his company agreed, without admitting or denying the allegations, to pay \$1.7 million, including a \$776,000 penalty.

In a market-manipulation case the NYSE uncovered, a CEO was found to have driven up his company's stock price by executing end-of-day purchases on July 18, 1995 through a relative's account just prior to his firm's secondary offering. Investors who bought during the offering paid an eighth of a point more per share than they should have, and the company was found to have earned an extra \$359,000 in proceeds. The SEC took disciplinary action against the CEO in 1997, while the NYSE took action against the registered representative through which the trades were exe-

cuted. An Exchange Hearing Panel decision found the rep guilty of failing to take appropriate action concerning the questionable customer orders.

To guard against such cases, the NYSE conducts special reviews of every initial and secondary offering, regardless of their price and size. “We look just as carefully at the pricing of transactions under 300 shares as we do block transactions [more than 10,000 shares],” Mysliwiec says.

INTERMARKET COOPERATION

The NYSE belongs to the Intermarket Surveillance Group, a cooperative that includes the domestic markets and affiliate member foreign exchanges, and through which investigative procedures, such as those followed after September 11, have been established. “We were, as always, pleased with the coordination of all the exchanges, the SEC

and the member firms,” says Pat Sizemore, director of Market Regulation at the Chicago Board Options Exchange. “This was an extraordinary effort on everyone's behalf.”

The Exchange works with other government and law-enforcement agencies, including the U.S. Attorney's Office. Recently, the NYSE shared some of its techniques and methodologies with the U.S. Treasury Department's Financial Crimes Enforcement Network, which works to prevent and detect money laundering, as well as the FBI, which has taken over the terrorist investigations.

While the outcome of the NYSE's post-September 11 investigations is yet to be

determined, the Exchange is proud to have played a role. “The movement of money through equities is just a small part of the wide-ranging federal investigation of money laundering and funding of terrorist organizations, but it added to the mix of financial information that was provided to the SEC,” Mysliwiec says.

“Extraordinary events such as September 11 test the financial markets, and we are always prepared to respond,” adds Judith Bryngil, vice president of another NYSE Market Trading Analysis unit. “But ultimately, as with all of our investigations, we do our utmost to protect the integrity of the marketplace and to advance the regulatory process against those who are trying to abuse it.” □



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