>>>>FAIRVIEW FLASH REPORT: SEC RISK ALERT ON UNAUTHORIZED TRADING AND SIMILAR ACTIVITIES<<<<

National Examination Risk Alert

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WHAT WOULD BE "UNAUTHORIZED TRADING?"	• Unauthorized Trading could be: ➢ "Rogue" or other unauthorized trading in client or proprietary accounts; ➢ Exceeding firm limits on position exposures, risk tolerances and losses; ➢ Intentional mismarking of positions; and ➢ Creating records of nonexistent (or sham) transactions.
WHERE DO I START?	• Firms should attempt to identify any circumstances that might allow an employee to execute or cover up unauthorized transactions. • Firms should review areas of employee responsibility such as traders, trader assistants, portfolio managers, brokers, investment advisers, order placement personnel or trading desks, as well as mid-or back-office, risk management and other personnel.
WHAT STEPS CAN I TAKE?	• Establish independent and mutually reinforcing controls. Identify risks and practices that could permit unauthorized trading ➢ Learn from past unauthorized trading incidents within the industry ➢ Review and/or test internal controls regularly ➢ Assess whether controls prevent unauthorized trading as a result of internal business changes and market conditions • Engage personnel/service providers in areas such as operational risk, audit, legal, compliance and management to develop improved controls and processes to address any identified weaknesses. • Employees should be properly trained to identify unauthorized activity. • Firms should communicate clearly how employees can escalate any potential activities that seem suspicious without fear of retaliation.
CAN YOU GIVE ME SOME EXAMPLES?	• Define independent and clear reporting lines. • Employees within the chain of management should have an appropriate understanding of the complex products and trading strategies used by the firm's traders. • Supervisors should review with traders, portfolio managers and others any positions that seem unusual given the strategy or client directive. • Review traders' incentive systems to ensure they are aligned with appropriate risk-taking. • Avoid aggregating functions with one trader or desk. • Encourage open-door policy with management for traders if any positions begin to lose value in an unexpected way. • Limit access to trading systems and ensure that only appropriate personnel have the authority to book trades in specific portfolios. • Some additional controls that could be reviewed on a daily basis: ➢ trade breaks, unfilled bids and offers ➢ changes in trading patterns, manual trade adjustments ➢ unexplained profitability to a specific book or investment mandate ➢ concentrations of profitable or unprofitable trades or patterns of trades and offsetting trades, with the same counterparty • Heightened scrutiny may include monitoring of frequent breaches of set risk limitations or recurring requests for trade limit increases for the same counterparty. The suggestions mentioned above are not meant to be all inclusive. Firms should consider these practices in assessing their own procedures and implementing improvements that will best protect the firm and its clients.

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