Surveillance Manual

The Egypt Capital Markets Development Project

Chemonics International Inc.

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SECTION I

Introduction

This procedures manual is designed to assist the Capital Market Authority (CMA) and Cairo and Alexandria Stock Exchange (CASE) market surveillance analysts and attorneys in reviewing alerts from the CASE on-line stock watch system and in conducting reviews and investigations of market activity that appears to be unusual.

This manual should be continuously updated to reflect changes in the CASE stock-watch system and the historical databases maintained by both the CMA and CASE, changes and additions to regulatory and legal requirements, and changes to existing and new procedures. Both organizations should coordinate changes to this manual on a regular basis. To facilitate this process, each section in the manual is dated to reflect the last time it was updated.

SECTION II

Documenting Reviews of Online Alerts

From the moment an online alert is selected for review until it is closed or referred for further investigation, the actions taken on that alert should be summarized on a hard-copy or electronic form designed for this purpose. This documentation is important to provide an "audit trail" of market surveillance reviews and to enable supervisory and oversight staff to review analysts' activities.

The form—hard copy or electronic—should provide the following information:

- Name and trading symbol of the security subject to the alert.
- Date and time of the alert.
- Type of alert, e.g. order imbalance.
- Name of the analyst who conducted the review.
- The current day's trading volume and prices (previous close, high, and low).
- A brief statement of what actions were taken to review the alert. For example, what historical trading data was reviewed by the analyst, what news sources were searched, what brokers were contacted, etc.
- The conclusion reached by the analyst as a result of the review. If the review was closed, the reason for closing must be stated. If the review was referred for further investigation, the reason further investigation is required should be explained.
- Final disposition of the review

A. Large Block Trades

Background

Large block trades can be part of a manipulative scheme by artificially attempting to create the appearance of an active market in a security. Such trading may also be evidence that a particular trader (or group of traders) are trying to gain control over the freely tradable shares of the security. A typical market manipulation scheme is to buy large amounts of stock in an effort to control the "float," or freely tradable shares. By doing so, the purchasers gain a significant amount of control over the pricing of the security, with a view to raising the price and selling their holdings at a profit.

Not all large block trades are manipulative, but when they occur in a relatively inactive stock, they deserve special scrutiny.

Review Procedure

The analyst's focus should be on large block trades that are unusual for the subject security and/or that cause the price of the security to move significantly.

1. Contact the broker(s) who executed the block on behalf of their customers. Ask detailed questions about the customers, obtaining the customers' name, address and telephone number, financial capabilities, why the customer wants to buy/sell such a large amount of stock, whether the customer has traded the stock previously, whether the customer has a relationship to the company, and whether the customer has non-public information about the company.

2. Contact the customer. Confirm the answers to the questions in (1).

3. Determine whether the facts gathered adequately explain the unusual block trade or whether there are questions remaining that may indicate manipulative intent. If questions remain open, the review should be referred for further investigation.

4. If, as in the case of the Review Procedure for Unusual Volume or Large Price Movement, there is evidence that the customer is aware of material non-public information, the company should be contacted and urged to release the information publicly. The large block trade should be referred for further investigation as possible trading on inside information.

B. Large Orders

Background

It is important to review large orders to determine (1) the accuracy of the order information—there may be an error; (2) the legitimacy of the order (whether the order is bona fide), and (3) whether there is an attempt to artificially influence the market for the security. As noted under the Procedure for Reviewing Alerts for Unusual Volume or Large Price Movement, unusual volume in a security – that could be caused by a large order – may indicate manipulation or undisclosed material developments at the company.

Review Procedure

1. Contact the broker who is displaying the order. Ask detailed questions about the customer, obtain the customer name, address and telephone number, the customer's financial capabilities (i.e., whether the customer does, in fact, have the financial means to pay for a trade if on the buy side), why the customer wants to buy/sell such a large amount of stock, whether the customer has previously traded in the stock and to what extent, and whether the customer has material, non-public information concerning the company in whose stock the order was placed.

2. Contact the customer. Confirm answers to the questions noted above.

3. To the extent the customer is aware of the order, authorized it, and has the financial capability to pay for a trade if the order is executed, the review can be closed.

4. To the extent the customer was unaware that an order had been entered on his behalf or if he does not have the financial means to pay for an executed trade, the analyst may want to seek approval to have the order cancelled/withdrawn.

5. The matter should be referred for a more in-depth investigation if the following circumstances apply:

    - the customer has a pattern of placing orders for which he cannot afford to pay
    - a broker has used a customer account without the authorization of the customer
    - the customer discloses that he has material, non-public information.

C. Marking the Close

Background

Marking-the-close is a practice whereby an attempt is made to artificially influence the day's closing price in a security by entering a trade that is fictitious or misleading in terms of actual market conditions existing at the close of the market. There are several motives for affecting the closing price in a security. Listed below are the most frequently encountered motives:

- To favorably affect the daily or weekly valuation of the broker/dealer's portfolio, manager's or mutual fund's inventory in a security
- To increase the equity in a margin account thereby reducing or eliminating margin calls1
- To favorably affect the valuation of a security that is used to collateralize a bank loan
- To set a higher closing price just prior to the pricing of the stock for a secondary offering.

Before determining to review a security for possible marking the close, the analyst should look for a pattern (e.g., ten or more days) of closing transactions on a consistent uptick or downtick from the previous transactions. A review should be opened when there is a strong pattern of closing transactions that are reported during the last 15 -30 minutes of the trading day by the same customer or broker over the prior three month period. Trades used to "mark the close" frequently involve a small number of shares. In determining how strong the pattern is:

- Determine whether the closing trade is consistently at a price that is equal to the best offer (or bid) at the time of the closing trade.

[1] A demand upon a customer to put up money or securities with the broker. The call is made when a purchase is made; also, if a customer's equity in a margin account declines below a minimum standard set by the exchange or by the firm.

- Determine the timing of the trade immediately prior to the closing trade. If the previous trade is reported several hours earlier, the closing trade may, in some instances, appear more suspicious.

Review Procedure

6. Determine the sources of the end-of-day trading (customer, broker/dealer).

7. Determine the execution time for all subject trades.

8. Prepare preliminary statistics of all relevant trading to determine how unusual the activity is. Below are ideas for preparing statistics.

    j) Total trades which closed the market

    - reported within 15 minutes of the close
    - that closed the market at an uptick
    - that closed the market at a flat tick
    - that closed the market at a downtick

    k) Total trades reported within 15 minutes of the close, but did not close the market.

    l) Total trades by subject broker/dealer or customer during the entire review period.

    m) Total number of days stock closed on the offer, including days of marking-the-close activity and other days.

    n) Total number of days during the review period.

    o) Total number of closing trades at upticks by other firms (if necessary).

    p) Net total purchases versus total sales (i.e., does the subject account seem to be accumulating stock or closing out a position).

9. Review the price movement of the stock during the period of the pattern of closing transactions. A price decline may indicate a motive for marking-the-close (especially if margin related).

10. Check other alerts to determine if the subject broker/dealer or customer may have also attempted to mark-the-close in other securities.

11. Review reports of previous investigations for subject broker/dealer or customer to identify prior questionable trading activity or prior disciplinary history.

12. After preparing the preliminary statistics and identifying the source of the possible marking-the-close activity, request the appropriate preliminary documentation from the firm where the account is held (i.e., new account forms and monthly account statements for all accounts beneficially owned or controlled by subject broker/dealer or customer) in an effort to determine the possible motive. Listed

below are the documents that the analyst may want to request and review and the other information that should be gathered about the customer.

- Account documentation and account statements for all accounts beneficially owned or controlled by subject customer and the salesman2 assigned to the account
- Determine if the customer has possible margin problems. If so, request appropriate documents
- Determine whether the customer is collateralizing a bank loan with the subject stock (interview the customer and/or obtain relevant documents)
- Determine whether customer has any affiliation with the company in whose securities the suspicious activity is occurring
- Determine whether the customer has any affiliation with the salesman assigned to the account
- Determine whether the trades are solicited or unsolicited

13. Prepare a schedule of all closing transactions by subject customer and interview the customer's salesman to gain additional information regarding the timing of the customer's transactions and possible motive for such activity

14. If the above review does not reveal a suspicious pattern of activity (e.g., activity is scattered amongst different broker/dealers or customers or there is a lack of motive), the analyst should close the review.

15. If, on the other hand, the review reveals potential violative conduct, the review should be referred for further investigation.

D. Orders and Trades Away from the Market

Background

Trades executed at other than the best bid or offer may signal an error or an attempt to disadvantage a customer. Such trades may also be an attempt to artificially influence the price of a security.

Review Procedure

The analyst's focus should be on determining whether the order/trade is genuine.

16. Contact the broker who entered the order or executed the trade. Confirm that the price displayed is, in fact, the price the customer specified. Ask the broker if he had discretion as to the price on the customer's behalf, whether he discussed with the customer that the

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[2] In this manual this term refers to the sales representative, at the brokerage firm, who handles the customer's account.

price is materially different from the current market price, why the customer wanted that particular price and how the price was determined.

17. Contact the customer and confirm the information in (1) above. Confirm that the price determination was made by and/or agreed to by the customer.

18. If the price is confirmed with the broker and customer, the review can be closed. To the extent the analyst has any concerns about the legitimacy of the order or has noted a pattern of trades/orders away from the market by the same brokers and/or customers, a referral for further investigation may be warranted.

E. Order Imbalance

Background

An order imbalance occurs whenever the volume represented by open orders to buy a particular issue is disproportionately larger than the volume represented by open orders to sell, or vice versa. An order imbalance may indicate that certain traders are acting on inside (or material, non-public) information. The analyst's primary focus should be on determining whether there are undisclosed corporate developments.

Review Procedure

19. Check the news. News from the company, industry news and world news released the night before or announced during the trading day could be the cause of the order imbalance.

20. If there is news that is likely to be causing the order imbalance, the review can be closed. A summary of the findings during the alert review should be placed on the proper form for completed reviews.

21. If there is no news, contact the company and inquire about any undisclosed corporate developments.

22. If the analyst uncovers information from the company about material events occurring at the company, the analyst may want to seek approval to require the company to issue a press release. There may also be a need to refer the discovery of undisclosed corporate developments for further investigation, particularly if the analyst notes aberrational price/volume activity in the preceding days.

F. Orders Quickly Executed that Move the Market

Background

Orders that are quickly executed *and* that move the price of a security may indicate "pre-arranged" trading, which in turn may indicate that the price or other terms of the trade are not being accurately reported to CASE. Pre-arranged trading occurs when a buyer and a seller agree in advance to trade at increasingly higher or artificial prices. It is frequently used in a manipulation.

Review Procedure

The analyst's focus should be on whether the orders and quick executions are indicative of "pre-arranged" trading.

23. Determine whether the buyer and seller are related or live at the same address.

24. Contact the broker(s) who displayed the buy and sell orders on the customers' behalf and ask detailed questions about the customers, the orders, and the basis for the price that was executed.

25. Assess whether there is a pattern of this type of order entry and quick execution involving the same customers in the same security.

26. Contact the customers to verify information in (2) above.

27. To the extent there is a pattern of this type of trading between the same customers in the same stock, the analyst may want to seek approval to have the trade cancelled. It may also be appropriate to refer the pattern of activity uncovered in the review for further investigation.

G. Unusual Volume or Large Price Movement

Background

The analyst should immediately try to determine what could legitimately be causing the unusual volume or the large price movement in the stock (e.g. news, overall market conditions, current events, bona fide customer orders, etc.) or whether the activity appears to violate a relevant rule or regulation.

If unusual volume in a security cannot be readily explained, the analyst should consider the possibility that the unusual volume is due to trading on inside information or that it is part of a manipulative scheme. Manipulation includes practices that are intended to mislead investors by artificially creating actual or apparent market activity. It is also defined as the intentional interference with the free forces of supply and demand. Manipulation further connotes intentional or willful conduct designed to deceive or defraud investors by controlling or artificially affecting the price of securities. Thus, unusual volume may signal possible market manipulation in the security. Traders may be trying to influence the market in the stock by creating active or apparent trading in that stock.

Unusual volume may also indicate that there are material developments at the company that have not yet been publicly disclosed, which traders are acting upon. Both manipulation and insider trading have to be considered when an alert for unusual volume cannot be readily explained.

A large price movement in a security that cannot be readily explained may indicate that traders are acting upon material developments that have not been publicly disclosed or that they are trying to artificially influence the market in the security.

Review Procedure

The following steps should be followed in reviewing an alert for unusual volume and/or for a large price movement in a security.

28. Check for company-specific and non-company-specific (including competitor company) news. News from a company, industry news and world news can affect the price and volume activity in specific securities, as well as the overall market. Often, what appears to be “unusual” price or volume activity is directly related to news. If there is news, the analyst should assess its materiality and determine whether it is reasonable to conclude that the price or volume change can be attributable to the news.

29. Check the Internet for “chat” and other information that could be influencing the price of the security. As the Internet and various World Wide Web sites become more popular, comments regarding companies can influence the trading activity in securities. A review of the Internet, including a company’s home page, may uncover information that would explain “unusual” price and volume. Such a review may also reveal rumors in the market place that may be fueling the activity.

30. Review recent quarterly/annual filings by the company. There may be information regarding corporate developments that is affecting the security’s price and volume.

31. Review daily trading data for the last three months. This will allow the analyst to quickly assess current price and volume activity relative to recent ranges. Taking a longer-term view of historical trading data is important in determining how far to go with the review.

32. Note overall market or industry trends to assess the subject company price movement against price movement for the industry of that company. Movement in the market or in a particular industry is supportive of movement (price or volume) in a specific security. If the overall market or an industry is significantly up or down, it may be reasonable to expect to see strength/weakness in a security.

33. Note size of trades. Large trades are typically indicative of institutional trading. Noting size of trades will give the analyst a good sense of where buying/selling pressure may be coming from. Check to see if there is volume concentration (greater than 50% of the volume) by a particular customer or broker.

34. If, after conducting the steps noted above, the analyst has a “reasonable explanation” for the price/volume activity, the review can be closed and the activities carried out in the review would be summarized on the “form” specified for completed reviews. In this situation, follow-up calls to brokers or the company are not necessary. “Reasonable explanations” include, but are not limited to:

    - lack of volume concentration
    - previous news, research or other information in the public domain
    - company contacts that provide an explanation of the price movement

- price/volume activity that are in line with broad market and/or industry performance
- overall price/volume does not appear unusual given the historic trading pattern in the stock

35. If there is no “reasonable explanation” for the activity, the analyst should consider calling brokers to obtain more information. The analyst should determine which brokers are most active in the security. Calls should only be made to brokers with the most orders and/or trades. The most important information to obtain from broker at this stage is anything that could help explain the unusual price/volume activity. The analyst should inquire about the broker’s knowledge of news, rumors, or other items that may be affecting the trading. The analyst should inquire about the source of the broker’s orders (one or many customers), how much order flow the broker has, and the total amount he is looking to buy or sell on behalf of customers.

36. The analyst should consider calling the company if he is unable to obtain information from the broker(s) that explains the price/volume activity. The most important information to obtain from a company is whether there are undisclosed corporate developments (pending material developments that have not been disclosed to the public) that may account for the unusual price/volume activity. If there are significant events at the company (e.g., the company is involved in merger discussions or earnings are due soon but are not going to meet expectations), it may be an indication that information has, in some way, leaked out. The company is also an excellent source of detailed information regarding factors that may be influencing the price/volume of its stock. The company should also be contacted if the review has uncovered rumors that require clarification. Where necessary, the company should be urged to disclose any material information to the public if there are rumors or if there has been trading based on that information.

37. If, after conducting interviews with brokers and/or the company, the analyst has information that reasonably explains the price or volume activity, the review can be closed.

38. If, on the other hand, the review reveals that there was unusual trading activity (i.e., increased price and/or volume) preceding a material news announcement, this should be referred for further investigation. For example, if a stock trades sharply lower the day before a company announces negative news or trades sharply higher the day before the company announces positive news, the matter should be referred. If the analyst discovers material undisclosed corporate developments that require a company to issue a press release, this should be referred.

If an analyst discovers significant price movement without a reasonable explanation (i.e., news, research), this should typically be referred. For example, a stock normally trades at LE1 or LE2, but over a two-day period moves to over LE5 per share on heavy volume. If an analyst discovers a concentration of volume (i.e., a broker or customer accounting for 50 percent or more of the volume in the stock) accompanied by price movement for which there is no reasonable explanation, this should be referred. If an analyst discovers that a company has issued a press release that appears potentially fraudulent or misleading, the matter should be referred for further investigation.

In summary, the following “red flags” uncovered during the review could potentially signal the need for a referral and further investigation:

- Volume concentration greater than 50 percent by one customer or broker.
- Price movement with no accompanying news.
- Concentrated or one-sided activity (i.e., a broker or customer is selling stock only, no buying activity).
- Retail activity (e.g.; significant selling to principal retail customers by a broker—a question arises as to the basis for customer solicitations).
- Poor company financials (questionable assets, low to no revenues, long term net losses, etc.).
- Internet activity (a significant number of messages).
- “Suspicious” news (e.g., a company with a small market capitalization suddenly announces a letter of intent to acquire a company with $100 million in revenues).
- Price activity (i.e., rising prices attributable to only one or two brokers or customers).
- Individuals trading the security (significant or known individuals with a disciplinary history).
- Foreign involvement (a significant amount of offshore activity in accounts in places like the Caribbean Islands).

H. Wash Sales and Matched Orders

Background

A wash sale is a securities transaction that involves no change in the beneficial ownership of the security. A matched order is the entering by any person of a sell (or buy) order knowing that a corresponding buy (or sell) order of substantially the same size and at substantially the same price either has been or will be entered. Matched orders are similar to “pre-arranged trading.” See also Review Procedure for “Orders Quickly Executed That Move the Market.”

Wash sales and matched orders are manipulative in that they are typically executed in an effort to create a false or misleading appearance of active trading in a security. Trades where the same customer bought and sold the same number of shares of the same stock at the same price should be reviewed for possible wash sales or matched orders.

Review Procedure

39. Contact the broker(s) who entered the orders on the customer’s behalf and ask detailed questions about the customer, the orders, and the basis for the price that was executed.

40. Assess whether the trades in question appear to be a part of a manipulative scheme.
41. Contact the customer to verify the information in (2) above.
42. To the extent that the trading appears to be a wash sale or a matched order, the analyst may want to seek approval to have the trade cancelled. It may also be appropriate to refer the activity in question for further investigation to determine whether there is a pattern of such activity and whether it is manipulative.

I. Reviews of Online Alerts

Sample Form

Name of the Security ____________________________________ Trading Symbol_____

Date and Time of the Alert _________________ Type of Alert ___________________

Analyst Conducting Review ____________________

Current Price and Volume Data ____

Summary of Actions Taken:

Conclusion:

Final Disposition:

Closed _______   ___________

Date

Or

Referred to _____________ ___________

Date

SECTION III

Procedure for Investigating Insider Trading

A. Introduction

Most securities' statutes do not define "insider trading." Illegal insider trading generally refers to purchasing or selling securities while in possession of material non-public information concerning such securities, or tipping[3] such information, where the trader or tippee breaches a fiduciary duty or a duty arising out of a relationship of trust or confidence.

The classic situation involves an insider to the company whose securities are the subjects of the insider trading. The insider, who may be an employee or a member of the board of directors, learns the subject material information before it is disclosed publicly. Since they learn the information in the course of their employment or relationship to the company as a director, they owe a fiduciary duty to the company not to use the information for their personal benefit. These insiders are also precluded from sharing the information with others, or tipping others about the material news prior to its public disclosure.

Insider trading can also apply to outsiders or non-employees of the company. In these cases, the outsider learns the subject material news in the course of their employment and they owe a fiduciary duty to someone other than the issuer whose securities are the subjects of the insider trading. These individuals are also precluded from using the information for their own personal benefit. The most well-known examples of this kind of insider trading, which falls under the misappropriation[4] theory of insider trading, are those that have been brought by the U.S. SEC involving employees of firms that printed documents for issuers that contained material news.

Insider trading cases typically involve the use of circumstantial evidence to prove that the individual who traded on the material news possessed the subject information. In the U.S., telephone records frequently provide the circumstantial evidence in tipping cases. Whether this type of circumstantial evidence is sufficient often depends upon the credibility of the defendant who may deny, under oath, that he received a tip. For this reason, evidence bearing on the credibility of potential defendants is critical. A statement discovered to be false, given by a defendant in the course of the investigation in order clear personal or third party blame is frequently the key of a successful investigative strategy.

A tip from an informant such as an unhappy employee, a competitor of the company, a market professional, or an unidentified caller can trigger an insider trading investigation. It can also be triggered by an on-line alert caused by unusual volume or a large price

[3] Disclosing confidential information so certain people can benefit from a trade.

[4] To take advantage of information that a company must disclose (such as information found in a 10-Q or 10-K, which outlines material events that will negatively or positively impact the company) before it is released to the public.

movement in the security. Finally, it may be initiated because the company releases material news.

B. Objectives of an Insider Trading Investigation

An insider trading investigation has the following objectives:

- Establish the "materiality" of the news
- Identify suspicious trades prior to the news
- Identify "insiders" and traders
- Establish possession of the news by connecting insiders and traders
- Establish intent to defraud (required in U.S.)
- Identify profits earned from the insider trading
- Establish fiduciary duty

The sections below describe the steps to be taken to satisfy each of these investigative objectives.

C. Step by Step Procedure for Investigating Insider Trading

Establish "Materiality"

Cases brought by the U.S. SEC have established the standards for measuring materiality throughout the world. In some cases, the definition has been included in the respective securities statutes of other countries. It is not, however, defined in the U.S. Securities Exchange Act. The first U.S. case to address the question of materiality involving insider trading was *Cady Roberts*.

In *Cady Roberts*, the U.S. SEC defined a material fact as one that could be expected to have an impact on the market price of the company's stock. This definition was affirmed and expanded by the Second Circuit Court in another famous insider trading case, *Texas Gulf Sulphur*. In *Texas Gulf*, the court stated that a further test of materiality lies in whether a reasonable man would attach importance to the information in determining his choice of investment action. Any facts that affect the future of the company and which may affect the desire of investors to buy, sell or hold the company's stock are material. The expectation of material market impact and the reasonable investor standards of materiality have been upheld in cases that have followed *Texas Gulf*. Subsequently, the courts have also concluded that non-public corporate information is material if there is any trading by individuals with access to that information.

Some examples of material news are:

- A merger, acquisition or joint venture
- A stock split or stock dividend
- Earnings and dividends of an unusual nature
- The acquisition or loss of a significant contract
- A significant new product or discovery
- A change in control or a significant change in management
- A call of securities for redemption
- The public or private sale of a significant amount of additional securities

- The purchase or sale of a significant asset
- A significant change in capital investment plans
- Establishment of a program to make purchases of the company's own shares
- A tender offer for another company's securities

Steps to Take to Establish Materiality

1. The subject news should be analyzed carefully against the standards established in Cady Roberts and Texas Gulf (absent similar legal direction from the Egyptian Courts) to determine if it was material. Did the price of the security move 10 percent or more following the public announcement of the news? Would a reasonable investor consider the news important in determining whether to invest in the company?

2. Did the price of the security increase or decrease (depending upon whether the news was positive or negative) prior to the news announcement? Was this activity unusual for the subject security? Review historical price/volume activity in the security.

3. Determine if other factors may have contributed to the unusual activity prior to the news. Research all other news that was released by the company during the 20-30 days prior to the subject news. Assess the impact, if any, of other news announcements had on the price/volume activity in the subject security.

4. Assess the industry/sector activity for the subject security (i.e. look to see if all securities in a particular industry/sector were moving in tandem with the subject security).

5. Further investigation does not generally need to occur and the case should be closed if:

   - The subject news is not material

   - There is other material news in the public domain which explains unusual activity prior to the subject news

   - There is no unusual price move or trading activity prior to the subject news (unless a tip has been received that insider trading occurred)

   - There is insignificant profit potential or loss avoidance as a result of the news

D. Identify Suspicious Trades

Steps to Take to Identify Suspicious Trades

1. Determine when insiders first knew the news. This may be assisted by requesting information from the subject company. The chronology may provide the analyst with the date discussions began at the company on the matter that was the subject of the news announcement. Further guidance on obtaining a chronology of events leading up to the material news event from the company is discussed elsewhere in this manual.

2. One of the most difficult aspects of an insider trading investigation is determining the period of time prior to the news that should be analyzed. If the company does not provide specific information concerning the period of time during which insider information was available, the type of news and the magnitude of the price move are the

basic criteria for determining the period of time that must be reviewed. Given the fact that every movement in price when there is news, however small, may be the result of insider trading, not all such situations can receive equal attention. Only the most clear cut cases should be pursued.

E. Identify Insiders and Traders

Steps to Take to Identify Insiders

1. Compile a list of potential insiders or tippees using all of the resources available. In the U.S., Standard and Poor's Corporation publishes a directory of directors and executives of public corporations and the Martindale-Hubbell Law Directory lists all law firms, their partners and associates and significant clients. All Egyptian resources of this type should be consulted, including the subject companies filings with the CMA, which could be a valuable source, particularly if these records contain information on key contracts, suppliers, venture partners, etc. The following is a list of possible insiders or tippees:

    - The company itself
    - Directors, officers, major security holders
    - Other employees
    - Outside professional advisors: lawyers, accountants, investment bankers, financial advisors, management counselors, public relations consultants, engineers, testing laboratories, etc.
    - Business connections: lenders, underwriters, proposed merger partners, customers, suppliers, etc.
    - Personnel of press, wire services, and other communications media
    - Personnel of the stock exchange, self-regulatory organizations, and government agencies
    - Financial analysts and institutional investors
    - Firms and associates of anyone on the list
    - Families of anyone on the list
    - Brokers of anyone on the list
    - Tippees of anyone on the list

2. All transactions during the period selected should be reviewed for suspicious trades. The process of identifying suspicious trades is part art and part science. Note trades by any individual who is included on the list of potential insiders and tippees. Other trades, whether large or small, that can be linked to other suspicious trades or to insiders should also be flagged. Any trade that occurs just prior to the news should also be considered suspicious.

F. Establish Possession of the Inside Information

Steps to Take to Establish Possession

1. Information should be gathered on each of the suspicious trades. If allowed under Egyptian law, telephone interviews of suspicious traders should be conducted as soon as possible. In conducting such an interview, consider using a speakerphone and have two analysts participate. After identifying yourselves and explaining the purpose of the call, ask questions such as:

   - Do you know…? (names of insiders, etc.)
   - Why did you buy/sell?
   - Do you know anyone else who bought/sold?
   - Did you know (the non-public information)?
   - Did you recommend the stock to anyone?
   - What documents did you have/rely on in deciding to buy/sell?
   - Where did you obtain them?
   - Did anyone recommend/suggest purchase/sale?

Ask the trader to call you back if he "forgot" to tell you anything. Summarize the results of the interview in writing for the investigation file.

2. The following documentary information from brokers should be gathered on each suspicious trader:

   - Monthly account statements going back six to twelve months.

     Monthly account statements usually contain a detailed record of a customer's securities trades, deposits, and withdrawals. These records should be reviewed to determine whether the identified suspicious trading is, or is not, consistent with the account holder's prior trading. This review may also reveal trading in other securities that is suspicious and assist in tracing the flow of money into and out of the account.

   - Account opening documents.

   - Any information gathered by the broker when the customer opened the account should be reviewed. This information should provide the customer's name, address, telephone number(s), and possibly his/her employer or other information. This information is especially useful when seeking to discover connections between the account holder and any "insider."

   - Order tickets [5]for the suspicious trades.

[5] A ticket written to show what time an order was placed and through which broker. The date, time, and size stamped on the ticket indicate the priority in which orders should be filled. An order ticket is important when discussing insider trading because the ticket is a method of tracking.

- The order tickets are essential because they establish the time the order was received by the broker. In addition, the order ticket should indicate whether the order was solicited or unsolicited although this information is not always accurate. Both sides of the order ticket should be requested because the time stamps may be on the back of the ticket.

- Corporate papers for partnership accounts.

  This information will identify all participants in the account and possible links to insiders.

3. Once the information in (2) has been received, it may be useful to gather additional information through an interview or written request of the salesman of the broker who handles the suspicious trader's account. Some reasons for contacting the salesman include:

   - To ascertain the trader's prior trading history.

   - To learn the circumstances and details surrounding the subject trades, i.e. solicited/unsolicited, time and type of order, special instructions, etc.

   - To establish if any possible links existed between a customer, an issuer, or the salesman.

   - To gain additional insight into the normal trading patterns of the stock.

   The following specific circumstances uncovered during the investigation to date require contact with the salesman:

   - The salesman or his firm has an obvious affiliation with the company and the salesman had trades in his own account or accounts in which he has an interest and/or he solicited other customer trades.

   - The salesman received an unsolicited order from an obvious or suspected insider and executed trades for his own account or accounts in which he has an interest and/or he solicited other customer trades.

   - The salesman's customers account for a large percentage of the suspicious transactions.

   Following is a list of suggested questions to include in an interview of a salesman (a more detailed discussion of suggested interview questions is included elsewhere in this manual):

   - Was the transaction solicited or unsolicited?

   - If solicited, what was the basis for the solicitation?

   - If unsolicited, did the customer indicate any reasons for the order?

- Were you given any special instructions regarding the order?
- When did you first become aware of the news? Through what source?
- To your knowledge, is your customer or any members of his family currently affiliated, or have they ever been affiliated with the company? Are you, or any members of your family currently affiliated, or have you ever been affiliated with the company?
- How long has your customer had an account with your firm? Was your customer's transaction consistent with his prior trading activity?
- In the case of partnership accounts, please provide the identity of the individual who placed the order.
- In the case of purchases, were the shares subsequently sold? If so, please provide the details of the sale, including the date and selling price.

4. Compile a list of questionable accounts (traders who had suspicious trades) and send a formal letter to the company for identification of these individuals. Further guidance on making a written request of the company is covered elsewhere in this manual under Written Requests.

G. Establishing Intent and Fiduciary Duty and Identifying Profits

Steps to Take to Establish Fiduciary Duty and Identify Profits

1. If allowed under Egyptian law, it may be useful to gather other documents from the company, from the company's underwriter, or from others, depending upon the focus of the investigation and the nature of the news. Some suggested documents to request are:

   q) "Deal documents"—the documents which contain the material non-public information, for example in the case of a merger agreement. In requesting such documents, be sure to request all drafts.

   r) Confidentiality agreements—employees of law firms, brokers, investment bankers, and companies routinely execute blanket confidentiality agreements with respect to information they receive in the course of their employment. These agreements are most helpful in establishing a duty of trust with respect to information that may have been used or conveyed in connection with suspicious trading.

   s) Personnel files—these files maintained by employers are extremely useful in establishing connections between insiders and traders. Frequently these files include personal identifying information such as residential addresses, histories of schools attended, jobs held and telephone numbers. Analysis of this information can uncover connections between insiders and traders.

   t) Analysts reports—traders frequently seek to explain their trading by basing it on analysts' recommendations and/or news articles concerning the company.

Knowledge of the existence and the content of these documents enable you to question traders about their suspicious trades thoroughly. These documents are available from the company, and from brokers, investment advisors, and news retrieval services.

u) Internal corporate accounting records—insider-trading cases which involve selling into the market prior to public announcement of poor earnings and other negative events will almost always require the review of internal accounting documents. In requesting these documents it is important to seek drafts as well. In addition, consideration should be given to obtaining copies of the various computerized files utilized in preparing these records.

v) Telephone records—the value of telephone records in insider trading cases cannot be overstated. Records can be obtained from phone companies, employers, hotels, calendars, and address books of traders who are targets. Since phone records are routinely destroyed, it is important to request the information in a timely fashion.

- In analyzing telephone records, the analyst should seek to determine not only connections between insiders and traders, but also other important information including sequence of calls and potential witnesses. In one case developed by the U.S. SEC, the analysis revealed a “third party number” that was called by both the trader and an insider. The SEC staff contacted the third party that happened to be a real estate broker who had brokered a real estate transaction between the trader and the insider. That transaction turned out to be the mechanism by which the trader compensated the insider for an illegal stock tip.

w) Chronologies—chronologies can be requested not only from the company, as discussed previously, but also from law firms, investment bankers, and tender offerors in order to determine what the material information was, when it was created, and when various persons had access to it. These chronologies show the locations, dates, times, participants and subject matter of relevant meetings and documents from the inception of discussion of the material event through its public disclosure.

- Chronologies also contain a listing of the names, addresses and telephone numbers of persons referenced therein. A master chronology for the investigation can then be created from the different chronologies received from a variety of sources.

x) Address books, personal calendars, and other similar records – these documents are essential in insider trading investigations. They assist the analyst in establishing connections between insiders and traders.

Other records, depending upon the facts and circumstances, and Egyptian law:

- Bank records
- Wire transfer instructions

- Photographs of individuals
- Guest lists
- Passports
- Handwriting samples
- Airplane manifests
- Rental application forms
- Real estate closing documents
- Building security sign in logs

H. Conclusion

Establishing proof of insider trading is not easy. As noted in the Introduction section, a successful case often depends on circumstantial evidence. Extensive gathering of documents and skillful interviews are critical to establishing links between insiders and traders. Because of the time consuming nature of insider trading investigations, initial investigations pursued to completion should have clear and convincing facts. For example, the following minimum criteria could be used to determine which cases are investigated in-depth:

- Clear materiality of the news

- Significant impact of the news on the price of the security following public announcement and existence of no other news to explain the price move

- Unusually heavy trading in the stock prior to the public announcement of the news with no other news to explain it

- At an early stage in the investigation, establishment of trading by an insider prior to the news

Once some experience has been gained, and at least one insider trading case has been successfully prosecuted, less clear-cut cases could be pursued.

SECTION IV

Requesting a Chronology of Events in an Insider Trading Investigation

A. Introduction

When an investigation is conducted into insider trading prior to a material announcement by a company regarding a merger, an acquisition, earnings or other corporate developments, it is essential to obtain from the issuer, and if appropriate the investment banker for the company, a chronology of the events that led up to the announcement.

B. Information to Include in Written Requests for a Chronology of Events

1. In the case of a merger or acquisition, the following information should be requested:

    y) From the company whose securities are the subject of the investigation and from the other company (referred to here as the "contra-party")

    - The date and circumstances of the initial contact between the company and the contra-party concerning the possibility of a business combination
    - A description, with corresponding dates, of all subsequent meetings, phone calls, etc., which relate to the proposed acquisition or merger
    - Copies of the minutes of all board meetings held during the relevant period
    - A list of those persons who either participated in or had knowledge of the events described above
    - The home and business addresses of those persons listed
    - Copies of any other publicly disseminated information (e.g. research reports and articles in trade journals and local newspapers) for a relevant time period
    - A description of the procedures utilized to ensure the confidentiality of material, non-public information

    z) From the company's investment banker:

    - The date and circumstances of the initial contact between the investment banker and the company regarding the retention of the firm in connection with a possible business combination transaction. (Request a copy of the engagement letter.)
    - A description, with corresponding dates, of all subsequent events (i.e. conversations, correspondence, meetings, etc.) that relate to acquisition offers involving the company, with particular emphasis on the events that occurred during the relevant time period

- A list of all firm employees or agents who either participated in or had knowledge of those events described above
- The home and business addresses of those persons listed by the firm
- A description of the procedures utilized by the investment banking personnel to ensure the confidentiality of material, non-public information
- A statement concerning whether the company was placed on a restricted list during the relevant period. If applicable, request that the firm provide a copy of the restricted list

2. In the case of an earnings announcement, the following information should be requested from the company (in the case of another corporate development, the information requested would be appropriately modified).

- The date when the internal accounting staff began the consolidation of earnings
- If applicable, the date when the company first had an indication that the financial results might be higher/lower than the company's and the market's expectations
- A description, with corresponding dates, of all events (e.g. conversations, correspondence, executive staff meetings, board meetings, etc.) at which time the financial results were discussed
- A list of all persons who either participated in or had knowledge of those events described above, including public relations firms, financial printers, law firms, and accounting firms
- The home and business addresses of those persons listed
- A description, with corresponding dates, of all contact (e.g. conversations, correspondence, meetings, etc.) the company had with financial analysts and investors regarding earnings estimates during the relevant period. (Copies of all research reports and/or recommendations published during the relevant time period should be requested
- Copies of any other publicly disseminated information (e.g. research reports and articles in trade journals and local newspapers) during the relevant time period
- A description of the procedures, if any, utilized by the company to ensure the confidentiality of material, non-public corporate information prior to public dissemination

C. Sample Questions to Include in a Chronology Request Regarding a Takeover or Merger

1. Which company made the original decision to proceed in this matter?

2. When was this original decision made?

3. Which individuals, inside or outside of the company, knew of the original decision?

4. When, how, and where was the first contact made between the companies concerning this matter?

5. Which individuals, inside or outside of the companies, knew of the first contact?

6. What was determined as a result of the first contact between the companies?

7. Which individuals, inside or outside the companies, were informed of the results of the first contact?

8. With reference to each subsequent contact between, or meeting of the companies, please supply information of a nature similar to that requested in Items #1 through #7 above.

9. What was the date of agreement in principle, if any, between the two companies?

10. Which individuals, inside or outside of the companies, knew of the agreement in principle?

11. What was the date of formal agreement between the two companies?

12. Which individuals, inside or outside of the companies, knew of the formal agreement?

13. What was the date that news of the agreement was released for public dissemination via new conference, newspapers, radio, television, or any other means?

14. Please provide the name of each organization, of the types specified below, whose services were utilized in connection with this matter:

    - Underwriter/investment banker
    - Law firm
    - Accounting firm
    - Lending institution
    - Public relations firm
    - Financial printer
    - Finder[6]

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[6]An individual acting in a private capacity who initiates contact between a company and contra-party concerning the possibility of a business combination.

D. Sample Letters Requesting a Chronology of Events

Sample letters requesting a chronology of events from companies, investment bankers and a law firm are attached.

Mr. John Doe
Chairman
XYZ Company
Cairo
Egypt

Dear Mr. Doe:

The Market Surveillance Department of the ________, pursuant to authority granted by __________, is responsible for monitoring trading activity in all CASE-listed securities including the routine review of price or volume aberrations. As we discussed on ______, we are currently conducting a review of activity surrounding the news of June 30, 2000 wherein XYZ Company said it was in discussions with unnamed parties relative to a possible business combination and the subsequent announcement on July 3, 2000 that your company agreed in principle to be acquired by ABC, Inc. In this regard, we are requesting that you furnish a detailed written chronology of events that led up to the announcements on June 30 and July 3, 2000. This chronology, among other things, should include the following information:

1. The earliest date when contact between XYZ and ABC was made;

1. A list of any subsequent meetings or conversations which took place between the two companies and which pertain to the announcements on June 30 and July 3, 2000;

1. A list of all persons who either participated in or had knowledge of those events described in number two (2);

1. A list of any outside parties (i.e. investment bankers, lawyers, accountants, etc.) who participated in the merger transaction prior to its public disclosure;

1. The home and business address of those persons described in number three (3) and four (4), as well as any known corporate affiliations of such persons;

1. Copies of any local news articles, research reports or recommendations, etc. that were published regarding XYZ during 2000 prior to the news of June 30, 2000; and

1. A description of the procedures utilized by XYZ and ABC to insure the confidentiality of material non-public information relating to the merger transaction prior to its public disclosure.

Please feel free to include any other information that you feel is pertinent to the Department's investigation. We would appreciate your cooperation in responding to our request by _________.

If you should have any questions concerning this request, please feel free to call me at ______________.

Sincerely,

Investigator
Market Surveillance

Mr. Robert Whatever
Managing Director
Investment Banking
Triple Securities Company
Cairo
Egypt
Re: I Company (ICO)

Dear Mr. Whatever:

The ______ Market Surveillance Department is conducting a routine review of trading in I Company (ICO) surrounding the April 3, 2000 announcement of the signing of a definitive agreement for the affiliation of IC with ABC Corp. To assist us in our review, it is requested that your firm furnish a detailed, written chronology of the events that led up to this announcement. This chronology should include, but not be limite to the following information:

1. The date and circumstances of the first contact between Triple Securities and ICO regarding the acquisition. Please provide copies of all documents, including any confidentiality agreements, relating t your firm's engagement as investment banker;

1. A description, with corresponding dates, of all subsequent events (i.e. conversations, correspondence, meetings, etc.) which relate to <u>any</u> acquisition/merger offers involving ICO;

1. A description, with corresponding dates, of all subsequent events (i.e. conversations, correspondence, meetings, etc.) which relate to the ICO/ABC transaction;

1. A list of all Triple Securities employees or agents who participated in, or were privy to those events list in numbers (1), (2) and (3), including investment banking personnel, salesmen, legal counsel, traders, financial printers, etc.;

1. The home and business addresses of those persons listed in number (4);

1. A description of the procedures utilized by the Triple Securities investment banking department to insur the confidentiality of material, non-public information regarding ICO;

1. Please advise if, and when, ICO was placed on any type of restricted list at your firm. If so, please provide a copy of the list and any relevant memoranda. Also advise as to procedures utilized by your fir to monitor proprietary and retail trading in securities during a restricted period.

Please feel free to include any other information that you feel is pertinent to the department's review.

Your firm's response should be received by _______. If you should have any questions regarding any aspect of this inquiry, please contact me at _________. Thank you in advance for your prompt assistance in this matter.

Sincerely,

Investigator
Market Surveillance

Mr. Martin Blow
BBB Law Firm
Cairo
Egypt

Dear Mr. Blow:

As we discussed on the telephone today, the ________ is conducting a routine review of trading in AAA. The time period under review concerns the May 15, 2000 news release that the Ahmed Corporation proposed to acquire all of the outstanding common stock of AAA for a cash price of LE 14 per share.

In conjunction with this review, we request that you provide on behalf of Ahmed Corporation, your client, a detailed, written chronology of events that led up to the May 15, 2000 announcement. This chronology should include the following information:

1. The earliest date and circumstances of discussions regarding the acquisition of AAA by Ahmed;

1. The dates and substance of all subsequent meetings that occurred with Ahmed relative to the possible acquisition including the specific time frame wherein price was discussed;

1. A list of all persons who either participated in or had knowledge of those events described in numbers one (1) and two (2), including investment bankers, public relations firms, financial printers, law firms, accounting firms, secretaries, lending institutions, etc.;

1. The home and business addresses of those persons listed in number three (3) as well as any known corporate affiliations of such persons.

Please feel free to include any other pertinent information that will assist us in reviewing the trading activity in AAA prior to the May 15, 2000 news release.

The staff would appreciate your cooperation in responding to this request by _______. Should you have any questions regarding any aspect of this request, please feel free to contact me at _________. Thank you in advance for your cooperation in this matter.

Sincerely,

Investigator
Market Surveillance

Ms. F. Natco
Vice President and Chief Financial Officer
B Systems, Inc.
Cairo
Egypt

Dear Ms. Natco:

Pursuant to our telephone conversation on ________, the _____'s Market Surveillance Department is conducting a review of trading in B Systems, Inc. (BSI) surrounding BSI's May 2, 2000 disclosure in which the Company stated that it expects Second Quarter 2000 earnings to be lower than anticipated.

In connection with this review, the staff requests that BSI provide a chronology of events that preceded the May 2, 2000 disclosure noted above. The chronology should include, but not be limited to, the following information:

1. A statement as to when the Company first had an indication that Second Quarter 2000 earnings would be lower than expected and when preliminary earnings figures became internally available;

1. The earliest date that your Company's internal accounting staff commenced preparation of Second Quarter 2000 figures;

1. A statement as to whether any internal meetings and/or discussions (e.g. Executive or Management meetings, Board meetings) were held prior to the release of projected earnings on May 2, 2000. If so, please provide details of date(s), time(s), and attendees;

1. A list of all persons who were privy to the earnings projection prior to the May 2, 2000 announcement. Please include legal counsel, accountants, investment bankers or others;

1. The home and business addresses of those persons listed in Item (4)

1. A description of any contact the Company may have had with analysts, money managers or others regarding any estimates for Second Quarter 2000 between the date referenced in Item (1) and prior to the May 2, 2000 announcement;

1. A description of the procedures, if any, utilized by BSI to insure the confidentiality of material, non-public corporate information prior to public dissemination.

Please feel free to include any other information that you feel is pertinent to our review. If possible, the staff would appreciate a response by _________.

If you have any questions concerning this request, please contact the undersigned at _______. Thank you for your on-going cooperation in this matter.

Sincerely,

Investigator
Market Surveillance

SECTION V

Questions to Cover in Interviews on Insider Trading Investigations

A. Introduction

These questions are relevant for investigations into insider trading and are organized according to the interviewee (e.g. salesman, issuer, or insider trader). Not all of the questions are worded in a way that is consistent with the guidelines set forth in the Procedures Section on "Conducting Effective Interviews." The questions should simply be viewed as indicative of the areas to be covered in an interview rather than the specific questions that should be asked. In most cases, the guidelines suggest better ways of posing each of these questions.

B. Interview of a Salesman

Background

43. How long have you been employed with the firm?
44. What is your current position?
45. Describe your responsibilities.
46. Do you have managerial responsibilities (i.e. do you supervise other employees?)
47. Do you have any personal accounts?
48. Do you have any beneficial interest in any other account?
49. If so, please state what type of accounts you hold and where they are held.
50. How many accounts do you currently service?
51. Are you an officer or director of any firm or company?
52. Are you married?
53. What is your spouse's maiden name?

If the salesman solicited transactions from customers

54. What was the basis for your solicitation?

55. Did you review financial annual/quarterly reports, company news announcements, industry news announcements?

56. How did you obtain information on the company to formulate your recommendation?

57. Did you consider the price or volume history of the stock?

58. Did you consider anything else?

59. Did you hear rumors regarding the company or the subject security?

60. Did you contact the company in connection with your solicitation? Who did you contact? What was his/her position? What did you discuss and when did this contact take place? Did you have any other contacts with the company?

61. How many accounts did you solicit?

62. How long have you been following the company?

63. How long have you been recommending the stock? Have you had an on-going recommendation?

64. When was the first time a customer purchased or sold the stock on your recommendation?

65. Approximately how many accounts purchases/sold as a result of your solicitation and how many shares did this represent?

66. Have you ever solicited the purchase/sale of the stock prior to this time?

67. When did this prior solicitation occur and how many accounts were involved and how many shares?

68. What prompted you to solicit at this time?

69. Did you purchase the stock for your own account or any account in which you have a beneficial interest?

70. Was the security on your firm's recommended list?

Background on customer accounts involved in possible insider trading

71. When was the account opened?

72. How did you acquire the account?

73. How did you initially meet the customer?

74. How long have you known the customer?

75. Are you related to the customer?

76. How would you characterize your relationship with the customer? Is the relationship strictly broker/client or do you also know the customer socially as well?

77. How often are you in contact with the customer? Is your contact mainly over the telephone or do you meet your customer in person?

78. What would be the basis for this contact?

79. What is the general investment purpose of the account (e.g., income producing, growth, speculation)?

80. Is the information on the new account documentation still current? For example, what is the customer's current occupation?

81. Does the customer maintain any other brokerage accounts? If so, where?
82. How active is the account? How often does the account trade?
83. What kinds of securities are held in the account?

Reason for the purchase/sale of the stock by the customer

1. Confirm whether the trade was solicited or unsolicited.
2. Has the customer ever purchased the stock prior to this time? If so, when and how many shares? Any other prior purchases?
3. When did the customer indicate to you that he wanted to purchase/sell the stock? Did the customer indicate why he purchased/sold the stock? Did you ask?
4. How long had the customer been following the stock before making the investment?
5. How did the customer become interested in the stock?
6. How did the customer obtain information on the company? Did the customer review annual/quarterly financial reports, new announcements concerning the company or industry news?
7. Was your firm recommending the stock?
8. Did the customer mention that he heard any rumors regarding the company?

Information on the actual transaction in the stock

1. How did the customer place the order?
2. When and about what time was the order placed?
3. Did he/she call or walk the order into the office?
4. Was it a limit or a market order?
5. What did the customer say?
6. Were there other discussions with the customer on the day of the purchase/sale? If so, describe the conversation.
7. When was the order executed?
8. Did the customer purchase/sell the stock in other personal accounts? If so, where and how many shares?
9. Did the customer direct the purchase/sale of the stock in any other account?
10. Did you discuss the customer’s purchase/sale with anyone else? If so, who, when, where, why and what was discussed?

11. How did the customer fund the purchase (e.g., cash, margin, loan, etc.)?

12. Repeat these questions for each additional purchase/sale by the customer on subsequent dates.

Events subsequent to the purchase/sale

1. Are you aware of the material news announcement released on ___? Give brief description of the news.

2. If yes, how did you learn of the news?

3. Did you have any contact with your customer following the news?

4. Did you discuss the material announcement?

5. Are you aware of how the customer first became aware of the news?

6. How would you characterize the customer's reaction to the announcement?

7. Did the customer subsequently sell the stock? If yes, when and at what price?

Activity by the salesman

1. Did you purchase the stock for your account or for any other account over which you have discretion or in which you have a beneficial interest?

Possible connections between customers and the company

84. Does the customer know anyone employed or previously employed by the company?

85. Does the customer know anyone employed or previously employed by the other company involved in the transaction?

86. Does the customer know anyone employed or previously employed by the law firms/investment banking firms or others participating in the transaction?

87. Review the names of significant purchasers or sellers of the stock with the salesman to ascertain if the customer knows any of them.

C. Interview of an Issuer Company

Following a material earnings announcement

1. When did the company first become aware that there would be a loss/gain?

2. When were the preliminary earnings figures first available inside the company?

3. Where there any special items or charges taken? Non-recurring items? When did the unusual event occur?

4. Who was aware of the preliminary earnings figures?

5. Who was responsible for preparing the earnings figures? Accounting Department? Outside auditors?

6. When were the financial figures finalized?

7. Were the figures released at the same time as they were in the same quarter in previous years?

8. Who was aware of the final figures?

9. When was the board of directors notified of the numbers, both the preliminary numbers and the final numbers?

10. Are the figures in line with market expectations?

11. What numbers did the market expect?

12. Did the company make any formal predictions?

13. Were there any previous public announcements forecasting earnings estimates for this quarter/year?

14. Are there any analysts that follow the company?

15. What range did the analysts forecast?

16. Did you have any discussions regarding expected numbers with any of these analysts?

17. Ask the interviewee to explain any heavy volume or unusual price movement in the company's stock prior to the news.

18. Was there any local news that affected the company, analyst recommendation, or research report?

19. To whom at the company should a request be addressed for a written chronology of events leading up to the announcement?

Following the announcement of a proposed merger (the same questions should be asked of the issuer's merger partner)

1. When was the initial contact between the two companies?

2. Who contacted whom first? When? How?

3. Why was there interest in the combination?

4. Was the company actively soliciting an acquisition?

5. Was the company considered a takeover target?

6. When did serious acquisition discussions begin?

7. Were there any other firms bidding also? Did the company receive any other offers?

8. When did subsequent contacts/meetings occur? When and how did they occur and who was involved?

9. Who was involved in the discussions?

10. Who was aware of the discussions?

11. When was the board of directors notified? How was it notified?

12. Was the board involved in the negotiations?

13. Was there a regular or special board meeting held? When?

14. What individuals outside of the company were aware of the discussions? Outside legal counsel, investment bankers, accountants, etc.

15. When were terms/prices first discussed?

16. When were the terms finalized?

17. Had the company made any previous public announcements that it was pursuing a transaction of this nature?

18. Had the company signed confidentiality agreements? When? Had any formal documents been signed such as letters of intent?

19. When was the due diligence conducted?

20. Was there any lag time between the terms being finalized and the news release about the transaction?

21. Can you recall any other key events regarding the acquisition?

22. Did either company retain an investment banker or an investment advisor? Get the names of the individuals involved in the discussions.

23. When were they retained?

24. Were they retained specifically for this acquisition?

25. If not, when were they brought in?

26. Did you have legal counsel? Get the name of the firm and the individuals involved in providing counsel.

27. Were you contacted by any analysts or brokers during the acquisition discussions? Who, when and what was discussed?

28. Do you know of any recent analyst recommendations or research reports on the company? Any recent newspaper articles?

29. Do you know of any rumors about the company regarding the acquisition?

30. Do you know of any reasons for the heavy volume or price increase/decrease prior to the announcement?

31. Who is the contact person at the other company? Get the telephone number of this person.

Following an announcement of a stock split or dividend

1. When did the company first discuss/propose a stock dividend or stock split?
2. Who was involved in the discussions?
3. Was there a special board meeting?
4. Had there been any previous disclosure regarding this dividend?
5. Did the company ever announce that they were considering this dividend?
6. Was this a regular or special dividend?
7. What are the effective payable and record dates?

a) Regular Dividend

- How much is the dividend? Stock or cash?
- Is the dividend being paid at the same time as in the past?
- Is the dividend the same amount as in the past?
- How long has the company been paying a regular dividend?
- Did the dividend require the full Board's approval?

b) Special Dividend

- Has the company ever declared a special dividend in the past? When? For how much?
- Where did the funding for the special dividend come from?
- Why is the special dividend being paid?
- Explain the unusual price or volume activity prior to the news announcement.

c) Stock Split

- What is the split?
- What effect will the split have on the company's stock?
- Why is the stock being split?
- What is the basis for the split?

Following an announcement of a significant contract

1. How significant is the contract?
2. What does the contract mean in terms of revenues for the company?
3. What financial impact will this contract have on the company?
4. Was there a bidding procedure?

5. What was the procedure for getting the contract?
6. When did the company first become involved in obtaining the contract?
7. Who was involved in the bidding process?
8. Who was aware the company had bid for the contract?
9. Was the public aware the company was bidding for the contract?
10. When was it announced?
11. When was the decision made about the contract award?
12. How was the company notified?
13. Who was notified?

D. Interview of a Purchaser Prior to the Material News

Background information

1. Where do you live? Who lives there with you?
2. Telephone numbers, both personal and business?
3. Telephone credit cards?
4. Identity of banks where you have accounts.
5. Foreign bank accounts?
6. Spouse (maiden name) and children's names?

Educational background

1. Briefly describe your educational background staring with high school.
2. Degrees obtained?
3. Graduate courses and degrees?
4. Major areas of study?
5. Other kinds of courses?
6. Professional licenses you hold?

Employment history

1. Briefly describe your employment history since graduation and the positions held.
2. Present position, title and responsibilities?
3. How long have you had these responsibilities?
4. Who reports to you?

Brokerage accounts and trading history

1. Where do you maintain brokerage accounts?

2. Are there any other accounts over which you have discretion or control, e.g. parents, children?

3. Who is the salesman on each of these accounts?

4. How long has each account been open?

5. Are you authorized to trade options?

6. What is the general investment purpose of each account, e.g. income producing, speculative, blue chip, etc?

7. What do you consider before making a decision to purchase a stock?

8. Provide relevant documents (opening account documents, statements, options agreements, etc.).

Reasons for decision to purchase the subject stock

1. When did you first consider purchasing the stock and why?

2. How long did you follow the security before making the investment?

3. What steps did you take in making the decision to invest in the stock?

4. Did you review annual/quarterly reports?

5. Did you review financial analysts' reports?

6. Did you discuss the stock or the company with a salesman? Was the salesman recommending the purchase of the stock?

7. Did you discuss the stock or the company with anyone prior to making the purchase?

8. Did you read any press releases or other communications by the company with the public? Where did you see the articles?

9. Did you consider the price history or volume in the stock?

10. Did you hear anything concerning a proposed business combination or other extraordinary transaction involving the stock?

11. What was the basis for your decision to invest? (This area should be thoroughly explored so every consideration is covered.)

12. Ask the individual to show relevant documents (e.g. any press releases, price history, or documents he claims he relied upon in making his investment decision).

Actual transaction(s) in the stock

1. What caused you to purchase the stock on that particular date?

2. What occurred, e.g. did your salesman call and when?

3. What did you say to the salesman and what did the salesman say regarding the stock? Was anyone else present?

4. How did you decide how many shares to purchase?

5. What was the price of the stock?

6. Did you purchase the stock through other accounts as well?
7. Why did you purchase through more than one account?
8. Did you receive a confirmation of your purchase?
9. Did you have subsequent conversations with the salesman after you placed your order?
10. Did you order the purchase of the stock for anyone else or on anyone else's behalf?
11. Ask for relevant documents such as account statements, order tickets, confirmations, etc.

Events subsequent to the purchase

1. When did the transaction settle?
2. How did you fund the purchase of the stock? Cash, margin, loan?
3. If the purchase was funded by a loan, from whom did you obtain the loan? Friend or relative? Any agreement concerning sharing the profits from the purchase?
4. Did you sell any other stock or other asset to make the purchase?
5. Repeat these questions for each additional purchase made by the individual on subsequent dates.
6. Determine if the individual learned any additional information concerning the company or its stock between his first purchase and second, third, etc. purchases.
7. What did you do with the proceeds/profits from your purchase (if sold after the news)?
8. Did you have any understanding with anyone concerning the sharing of any profits from the transaction?
9. Did you tell anyone about purchasing the stock or your intention to purchase the stock?
10. Did you recommend or suggest to anyone that they consider purchasing the stock?
11. When did you first become aware of the material news?
12. How were you informed?
13. What was your reaction to the announcement? Did you discuss it with anyone?

Possible connections with the company

1. Do you know anyone employed or previously employed by the company?

2. Do you know anyone employed by the other company involved in the transaction (if applicable)?

3. Do you know anyone employed by the law firms/investment banking firms/investment advisors to the companies participating in the transaction?

4. Review the list of names of other substantial purchasers of the stock with the individual to determine whether he knows any of them.

5. Are you aware of anyone else who purchased the stock?

Other affiliations

1. Are you a member of any social clubs or athletic clubs? Which ones?
2. What other organizations are you a member of?
3. Any fraternities or sororities?
4. Financial condition?
5. What is your net worth and present salary?
6. What other sources of income do you have?
7. Do you have any large debt? Please describe.

SECTION VI

Procedure for Investigating a Market Manipulation

A. Introduction

Manipulation is defined as a series of transactions designed to raise or lower the price of a security or to give the appearance of trading for the purpose of inducing others to buy or sell. In essence, a manipulation is intentional interference with the free forces of supply and demand.

Under the securities laws in the U.S., generally speaking there are three elements to a manipulation. These three elements are:

- A series of transactions must be effected.
- These transactions must:

    - Create actual or apparent trading in a security or
    - Cause the price of the security to rise or decline

- The purpose of the transactions must be to induce others to buy or sell the security.

Certain types of manipulative activity, such as pre-arranged trading and wash sales, are expressly prohibited in a country's securities laws. In many cases, however, wash sales [7]or pre-arranged trading are only one part of a larger manipulative scheme. Some other trademarks of a manipulation are the following:

1. Purchasing at increasing prices and establishing a large long inventory position

2. Purchasing at successively higher prices despite an existing large long inventory position, high transaction costs, or absence of market demand or order flow (i.e. economically irrational trading)

3. Bidding at increasingly higher prices, even when the firm is the sole high bidder (price leadership), despite a large long inventory position in the security;

4. Repeatedly increasing the high bid in the absence of significant demand other than its own retail accounts

5. Purchasing the security at prices higher than the first is selling the security

6. Executing transactions away from the highest bid and lowest offer, especially when the firm is showing the high bid or low offer

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[7]To sell stock at a loss and buy it back the next day in order to reap the tax benefit gained from selling at a loss. To prevent this kind of activity, the wash sale rule says that if one sells a stock at a loss, the same security cannot be repurchased before 30 days.

7. Purchasing many more shares from other brokers than selling to other brokers (i.e. a net buyer) and selling the difference to retail accounts, "parking[8]" the shares in a retail account or holding the shares in inventory. This activity has the effect of reducing the security's floating supply, or shares available for purchase or sale.

8. Rather than allowing shares of stock to reach the marketplace, the firm buys all shares sold by its retail customers and places them in its inventory.

9. Dominating and controlling the market for the security, the firm's trading activity completely overshadows that of any other broker.

10. Significant trading profits are generated by the subject broker's activity.

11. The firm traded the security at a loss with certain retail accounts that, in turn, generated significant trading profits. It may appear that the firm lost money or made very little money; however, the firm's owners may have profited greatly.

12. The firm's inventory position (or inventory combined with suspected nominee accounts' positions and firm principals' positions) represents a large percentage of the floating supply, it could be argued that the firm controls the supply of the security

13. Pre-arranged block trading of a significant percentage of the float by a relatively small number of accounts

14. A pattern of trading between two brokers where virtually the same volume of shares are sold back and forth to one another with essentially no profit being generated by either firm. These transactions may reflect circular trading, wash sales or matched orders

15. Guaranteeing purchasers against loss

16. Cash payments to persons who in turn convince others to purchase the security

17. Use of nominee accounts to conceal the actual control of the security and the purpose of the widespread buying or selling activity

18. Marking the close in the security

19. Market hype or publicity

20. Refusal to execute customer sell orders

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[88]When a broker, using a customer account, accumulates a lot of shares in order to artificially drive up demand and price. Although "parking" is, in itself, an illegal action, brokers may often "park" shares in a discretionary account (customer's have given the broker full discretion to manage the account as they see fit), therefore this single action is not technically illegal. But, brokers have also been known to "park" shares in non-discretionary accounts without the customer's consent, which is illegal.

21. Ghosting of orders[9]

Proof of a manipulation almost always depends upon circumstantial evidence. The third element of a manipulation noted above – for the purpose of inducing others to buy or sell the security – can only be inferred from the individual's pattern of trading in the security. Rarely will a manipulator confess to the manipulation.

As a result, proving a manipulation is a complicated and arduous process involving analysis of a mass of factual detail. The facts of the case, taken as a whole, must paint a picture of a manipulative scheme designed to tamper with free market forces.

B. Step by Step Procedure for Investigating a Market Manipulation

Preliminary Analysis of the Suspicious Price Movement

1. Define the time period of the potential manipulation and the extent of the price move in the security. (Include a reasonable period before and after the potential manipulation for comparison purposes.)

2. Conduct a detailed analysis of trading data in the security during the period to determine the following:

    - Whether any broker dominated (over 50 percent) the trading in the security during the subject period
    - Whether any broker was regularly the highest bidder or the highest offeror
    - Whether any broker significantly led all other brokers in increasing bids
    - Whether any broker had significant long or short positions in the security

3. Review news releases published about the company before and during the subject period to determine whether they may explain the price movement.

4. Review general market conditions and conditions in the company's industry during the period to determine whether they explain the price movement.

C. Gathering Records Concerning Brokers, Customers, and the Company

1. Gather the following information from brokers:

    - Trading information for the entire period

    - Copies of all order tickets with legible time stamps, purchase and sale blotter or equivalent, stock inventory records, proprietary account records, and Profit and Loss statement on the stock

    - Customer account information: new account cards, customer account agreements, applicable powers of attorney, copies of checks payable to customers,

[9] When a broker tries to drive price up or down by inputting an artificial buy or sell order at a high volume.

correspondence, relevant sales and promotional material, customer complaint letters, customer account statements, customer confirmation slips

- Firm proprietary account information: daily stock inventory position, pricing procedures and standards, daily stock trading report (P & L)

- Compliance data: audit reports, reports of compliance reviews, firm procedures manuals

2. Gather the following information from the company:

   - Press releases during the period
   - Schedule of purchases and sales by officers and directors
   - Proxy material
   - Annual and quarterly reports;
   - Research reports
   - Filings with the CMA

3. Gather the following information from customers:

   - Sales literature and promotional materials received
   - Notes of telephone calls
   - Complaint letters

D. Reconstruct Trading History and Analyze Data

Reconstruct the trading in the security during the period, looking for trademarks of a manipulation as noted in the Introduction.

1. Schedule the daily price history (in time sequence) before, during, and after the manipulation period.

2. Schedule the daily opening and/or closing prices for “marking the close” patterns and other unusual price increases or decreases.

3. Schedule the daily purchase and sale volume before, during, and after the manipulation period.

   - Reflect the percent of total volume by each dominant purchaser or seller
   - Analyze for any volume trading patterns, such as “parking”

4. Schedule the bid and offer prices entered by dominant broker purchasers or sellers. Prepare separate analyses for high bidder or high offeror and for upticks and downticks.

5. Schedule the daily stock inventory position of dominant brokers.

6. Schedule the daily purchases and sales during the period.

7. Schedule the amount of trading profits (realized or unrealized) and commissions earned by dominant brokers.

E. Analyze Information for Basis for Demand for the Security

1. Review company news releases, company filings with CMA or promotional material for false or misleading statements that could have been made to stimulate demand for the security.

2. Review brokers' sales literature for material containing misrepresentations and/or omissions of material facts; look for high-pressure sales scripts.

3. Gather information from investors through questionnaires, surveys or interviews.

4. Review order tickets for unsolicited versus solicited transactions and for special notations or explanations.

F. Analyze Evidence of Motive or Manipulative Purpose

It is important to gather information directly from the company and/or the company's transfer agent for this step in the investigation. It is also important to gather information from any available sources regarding the relationship between and/or background of the company and any involved brokers or salesmen.

1. Review the schedule of realized or unrealized trading profits and/or commissions for evidence of motive.

2. Look for evidence of outstanding loans secured by the stock held by individuals suspected of being involved.

3. Review brokers' due diligence files.

4. Review personal diaries and calendars of certain individuals suspected of being involved.

5. Review dominant brokers' financial condition.

6. Look for warrants or options granted or additional securities issued to individuals suspected of being involved.

7. Gather additional information from the company regarding promoters, insiders, etc.

8. Review company's status in meeting the CASE listing requirements.

G. Question Witnesses

The list of potential witnesses not only includes customers, personnel of brokers, and representatives of the company, but also bankers, secretaries, promoters, and others with an interest or involvement in the company or the stock.

H. Request Additional Documents Not Previously Obtained

As a result of information gathered from witnesses and learned from the analyses already performed, it may be necessary to gather additional documents such as telephone records, bank accounts, desk calendars, correspondence, etc.

I. Conclusion

An investigation into a market manipulation requires the ability to gather, analyze, and organize significant volumes of data and information. Proof of a manipulation nearly always depends upon circumstantial evidence.

Since manipulation investigations are time consuming and there are few shortcuts, some of the trademarks of a manipulation, as noted in the Introduction, should be evident before an in-depth investigation is initiated.

For further guidance on investigating a market manipulation, see “Primer: Investigating and Proving a Market Manipulation,” which is included in the Market Surveillance Reference Manual.

SECTION VII

Conducting Effective Interviews

Whether an interview is conducted informally over the telephone or formally in-person, no matter what type of investigation is involved, observing the following guidelines will ensure a more effective and productive interview.

1. The most effective way of asking questions and following-up answers is to think in terms of asking questions that answer WHO, WHAT, WHERE, WHEN, WHY, AND HOW.If you consider asking these kinds of questions no matter what subject area you are covering in the interview, it is likely that you will touch all of the major areas that need to be covered.

2. It is important to consider your interview as a string of questions and follow-ups which are put together in a certain order for a particular reason. Having an outline to follow will help you maintain your planned order.

3. The quality of the answer usually depends upon the quality of the question. If you want a clear and concise answer, you need to ask a clear and concise question. Here are some basic “Do’s” and “Don’ts”.

Do

- Try to keep your questions short and simple. Let the person you are interviewing (“interviewee”) do most of the talking.

- Be sure the interviewee answers out loud – nodding or shaking one’s head is not good.

- Whenever you use a term that is generally known in the securities industry but may not be known outside of the industry, ask the interviewee what his/her understanding of the term is to make sure that he/she has a clear understanding.

Don’t

- Don’t ask two questions in one question.

- Don’t ask another question until the interviewee has answered the previous question. If there is a silence after you ask a question, it probably means the interviewee is thinking about his/her answer.

- Don’t jump in with another question or rephrase your question unless you are asked to do so. Just be patient and wait for an answer.

- Don’t cut off the interviewee’s answer. Be sure he has answered completely before asking the next question.

- Don’t start questions with, do you remember if, do you know if, or other introductory phrases that detract from the substantive question you are asking. Here are some examples:

a) Wrong Way: "Do you remember if Mr. Brennan told you that the commissions were excessive?"

b) Right Way: "What did Mr. Brennan tell you regarding the amount of the commissions charged?"

4. Look at the interviewee (if the interview is being conducted in person) when you are asking the question. Do not read the question from your outline, if possible. It would be preferable to read the question to yourself, then look up and ask the question.

5. Consider how you are going to ask the question. The same question can be asked many different ways and therefore can have many different meanings depending upon what words you choose to emphasize.

6. Your primary responsibility is to ask relevant, probing questions, listen to the answer, and be ready to ask follow-up questions based on answers given. This is really the heart of the task of conducting an interview – to be able to move from an outline of topics to cover and delve deeper into the issues contained in the answers provided by the interviewee.

7. To be in a position to ask a follow-up question, you must be concentrating on the answers being given by the interviewee, not on the last question asked, or on the next question listed on your outline. This also means that you have to have a very good knowledge of the subject being discussed with the interviewee. You can accomplish this during your preparation for the interview.

8. Use your outline only as a guide. Do not consider yourself tied to it. If the interviewee wants to bring you to another area of interest, use your judgment as to whether to follow-up with further questions in the new area. At the end of the interview, use your outline to be sure that you have covered all of the areas that you intended to cover.

9. Consider making small checks on your outline next to items that you have covered so if you skip around you will be able to determine where on your outline you may need to go back.

10. You should not be attempting to write down everything being said by the interviewee. Rather, you should use your time to listen and react to what is being said. Notes should be limited to what is required to be able to ask follow-up questions.

11. If the interview is not being recorded, it is useful to have another person present or listening in on a telephone interview. The second person can take notes for you and can suggest follow-up questions that you may not think to ask.

12. Beware of rephrased questions by the interviewee – or his/her attorney if there is one present at the interview. Sometimes the attorney will eliminate a critical aspect of the question. If you think the question is clear, ask the interviewee if he/she understands the question. It is better to repeat a question rather than rephrase it.

13. Make sure you understand the answer before moving on to another question. You don't need to agree with the answer, but be sure that the answer is clear and not ambiguous.

Don't be afraid to ask a question over, or in a different way so as to elicit the answer to your question.

14. If you do not understand the answer given or a term used by the interviewee, ask for a further explanation of what you did not understand.

15. Consider the use of silence after the interviewee has given an answer that you feel is not complete, or that the interviewee may be willing to expand upon. This is an unspoken way of saying, "I am waiting for you to complete your answer."

16. Be sure that the answers to questions are responsive. If the answer does not respond to the question, explain that to the interviewee and repeat the question. To be able to do this you must really listen to the interviewee's answer.

17. The ultimate questions are: What else? Anyone else? What happened next?

GLOSSARY

FINDER: An individual, acting in a private capacity, who initiates contact between a company and contra-party concerning the possibility of a business combination

GHOSTING OF ORDERS: When a broker tries to drive price up or down by inputting an artificial buy or sell order at a high volume

MARGIN CALLS: A demand upon a customer to put up money or securities with the broker. The call is made when a purchase is made; also, if a customer's equity in a margin account declines below a minimum standard set by the exchange or by the firm

MISSAPPROPRIATION THEORY: To take advantage of information that a company must disclose (such as information found in a 10-Q or 10-K, which outlines material events that will negatively or positively impact the company) before it is released to the public.

ORDER TICKET: A ticket written to show what time an order was placed and through which broker. The date, time, and size stamped on the ticket indicate the priority in which orders should be filled. An order ticket is important when discussing insider trading because the ticket is a method of tracking.

PARKING: When a broker, using a customer account, accumulates a lot of shares in order to artificially drive up demand and price. Although "parking" is, in itself, an illegal action, brokers may often "park" shares in a discretionary account (customer's have given the broker full discretion to manage the account as they see fit), therefore this single action is not technically illegal. But, brokers have also been known to "park" shares in non-discretionary accounts without the customer's consent, which is illegal.

SALESMAN: In this manual this term refers to the sales representative, at the brokerage firm, who handles the customer's account.

TIPPING: Disclosing confidential information so certain people can benefit from a trade.

WASH SALES: To sell stock at a loss and buy it back the next day in order to reap the tax benefit gained from selling at a loss. To prevent this kind of activity, the wash sale rule says that if one sells a stock at a loss, the same security cannot be repurchased before 30 days