
The Law of Insider Trading: Legal Theories, Common Defenses, and Best Practices for Ensuring Compliance

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INTRODUCTION

The government's 2011 prosecution of hedge fund manager Raj Rajaratnam and the various investigations into the use of expert networks by hedge funds and other institutional investors have prompted questions about the law of insider trading, permissible methods of gathering information, general defenses to allegations of insider trading, and the ways in which firms can reduce risks of liability. As a first line of defense, investment firms should ensure that robust and comprehensive compliance programs are in place to reduce the risk of potential insider trading. Regardless of the quality of their compliance procedures, however, institutional investors and financial services personnel may be suspected of, or even face criminal and civil charges for insider trading. To assist firms and individuals in considering and weighing possible defenses against actions brought by the Department of Justice ("DOJ") or the Securities and Exchange Commission ("SEC"), this Article (1) provides an overview of the relevant law regarding insider trading, (2) discusses some of the general legal and factual defenses that may be raised, depending on the facts and circumstances of the case, and (3) provides guidelines for establishing and maintaining an effective compliance program to minimize the risks of insider trading liability.