First arrest in high-profile insider trading investigation

Andre Damon
27 November 2010

The US government arrested Don Chu, an investment research firm employee Wednesday, in the first charge related to an ongoing insider trading investigation.

District attorney Preet Bharara said Chu arranged “for insiders at publicly-traded companies to provide material, nonpublic information to...clients.” In exchange, the government alleges, Chu’s clients, mostly hedge funds, conducted transactions through his company’s trading arm.

Chu is charged with one count of conspiracy to commit securities fraud and one count of conspiracy to commit wire fraud. The first charge carries a maximum penalty of five years, and the second carries up to 25 years.

The US attorney did not reveal the name of Chu’s firm, but he has since been identified as the Taiwan associate for the US-based firm, Primary Global Research. The firm is located in California and has offices in New York. It is part of a growing number of “expert network” firms, which pair investment firms with people knowledgeable with the businesses they invest in.

It is illegal for these experts to disclose information that is not public or readily available. “Insider trading basically comes down to where you know or ought to know that the person from whom you’re getting this information has a duty to someone else to keep it confidential,” former Securities and Exchange Commissioner Paul Atkins told the *Wall Street Journal* Tuesday.

The FBI says that Chu knowingly paired employees of companies together with investors who wanted to make trades based on the value of those companies. For example, in 2008, Chu allegedly gave a hedge fund partner named C.B. Lee access to an employee of a technology company who told Lee the company’s earnings figures before the official earnings report came out.

When Lee questioned Chu as to whether the connection was legal, Chu said he was “nervous” about the SEC investigating him, and that for this reason he did not want to get “too involved” in the United States, according to the government.

The US attorney’s office said Chu was arrested Wednesday because he was scheduled to depart for Taiwan within the next few days.

In recent years, hedge funds and other large investors have moved away from using research generated by large banks and have relied more on “expert networks” like Chu’s company. There are currently about 40 such firms, up from eight in 2001.

Over a third of large investment companies use these types of expert networks, according to a 2009 survey. Consultants in these networks receive hundreds of dollars per hour for meetings and phone calls with financial firms, and the networks’ clients often pay tens of thousands in annual subscription fees.

While all expert networks would claim that their internal policies bar experts from discussing non-public matters, the conversations between “experts” and traders are not generally monitored.

Chu’s arrest is part of a three-year investigation into insider trading at Wall Street firms. The investigation has thus far involved dozens of companies. The FBI confiscated documents from three hedge funds Monday in connection with the investigation.

If the information gathered by the FBI and presented by the district attorney is correct, it would mean that Chu and his firm conspired to assist companies in insider trading. As the investigation itself indicates, however, this is part of a much broader trend.

At the same time, there is a definite element of evasion in the government’s case. The type of insider trading described by the indictment of Chu pales in comparison to the criminality that pervades Wall Street. The entire American economy has been built up on an edifice of speculation and fraud, in which the major financial institutions regularly manipulate markets to ensure vast profits.

These operations culminated in the wholesale looting of the economy prior to and during the economic crisis that erupted in 2008. There was a real element of calculation in the inflation of the housing bubble, which funneled trillions into Wall Street, and then the subsequent bank bailout once this bubble collapsed.

No one has been held accountable for this catastrophe, which has led to the worst economic crisis since the Great Depression, throwing millions out of work and devastating living standards throughout the country and internationally. Far from prosecuting those responsible, the government—including both the Bush and Obama administrations—have functioned as co-conspirators.

The prosecution of Chu, and any others that follow, is intended to present a false portrait: that the government is working to prosecute Wall Street criminals, when in fact it is doing nothing of the sort.