WORKING THE SYSTEM

Open-Government Laws Fuel Hedge-Fund Profits

BY BRODY MULLINS AND CHRISTOPHER WEAVER

WASHINGTON—When SAC Capital Advisors LP was weighing an investment in Vertex Pharmaceuticals Inc., the hedge-fund firm contacted a source it knew would provide nonpublic information without blinking: the federal government.

An investment manager for an SAC affiliate asked the Food and Drug Administration last December for any “adverse event reports” for Vertex’s recently approved cystic-fibrosis drug. Under the Freedom of Information Act, the agency had to hand over the material, which revealed no major problems. The bill: $72,50, cheaper than the price of two Vertex shares.

SAC and its affiliate, Sigma Capital Management LLC, snapped up 13,500 Vertex shares in the first quarter and options to buy 25,000 more, securities filings indicate. The stock rose that quarter, then surged 62% on a single day in April when Vertex announced positive results from safety tests on a separate cystic-fibrosis drug designed to be used in combination with the first.

Finance professionals have been pulling every lever they can these days to extract information from the government. Many have discovered that the biggest lever of all is the one available to everyone—the Freedom of Information Act—conceived by advocates of open government to shine light on how officials make decisions. FOIA is part of an array of techniques sophisticated investors are using to try to obtain potentially market-moving information about products, legislation, regulation and government economic statistics.

“It’s an information arms race,” says Les Funtleyder, a longtime portfolio manager and now partner at private-equity firm Poliwog Holdings LLC. “It’s important to try every avenue. If anyone else is doing it, you need to, too.”

A review by The Wall Street Journal of more than 100,000 of the roughly three million FOIA requests filed over the past five years, including all of those sent to the FDA, shows that investors use the process to troll for all kinds of information. They ask the Environmental Protection Agency about pollution regulations, the Department of Energy about grants for energy-efficient vehicles, and the Securities and Exchange Commission about whether publicly held companies are under investigation. Such requests are perfectly legal.

Some investors and officials at companies that make FOIA requests on investors’ behalf said in interviews that hedge funds and other Wall Street firms are increasingly using the open-records system to gather information relevant to investment decisions. They said FDA reports about pharmaceutical companies are of particular interest.

One of the quirks of the process is that the first person to ask for something is typically the first to get it—an incentive to dig for valuable information quickly, and an irritant to those who say all investors should get it at once.

Investors say they rarely make trades solely based on information obtained through the open-records law, but that such material helps them to piece together investment strategies or evaluate a company’s prospects.

A spokesman for SAC and Sigma declined to comment.

SAC’s use of the FOIA system plays no part in the criminal case being pursued by the Justice Department against the firm for alleged insider-trading. SAC has pleaded not guilty and denied wrongdoing.

There is nothing improper about trading on information obtained through a FOIA request because the government has no duty to keep the information private.

Any individual, from local activist to political operative to investor, can file an information request under the law. Federal agencies that receive requests—Congress and some White House offices are excluded—are required to turn over information, using “the most efficient and least costly methods” to comply. Some areas are off limits, including information about national security, law-enforcement investigations and internal deliberations, such as whether the FDA might approve a new drug. “The FDA takes very seriously its responsibility to protect confidential and trade-secret information received from companies we regulate,” an FDA spokeswoman said. “The agency has processes in place to ensure that sensitive information is appropriately removed.”

When an individual asks for government documents, that request itself becomes part of the public record. The Journal reviewed more than 100,000 such open-records requests since the beginning of 2008 and obtained hundreds of specific information requests filed by investors, along with copies of the documents that investors received from the government.

The precise number of requests from investors is impossible to tally because many come from third-party organizations that send requests on behalf of
Mr. Funtleyder of Poliwogg Holdings says information such as adverse-event reports on drugs can be useful for investors. "If [FDA data] was within the threshold of acceptability, you'd feel a lot more confident going forward with your investment," he says.

Investors also use FDA information to scan the horizon for possible problems, for instance, during the rollout of a new drug. In February, hedge fund Kingdom Capital Management LLC asked the FDA for reports relating to a recently approved prostate treatment made by Medivation Inc., a San Francisco-based pharmaceutical firm. Wall Street was interested in how the drug would compare to a rival medicine marketed by Johnson & Johnson.

The agency responded two days later with more than 100 pages of complaints it had received about people who reported health problems after taking the Medivation drug.

Kingdon cut its ownership to 306,000 common shares as of March 31, compared with 510,000 at the end of 2012, securities filings show. During that time, Medivation shares fell 8.6%, a decline analysts attributed to second-guessing about the potential market size for the new treatment and competition from existing products. Kingdon declined to comment.

Investors are especially interested in Form 483s, facility-inspection reports that "are the most intimate look at what is going on inside a pharmaceutical firm," says Ms. Bobka of FOI Services. Investors "love this stuff."

FDA inspectors can enter and inspect any private facility that manufactures, processes, tests or packages drugs or medical devices that will be transported across state lines. Reports tend to include information about a company's testing and manufacturing procedures, production capacity and compliance with federal rules.

The FDA says it performed 5,500 inspections of medical device and drug facilities in the 2012 fiscal year. In about half of those cases, the agency would use an inspection report detailing problems it found. The FDA produced 50% more inspection reports in 2012 than it did in 2008, according to agency figures.

The only way investors can get most reports is to send an open-records request to the FDA. Under a 1996 law, when the agency gets frequent requests for the same record—generally more than three—it has to make them public on its website. But there isn't any specific deadline for doing so, says Christopher Kelly, an FDA spokesman. That means first requesters can get records days or even months before they are posted online.

In March 2009, Genzyme Corp., a drug manufacturer based in Cambridge, Mass., said the FDA had found problems with the primary manufacturing plant where it produced top-selling treatments for a variety of rare enzyme-related diseases. The announcement sparked a buzz on Wall Street and the stock plummeted. In an effort to find out how serious the problems were, SAC and a dozen other Wall Street firms sent document requests to the FDA seeking the inspection report.

Later that month, the FDA turned over to SAC a six-page report that detailed an array of problems. Among other things, the report disclosed that the inspection lasted nearly a month. The FDA also sent SAC letters between the agency and Genzyme officials that suggested the matter wasn't going to be fixed quickly.

The FDA mailed the documents to SAC on March 30, 2009, one day before the end of the first quarter. Over the following three months, SAC and its affiliates reduced their combined stake to 127,000 shares, from 221,000 at the end of the first quarter, according to securities filings. Over the six-month period ending June 30, Genzyme shares declined 16%.

The FDA posted the Genzyme inspection report on its website five months after it was sent to SAC. Some pages were missing. It posted the entire file in March 2010, a year after SAC got it. Genzyme has since been purchased by French drug company Sanofi SA.

Gregory Wade, a health-care analyst with Wedbush Securities, a Los Angeles asset-management firm, says FDA reports should be made available to all investors simultaneously. "If there's a problem with a facility, it can have a huge impact on the company's stock price," he says.

About 125 full-time workers process requests sent to the FDA, according to an annual report compiled by the agency. Handling the roughly 10,000 requests sent to the FDA in fiscal 2012 cost the government $33.5 million, more than three times
Data Mining
Hedge funds and other sophisticated investors are using the Freedom of Information Act to obtain nonpublic information from the FDA and other federal agencies.

Government agencies that get the most FOIA requests, 2012

<table>
<thead>
<tr>
<th>Agency</th>
<th>Requests</th>
</tr>
</thead>
<tbody>
<tr>
<td>Department of Homeland Security</td>
<td>190,589</td>
</tr>
<tr>
<td>Department of Justice</td>
<td>69,456</td>
</tr>
<tr>
<td>Department of Health and Human Services</td>
<td>68,467</td>
</tr>
<tr>
<td>FDA</td>
<td>66,078</td>
</tr>
<tr>
<td>Department of Defense</td>
<td>66,078</td>
</tr>
<tr>
<td>Social Security Administration</td>
<td>31,329</td>
</tr>
<tr>
<td>Department of Veterans Affairs</td>
<td>24,423</td>
</tr>
<tr>
<td>Department of Agriculture</td>
<td>22,175</td>
</tr>
<tr>
<td>Equal Employment Opportunity Commission</td>
<td>18,726</td>
</tr>
<tr>
<td>Department of Labor</td>
<td>18,560</td>
</tr>
<tr>
<td>State Department</td>
<td>18,521</td>
</tr>
</tbody>
</table>

Sources: FOIA.gov; FDA

The FDA and FOIA

- FDA's FOIA office budget: $30 million
- FDA's FOIA office personnel: 150
- FDA inspections of drug and medical device companies: 6,000

Andrew Hack, an analyst for hedge fund Millennium Management, has sent more than two dozen information requests to the FDA since 2011. In December 2011, he sought help from an agency staffer about a request for inspection reports for drug maker Regeneron Pharmaceuticals Inc.

Regeneron had won FDA approval for a new drug, Eylea, to treat a leading cause of blindness in the elderly. Sales were expected to take off—as long as the firm's manufacturing facilities continued to meet FDA standards. Millennium owned 10,000 shares of Regeneron at the end of 2011.

In early 2012, Millennium received an inspection report from the FDA, which found no significant problems. Millennium tripled its ownership in Regeneron to 31,800 shares by March 31, 2012. Regeneron's stock doubled during the first quarter of 2012 to $116.62.

The FDA billed Millennium $23,10 to process the request. Two months later, on March 2, 2012, the agency put the inspection report on its website.

Sophisticated investors know how to read the tea leaves in the reports, says Kristin West, who runs the Office of Research Compliance at Emory University, which conducts clinical investigations of new drugs, as required for FDA approval.

"The specific details under each of the general observations are what matter," she says. "If those detailed findings show no systemic problems, those are the ones that investors are not going to worry about."
Traders Pay for an Early Peek at Key Data

On the morning of March 15, stocks stumbled on news that a key reading of consumer confidence was unexpectedly low.

One group of investors already knew that. They got the University of Michigan’s consumer report two seconds before everyone else.

By Brody Mullins, Michael Rothfeld, Tom McGinty and Jenny Strasburg

Infinium Capital Management, a high-speed trading firm in Chicago, used the information to launch a wave of trading in futures contracts, in just one example of the activity that followed. In a single second, according to a Wall Street Journal analysis, traders from various firms bet nearly seven million shares that equity markets would decline—which was exactly what happened when news of the survey became widely known.

Economic reports from public universities, trade groups and other nongovernmental organizations can move markets as surely as official data from the U.S. government. But unlike government reports, where prices are set to make certain no one gets them ahead of time, few rules control release of nongovernmental economic reports. Unknown to many investors, selling early access is routine.

This is a “blind spot” in U.S. law, said Richard Painter, a former Republican White House ethics lawyer. Groups, he said, should “not be allowed to selectively disclose market-moving data to people who pay more money—that is not right.”

But it is legal, and so is trading on the advance peaks. Even as securities rules bar companies from selling access to select data, and as authorities vigorously pursue insider trading in all its forms, no law prevents investors from trading on nonpublic information they have legally purchased from other private entities. Trading would be illegal only if the information was passed through a breach of trust, said securities lawyers.

“If someone gives you permission to use the information, then there is no problem,” said Steve Crimmins, a former Securities and Exchange Commission enforcement official now at law firm R&L Gates LLP.

Besides the Michigan consumer-sentiment survey, reports released early to paying customers include a Chicago-based barometer of business activity and a widely followed manufacturing index from the Institute for Supply Management—which said Wednesday it is re-evaluating how it releases its data.

Other organizations, including trade associations and private research firms, sell data that move industry-specific stocks and futures markets on everything from agriculture to truck sales. Among investment firms that have subscribed to such reports are SAC Capital Advisors L.P., Tudor Investment Corp., and Wellington Capital Management, according to people familiar with the matter. The firms declined to comment.

“It’s not an exclusive club,” said Infinium’s chief operating officer, Gregory Eckbush. He said his firm needs to have an advance look at the consumer-sentiment survey to keep from getting “flattened” by other futures traders.

Mr. Eckbush said Infinium attributes around 10% of its annual revenue, or close to $18 million in recent years, to using high-speed news and economic-data feeds, in a strategy he called “event jumping.”

Trading on such reports, called the “news-feed trade,” is emblematic of an era in financial markets dominated by hair-trigger trading measured in fractions of seconds.

At its speediest, this means trading by algorithms based on what is known as “machine-readable news.” Paul Rowady of research firm Tabb Group, who studies the economics of trading, estimates the delivery of machine-readable news will generate $75 million in revenue for financial-news providers this year, up almost 50% in five years.

Sharad Kumar, a veteran of several high-speed trading firms, said the availability of early access to nongovernmental data creates an arms race in which firms pay for it to avoid being at a “huge disadvantage.” At the same time, its cost can be “a barrier to entry” for smaller traders, he said.

The early look at the consumer-sentiment findings comes from Thomson Reuters Corp. The company will pay the University of Michigan $1.1 million this year for rights to distribute the findings, according to the university. Next year, it will pay $1.2 million.

In turn, Thomson Reuters’s marketing materials say the firm offers paying clients an “exclusive 2-second advanced feed of results...designed specifically for algorithmic trading.”

Clients who pay a subscription fee to Thomson Reuters, which for some is $5,000 a month plus a $1,025 monthly connection charge, get the high-speed feed at 9:54:08 a.m. Eastern time.

Those who pay for Thomson Reuters’s regular news services get the report two seconds later. At that point, it swiftly becomes widely available through other news providers as well, including Wall Street Journal publisher Dow Jones, a News Corp. unit that is a Thomson Reuters competitor.

Five minutes later, at 10 a.m., the university posts the numbers on its website.

Richard Curtin, an economist who runs the university’s survey, said he knows the deal gives an advantage to select investors.

“Hardly anyone would pay for it if they didn’t see a profit motive,” Mr. Curtin said. Later, he added: “This research is totally funded by private sources for the benefit of scientific analysis, to assess public policy, and to advance business interests. Without a source of revenue, the project would cease to exist and the benefits would disappear.”

Thomson Reuters said in a
New York offices of Thomson Reuters, distributor of some key indexes.

statement: “Thomson Reuters is a leading provider of data and analytics to many categories of participants in financial markets such as investors, asset managers, traders, and high-frequency traders. Thomson Reuters, like many information providers, looks to produce and secure exclusive content to help its customers make better informed trading and investment decisions. Thomson Reuters is open and transparent about how data is released but always looks for ways to improve this transparency further. Anyone wishing to invest or trade on this data can subscribe to the service that best meets their data needs.”

Matthew Winkler, editor in chief of Reuters rival Bloomberg News, criticized the University of Michigan’s arrangement with Reuters in a letter to the university’s president and provost in April 2012.

“As an institution that receives public funding, the university has a legal and ethical obligation to be accountable to the public. If such organizations as Bloomberg News, Reuters, Dow Jones and others do not have equal access to information, neither does the public,” Mr. Winkler wrote, in a communication reviewed by the Journal. He said Reuters’s subscribers had “an unfair advantage.”

Sueylin Scarnecchia, then the university’s general counsel, responded to Bloomberg that university officials “have always been comfortable that our relationships and structures were in full compliance with all applicable laws.”

Six years earlier—before Reuters acquired distribution rights—Bloomberg itself bid for them, promising it would create a level playing field.

After its offer wasn’t accepted, a Bloomberg executive editor emailed the university complaining that in the deal the school planned to make with Reuters, “you will be guaranteeing that every other news organization—to say nothing of every investor who doesn’t subscribe to Reuters—will be disadvantaged. No wonder Reuters is willing to pay you so much more than Bloomberg: While we were offering money to help the University create a system that is fair to everyone, they are paying you to guarantee an unfair one!”

A university economist told Bloomberg at that time that those were difficult issues the university was grappling with.

Journal publisher Dow Jones doesn’t exclusively distribute indicators created by nongovernmental entities but does send some exclusive content reported by its news staff to premium subscribers before it is published on general newswires or on its website. Most Journal articles are available only to subscribers.

The Chicago Business Barometer is a monthly index of economic activity based on a survey of companies in that area. German financial exchange Deutsche Börse AG bought the right to produce and distribute the Barometer two years ago, and sells early access to it starting at about $2,600 a year.

Customers receive “this market-moving data 3 minutes before public release,” according to the website of a Deutsche Börse affiliate. Paying customers can get the early release by email, conference call or a machine-readable feed.

Subscriptions are “open to everybody and all customers receive the report simultaneously, regardless of delivery method,” a spokeswoman for Deutsche Börse said.

On April 30, the Barometer showed its lowest reading in 3 ½ years. Those who bought early access found this out at 9:42 a.m. Eastern time.

Jump Trading LLC, a high-speed trading firm in Chicago, used the head start to make negative bets on securities that tend to move with the report, according to people familiar with its operations. Jump declined to comment.

This was part of a flurry of
trading at 9:42. In one minute, the SPDR S&P 500, an exchange-traded fund that tracks the stock market, traded 1.4 million shares, triple the number traded in the previous minute.

Its share price was 24 cents lower by 9:45, the time when anyone who wasn’t paying Deutsche Börse for an early look got the news.

In contrast to “the fast money” that uses the early report, “the dumb money” comes along three minutes later with the Barometer’s general release, said Caleb Epplett, a former trader at Chopper Trading LLC, another Chicago high-speed firm. “Anybody who’s anybody is going to have that number when it [first] comes out,” he said.

Chopper said it trades on Deutsche Börse’s high-speed access but declined to discuss specific transactions.

Jim Overdahl, an economist and an adviser to a traders’ group at the Futures Industry Association, to which Jump, Chopper and Infinium all belong, said: “Professional traders subscribing to services that provide the fastest possible access to news rarely differ from your paying extra for online access to a favorite newspaper instead of waiting for the paper to plop on your doorstep the next morning. For some people, it’s worth the premium to get access to news in real time.”

Besides the Chicago Business Barometer, Chopper said it trades on an early release of the monthly manufacturing index from the Institute for Supply Management, or ISM.

That index—beefed up during the Great Depression when President Hoover was frustrated by a lack of data—is regarded by many as the single most important economic report coming from the private sector.

Last summer, the ISM began offering access to survey results through Thomson Reuters’ high-speed feed. Customers who want it pay Thomson Reuters a fee of about $2,000 a month, plus the $1,025 monthly for a high-speed connection if they don’t already have it.

The manufacturing data are scheduled to be released to the public at precisely 10 a.m. by Thomson Reuters’ high-speed news feed and also via news release from the ISM.

In fact, the ISM news release routinely goes out five to 10 seconds late, giving that much of an edge to customers of Thomson Reuters’ high-speed news feed, according to records from the release and people familiar with it.

Thomson Reuters’ sales team has been tracking the lag as a selling point for the high-speed feed, according to an emailed sales pitch to a prospective client viewed by the Journal.

On Feb. 1, the ISM manufacturing number was good, exceeding expectations. This rippled through stock, options, futures and currency markets.

In the single second after the clock struck 10—with the ISM news release not yet in the hands of subscribers—volume in the SPDR S&P 500 exchange-traded fund soared to 719,000 shares, from about 27,000 in the prior second.

The Journal analysis shows most of the trades were bets on the fund to rise. It did rise. Within five minutes, these bets collectively rose in value by almost $100,000.

The ISM’s chief executive, Thomas W. Derry, said he wasn’t aware of a delay in the 10 a.m. broad release of the data. He said the ISM “strongly believes that this data is released on equal terms to everyone.”

Later, Mr. Derry said the ISM is “assessing whether it makes sense to continue” its arrangement with Thomson Reuters.

The University of Michigan’s consumer-sentiment survey, produced since 1946, is considered by some economists to be the best predictor of future U.S. household spending.

On March 15, its mid-month update landed with a thud. Economists polled by Dow Jones Newswires expected the index to come in at 78, which would have been up slightly from the prior month. Instead, it fell steeply to 71.3.

During the two-second window that Thomson Reuters gave to some clients, traders made short-sale bets against 1,624 separate securities. More than 85% of those securities saw their prices fall within five minutes, according to the Journal’s analysis. The price action increased the value of these short positions, if still held, by hundreds of thousands of dollars.

The hectic trading during the two-second window before public release of the surprisingly negative report included these examples:

- Trading that morning in the Consumer Discretionary Select Sector SPDR, an ETF tracking stocks that do well when consumers feel flush, averaged 177 shares a second. But during the first second when Thomson Reuters fed the disappointing re-

suit to certain clients, 59,839 shares traded. Stock-exchange data show most trades were negative bets. Benefiting them, the share price fell as much as 21 cents in the next five minutes.

- Volume in the SPDR S&P 500 fund also skyrocketed in that key second, to nearly 310,000 shares from just 1,000 total in the previous two seconds. Two-thirds of the bets were negative. These were rewarded when the ETF’s share price dipped by as much as 27 cents over the next five minutes.

- On the Chicago Mercantile Exchange, Thomson Reuters’s release coincided with a spike of trading in futures contracts based on the S&P 500 index, according to data collected by market-research firm Nanex LLC. Volume in that single second totaled 4,196 contracts, which was a level that had been exceeded by only 50 other individual seconds since the beginning of 2012.

At the ISM, Mr. Derry, in noting that his group is re-evaluating how it releases its manufacturing index, said: “We are in the business of distributing important economic data, not in the business of providing privileged access to a certain class of investors.”
Exchange’s News Service for Traders Draws Scrutiny of Investigators

By Brody Mullins and Scott Patterson

WASHINGTON—Several times a month, the Labor Department invites news reporters to a sealed room for an early look at soon-to-be-released reports such as the unemployment rate. One organization attending in recent years stands out from the rest.

Founded by an investment firm and now owned by the Deutsche Börse stock exchange, Need To Know News has operated with an overriding mission: sending data directly from the government through high-speed lines to financial firms that are able to trade on it instantly. Some have paid $375,000 a year for the service.

The ability of such an organization to gain a position at the heart of the government’s system for releasing economic reports turns on its head an embargo arrangement created decades ago to give writers time to digest complex data and produce reports for broad public dissemination.

It is legitimate, though, under the Washington press corps’ loose rules on what counts as a media outlet. It also is an example of how in an era of Internet speed and algorithmic trading, finance professionals have figured out how to take advantage of the federal system for releasing reports in ways ordinary investors can’t.

Concerns about the fairness of this, along with suspicions that market-moving data sometimes leak out a fraction of a second early, are leading some in the government to rethink whether the current system still works. The suspicions of leaks also lie behind a long-running, still-unresolved federal investigation that has entailed scrutiny of a wide range of news organizations.

Need To Know News has been close to the center of this probe. A look at

Lockup: How one federal agency, the Labor Department, releases economic reports

7:30 A.M. TO 8 A.M.
1. Reporters arrive at Labor Department. They are given lockers to store their electronic devices and all other personal items except paper.
2. Reporters enter the room through a metal detector.

8 A.M. TO 8:29:59 A.M.
3. Doors are shut at 8 a.m., and the reporters receive copies of economic reports that are embargoed until 8:30.
4. Reporters work at computers that are temporarily blocked from the Internet by a black box device. Some prepare articles or broadcast reports; others just enter raw data into the computer.

8:30:00 A.M.
Reports and machine-readable data feeds go out. At trading firms, computers instantly make securities trades.

The Labor Department has three to five people in the room to pass out reports, explain the data and enforce security.

A security guard oversees the metal detector.

Hidden on the walls are devices to detect wireless signals. The walls are reinforced with material that doesn’t let wireless signals penetrate them.

Source: People familiar with the lockup room

Reporting by Brody Mullins; graphic by Joe Sheyalak/The Wall Street Journal
the service sheds light on growing concerns about data releases.

In 2011, the Securities and Exchange Commission subpoenaed computer hard drives used by Need To Know News reporters, documents reviewed by The Wall Street Journal show.

The same year, the Federal Bureau of Investigation installed a hidden camera at a Labor Department room where reporters gather to see economic reports. A half-hour of advance of their release under a news-embargo system that is known as a "lockup." Last year, the Labor Department took the unusual step of essentially banning Need To Know News from its lockups.

Need To Know News retained access at other federal agencies as well as several foreign governments and private groups that release market-sensitive reports.

While declining to comment on the FBI or SEC moves, Deutsche Börse said that it "always operates its financial news and other market data businesses strictly in compliance with applicable laws, regulation and other codes of conduct." In addition, "we strive to maintain good and appropriate relationships with governmental and regulatory bodies," it said in a statement. "Our standard practice is to cooperate fully with regulatory process reviews and investigations conducted by these government entities."

Bloomberg L.P., Thomson Reuters Corp. and News Corp.'s Dow Jones & Co., publisher of The Wall Street Journal, compete in sending government economic numbers to traders as soon as released. In contrast to Need To Know News, they also produce articles about the reports for broad public dissemination. The three declined to comment on Deutsche Börse's organization. As for the federal probe, all said they had done nothing wrong.

Driving the competition to transmit data as fast as possible is the rise of high-frequency trading—rapid-fire investing done by computers, often after receiving data sent in "machine readable" form. Defenders say this procedure, by more rapidly feeding economic news into the market, helps make prices more efficient, benefiting all investors.

But the machine-readable-data process has its critics, some outspoken. "It's a ruse for getting what is essentially insider information ahead of the public," said Michael Greenberger, a former senior official at the Commodity Futures Trading Commission, who spoke generally and not of any particular organization.

At the National Association of Realtors, which uses media to release home sales data, spokesman Walter Molony, also speaking generally, said, "Some of these firms came in sneakily without clarifying who they were...It was like a slow revelation over time as we came to understand the competition for this data on a nanosecond basis."

A news event on Sept. 2, 2011, shows the critical role of speed in trading. Investors were expecting a positive monthly employment report that morning; instead, the economy added no net new jobs. A Swiss investment fund, Da Vinci Invest AG, got this number a fraction of a second after its release via Need To Know News, zapped from its seat inside the Labor Department. Da Vinci's computers instantly made trades on European markets that within minutes showed a 13% gain, said the firm's founder, Hendrik Klein.

Need To Know News "was the fastest service" when the firm became a client in 2009, he said, and "they're still the best."

Deutsche Börse said providing news is an important part of its offerings to investors. It also owns a service called Market News International, with which it said it now is combining Need To Know News's resources.

Need To Know News was formed in 2004 by a Chicago investor in a firm, Allston Trading, whose traders thought they sometimes weren't getting economic data as fast as some competitors, said John Harada, an Allston co-founder who later became the news service's owner.

To get direct access to government reports, it needed media credentials. That was a test made easier to meet by a quirky, inconsistent procedure in Washington.

Handing out media credentials isn't done by the government but by volunteer boards of journalists operating out of Congress. The purpose is to prevent the government from regulating the press, a matter fraught with First Amendment sensitivities. Congress has "press galleries" that credential journalists from various kinds of news outlets. Applicants must be "bona fide news gatherers" who give their attention chiefly to that activity or get more than half of their income from it.

Beyond that rule, criteria vary. The press gallery that includes magazines, for instance, excludes organizations owned by financial exchanges; other galleries don't.

Once people have a credential from a gallery in Congress, most federal agencies let them attend press events such as lockups.

Need To Know News applied to the radio-and-television press gallery, describing its intended audience as "financial traders sitting at their desks, listening to these live reports." Although a similar applicant was rejected a decade earlier by a different press gallery, Need To Know News won the media credential it sought.

Among its first reporters was Dennis Moore, whose job was to produce a brief audio report for traders. He said he was often finished by midmorning.

In late 2005, the trading firm that owned Need To Know News agreed to sell it to Mr. Harada, a former trader at the old Salomon Brothers, where Michael Bloomberg, founder of Bloomberg LP, was his boss and co-founder. His mentor, Mr. Harada developed sophisticated technology to route data directly from the government to traders with the goal of being the fastest. He hired a former trader, Mary Beth Slack, to run the Washington operation.

Mr. Harada said it charged $5,000 a month initially, and $10,000 once it was more established. The price evidently kept going up; a November 2012 price list reviewed by the Journal cites a cost of about $31,000 a month for data from Washington. Deutsche Börse said it doesn't disclose pricing.

Clients included such fast-trading firms as Two Sigma Investments LLC in New York and Jump Trading LLC in Chicago, according to people familiar with those firms.

The timing was perfect: Wall Street was increasingly moving to trading by computers. High-speed algorithmic trading now makes up more than half of U.S. trading.

Salespeople for Need To Know News stressed that it was designed by former traders for traders. "We spoke their language," Mr. Harada said. By 2007, it was in press rooms at the departments of Labor, Commerce and Treasury.

Trouble began in 2008. Need To Know News faced accusations that it had transmitted the gist of remarks by Federal Reserve Chairman Ben Bernanke slightly before an embargo lifted. A reporter was using "some sort of a 'voice-activated algorithm' that involves speaking numbers into a telephone line during the lock-up," wrote Chad Pergram, then a member of the radio-and-TV press gallery's board, in an email to other members. Press-galley staff said the information "is in fact going to traders, which in effect, gives them an advantage because they know the Fed's thinking before anyone else on the planet does," he wrote.

The board informed Need To Know News in March 2008 that other media firms "have expressed concern as to whether your organization continues to meet the membership criteria." The board took no further action, though later that year it revoked the credential of a Need To Know News reporter who spent part of her time running a financial consulting firm. She signed an affidavit contending she met the rules, and a Need To Know News lawyer also defended her right to a credential.

Mr. Harada chided a critic of the service to sour grapes, "Our larger competitors didn't like the idea of someone..."
who could move faster with their technology, so they started rumors about us," he said.

Concerns arose at the Labor Department as well. In June 2008, it accused Need To Know News of violating lockup rules in four consecutive sessions.

Need To Know News reporters in its lockups were allowed to have a phone connection starting one minute before news embargoes lifted. Reporters for Need To Know News "openly, willfully and repeatedly" violated the rules by talking during this minute, the Labor Department wrote to its bureau chief, Ms. Slack.

Confronted, she "shook her finger" at a Labor Department official and said: "You just try to shut us down. You'll be hearing from our lawyers," according to a summary of the exchange compiled by the department. Ms. Slack left in spring 2011. Deutsche Börse said it doesn't comment on personnel matters involving ex-employees. Ms. Slack didn't respond to a question about the incident.

In 2009, the Labor Department hired a media-relations chief who had briefly worked on Wall Street. The official, Carl Fillichio, worried that press lockups were sometimes being manipulated for the benefit of high-frequency traders, according to emails and Labor Department officials. Employees of his office began passing concerns to the department's internal investigators.

Need To Know News may be a "front for a trading organization" and "gaming the system," one media-relations employee told the department's labor-racketeering and fraud division in a May 22, 2008, email reviewed by the Journal after an open-records request.

Deutsche Börse said it couldn't comment on matters prior to its acquisition of the news service, which occurred later in 2009.

Mr. Harada said he sold because "eventually the other news agencies could throw enough money at their technological shortcomings and be faster than NTKN. I could see that this was going to become an increasingly expensive technology arms race."

In 2011, prosecutors and regulators began acting on what documents reviewed by the Journal show were long-running suspicions of leaks to traders from press lockups.

The SEC collected hard drives from computers Need To Know News used at the Labor Department. The same year, the FBI installed a hidden camera in the ceiling of the Labor Department's media room to monitor the activities of Need To Know News during lockups, according to emails and to officials familiar with the matter. The emails showed that officials suspected the organization was using technology to get around the system for blocking data until the release.

A recent report from the Commerce Department's inspector general said the FBI found some technical ways this could be done. It didn't link them to Need To Know News.

Besides Labor, one other department, Agriculture, has cameras, but in its case they aren't secret. Earlier this year, a Dow Jones Newswires reporter was seen using an iPad, a device not allowed in lockups, and Newswires was suspended from the department's lockups for a month. There was no accusation the reporter tried to beat the embargo.

In April 2012, the Labor Department made a rare departure from the long tradition of leaving it to journalist boards to decide who qualifies to attend press events. The department set up rules saying it would admit only "primarily journalistic" enterprises focused on "fostering improved public understanding of the data." Organizations had to apply to attend. The department then didn't accept Need To Know News and three others.

This year, Deutsche Börse found another way to send data from Labor Department reports to its trader clients. It set about combining Need To Know News's operations with those of the exchange's other service, Market News International. MNI produces articles for the public, and it had passed muster with the Labor Department.

Through MNI, Deutsche Börse said, it would continue to deliver government data in machine-readable form.

“We still do the same functions...even though now under the MNI banner,” an MNI official emailed one federal department in April, asking to transfer two Need To Know News reporters to the MNI staff.

The Labor Department declined to comment on Deutsche Börse's move.

—Devlin Barrett contributed to this article.
Tip on Policy Shift Jolted Health Shares

BY BRODY MULLINS AND TOM MCGINTY

WASHINGTON—Alerted by a private message about a potential coming change in government health-care policy, certain investors earlier this week sparked a frenzy of trading in some of the industry's largest companies.

The last-minute action, which drove the shares sharply higher before the close of trading, is throwing a spotlight on the controversial "political intelligence" industry, the subject of a report due Thursday by the investigative arm of Congress.

The instigator for Monday's rally was a report from a Washington-based investment-research firm that often ferrets out policy news and analysis for investors, according to industry experts and market data from that afternoon. About 15 minutes before markets closed, the firm correctly predicted the Obama administration would reverse course on big spending cuts that would have hit health insurers.

The resulting stock surge is one of the most dramatic examples in recent years of how tips and insights from Washington's burgeoning political-intelligence business can drive trading on Wall Street, potentially leading to big profits for those in the know.

Shares in several big insurers rose as much as 8% between the time the firm, Height Securities, made its prediction at 3:42 p.m. and when markets closed. Volume for those companies in those final minutes was higher than the rest of the trading day put together. The government announced its change in policy about 35 minutes after the emailed scoop, which was reviewed by The Wall Street Journal.

Shares continued to rise after the opening bell the next day. AHeight executive acknowledged that the firm's alert led to the trading surge but said it did nothing wrong.

The activity came the same week the U.S. government is expected to release its first study of the political-intelligence business. The report by the Government Accountability Office is set for Thursday release and expected to signal the starting point for a congressional push to regulate the industry.

According to people familiar with it, the report finds it is often difficult to prove how market-moving information seeps from government insiders to stock traders.

"When a political-intelligence firm is able to anticipate a move by the federal government and alert investors, that raises questions," said Sen. Charles Grassley (R., Iowa), one of the lawmakers who want such firms to disclose more information about their activities, referring to Monday's trading activity.

If political-intelligence firms are getting their information from the agency, Congress or the White House, "that's unfair to everyday investors," Mr. Grassley said in a written statement.

The business of "political intelligence" isn't illegal but has come under increasing scrutiny as it has grown rapidly. Last year, Congress came close to approving a provision that would require individuals who get paid to gather government information for investors to make public their names and clients.

That provision was eventually stripped from a related piece of legislation designed to limit the possibility of insider trading by lawmakers and their staffs. A measure requiring the GAO study was approved in its place.

The rules regarding the political-intelligence industry are murky. Under Congress's new insider-trading law, passed last year, it is now clear that government officials for the most part cannot intentionally pass along nonpublic, market-moving information to individuals if they know the information will be used to make stock trades. More broadly, securities laws generally prohibit trading on material nonpublic information about activities at federal agencies.

Little, however, prevents lobbyists and other Washington insiders from gathering information, testing a hypothesis with former government officials and making informed predictions about coming government actions. Regulators have never brought an insider-trading case against a political-intelligence firm, member of Congress or congressional aide.

Tuesday's trading was related to the possibility of a change in how the government pays private insurers to run Medicare health plans for seniors and the disabled. Nearly one in three people on Medicare are on such plans, called Medicare Advantage.

Once a year, the agency that oversees Medicare, the Centers for Medicare and Medicaid Services, or CMS, adjusts the amount of money it plans to allocate for the plans the following year. The agency surprised Congress and Wall Street earlier this year when it announced that it would likely cut rates steeply. One key payment metric was set to fall 2.2%.

Tuesday was the deadline for the agency to set final rates for 2014. Many health-care analysts didn't expect changes and health-insurance stocks were mostly flat during the day.

At 3:12 p.m., Height Securities sent a report to its Wall Street clients with a surprising development: CMS planned to reverse course—a major boon for insurers.

"We now believe that a deal has been hatched to protect Medicare Advantage rates," Height Securities wrote in the email. "This is a dramatic change in historical policy aimed to smooth the confirmation" of a new head of CMS.

Height Securities is a broker dealer regulated by the Securities and Exchange Commission. One of its services to clients is providing research on macroeconomic and policy developments in Washington.

Andrew Parmentier, managing partner with Height Securities, said its health-care analyst had been following the issue for some time, and that no one at the firm did anything wrong. He acknowledged the firm appeared to be the source of the trading spike after it picked up a rumor that CMS would scratch the cuts.

"Height Securities has established specific procedures to reduce the risk that is inherent in gathering information from government employees for investment purposes," he said.

CMS didn't immediately respond to a request for comment.

After the email, trading surged in shares of health insurers. Three of the biggest gainers were Humana Inc., UnitedHealth Group Inc. and Aetna Inc., which rank among the biggest companies that provide Medicare Advantage plans.

Volume in the three stocks exploded after 3:43 p.m., according...
to a Journal analysis of trade data provided by Telvent DTN. In the final 17 minutes of trading, the value of trades in those three companies' shares totaled $662.8 million, more than the entire day up to that point.

About 30 minutes after the markets closed, CMS announced it had reversed the payment cuts it had previously proposed.

Insurance stocks rallied Tuesday, too. The three insurers each gained between 3.7% and 5.5%.

Humana shares closed with a two-day gain of 14.5%. UnitedHealth and Aetna were up 7.9% and 6.2%, respectively.

Humana and Aetna declined to comment. UnitedHealth said it doesn't comment on its stock movements.
Stocks’ Surge Is Linked to Lobbyist
Trading in Health-Care Shares Soared After a Research Firm’s Report About a Coming Policy Change

WASHINGTON—A key source for a private report that sent health-care stocks on a tear earlier this month is a former top congressional aide who is now a health-industry lobbyist, according to emails reviewed by The Wall Street Journal.

Mark Hayes is currently an outside lobbyist for health-insurance giant Humana Inc. His email to Washington investment-research firm Height Securities, alerting it to a government decision that will save the industry billions of dollars, was a final piece of confirmation Height received before blasting a news alert to its clients, according to emails and people familiar with the matter.

The Height report now is the subject of a preliminary probe from the Securities and Exchange Commission, according to people familiar with the matter. The SEC has contacted individuals involved to determine whether anyone leaked or passed along word of the decision in violation of insider-trading laws.

The SEC’s probe represents the agency’s first known look at the political-intelligence industry, the burgeoning business of collecting market-moving information from Washington and providing it to Wall Street.

If anyone passed along material nonpublic information from the government, they could violate insider-trading rules. Prosecutors have brought few cases in this area, leaving the boundaries of how Washington shares information somewhat unclear.

In this case, on April 1 Height sent a report to clients 18 minutes before the end of trading that predicted—correctly—it turned out—a government agency would drop planned cuts in funding for insurers that offered Medicare Advantage plans.

The report snagged the attention of big hedge-fund firms that placed profitable trades, according to people familiar with the trading activity. Shares in several health-care companies, including Humana, climbed sharply before the market close and again when trading opened the next day.

SAC Capital Advisors and Viking Global Investors, hedge-fund firms with billions under management, were among those placing bets that health-care stocks would rise, the people said. It isn’t clear what factors went into their trading decisions. Representatives of the hedge-fund firms declined to comment.

Mr. Hayes declined to comment. A spokeswoman for his employer, law and lobbying firm Greenberg Traurig, said Mr. Hayes performed his own analysis and “did not receive or disseminate material nonpublic information.”

Andrew Parmentier, a managing partner with Height Securities, said “this was good research, based on close analysis and permissible sourcing.” He added: “Our analyst did not get material nonpublic information from the government.”

The involvement of Mr. Hayes hints at how Washington’s close-knit community of lawyers, lobbyists and staffers can be fertile ground for the kind of tips that drive market trading.

From late 2002 to late 2010, Mr. Hayes worked on the Senate Finance Committee, the panel that oversees health-care policy. For four years, he was the top health-care aide for Sen. Charles Grassley, including when the Iowa Republican was committee chairman.

Sen. Grassley, who is leading the charge to clamp down on political-intelligence has opened an investigation into whether there was a leak. A spokeswoman for Mr. Grassley said the office wasn’t told about the agency’s decision in advance.

Mr. Hayes lobbies for Humana, which pressured the government’s Centers for Medicare & Medicaid Services to drop its planned cuts to certain insurance plans. A Humana spokesman said the company had no advance warning of the decision.

In addition to his work as a lobbyist, Mr. Hayes and Greenberg Traurig work for Height, which is also a registered broker-dealer. They are paid to give advice on policy matters. Mr. Parmentier said his firm didn’t know Mr. Hayes also worked for Humana.

There are no rules preventing corporate lobbyists from working for political-intelligence firms. Because there are no requirements to disclose political-intelligence work, public officials have no way of knowing whether a lobbyist for a company also is passing along tips to traders.

The back-and-forth between Mr. Hayes and Height transpired April 1 after a Height policy analyst, Justin Simon, scrambled to chase rumors of CMS’s decision, emailing an array of contacts around Washington, including an aide to Sen. Orrin Hatch (R., Utah), the top Republican on the Finance Committee, and a lobbyist for Humana. Neither responded, according to the correspondence reviewed by The Wall Street Journal.

At 3:12 p.m., Mr. Hayes told Mr. Simon in an email he had “heard from very credible sources” a decision had been made to restore the payments.
Heads Up | Emails between Mark Hayes and a Height analyst about the health-care policy change

From Mark Hayes to Justin Simon, the Height analyst  
Sent on Monday, April 1, 2013, 3:12 p.m.  
Our intel is that a deal was already hatched.

From Mark Hayes to Justin Simon  
Sent on April 2, 8:49 p.m.  
Justin – It is this email that was circulated all over...just the part from me. Very bad. I have a lot of damage control to do on multiple fronts because of this.

From Justin Simon to Mark Hayes  
Sent on April 2, 8:55 p.m.  
I'm very sorry mark.  
There is nothing I can say to describe the level of embarrassment and remorse I feel over this situation[.] I will not be able to sleep over it tonight...

“Our intel is that a deal was already hatched,” Mr. Hayes wrote in the email.

As Height scurried to verify the tip with public officials, another Height employee forwarded Mr. Hayes’s email to several congressional aides in an attempt to confirm the information. At 3:42 p.m., Height sent a similarly worded alert to its Wall Street clients. Trading in health-care stocks surged.

A spokeswoman for Mr. Hatch said that “our office did not engage Height on this issue until after CMS made its announcement and this rumor started circulating,” she said. She said the committee didn’t get advance notice of the news.

CMS made its decision public at 4:24 p.m. The agency declined to comment.

The following day, Mr. Hayes criticized Height for forwarding his email. “I have a lot of damage control to do on multiple fronts because of this,” Mr. Hayes wrote to Mr. Simon. “There is nothing I can say to describe the level of embarrassment and remorse I feel over this situation,” Mr. Simon replied. “I will not be able to sleep over it tonight...”