

INSIGHTS FROM CFA SOCIETY SINGAPORE

# Spoofing to boost returns for clients

Disclosure of one's trading strategy to clients does not permit illegitimate market manipulation schemes. **By CFA Society Singapore Advocacy Team**

EVERY so often retail investors in Singapore are greeted by news of market manipulation in the capital market. *The Straits Times* reported on Oct 7, 2019, of two men sent to jail for spoofing in the Singapore derivatives market in 2015 and 2016.

Spoofing typically involves an investor or trader submitting orders only to withdraw them to artificially raise the volume and price for devious reasons.

In December 2022, the Singapore High Court sentenced two masterminds behind the crash of three stocks listed on the Singapore Exchange (SGX). In 2013, Blumont Group, Asiasons Capital and LionGold Corp were suspended from trading following a collapse in their share prices. This collapse was preceded by a massive increase in the share price in all three counters. When trading suspension was lifted, the three companies had lost more than 80 per cent of their market value prior to the price slump. As a result, investors suffered significant losses.

Regulators prohibit market manipulation. But what other assurances can one rely on to lower the probability of a rigged market?

## The Market Manipulation Standard

CFA Institute, a global association for investment professionals, does provide guidance via its Market Manipulation Standard. This standard requires that finance professionals uphold market integrity by prohibiting market manipulation. Market manipulation includes practices that distort security prices or trading volume with the intent to deceive people or entities that rely on market information. Market manipulation damages the interests of all investors by disrupting the smooth functioning of financial markets and lowering investor confidence.

Market manipulation may lead to a lack of trust in the fairness of capital markets, resulting in higher risk premiums and reduced investor participation. Following the collapse of Blumont, Asiasons and LionGold, daily volumes on the Singapore bourse declined markedly. According to SGX data, average daily traded volume fell more than 60 per cent in the 12 months after September 2013.

A reduction in the efficiency of a local capital market may negatively affect the growth and economic health of the country, and may also influence the operations of the globally interconnected capital markets.

Although market manipulation may be less likely to occur in mature financial markets than in emerging markets, cross-border investing increasingly exposes all global investors to the potential for such practices.

## Types of market manipulation

Market manipulation includes (1) the dissemina-



Market manipulation damages the interests of all investors by disrupting the smooth functioning of financial markets and lowering investor confidence. PHOTO: PIXABAY

tion of false or misleading information, and (2) transactions that deceive or would be likely to mislead market participants by distorting the price-setting mechanism of financial instruments. The development of new products and technologies increases the incentives, means, and opportunities for market manipulation. Additionally, the increasing complexity and sophistication of the technologies used for communicating with market participants has created new avenues for manipulation.

**Transaction-based manipulation:** This form of manipulation involves instances where an investor or trader knew or should have known that their actions could affect the pricing of a security.

This type of manipulation includes, but is not limited to (1) transactions that artificially affect prices or volume to give the impression of activity or price movement in a financial instrument, which represent a diversion from the expectations of a fair and efficient market, and (2) securing a controlling, dominant position in a financial instrument to exploit and manipulate the price of a related derivative and/or the underlying asset.

The Market Manipulation Standard is not intended to preclude transactions undertaken on legitimate trading strategies based on perceived market inefficiencies. The intent of the action is critical to determining whether it is a violation of this standard.

**Information-based manipulation:** This other form of manipulation includes, but is not limited to, spreading false rumours to induce trading by others. For example, investors or traders must refrain from "pumping up" the price of an investment by issuing misleading positive information or overly optimistic projections of a security's worth only to later "dump" the investment

(ie, sell it) once the price, fuelled by the misleading information's effect on other market participants, reaches an artificially high level.

## Ethics in action

Today's case is based on a US Commodities Futures Trading Commission enforcement action from February 2019. As a guide, the desired ethical behaviour required is based on the CFA Institute Code of Ethics and Standards of Professional Conduct.

## Case study in spoofing

Alex Lo is a commodities trader for a regional bank. He often places customer orders for precious metal futures contracts. Then soon after placing a customer order, he will place a significantly larger order on the other side of the trade for his personal account. For example, when a customer order is a "sell" order, Alex would follow with a much larger "buy" order from his personal account.

Typically, Alex's orders for his personal account are placed slightly lower than best price, reducing the likelihood of his order being filled immediately. As soon as the customer order is executed, Alex cancels his personal trade order. Are Alex's actions acceptable?

**Analysis:** Alex is engaged in a market manipulation scheme in violation of CFA Institute's Market Manipulation Standard, which prohibits finance professionals from engaging in practices that distort prices with the intent to mislead the market. By trading in this manner, Alex is engaging in "spoofing". His personal orders, which he routinely cancels, are fake or spoof orders entered with the intent to send false signals to market participants.

So for example, by placing spoof orders to buy, Alex sends market participants a false signal of greater demand, creating the impression that the price would likely rise and tricking market participants into executing against his genuine customers' orders to sell. This causes his customers' genuine sell orders to be filled sooner, at a better price, or in larger quantities than might otherwise occur.

Although Alex's spoofing practice is boosting returns for his clients' trades, he is doing so at the expense of market integrity. The order of trading between client orders and those for his personal account is irrelevant. In fact, his personal trades are never executed – an integral part of the spoofing scheme. And because Alex is not following a legitimate trading strategy, disclosure of his strategy to his clients does not legitimise or permit his market manipulation scheme.

**The writers are CFA charterholders who volunteer with CFA Society Singapore on advocacy issues with a view to promoting financial literacy among retail investors and improving overall standards and integrity in the industry. Should you have comments and feedback, do write to the CFA Society Singapore advocacy committee: [advocacy@cfasocietysingapore.org](mailto:advocacy@cfasocietysingapore.org)**