MARKET MANIPULATION & HOW THE TTSEC PROTECTS INVESTORS

Mark Twain once exhorted, *"You're never wrong to do the right thing"*. This remains sound guidance and very much applicable when participating in the capital markets. Market actors are fully cognisant of the types of conduct and behaviours, which while falling short of the ambit of the law, are outright improper, morally reprehensible and wholly unethical; and therefore should be avoided in the interest of fair trading practices. Market manipulation is a category of "financial misdeeds" or market abuse which is provided for under sections 91-99 of the Securities Act, 2012.

Trinidad and Tobago Securities and Exchange Commission (TTSEC), as the regulator of the securities industry, would be required to bring an action where market manipulation is alleged against a registrant, to '*ensure orderly, fair and equitable dealings in securities'*, are maintained.

Market manipulation is defined as any intentional or willful conduct designed to deceive or defraud investors by controlling or distorting market activity. The use of false or misleading information is usually essential to the success of a manipulative scheme. This represents deleterious conduct as it affects the integrity of the securities marketplace. The price of a security (and trading volume) should be determined by the unimpeded collective judgment of buyers and sellers. Market manipulation alters the independent trading and pricing mechanism of the marketplace and turns it into a stage-managed performance, which can lead to tremendous losses to investors. The two main types of market manipulation schemes are:

(1) Pump and Dump Schemes; and
(2) "Traditional" and "classical" trading schemes such as churning, mark-ups, scalping and touting.

Pump and Dump Schemes

These occur when a fraudster deliberately and artificially inflates the price of a stock, and then dumps his holding of securities on the market at the artificially induced price. These schemes work best where stocks are thinly traded, that is, only a small portion of the issued stocks are available for regular trading, and the perpetrator can control the float (i.e. the shares of a company that are freely available to investors). Small events in the market can cause relatively large price increases thereby making it easy to attract prospective buyers before eventually dumping the security.

In order to pump up the price of a stock, false or misleading information is supplied over the internet, bulletin boards, chat rooms, false e-mails, or false press releases. This information can also come from brokers, “boiler rooms”, faxes and answering machines. Additionally, the schemes may “manufacture” trading activity by ensuring that there are matched or coordinated sales, i.e. the perpetrator or affiliate operates on both sides of a transaction.

All these factors create an illusion of demand which can cause the price of a security to inflate. The perpetrator then sells at the inflated price in order to prevent other investors from capitalising on this inflated price.

These actions are usually orchestrated by the perpetrator through the use of a “shell company”. A shell company is one that has no operating business but exists solely for the purpose of merging with an operating company. Shell companies enable perpetrators to control the float of an issuer’s stock because the price of the stock is initially low.

Fraudsters using pump and dumps schemes have become quite sophisticated in their execution of these types of scams. Internet users are more often the target of these schemes. An example of a pump and dump scheme, involved the 2005 case of Orex Gold Mines Corporation where fraud related charges were eventually proffered against the perpetrator. In Trinidad and Tobago, a perpetrator found guilty would be charged under sections 91 - 99 (“False trading and artificial prices in a securities market”) of the SA 2012; and would be liable on summary conviction to **a fine of two million dollars** and **imprisonment for five years.**

Manipulation based on Trading

In the case of traditional or classical trading, the market is manipulated through the concerted efforts of traders, brokers and others engaged in trading and/or the handling of quotations. Manipulative conduct through trading may harm investors although they may not necessarily move market prices significantly. Among the more frequently observed manipulative schemes are:

(1) Churning,
(2) Mark-ups,
(3) Scalping, and
(4) Touting.

Churning refers to excessive trading in a customer’s account, i.e. when a broker buys and sells the same stock several times in the same month without the authorisation of the customer. The broker dishonestly earns a commission every time he buys or sells a stock and also puts the customer’s interests at risk.

Mark-up represents the difference between the higher price charged to a customer by a dealer and the lowest current offering price which is agreed upon among dealers. In this circumstance, dealers acting on behalf of their customers can abuse existing arrangements in order to make abnormally high profits.

Scalping this occurs when a market actor (such as an investment adviser) purchases a security for a client before recommending the security and then sells the security at a profit, upon the rise in

the market price following the recommendation. These transactions usually take place within the same day or can also take place over a few minutes. Scalping is also known as **front-running** when performed in advance of large buy orders even without a recommendation.

Touting refers to any person who is paid directly or indirectly to recommend the sale of any security, without disclosing this fact and the amount of compensation to be received. Once someone is paid to recommend a security, this information should be provided to the market. Touting is also an illegal practice in the securities market since it contravenes the principle of full disclosure to the market and gives an unfair advantage to some investors over others.

The TTSEC has various mechanisms at its disposal to combat market abuses within the local securities industry including legislation, registration, monitoring and surveillance, conducting inspections and enforcement on registrants, as well as investor education programmes.

We invite our readers to refer to the previously published article headlined *"Be on your Guard against….. Market Manipulation Schemes"* which can be sourced via the TTSEC's website: https://www.ttsec.org.tt/be-on-your-guard-against-market-manipulation-schemes/. Our Investor Education website (https://investucatett.com/) is also an excellent source of information. We encourage anyone who may has been affected or are aware of such practices, to contact us via our Customer Complaints portal (https://www.ttsec.org.tt/site/investor-complaints/), email or letter.

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