Watching Out for Stock Manipulation

By **EMILY CHOO,** CEO, Gem Comm

Stock market manipulation is prohibited in most countries, including the United States, European Union and Australia, where legislation against market abuse exists to deter certain market transactions. In Singapore, there are civil and criminal penalties for manipulating the stock market, highlighting the tough stance that regulators take against such contraventions.

Market manipulation is the deliberate attempt to interfere with the free and fair operation of the market by creating false or misleading appearances with respect to the price of or market for a stock, commodity, currency or product.

Stock market manipulation is the act of artificially inflating or deflating the price of a stock or otherwise influencing the behaviour of the stock market for personal gain. Manipulation is illegal in most cases, but it can be difficult for regulators and other authorities to detect.

Section 198(1) of the Securities and Futures Act provides that a person shall not carry out two or more transactions in securities of a corporation which will have the effect of affecting or maintaining the price of the securities, with intent to induce other persons to subscribe for, purchase or sell securities of the corporation or of a related corporation.

Types of manipulation

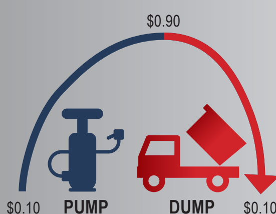
There are many ways of manipulating the stock market, limited only by the creativity of the perpetrators.

The box, "Types of Market Manipulations" describes the basics of four major types of stock market manipulation. Other types of manipulations go by labels such as "pools", "lure and squeeze", "quote stuffing" and "cornering the market".

Types of Market Manipulations

WASH TRADING

The manipulator(s) buy and sell the same stock at about the same price, usually in large quantities, through different brokers. The increase in activity is to attract additional investors and increase the price.



PUMP AND DUMP

This involves artificially inflating the price of owned stocks in order to sell the cheaply purchased stocks at a higher price. This is a common technique for penny stocks which are generally illiquid.

The share price of a stock is flat and there may be hardly any trading in it for days, weeks or months, but suddenly there are tens of thousands of shares trading hands, perhaps for multiple days in a row, accompanied by "hot tips" on the stock. This is a red flag of a "pump and dump" scheme.

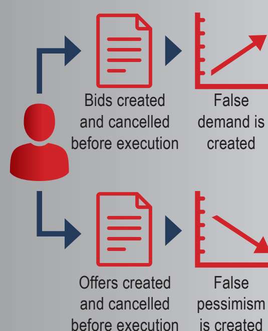
BEAR RAIDING

A bear raid occurs when a group of brokers and traders collectively seek to drive down the value of the stock. The goal of a bear raid is to push the stock lower as fast as possible in order to create fear in the market. This fear creates panic selling which can be used to make quick gains in short positions.

In a bear raid, there will be enormous amounts of unsubstantiated negative news flooding on texts, stock blogs etc. Large short-sell orders continually flooding the market.

MARKET CORNERING

This involves purchasing enough stock in a company in order to be able to manipulate and control prices. Lightly traded stocks are more vulnerable to this dangerous scheme.



SPOOFING AND LAYERING

Spoofers bid or offer with the intent to cancel before the orders are filled. The incessant buying and selling are intended to attract other traders (particularly high-frequency traders) to induce a particular market reaction. Spoofing is profitable to the spoofer who can time buying and selling based on the manipulation.

Layering is a variant of spoofing where the trader enters multiple visible orders on one side of the market at multiple price tiers, which cause the midpoint of the spread to move away from those multiple orders, and the same trader executes a trade on the opposite side of the market.

Most stock manipulations are accompanied by rumours and fake news. Many stock market manipulators attempt to spread false news about a company or even of other aspects of the economy to swing the market in their favour. In 2013, US$130 billion (S$177 billion) in stock value was wiped out in a matter of minutes following a tweet about an "explosion" that hurt the administration of US President Barack Obama, resulting in market jitters.

Penny stocks – small-cap companies with a low price (much less than a dollar) – are more prone to manipulation because they are more affordable (easier to corner), less traded, and not as closely watched by analysts and other market participants as the mid- and large-cap companies.

Case examples

Market manipulation has been around for about as long as markets have existed. Today's increasingly complex electronic markets have provided new tools and opportunities to do so.

Some of the more notorious examples around the world are:

- **2010 flash crash.** A UK-based trader, Navinder Singh Sarao was partly responsible for the collapse and rebound of stock indices such as the Dow Jones Industrial Average, S&P and Nasdaq Composite. The crash lasted 36 minutes. The Dow Jones had its second biggest intraday point drop up to that point, plunging almost 1,000 points (9 per cent). Sarao utilised a specialised trading software to order large quantities of buy and sell orders, and pre-programmed his systems to correct and cancel his bids before they were executed. In this classic case of spoofing the tape, Sarao profited US$40 million from his exploits. Spoofing, layering and front running are now banned.

- **Silver futures conspiracy.** A series of anti-trust class action suits were brought by investors collectively against JP Morgan Chase and HSBC in 2010. The suit claims that the two banks manipulated the market by coordinating large trades to lower the prices of silver. As a result, substantial illegal profits were made by them, harming investors and restraining competition in the process.

- **Montgomery Street Research (MSR) wash trading lawsuit.** The owner of MSR, Paul Pollack, allegedly simultaneously bought and sold a security to give a false appearance of liquidity and to generate market activity. More than 100 "wash trades" were done through five brokers-dealers because MSR was soliciting investors for its client, and the intent was to mislead the potential investors about the genuine supply and demand for the rarely traded security. MSR profited more than US$2.5 million.

- **Shanghai-HK stock manipulation.** In this cross border case in 2016, Tang Hanbo and Wang Tao were charged with making 41.9 million yuan (S$8.4 million) by manipulating the shares of Zhejiang China Commodities City Group Co Ltd via trading accounts in Hong Kong and Shanghai. They had engaged in practices such as spoofing, manipulating opening and closing prices, and self-trading. The regulator, China Securities Regulatory Commission, imposed combined penalties of 1.2 billion yuan.

Homegrown cases

Singapore is not spared its stock manipulation cases. A recent one is the ongoing case of Kimly Limited, a coffee shop operator. Following investigations by the Commercial Affairs Department and Monetary Authority of Singapore, two senior executives, Executive Chairman Lim Hee Liat and Executive Director

Chia Cher Khiang were arrested in December 2018 for offences under Section 199 of the Securities and Futures Act.

Section 199 prohibits a person from knowingly or recklessly making or disseminating false or misleading information and statements that are likely to induce subscription of, or the sale or purchase of securities or which are likely to affect the market price of securities.

Perhaps, the biggest securities fraud may be the infamous 2013 penny stock saga, involving three companies: Asiasons Capital (now known as Attilan Group), Blumont Group, and LionGold Corp. (See box, "The 2013 Penny Stock Saga in Singapore " on the next page).

In 2013, the drastic drop in three penny stocks sent shockwaves throughout the market, leading to numerous investigations and lawsuits. The three companies had huge run-ups in September, becoming billion-dollar businesses briefly before crashing on 4 October.

The crash within an hour of trading (a frenzied 40 minutes, to be exact) culminated in an approximate S$8 billion loss in shareholder value, sending the market into frantic disarray. This was the biggest securities fraud case in Singapore's history and the effects have been far-reaching, highlighting how the broader market may be destabilised by such irresponsible actions.

Warning signs and defences

Companies and individuals generally stand to lose out in a market manipulation. In fact, the broader market and economy may also suffer in the event of a severe market crash that spreads beyond a few indices and counters.

As a guideline, individual investors should avoid low volume stocks as these are prime targets for manipulation. Investing for the long term by understanding the company well is the best form of protection.

At the same time, extreme price volatility and stock activity should put investors and boards on notice, as out-of-norm behaviours warrant a second look.

It may also be worth companies taking notice of potential perpetrators. These include short-sellers, traders using algorithmic trading strategies, and significant shareholders in the company. The tragic irony is that some manipulators are shareholders who are also executives in the company, and who may have painstakingly built up the company and even brought it to floatation and its foremost position.

Good governance can be key to minimising or preventing stock market manipulation. An effective board comprising quality and accountable directors can guard against insiders engaging in market manipulation, and be alert to external manipulation.

Regulators can also step up policing and enforceability action, to send a signal and tone to the wider marketplace that such misconduct and malpractices are not permitted.

Whistleblowing policies can be set in place, to encourage self-regulation in a market that is increasingly becoming more sophisticated in terms of the crimes committed and the difficulties in detection.

In essence, stock manipulation, in whatever form, is illegal, irresponsible and unethical.

The vigilance against the irreparable harm caused by such actions should be entrenched at all levels, from the regulators to the board and management, to ensure that fair market practices are always observed and adhered to, without exception. ■

The 2013 Penny Stock Saga in Singapore

The three SGX-listed companies

- Asiasons Capital (now known as Attilan Group): a fund management company. (Market cap: S$2.8 billion at peak vs. S$2.2 million at low point)
- Blumont Group: a sterilisation services provider. (Market cap: S$6.3 billion at peak vs. S$4.5 million at low point)
- LionGold Corp: a gold mining company. (Market cap: S$1.6 billion at peak vs. S$2.8 million at low point)

The three alleged manipulators

- John Soh Chee Wen, a Malaysian businessman said to be the mastermind.
- Quah Su Ling, Director and CEO of IPCO.
- Goh Hin Calm, Senior Finance and Administration Manager of IPCO.

How was it done?

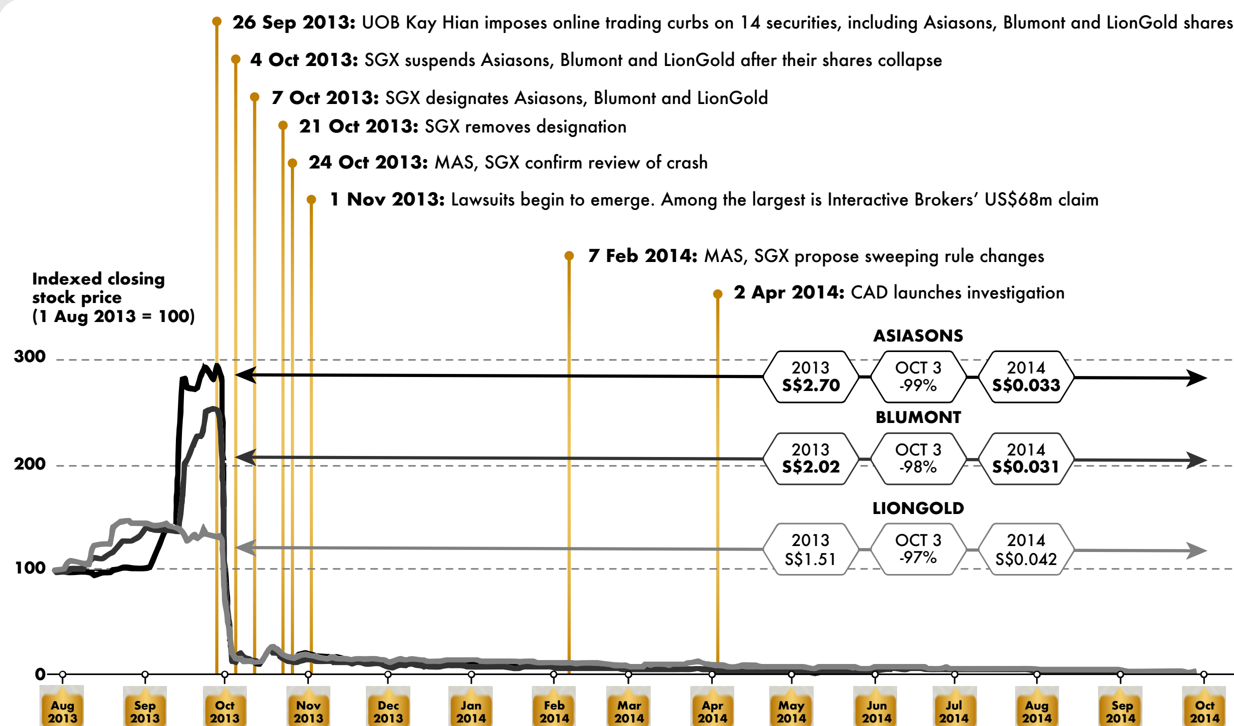
Using the technique of "wash trading", the three persons allegedly proxied almost 200 accounts that were owned by 59 individuals and corporations, and manipulated share trading in the three companies "to create an illusion of liquidity and demand for these shares by making thousands of manipulative trades… and to control the supply of these shares available to the market to influence the price of these counters".

Over the span of nine months, these counters rose more than 800 per cent before finally crashing in October 2013, sparking a rout of penny stocks on the SGX.

How did it go wrong?

Quah was an investor in Asiasons in 2008, and subsequently became a shareholder of Blumont and LionGold, where she placed the shares as collateral for a loan facility in Goldman Sachs.

Following a missed margin call issued by Goldman Sachs, Quah was required to repay the entire loan (S$61



million) in cash. On 2 October 2013, the bank proceeded to issue a notice of default and started to force sell Quah's holdings in Asiasons, Blumont and LionGold.

According to court documents filed by Quah's lawyers, Goldman Sachs had also issued similar margin calls to James Hong and Ng Su Ling (Blumont's executive director and independent director then respectively) about the same time, and proceeded to force sell their shares in the three companies, thus sparking the start of the penny stock crash.

What happened in court?

Soh has been in Singapore Changi prison for the past two years, waiting for his trial to begin. He has been charged with alleged involvement in the Singapore penny stocks crash of 2013, and will get his day in court later in 2019.

He faces 189 charges under the Securities and Futures Act for allegedly being the mastermind behind the Singapore penny stocks crash. Quah faces 178 charges. Goh faces 6 charges (Note: Information is updated as of 15 March 2019).

The market aftermath

Market activity has seen a distinct drop following the 2013 penny saga, with 2014-2016 average market turnover value being 25 per cent lower than the 2010-2012 average market turnover.

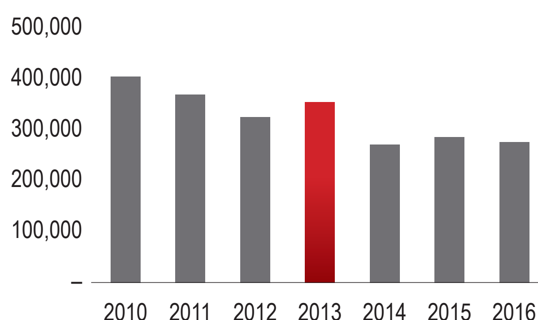
The median value per trade between 2014 and 2016 was S$0.63, compared to S$0.39 in 2013, suggesting the market's still cautious attitude towards penny shares as well as the slew of measures that has been introduced post-saga.

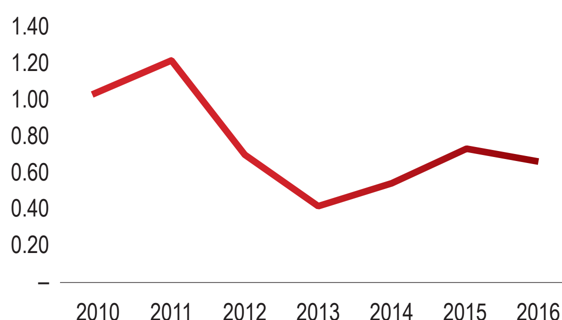
A number of SGX regulations were tweaked, including the 20 per cent band, and the T+2 settlement, following the crash.

T+2 Settlement Singapore

The Singapore Exchange (SGX) launched a new securities settlement and depository framework and system on 10 December 2018, which will reduce settlement cycles from three to two days (T+2) and enable simultaneous settlement of money and securities. The T+2 settlement cycle brings the Singapore bourse in line with global markets including Australia, the European Union, Hong Kong and United States.

The shortened settlement cycle is expected to reduce credit, market and liquidity risks and enhance efficiency of transactions.





Source: SGX