

The DOJ, SEC, CFTC, FERC and Uneconomic Market Trading

Uneconomic trading in regulated markets is a key focus of market regulators such as the DOJ, SEC, CFTC and FERC. Traders at times, for example, take different positions in select markets which can result in losses in one market and profits in another. Traders also at times place positions in a market for strategic tactical reasons rather than with the intent of executing the position. This type of trading can move the market price to benefit the trader while deceiving other market participants.

One trading technique tied to this market approach is “spoofing.” Using this approach a trader may place position on one side of a market that they want filled and which is partially visible to others and a trade on the opposite side of the market that they later intend to cancel which is displayed. The point is to deceive other market participants in an effort to generate a faster fill at better prices. The result can be significant losses for those deceived and significant profits for the trader. While this practice has been used for years, the addition of a “spoofing” statute to the CFTC’s tool box under Dodd-Frank has generated a larger focus on the practice.

Spoofing

In the Matter of Tower Research Capital LLC, CFTC Docket No. 20-06 (Nov. 6, 2019) is an example of a CFTC spoofing case. Tower Research was previously registered with the agency as a commodity trade adviser and pool operator. Those registrations were withdrawn. Now the New York based firm is a proprietary trader on the Chicago Mercantile Exchange or CME.

Over a two-year period, beginning in the first quarter of 2012, the firm used three traders to place numerous futures market transactions, often in mini S&P, E-mini NASDAQ 100 and E-mini Dow (\$5) Futures contracts. The traders typically placed one or more orders they wanted filled on one side of the market. Frequently, the position only showed a small quantity available. On the opposite side of the market one or more orders were placed that the trader intended to cancel. This order was typically fully visible. The point

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was to induce other market participants to quickly respond to the partially visible orders the trader wanted filled, thereby obtaining better execution by creating a false impression of supply and demand. These orders would be canceled as the fills came in for the others.

The three traders at Tower Research repeated this technique multiple times over the two year period. Millions of trades were placed and filled while others were placed in the market and then cancelled, repeatedly deceiving other market participants.

The trading approach used by Tower violated Section 4c(a)(5)(C) of the CEA which prohibits the trading practice known as spoofing. It also violated Section 6(c)(1) of the Act and regulation 180(1) thereunder which precludes manipulative and deceptive conduct. In essence Tower “engaged in a manipulative and deceptive scheme wherein the Traders Spoof Orders to intentionally send false signals to the market that they actually wanted to buy or sell the number of contracts specified in the Spoof Orders,” according to the Order.

To resolve the proceedings Tower consented to the entry of a cease and desist order based on the sections cited in the Order. The firm also agreed to pay restitution of \$32,593,894, a penalty of \$24,400,000 (reduced through cooperation) and disgorgement of \$10,500,000. Offsets are included for payments made to the DOJ. Tower also settled with the DOJ, entering into a deferred prosecution agreement.

Comment

While the *Tower* case is based primarily on the spoofing provision recently added to the commodity statutes, the case reflects basic market manipulation principles. This is reflected in the case citations in the CFTC order which include SEC actions as well as those brought by the CFTC. Indeed, the basic principle that market participants cannot take actions which are designed to intentionally deceive other market participants is long embedded in the law of manipulation.

Other agencies are using these principles to police their markets without a spoofing statute. For example, FERC has brought actions charging manipulation tied largely to uneconomic trading as one segment of a larger transaction through which the firm moved the existing price to its benefit. Firms with trading operations would be well advised to revisit their trading compliance programs.