Market manipulation: distortion of market prices and squeeze/corner

Surveillance & Enforcement reprimanded a trader on 13 October 2010 for distorting market prices (in contravention of point 1.16 para. 2 of the Scoach Switzerland General Conditions[1]) and effecting a squeeze/corner (in contravention of point 1.16 para. 6 of the Scoach Switzerland General Conditions in conjunction with points 2.8 and 2.9 of Scoach Switzerland Directive 22[2]).

Shortly before 5 p.m. on xx December 2009, Head Trader X at Bank A (the issuer) bought 10,000 ABCD put warrants at CHF 0.21 each as market maker. The seller was an active arbitrageur (Participant B). Roughly two minutes after this trade, Head Trader X ceased market making in ABCD warrants. After the close of trading on the same day, Head Trader X provided new quotes for ABCD warrants with prices between CHF 1.19 and CHF 1.20, representing an increase of approximately 500%, despite the fact that there had been barely any change in the underlying (SMI). Furthermore, this higher pricing affected only ABCD warrants and was not applied to other SMI-based products for which Head Trader X also provided quotes. Over the next three days, market making in ABCD warrants was continued at an excessively high price level – CHF 1.20 to CHF 1.21. This pricing was not justified by the underlying (SMI). As a result of this situation, Participant B was forced to cover his position at CHF 1.21.

Point 1.16 para. 2 of the Scoach Switzerland General Conditions (GC) states the following: "Securities transactions or mere order entries made to give the impression of market activities or to distort market liquidity, market prices or the valuation of securities, as well as fictitious transactions and orders are not permissible (market manipulation)." The excessively high pricing deliberately employed by Head Trader X in this case – over several days, in fact – represented a risk to potential investors and negatively effected market integrity in that the unjustified price increase would have filtered through to other market participants (e.g. retail investors etc.). Investors have a right to assume that the quotes provided by a market maker are fair. In this case, however, they were anything but fair, meaning that the pricing quoted by Head Trader X contravened point 1.16 para. 2 of the Scoach Switzerland GC.

Details regarding the prohibition of market manipulation are set out in Directive 22 (see point 1.16 para. 6 of the Scoach Switzerland GC in conjunction with points 2.8 and 2.9 of Scoach Switzerland Directive 22), including the practice known as squeeze/corner. This may be effected, for example, when a market maker's monopoly or dominance with regard to a particular security is exploited such that a party with a short position has no other option than to buy coverage from the market maker at an excessively high price. Given that Head Trader X was well aware in this case – as he confirmed to Surveillance & Enforcement – that Participant B had a short position and would have to buy coverage at the increased price, Head Trader X's actions qualify as a squeeze/corner.

Surveillance & Enforcement reprimanded Head Trader X and ordered him to pay the cost of the proceedings in the amount of CHF 5,000.

[1] Version dated 6 March 2009, in force from 1 April 2009 to 31 October 2010

[2] Version dated 19 February 2009, in force from 1 April 2009 to 31 October 2010