How to Report Spoofing and Earn an SEC Whistleblower Award

Article By

Jason Zuckerman
Matthew Stock
Katherine Krems

Zuckerman Law
Whistleblower Protection Law Blog

Related Practices & Jurisdictions

- Administrative & Regulatory
- Securities & SEC
- Criminal Law / Business Crimes
- Financial Institutions & Banking
- All Federal

Sunday, August 15, 2021

Spoofing is a form of market manipulation where traders artificially inflate the supply and demand of an asset to increase profits. Traders engaged in spoofing place a large number of orders to buy or sell a certain stock or asset without the intent to follow through on the orders. This deceptive trading practice leads other market participants to wrongly believe that there is pressure to act on that asset and “spoofs” other participants to place orders at artificially altered prices.

Spoofing affects prices because the artificial increase in activity on either the buy or sell side of an asset creates the perception that there is a shift in the number of investors wanting to buy or sell. Spoofers place false bids or offers with the intent to cancel before executing so that they can then follow-through on genuine orders at a more favorable price. Often, spoofers use automated trading and algorithms to
achieve their goals.

The Dodd-Frank Act of 2010 prohibits spoofing, which it defines as “bidding or offering with the intent to cancel the bid or offer before execution.” 7 U.S.C. § 6c(a)(5)(C). Spoofing also violates SEC rules, including the market manipulation provisions of Section 9(a)(2) of the Securities Exchange Act of 1934.

Spoofing Enforcement Actions

In the Matter of J.P. Morgan Securities LLC

On September 29, 2020, the U.S. Securities and Exchange Commission (“SEC”) announced charges against J.P. Morgan Securities LLC, a broker-dealer subsidiary of JPMorgan Chase & Co., for fraudulently engaging in manipulative trading of U.S. Treasury securities. According to the SEC’s order, certain traders on J.P. Morgan Securities’ Treasuries trading desk placed genuine orders to buy or sell a particular Treasury security, while nearly simultaneously placing spoofing orders, which the traders did not intend to execute, for the same series of Treasury security on the opposite side of the market. The spoofing orders were intended to create a false appearance of buy or sell interest, which would induce other market participants to trade against the genuine orders at prices that were more favorable to J.P. Morgan Securities than J.P. Morgan Securities otherwise would have been able to obtain.

JPMorgan Chase & Co. agreed to pay disgorgement of $10 million and a civil penalty of $25 million to settle the SEC’s action. In addition, the U.S. Department of Justice (“DOJ”) and the U.S. Commodity Futures Trading Commission (“CFTC”) brought parallel actions against JPMorgan Chase & Co. and certain of its affiliates for engaging in the manipulative trading. In total, the three actions resulted in monetary sanctions against JPMorgan Chase & Co. totaling $920 million, which included amounts for criminal restitution, forfeiture, disgorgement, penalties, and fines.

United States of America v. Edward Bases and John Pacilio

On August 5, 2021, a federal jury convicted Edward Bases and John Pacilio, two former Merrill Lynch traders, for engaging in a multi-year fraud scheme to manipulate the precious metals market. According to the U.S. Department of Justice’s (“DOJ”) press release announcing the action, the two traders fraudulently pushed market prices up or down by routinely placing large “spoof” orders in the precious metals futures markets that they did not intend to fill.

After manipulating the market, Bases and Pacilio executed trades at favorable prices for their own gain, and to the detriment of other traders. The DOJ’s Indictment detailed how Bases and Pacilio discussed their intent to “push” the market through spoofing in electronic chat conversations.

In the Matter of Nicholas Mejia Scrivener

The SEC recently charged a California day trader with spoofing, where he placed multiple orders to buy or sell a stock, sometimes at multiple price levels that he did
not intend to execute. The SEC alleged that the purpose of the false orders was to create the appearance of inflated market interest and induce other actors to trade at artificial prices. The trader then completed genuine orders at manipulated prices and withdrew the false orders. The SEC found that the trader’s conduct violated Section 9(a)(2) of the Exchange Act of 1934, and the trader settled by consenting to a cease-and-desist order and paying in disgorgement, in interest, and a civil penalty.

SEC and CFTC Whistleblower Awards for Reporting Spoofing

Under the SEC Whistleblower Program and CFTC Whistleblower Program, a whistleblower who reports spoofing to the SEC or CFTC may be eligible for an award. These practices may constitute spoofing:

- Placing buy or sell orders for a stock or asset without the intent to execute;
- Attempting to entice other traders to act on a certain stock or asset to manipulate market prices and profitability;
- Creating a false appearance of market interest to manipulate the price of a stock or asset;
- Placing deceptively large buy or sell orders only to withdraw those orders once smaller, genuine orders on the other side of the market have been filled;
- Using false orders to favorably affect prices of a stock or asset (to increase market prices if intending to sell or to decrease market prices if intending to buy) so that one can then receive more ideal prices for a genuine order.

If a whistleblower’s information leads the SEC or CFTC to a successful enforcement action with total monetary sanctions in excess of $1 million, a whistleblower may receive an award of between 10 and 30 percent of the total monetary sanctions collected.

Since 2012, the SEC has issued nearly $1 billion to whistleblowers and the CFTC has issued approximately $123 million to whistleblowers. The largest SEC whistleblower awards to date are $114 million and $50 million. The largest CFTC whistleblower awards to date are $45 million and $30 million.

How to Report Spoofing and Earn a Whistleblower Award

To report spoofing and qualify for a whistleblower award, the SEC and CFTC require whistleblowers or their attorneys report their tips online through their Tip, Complaint or Referral Portals or mail/fax Form TCRs to the whistleblower offices. Prior to submitting a tip, whistleblowers should consider scheduling a confidential consultation with a whistleblower attorney.

The path to receiving an award is lengthy and complex. Experienced whistleblower attorneys can provide critical guidance to whistleblowers throughout this process to increase the likelihood that they not only obtain, but maximize, their awards.
SEC and CFTC Whistleblower Protections for Disclosures About Spoofing

The SEC and CFTC Whistleblower Programs protect the confidentiality of whistleblowers and do not disclose information that might directly or indirectly reveal a whistleblower’s identity. Moreover, a whistleblower can submit an anonymous tip to the SEC and CFTC if represented by counsel. In certain circumstances, a whistleblower may remain anonymous, even to the SEC and CFTC, until an award determination. However, even at the time of an award, a whistleblower’s identity is not made available to the public.

© 2021 Zuckerman Law

National Law Review, Volume XI, Number 227

Source URL: https://www.natlawreview.com/article/how-to-report-spoofing-and-earn-sec-whistleblower-award