

### **Market manipulation: distortion of market prices and squeeze/corner**

**Surveillance & Enforcement reprimanded a trader of a Scoach Switzerland participant (Bank A) on 4 August 2011 for distorting market prices and effecting a squeeze/corner. The trader was also ordered to pay the cost of the proceedings.**

Bank A is the issuer and market maker of the put warrant ABCD. Trader X, an employee of Bank A, was responsible for setting the pricing or the parameters of the quote engine for the put warrant ABCD on dd/mm/2010. On that date at [time], the quotes for the put warrant ABCD were reduced from CHF 0.15 - 0.17 to CHF 0.11 - 0.12 within just a few seconds. A counterparty then purchased [quantity] ABCD put warrants at CHF 0.12. A short time later, the buyer sold these [quantity] ABCD put warrants back to the market maker at CHF 0.15. After this, Scoach Switzerland's Market Control declared the trade executed at CHF 0.12 a mistrade. The cancellation of this trade resulted in an unwanted short position of [quantity] ABCD put warrants for the original buyer. The market maker then started to raise the quotes continually up to CHF 0.18 - CHF 0.20, despite the fact that there had barely been any change in the underlying (SMI). The counterparty that was now short thus had no other choice but to cover the position by buying from the market maker at CHF 0.20. The higher pricing by the market maker concerned only the put warrant ABCD. No other securities priced by Trader X that also have the SMI as their underlying were affected.

According to point 1.16 para. 2 of the Scoach Switzerland Ltd General Conditions<sup>1</sup> (Scoach Switzerland GC), order entries made to distort market prices or the valuation of securities are not permissible (market manipulation). During the proceedings, Trader X claimed that his pricing of the put warrant ABCD was a reaction to his frustration at repeated arbitrage by the same counterparties. This confirmed the suspicion that Trader X had deliberately set the pricing too high. Such behavior poses a threat to potential investors and is detrimental to the market's integrity, since an inexplicable increase in pricing has a knock-on effect on other market participants. Investors have a right to assume that the quotes provided by a market maker are fair. By his excessively high pricing Trader X violated point 1.16 para. 2 of the Scoach Switzerland GC.

Detailed provisions on the prohibition of market manipulation are contained in Scoach Switzerland Directive 22<sup>2</sup> (cf. point 1.16 para. 6 Scoach Switzerland GC), including the practice known as squeeze or corner. In a squeeze or corner, one market participant effectively forces another market participant known to be short into covering the short position at an exaggerated price. 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 Trader X was well aware in this case – as he confirmed to Surveillance & Enforcement – that the counterparty had a short position and would have to buy coverage at the increased price, Trader X's actions qualify as a squeeze/corner.

Surveillance & Enforcement reprimanded Trader X and ordered him to pay the cost of the proceedings in the amount of CHF 3,000.

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<sup>1</sup> Version dated 06.03.2009, in force from 01.04.2009 to 31.10.2010.

<sup>2</sup> Version dated 19.02.2009, in force from 01.04.2009 to 31.10.2010.