Market Surveillance Glossary

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The purpose of market regulation is to keep a market fair and orderly, by surveilling and identifying potentially illegal trading. Surveillance is difficult: the number of transactions that must be examined is enormous, and even if the necessary databases exist, analysts cannot examine every transaction. Potential illegal trading is likely to consist of associations of traders and possessors of information: analysts must be able to detect unusual patterns of trading activity, as well as links between patterns of names.

For the last 100 years, many illegal trading patterns have been classified by the compliance, regulatory and market surveillance communities. Some patterns are identified by examining price and volume movements, and determining whether these movements are statistically “unusual.” This detection process is valid as long as the statistical tests — called “Stockwatch Alerts” in the case of equity markets — are valid. After an unusual movement is detected, compliance analysts must examine the actual trade data to determine which trader caused the unusual trade. In the simplest cases, only a single trader was involved in the trades that caused the alert. Some of these illegal activities that can be the cause of the trades include:

Activities Detected Through Suspicious Trading Patterns (Single Trader)

1. Bear Raid
   Taking over a company by manipulating its stock price, by first selling (to lower the price), and then repurchasing at the lower price.

2. Capping
   Manipulating stock prices (lowering or maintaining) in order to influence the exercise of an existing options position.

3. Pegging
   Manipulating the price of a stock (raising or maintaining) in order to influence the exercise of an existing options position.

4. Manipulation Prior to the Pricing of Related Products
   Manipulating certain stocks that influence the price of other stocks or related financial products.

5. Mini-Manipulation
   Manipulating the price of an option on a stock by manipulative trading in the underlying stock.

6. Overtrading (Securities Taken In Trade)
   If a broker-dealer purchases (or arranges the purchase of) securities taken in trade (swaps) not at the current fair market price. The purchases are usually for a fixed price offering,

7. Wash Sale
   Giving the impression of high trading activity by buying and selling the same stock at the same price, through the same broker-dealer.

8. Improper Execution
   As opposed to "best execution," the execution at unfair prices such that the buyer (seller) does not incur the lowest (highest) reasonable cost. Improper execution can be due to an improper spread (the difference between the inter-dealer best bid and best offer); an improper markup (the amount charged to the buyer's cost in a principal trade over the best inter-dealer offer); or an improper markdown (the amount deducted from the seller's proceeds below the highest inter-dealer bid).

In other cases, many individuals or companies were involved that caused the alert. Some of these illegal activities that can be the cause of the trades include:

Activities Detected Through Suspicious Patterns of Name Associations

1. Acting in Concert
   Two or more persons working together to gain control of a company or manipulate the price of a security.

2. Cornering the Market
   Two or more persons working together to inflate the price of a stock, by acquiring a very large position in the security.

3. Collusion
   Two or more persons working together so as to create a false impression of market activity or to artificially interfere with supply and demand. Typical activities include making agreements to fix prices or otherwise control a market (likely to violate anti-trust laws, aside from industry rules and regulations); overbidding by entering unauthorized or inflated orders or indications of interest; evading credit restrictions or reporting requirements or to conceal or disguise the true ownership of securities; facilitating or aiding in any of the above or similar activities.

4. Daisy Chain
   A pattern of fictitious trading by a group of persons for the purpose of manipulation: the group profits when an unsuspecting person "bails out" the group.

5. Front-Running
   Someone (with knowledge of an imminent transaction) buying or selling a stock (or option or index in that stock) in order to take advantage of the information.

6. Insider Trading
   Someone (with non-public knowledge of a company) buying or selling a stock (or option or index in that stock) in that company in order to take advantage of this non-public knowledge.

7. Parking
   Hiding the true ownership of securities (and thereby avoiding fees, legal disclosures, capital requirements, anti-trust filings, or to extend financing otherwise prohibited), by creating a set of fictitious transactions and trades.

8. Pre-arranged Trades
   Transactions in which the price, terms or contra-side have been prearranged and which are not subject to normal market risk. The transactions may be illegal under both securities and tax laws.

9. Year End and "As Of" Trades
   Transactions executed at year end or as of a particular date in order to establish gains or losses for tax purposes or conceal portfolio losses or true positions from accountants, auditors or regulators. These trades may violate regulatory prohibitions against prearranged trading and may result in allegations of parking.

10. Marking the Close
    Transactions executed at or just before the market close to print favorable prices for inappropriate purposes, such as inflating position valuations or avoiding margin calls.

11. Rumors
    Starting or spreading rumors in order to influence the price of a stock.

12. Short Squeeze
    Persons who sell a security short paying inflated prices, because the price of a stock was inflated by someone cornering the market.