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## DECISION NOTICE

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To: **7722656 Canada Inc formerly carrying on business as Swift Trade Inc**  
Of: **c/o BRMS Holdings Inc**  
**55 St Clair Ave, West**  
**Toronto**  
**Canada M4V 2Y7**  
Date **6 May 2011**

**TAKE NOTICE: The Financial Services Authority of 25 The North Colonnade, Canary Wharf, London E14 5HS (“the FSA”) has decided to take the following action:**

### **1. ACTION**

- 1.1. For the reasons set out in this Notice, the FSA has decided to impose on Swift Trade Inc (“Swift Trade”) a financial penalty of £8,000,000 pursuant to section 123(1) of the Financial Services and Markets Act 2000 (“the Act”) for engaging in market abuse.

### **2. REASONS FOR THE ACTION**

- 2.1. The FSA has decided to take this action as a result of the behaviour of Swift Trade during the period 1 January 2007 to 4 January 2008 (“the Relevant Period”). Throughout the Relevant Period, Swift Trade systematically and deliberately engaged in a form of manipulative trading activity known as “layering”. This manipulative

trading caused a succession of small price movements in a wide range of individual shares on the London Stock Exchange (“the LSE”) throughout the Relevant Period from which Swift Trade was able to profit. The trading activity involved tens of thousands of orders, was repeated on many occasions and was conducted in many different shares over the Relevant Period.

- 2.2. Layering involves entering relatively large orders on one side of the LSE order book (“the order book”), which has the effect of moving the share price as the market adjusts to the fact that there has been an apparent shift in the balance of supply and demand. This is then followed by a trade on the opposite side of the order book which takes advantage of, and profits from, the share price movement. This is in turn followed by a rapid deletion of the large orders which had been entered in order to cause the movement in price, and by a repetition of this behaviour in reverse on the other side of the order book. Swift Trade placed the large orders in order to give a false and misleading impression of supply and demand. The large orders were not intended to be traded. They were carefully placed close enough to the touch price (i.e. the best bid and offer prevailing in the market at the time) to give a false and misleading impression of supply and demand, but far enough away to minimise the risk that they would be executed. They were deleted in seconds in order to further minimise the risk that they would be traded. The trading activity caused many individual share prices to be positioned at an artificial level, from which Swift Trade profited directly.
- 2.3. An example of the trading activity is set out in Appendix 1 together with an illustration of how the highly unusual and manipulative trading pattern used by Swift Trade stood out from the market as a whole. This example dates from January 2007 but Swift Trade engaged in similar trading activity throughout the Relevant Period.
- 2.4. The FSA regards this as a particularly serious case of market abuse for the following reasons:
  - (1) the manipulative trading was deliberate, was intended to create a false or misleading impression and an artificial share price and was undertaken to achieve a profit;
  - (2) the manipulative trading was widespread and systematic. It was repeated on many occasions and in many different shares on the LSE over the Relevant Period;
  - (3) the manipulative trading was undertaken by many individual traders, sometimes acting in concert with each other, and was widespread across many trading locations worldwide. Swift Trade disseminated this trading strategy to individual traders and trading locations;
  - (4) Swift Trade profited substantially from the trading to the detriment of other market participants;
  - (5) although Swift Trade became aware in March 2007 that the LSE had raised concerns regarding the trading activity, not only did Swift Trade continue its manipulative trading, it also actively sought to evade restrictions on the

trading. It refined the trading pattern which made it less easy to detect, it purported to impose effective controls on the trading when this was not the case, and it took steps to avoid regulatory scrutiny by changing its Direct Market Access (“DMA”) provider;

- (6) while the price movements which Swift Trade caused were short term, they still operated to the detriment of other market participants at the time of trading. Further, the trading activity had significant market impact for a prolonged period in a variety of FTSE 100 and FTSE 250 stocks because it was widespread, systematic and repeated. The volume of the manipulative trading was large enough to misrepresent the overall liquidity on the order book for the shares in question and to deter genuine liquidity providers from trading when they perceived that manipulative trading was being undertaken;
  - (7) the manipulative trading disrupted and distorted the price formation process; and
  - (8) conduct of this kind, if unchecked, could undermine market confidence.
- 2.5. Swift Trade was a Canadian company incorporated in Toronto, Ontario. It was not an FSA authorised firm nor was it a member of the LSE.
- 2.6. Swift Trade operated a network of over 50 customers based in over 150 trading locations worldwide which in turn engaged over 3,000 traders. Throughout the Relevant Period, Swift Trade placed orders to buy or sell swaps or contracts for difference (CFDs) with LSE member firms providing DMA to the order book. Those orders were then reflected on the order book by orders for shares placed by the DMA provider as an immediate and automatic hedge to Swift Trade’s synthetic orders.
- 2.7. The trading activity involved placing individually or cumulatively large orders to buy or sell shares on the order book, the majority of which orders were subsequently cancelled without being executed. Relatively small orders were placed on the opposite side of the order book. The large orders gave the impression of substantive demand for, or supply of, the shares and had the effect of moving the share price such that the smaller orders entered on the other side of the order book became more attractive and were executed, at which point Swift Trade’s large orders were rapidly cancelled. Swift Trade profited from the small price movements which followed such orders by buying after triggering a fall and selling after triggering a rise in the share price.
- 2.8. The large orders were not intended to be traded and were very unlikely to be traded because of the combination of their size, their distance from the touch price and their short duration given their rapid cancellation. They created a false impression of supply of or demand for, or price of, the shares in question as there was no intention to trade at the prices and in the quantity stated. The purpose of the large orders was to trigger share price movements from which Swift Trade could profit.
- 2.9. Individual price movements were small. However, the trading activity created a distinct movement of the price first one way and then the other. This movement was created by Swift Trade which was then in a position to gain an advantage over other

market participants by trading in response to the price movement it had caused. By repeating the pattern many times a day and in a large number of shares across a range of market sectors, the small benefit from each individual price movement was magnified. It has not been possible to quantify Swift Trade's profits precisely; however, they were substantial and in excess of £1.75 million.

- 2.10. Accordingly Swift Trade effected transactions and/or orders to trade which gave, or were likely to give, a false or misleading impression as to the supply of, demand for or the price of the shares in question. Further, the trading activity secured, or was likely to secure, the price of the shares in question at an artificial level.
- 2.11. Swift Trade's behaviour constituted deliberate market abuse in breach of section 118(5)(a) and (b) of the Act. The FSA considers that this conduct warrants the imposition of a significant financial penalty.

### **3. RELEVANT STATUTORY PROVISIONS**

- 3.1. The relevant statutory and regulatory provisions are set out in Appendix 2.

### **4. FACTS AND MATTERS RELIED ON**

#### **The trading activity**

- 4.1. As set out above and as illustrated in Appendix 1, the manipulative trading activity involved the placing of a series of short-lived and large orders to buy or sell shares on the order book close to the touch price throughout the Relevant Period. These orders to buy or sell shares were triggered by orders from Swift Trade to buy or sell swaps or CFDs and the orders on the order book formed the mirror image of those synthetic orders. The vast majority of these large orders were cancelled within seconds of being placed without being executed, following the execution of a smaller trade on the opposite side of the order book which took advantage of and profited from the artificial movement in price which had been caused by the placing of the large orders. The large orders were subsequently re-entered on the opposite side of the order book.
- 4.2. As appears from the example set out in Appendix 1, Swift Trade's large orders gave the impression of substantial demand for, or supply of, the shares. They had the effect of moving the share price up (for bids) or down (for offers) such that the smaller orders which were entered by Swift Trade on the other side of the order book became more attractive and were executed. At this point, the large orders were cancelled.
- 4.3. Swift Trade profited from the small price movement which followed its large orders by buying after triggering a fall and selling after triggering a rise in the share price.
- 4.4. This pattern of trading was repeated on many occasions and in many different shares over the Relevant Period, comprising tens of thousands of orders. Although individual price movements were small, over time the cumulative profits resulting from the manipulative trading were substantial.

- 4.5. The large orders were placed close enough to the touch price to create an impression of supply or demand, while being far enough away from the touch price to have little risk of being executed. They were very short-lived and the vast majority of the large orders were cancelled without being executed, often in a matter of seconds. These orders were artificial.

#### **Direct Market Access**

- 4.6. Swift Trade's orders during the Relevant Period were effected on the LSE through Swift Trade's DMA providers. DMA is a service offered by some stockbrokers who are LSE member firms that enables investors to place buy and sell orders directly on the order book. In order to achieve direct access to the order book, Swift Trade placed orders to buy or sell swaps or CFDs with its DMA providers. On receipt of the order from Swift Trade, the relevant DMA provider in turn immediately and automatically placed an order to buy or sell shares on the order book. When Swift Trade cancelled its order to buy or sell swaps or CFDs, the DMA provider in turn cancelled its order to buy or sell shares on the order book and Swift Trade's cancellations were only accepted to the extent that the corresponding orders had not been executed on the order book. Trading in shares on the order book by the DMA provider was a direct reflection of the trading in swaps or CFDs by Swift Trade.
- 4.7. Swift Trade understood that its orders to trade swaps or CFDs placed with its DMA providers would result in a matching order for shares on the order book, as set out above. It was to Swift Trade's advantage to trade in swaps and/or CFDs rather than the underlying shares as this avoided the need to pay stamp duty.

#### **Swift Trade's role in the trading activity**

- 4.8. Swift Trade was a Canadian company which was incorporated in Toronto, Ontario on 6 June 2002. The majority shareholder in Swift Trade (via a holding company) was Peter Beck. He was also the President and Chief Executive Officer of Swift Trade. Initially Swift Trade structured its business as a proprietary trading business whereby it employed individuals to trade on Swift Trade's own account.
- 4.9. In about 2004 Swift Trade changed the outward structure of its business model. Rather than directly employing individual traders, it devolved its proprietary trading to an ostensibly independent arms-length customer ("Customer A") which engaged Swift Trade's trading staff as independent contractors. Although a separate legal entity and ostensibly independent, Customer A was in fact indirectly owned and controlled by Peter Beck.
- 4.10. Thereafter, Swift Trade entered into similar ostensibly arms-length customer relationships with a number of the individual traders it had previously employed directly. It also set up a further ostensibly independent arms-length customer ("Customer B") which was trading on the LSE by January 2007. Swift Trade and Customer A agreed to assign to Customer B all rights under agreements with trader managers and traders retained as independent contractors in many locations worldwide with effect from 1 September 2007. Customer B purported to operate as an independent company but was subject to the direction and control of Swift Trade.

- 4.11. Swift Trade operated a network of over 50 customers based in over 150 trading locations worldwide, which in turn engaged over 3,000 traders as independent contractors. These traders engaged in day trading and were not permitted to hold positions overnight. During the Relevant Period, none of the trading locations which engaged in the manipulative trading were in the United Kingdom.
- 4.12. The manipulative trading activity was ostensibly conducted independently of Swift Trade by traders retained by its customers, with Swift Trade providing the trading platform and required connectivity to the LSE. However, Swift Trade directed and controlled the manipulative trading activity in the following ways:
- (1) Swift Trade actively disseminated the trading strategy to individual traders and trading locations;
  - (2) certain customers (including Customers A and B) which purported to be independent legal entities operating an arms length commercial relationship with Swift Trade were in fact subject to the direction and control of Swift Trade and/or Peter Beck throughout the Relevant Period. Swift Trade was able to exert extensive influence through its contracts with Customers A and B; for example, Swift Trade directly supervised the trading of these customers through the trader managers it appointed and the principals of Customers A and B had no involvement with the trading;
  - (3) Swift Trade exerted influence over other customers through its contracts with them. For example, it required customers to comply with all Swift Trade policies and procedures in force from time to time and it capped the level of commission payable by one customer to its traders; and
  - (4) other customers had close links to Swift Trade in that they were ostensibly directed by former employees of Swift Trade or an affiliate. Swift Trade had the opportunity to, and did, influence and direct the trading activity of these customers.
- 4.13. Swift Trade funded the manipulative trading activity by depositing substantial margin with its DMA providers.
- 4.14. Swift Trade typically received a 27% share of its customers' trading profits rather than charging a flat fee per transaction. Accordingly, Swift Trade had a direct interest in the trading being profitable and profited directly from the manipulative trading activity.
- 4.15. Although the way in which Swift Trade structured its business operations gave the impression that it only operated as an intermediary, in fact throughout the Relevant Period it was acting as a proprietary trader.

- 4.16. Swift Trade's trading activity was not representative of the market as a whole and was not typical day trading activity.

#### **Concerns raised by the LSE**

- 4.17. DMA providers are members of the LSE. The LSE first expressed concerns to Swift Trade's DMA provider regarding the manipulative trading activity in March 2007. It continued to express concerns throughout the Relevant Period and those concerns were expressed clearly to Swift Trade. Swift Trade contended that the activity was legitimate and that traders were merely reacting quickly and independently to changing market conditions. In March 2007 Swift Trade purported to impose controls to prevent traders from engaging in manipulative trading and represented to the DMA provider and the LSE that it had done so and that those controls were effective. However, no effective controls were imposed by Swift Trade to prevent such trading, despite its technical capabilities and resources. The manipulative trading activity continued despite the concerns expressed.
- 4.18. In order to meet the LSE's concerns, in June 2007 the DMA provider itself began to impose directly a series of controls on Swift Trade's trading. These included controls in relation to:
- (1) the minimum time orders were to be left on the order book;
  - (2) a restriction on the number of open orders per trader per share; and
  - (3) a limit on the size of individual orders.
- 4.19. At around this time, modifications were made to the manipulative trading involving, for example, the placing of a small number of very large orders instead of a large number of smaller orders, although the net effect was the same in that a large cumulative position was created and then cancelled. These modifications made it less easy to detect the trading pattern. However, from June 2007 there was a significant falling off in the volume of the manipulative trading, as it was significantly hampered by the DMA provider's restrictions and controls. Furthermore there was a real risk that the DMA provider would permanently switch off Swift Trade's LSE access, which had been temporarily suspended on 31 May 2007 and was suspended again on 20 June 2007, if the trading activity continued. In June 2007 Swift Trade switched DMA providers.
- 4.20. By switching DMA providers Swift Trade was able to conduct the trading activity via the new DMA provider without being subjected to the restrictions and controls which had been imposed by the previous DMA provider. Swift Trade was able to continue the abusive trading activity by ensuring that it did the following:
- (1) Swift Trade continued to modify the manipulative trading, which made it more difficult to detect;
  - (2) Swift Trade did not advise the new DMA provider of the restrictions and controls to which its previous trading had been subject;

- (3) Swift Trade did not itself implement systems controls and removed any controls which had been imposed under the first DMA provider; and
- (4) Swift Trade did not advise the new DMA provider of the concerns which had been raised by the LSE.

4.21. The first DMA provider switched off Swift Trade's access to the LSE in September 2007 and Swift Trade commenced trading through the new DMA provider in October 2007. The controls previously put in place were not replicated by Swift Trade or by the new DMA provider, which had not been informed of the LSE's concerns regarding Swift Trade's trading. The manipulative trading activity resumed via the new DMA provider, albeit with some modifications which made the activity more difficult to detect. However, manipulative trading was detected by the LSE despite these modifications and concerns were expressed by the LSE. The new DMA provider implemented a manual post-trade transaction monitoring programme to monitor Swift Trade's trades.

4.22. The table below indicates the number of hits generated on the LSE's layering report tool by Swift Trade's trading through each of the two DMA providers over the Relevant Period. This tool was designed to detect potentially manipulative trading involving large orders on one side of the order book, a trade occurring on the opposite side and then a deletion of the large orders. The vast majority of the hits relate to trading activity through the two DMA providers that provided access to the LSE for Swift Trade, and Swift Trade was the only client of the second DMA provider at the time.

| Month  | Total Number of Hits | Number by DMA 1 | DMA 1's % of total | Number by DMA 2 | DMA 2's % of total | Notes     |
|--------|----------------------|-----------------|--------------------|-----------------|--------------------|-----------|
| Jan-07 | 7,105                | 6,860           | 96.6               | 0               | 0                  |           |
| Feb-07 | 3,248                | 3,094           | 95.3               | 0               | 0                  |           |
| Mar-07 | 8,057                | 7,915           | 98.2               | 0               | 0                  | (1)       |
| Apr-07 | 4,170                | 4,057           | 97.3               | 0               | 0                  |           |
| May-07 | 4,205                | 3,991           | 94.9               | 0               | 0                  |           |
| Jun-07 | 627                  | 78              | 12.4               | 0               | 0                  | (2) & (3) |
| Jul-07 | 805                  | 25              | 3.1                | 0               | 0                  |           |
| Aug-07 | 1,718                | 25              | 1.5                | 0               | 0                  |           |
| Sep-07 | 1,164                | 3               | 0.3                | 0               | 0                  | (4)       |
| Oct-07 | 5,926                | 0               | 0                  | 5,156           | 87                 | (5)       |
| Nov-07 | 16,470               | 1               | 0                  | 15,737          | 95.5               |           |
| Dec-07 | 10,755               | 0               | 0                  | 10,370          | 96.4               |           |
| Jan-08 | 2,001                | 0               | 0                  | 571             | 28.5               |           |
| Totals | 66,251               | 26,049          | 39.3               | 31,834          | 48.1               |           |

Notes to table

- (1) Swift Trade was on notice of the regulatory concerns by 22 March 2007 and issued Trader Alerts on and after that date which told traders not to engage in manipulative trading and purported to impose controls. For example, it told traders they should leave orders in the market for a reasonable time before cancelling them
- (2) The first DMA provider (DMA 1) suspended Swift Trade's access from 1 to 5 June 2007 to allow Swift Trade time to implement a technological fix such that each trader may have no more than 2 orders per side per security at any time with no less than 5 seconds between the placing of

each order. DMA 1 required Swift Trade to build these restrictions into its system before reinstating access.

- (3) Swift Trade signed contracts with the new DMA provider (DMA 2) on 18 June 2007
- (4) DMA 1 terminated Swift Trade's access on 7 September 2007
- (5) Swift Trade started trading through DMA 2 on 3 October 2007.

4.23. As the table indicates:

- (1) even though Swift Trade purported to introduce controls in March 2007, there were still substantial layering hits after this, indicating that those controls were ineffective;
- (2) the number of layering hits reduced substantially in June 2007 when the first DMA provider introduced controls over Swift Trade, indicating that these controls were largely effective;
- (3) the number of layering hits increased dramatically from October 2007 when Swift Trade started trading through the new DMA provider, with no restrictions in place.

4.24. Swift Trade was able to suspend or terminate access by individual traders or trading locations to the LSE and other exchanges. Despite the continuing and escalating concerns expressed, Swift Trade failed to take any effective action to stop the manipulative trading, which was not limited to isolated offices or individual traders. Rather, Swift Trade and Peter Beck instructed traders to trade in a way designed to avoid detection by regulators. The manipulative trading was undertaken by many individual traders, sometimes acting in concert with each other, and was widespread across many trading locations worldwide. In the example at Appendix 1 of Stock E on a date in January 2007, Swift Trade's trading activity involved three different office locations (two in China, and one in Canada) and 19 individual traders. Swift Trade did not terminate the access of any trader or trading office for manipulative trading on the LSE during 2007. Swift Trade suspended three traders in Budapest on about 25 July 2007 but within a week it was pressing the first DMA provider to agree to their reinstatement on the basis that a limit had been imposed on the maximum value of any order. Two of these traders (who were associated with Customer B) resumed trading after Swift Trade's move to the new DMA provider, by which time the maximum order value control had been removed.

4.25. On 3 December 2007 the LSE issued London Stock Exchange Notice N78/07 to provide clarification and further guidance with respect to the Rules of the LSE regarding misleading acts, conduct and prohibited practices (LSE Rule 1400). Notice N78/07 expressly identified layering as activity that could create a misleading impression of liquidity. Notice N78/07 was prompted by the LSE's concerns as to Swift Trade's trading.

4.26. The manipulative trading continued despite Notice N78/07. On 4 January 2008, at the request of the LSE, Swift Trade's new DMA provider withdrew Swift Trade's access to the LSE.

## **Impact on the market**

- 4.27. Prescribed markets such as the LSE provide a price formation mechanism which operates according to the market forces of supply and demand. Market users expect the price formation mechanisms of prescribed markets to reflect the operation of market forces rather than the outcome of improper conduct by other market users. In circumstances where there is artificial market activity such that the price at which investments are traded does not reflect the interplay of proper supply and demand, this activity will give market users a false or misleading impression and the prices of those investments will be secured at an artificial level.
- 4.28. The LSE Rules specifically require that all orders must be firm. Market participants are entitled to proceed on the assumption that there is an intention to trade behind the orders that appear on the order book and that the order book represents the interaction of real supply and demand. If there is a perception that this is not the case, this will have a direct impact on the confidence of market participants in the price formation process.
- 4.29. Swift Trade's large orders were not intended to be traded. They created a false impression of the supply of, the demand for or the price of, the shares in question as there was no intention to trade at the prices and in the quantity stated. The purpose of the large orders was to trigger share price movements from which Swift Trade could profit.
- 4.30. The extensive use of orders which were not intended to be traded and which were, in effect, non-executable owing to a combination of factors such as their distance from the touch price, their size and the short length of time they remained on the order book (as shown in Appendix 1), had a significant impact on the appearance of demand or supply for the stocks in question at the time the activity was undertaken. Such orders were artificial.
- 4.31. Individual price movements were small. However, the trading activity created a distinct movement of the price first one way and then the other. This movement was created by Swift Trade which was then in a position to gain advantage over other market participants by trading in response to the price movement it had caused. By repeating the pattern many times a day and in a large number of shares across a range of market sectors, the small benefit from each individual price movement was magnified. It has not been possible to quantify Swift Trade's profits precisely; however, they were substantial and in excess of £1.75 million.
- 4.32. While the price movements which Swift Trade caused were short term, they secured the prices of the shares in question at an artificial level. Further, the trading activity had market impact for a prolonged period in a variety of FTSE 100 and FTSE 250 stocks. The volume of the manipulative trading was large enough to misrepresent the overall liquidity on the order book for the shares in question.
- 4.33. The manipulative trading disrupted and distorted the price formation process, to the detriment of other market participants.

- 4.34. This type of trading activity is viewed by the LSE as a major concern as it undermines confidence in the orders entered on to the order book, the fairness of the LSE's markets and the level of liquidity on the order book.

### **The dissolution of Swift Trade**

- 4.35. On 13 December 2010 Swift Trade was voluntarily dissolved under section 210(3) of the Canada Business Corporations Act 1985 ("CBCA"). The FSA was informed by the former holding company of Swift Trade that Swift Trade's assets were transferred to the former holding company. It was represented on behalf of this holding company that it held in trust the remaining assets of Swift Trade and that any creditor's claims including fines levied by the FSA would be paid out of these funds. The FSA has received no indication as to the amount of funds that are being held on trust.
- 4.36. Despite the dissolution of Swift Trade the CBCA allows for the FSA's proceedings against Swift Trade to continue as if Swift Trade had not been dissolved.

## **5. REPRESENTATIONS FINDINGS AND CONCLUSIONS**

### **Representations**

- 5.20. Swift Trade made written representations arguing against the continuation of the action proposed in the Warning Notice dated 27 October 2010. In addition to their written representations Swift Trade provided two reports from expert witnesses. Swift Trade did not make any oral representations to the RDC.

#### *The correct legal interpretation of section 118 of the Act*

- 5.21. Swift Trade contended that there was a "fundamental question as to whether the instruments ... [were] qualifying investment for the purposes of section 118(5)". It was submitted that the fact that the relevant instruments, CFDs, had not been expressly included within section 118(1)(a)(i) – (ii) meant that they were not covered by section 118(5). In support of this contention it was noted that section 118(1)(a)(iii) expressly includes investments related to qualifying investments and thus sections 118(2) and 118(3) cover derivative contracts and CFDs. Swift Trade submitted that a comparison between the explicit inclusion of investments related to qualifying investments in section 118(1)(a)(iii) and the omission of equivalent wording in section 118(1)(a)(i) – (ii) demonstrated that it was not intended that section 118(5) should cover derivative contracts or CFDs.

#### *The involvement of Swift Trade and Peter Beck in directing the trading*

- 5.22. Reliance was placed upon the opinion of one of the two experts to support Swift Trade's contention that it had not influenced the trading strategy of any of its clients. Whilst one of these two experts stated that:

“whether the Swift Trade pattern of trading as complained of by the FSA was implemented by a single controlling authority is clearly a factual issue rather than one for expert opinion”

the other expert was prepared to conclude that:

“I do not believe that this activity was in any way planned, organised or orchestrated or indeed even discreetly encouraged by Swift Trade”.

- 5.23. The expert who was prepared to comment on Swift Trade’s involvement in the manipulative trading opined that “co-ordination or even simple co-operation between traders alleged by the FSA is also implausible given Swift Trade’s financial model”. It was suggested that it would have been inimical to the principles underpinning a ‘Darwinian’ model, such as that which was employed by Swift Trade and its clients, for a layering strategy to have been disseminated and/or co-ordinated by Swift Trade. Furthermore it was argued that the ‘Darwinian’ model provided the best explanation for how a trading strategy such as layering could have been disseminated without Swift Trade’s involvement. It was asserted that the layering strategy would have become widespread because:

“The principle of these businesses is highly Darwinian, they seek to have a large number of traders each evolving their own trading strategy, those that are profitable will survive, those [that] are not will leave. Inevitably traders will copy each other and the more successful strategies will become more prevalent. As new traders are brought in they will also tend to copy the more successful traders’ strategies. This is a perfect example of an eco system.”

*The impact of the trading*

- 5.24. It has been submitted on Swift Trade’s behalf that, whether or not it could be demonstrated that it had orchestrated the layering activity, the FSA was wrong to allege that this behaviour disrupted and distorted the market. One of the expert reports submitted on Swift Trade’s behalf contended that the FSA’s assertions about the likely impact of the layered order were “fundamentally illogical”. It was argued that because the orders were said by the FSA to have not been intended to be executed then if that hypothesis were to be correct the orders would not have had a significant impact on the relevant price. It was noted that the FSA alleged that the orders were placed some way away from the touch price and that they were only on the market for a short period of time. It was therefore asserted that if the FSA were correct then these orders would not have had a significant impact on the price.
- 5.25. It was further argued that the FSA’s allegations about the placing of the orders were not only illogical but also lacking in any statistical support. It was suggested that the examples of abusive trading presented by the FSA generally ran counter to the allegations being made and that instead they involved:

“layered orders that were close or within the touch price and hence did have a significant probability of execution”

In particular it was argued that large orders had a high probability of being filled.

- 5.26. Furthermore it was stated that the FSA’s assessment of volatility was imprecise and unfocussed. It was argued that in the absence of more precise calculations there was

little support for the suggestion that there was clear evidence of consistently higher market price volatility when Swift Trade was in the market. In summary it was concluded that

“the FSA has not proved at any reasonable level of significance that the trading activities of Swift Trade have resulted in distortions of the price setting process for LSE stocks.”

Indeed criticisms were made of much of the statistical models used by the FSA to conduct its analysis in this case.

- 5.27. Additionally it was commented that in practice there was little likelihood of the layering activity having an impact on the market. It was asserted that the market makers were sophisticated enough to respond to such trading patterns and that consequently the market would not be adversely affected by layering. In fact, it was claimed that there would be so little impact from such trading that it was questioned whether it could be fairly assumed that Swift Trade had engaged in layering to generate any profit. It was speculated that if there were to have been any negative impact it would have been upon algorithmic traders and that this was of general benefit to the wider market.

#### *The connection between Swift Trade and the UK*

- 5.28. Some time after the dissolution of Swift Trade, representations were received from the holding company which purports to hold in trust the remaining assets of Swift Trade. This holding company submitted that Swift Trade had fully co-operated with the FSA’s investigation notwithstanding the fact that it was an entity which was regulated in Ontario. It was noted that this “co-operative approach was confirmed and superseded by subsequent orders made by the Ontario Securities Commission (“OSC”) requiring Swift Trade to provide the FSA with information regarding its operations and client base”. However, notwithstanding the willingness that had been displayed to assist the FSA, it was submitted that in reality there had never been any “real and substantial” connection between Swift Trade and the UK. It was accepted that Swift Trade’s clients could have had an indirect impact on the markets in the UK. However it was submitted that the reports of the two expert witnesses, whose reports accompanied the written representations, had demonstrated that this had not happened. Instead it was submitted that the allegations against Swift Trade were “without substance and based fundamentally on the complaints of two high-frequency algorithmic trading firms”
- 5.29. It was stated that a decision had been taken in the light of the foregoing that neither the holding company nor any other potential successor organisation to Swift Trade would continue to engage with the process. It was explained that it was felt that expenditure on this was “no longer appropriate, nor justifiable”

#### *Financial penalty*

- 5.30. Swift Trade made no representations concerning the size of the financial penalty which was proposed in the Warning Notice. Furthermore Swift Trade did not make

any representations about its ability to pay the financial penalty or the impact that the imposition of such a penalty would have upon it.

## **Findings**

- 5.31. Notwithstanding the representations submitted on behalf of Swift Trade the FSA has decided to continue with the action proposed in the Warning Notice. The FSA finds that Swift Trade engaged in market abuse by effecting transactions and/or orders to trade which gave, or were likely to give, a false or misleading impression as to the supply of, demand for or the price of the shares in question. The FSA considers that the trading activity secured, or was likely to secure, the price of the relevant shares at an artificial level.

### *The correct legal interpretation of section 118 of the Act*

- 5.32. The FSA considers that whilst the synthetic instruments which Swift Trade dealt in were not in themselves qualifying instruments they were related to qualifying instruments and are therefore covered by s.118(5). The layering activity was in relation to qualifying investments admitted to trading on a prescribed market within the terms of section 118(1)(a) of the Act because the CFDs and swaps which Swift Trade actually traded in were directly correlated to the price and volume of the underlying qualifying investments. Further, its trading was conducted with a view to moving the price of the qualifying investments to which the price of the CFDs and swaps was directly correlated. The FSA therefore considers that because Swift Trade's activity occurred in relation to qualifying investments, the firm's conduct does not fall outside of the terms of the Act. Instead the FSA considers that the firm traded in products which engaged s.118 and this therefore brings Swift Trade's conduct within the ambit of the section.

### *The involvement of Swift Trade and Peter Beck in directing the trading*

- 5.33. The FSA finds that Swift Trade did direct the manipulative trading activity. The FSA rejects the assertion that Swift Trade did not have any involvement in the trading activity except as an electronic order router. Instead the FSA considers that the only credible explanation for the utilisation by a wide range of Swift Trade customers across a wide range of geographical locations and time zones of the same, highly unusual, trading strategy was that Swift Trade was directing and controlling the trading activity. Furthermore the FSA finds that there is clear evidence not only that Swift Trade was aware that 'layering' was occurring but also that it had disseminated this trading strategy having identified this as an effective way of manipulating the market.
- 5.34. The FSA finds that Swift Trade continued to direct the trading that was conducted through its platform despite the fact that it had purportedly changed its business model from that of a proprietary trader to a structure where it provided the trading platform and the required connectivity to the LSE for customers who were ostensibly independent and at arms-length. The FSA considers that despite the outward appearance of independence between Swift Trade and its customers, such as Customers A and B, the true position was that Swift Trade was involved in the direction and control of these entities. Swift Trade was able to exert influence,

through contracts with customers, which demonstrate that it had not relinquished control of the trading of these customers. The control which Swift Trade had as a result of contracts with its various customers was augmented by the close links between Swift Trade and personnel employed by its customers. The FSA considers that Swift Trade had a significant incentive to maintain control over the trading activity of its customers as it took a substantial portion of the trading profits of these customers. The FSA finds that these connections between Swift Trade and its customers give rise to the compelling inference that the unusual layering activity seen in this case was disseminated and utilised at Swift Trade's direction.

- 5.35. Furthermore the FSA considers that the opaque business model adopted by Swift Trade and its attempts to evade regulatory scrutiny or control demonstrate that Swift Trade was knowingly and deliberately engaging in market abuse. Swift Trade did not properly engage and respond to the LSE when concerns were raised as to the layering activity. Instead of addressing any of the concerns raised by the LSE the firm simply attempted to ensure that the impugned trading activity avoided scrutiny. Swift Trade did have some internal controls, however these were not consistently applied and when external controls were imposed by its DMA provider Swift Trade changed to another DMA provider to avoid the strictures of these controls. These efforts to evade any effective restraint being put upon the layering activity were accompanied by a business structure that was designed to shield Swift Trade from robust scrutiny and to thus ensure that the trading could continue.
- 5.36. The FSA finds that the evidence, set out in the paragraphs above, of Swift Trade's involvement in facilitating, disseminating and directing the abusive trading strategy is further bolstered by certain internal communications at Swift Trade and an account given by a former employee when interviewed by the OSC. Various internal communications at Swift Trade provide clear evidence that the management of Swift Trade were not only aware that layering was occurring but that they were urging traders to continue making profits whilst endeavouring to evade drawing any regulatory attention to their activities. This evidence is complemented by comments in interview made by a former employee of Swift Trade in which he describes the efforts that the management of the firm made to disseminate the trading strategy. The FSA considers that this amply demonstrates that Swift Trade was directing this activity.
- 5.37. In the light of the foregoing findings the FSA rejects the explanation put forward on behalf of Swift Trade to explain how various traders and trading locations could have come up with the same trading strategy without Swift Trade having been involved in directing this activity. Whilst the 'Darwinian' hypothesis provides a theoretical and abstract explanation as to how traders could have come up with the same trading strategy independently of each other, the FSA considers that in the circumstances of the case this hypothesis is not a plausible explanation. Instead the FSA considers that Swift Trade disseminated this trading strategy and directed the trading activity.

#### *The impact of the trading*

- 5.38. The FSA finds that Swift Trade's manipulative trading distorted the price formation process operating on the LSE and that this was to the detriment of other market participants. The FSA has noted the criticisms made of its assessment of the impact

of the trading but does not consider that these criticisms have any impact on the FSA's determination of the nature of the impact that this trading had on the market. Indeed the FSA finds that some of these criticisms are not sustainable whilst other points that have been raised do not undermine the FSA's assessment of the market impact of this manipulative trading.

- 5.39. The FSA rejects the argument, which was put forward on behalf of Swift Trade, that the touch price is not capable of being influenced by orders which are significantly away from the touch and which are short lived. The FSA considers that the depth of the order book is an important factor in the price formation process. When considering to buy or sell, market participants will take account of the state of the order book and thus the depth of orders on the book can influence the price formation process. The FSA considers that though many large orders were some way away from the touch price and also were very short lived, they would still have influenced the touch price as they would have given an impression of the demand for a particular stock. The FSA finds that part of the abusive trading strategy involved placing large orders that would give a misleading impression as to demand for a stock, without intending that these orders would actually be executed. Furthermore the FSA rejects the analysis put forward on behalf of Swift Trade and concludes that the evidence suggests that though there was a theoretical possibility that large orders would trade there was in fact no intention to execute the vast majority of these orders as demonstrated by the small numbers of large orders that did actually execute.
- 5.40. The FSA rejects the submission that the conclusions it reached concerning the relative volatility of stocks were unreliable. The FSA finds that when Swift Trade was involved in trading in a particular stock there was a very rapid up and down movement in the relevant prices. The FSA therefore finds that when Swift Trade was actively trading in a stock there was often marked volatility in that particular stock.
- 5.41. The FSA rejects the criticisms made of the statistical evidence which has formed part of the basis for the assessment of the market impact of Swift Trade's trading activity. The FSA considers that the statistical models which were used in this matter were appropriate and reliable and that the criticisms that have been made are not of any material significance. Furthermore the FSA notes that its assessment of the market impact of Swift Trade's trading activity was not wholly dependent upon the statistical analysis conducted in this case. However to the extent that the FSA's analysis did rely upon the statistical evidence, the FSA considers that it is reasonable to conclude that Swift Trade's activity had a statistically significant impact on the relevant prices of shares.
- 5.42. The FSA rejects the suggestion that Swift Trade's activity did not impact upon the market because other sophisticated users of the market would have been able to respond to Swift Trade's activities and they would have adjusted their models accordingly. The FSA finds that the abusive behaviour in this case was difficult to spot even for the most sophisticated of market users. In any event the FSA considers that such manipulation of the market, as has been identified in this case, can not be excused on the basis that others within the market would potentially have spotted the abusive behaviour and then would have responded accordingly.

- 5.43. It was also reasoned, on behalf of Swift Trade, that if any of its activities did have an effect on the touch price then this would have only been to the detriment of algorithmic traders and that there would not have been any negative impact on the wider market. To the extent that any algorithmic traders may have been affected it was suggested that this would have saved the money of more “traditional” and “fundamental” market participants. The FSA rejects this argument as being very flawed. The FSA considers that any market participant would suffer from a trading strategy such as layering which affected the price formation process and an assessment of the liquidity in a particular stock. Furthermore the FSA finds that any and all market participants would suffer from an activity that undermines their confidence in the integrity of the price formation process and in the market more generally. Additionally the FSA finds that it is not reasonable to dismiss the impact that this layering may have had on algorithmic or high frequency trading. Algorithmic and high frequency trading is a legitimate activity and therefore an abusive strategy which is designed to exploit these forms of trading is unacceptable.
- 5.44. The FSA also rejects the submission that the manipulative trading strategy was not necessarily designed to increase Swift Trade’s profits. The FSA finds that whilst each individual price movement and related trade may not have generated a significant profit the cumulative effect of this trading was to generate a significant and improper income for Swift Trade as a consequence of the overall effect on the market of the prolonged abusive trading activity in many different stocks. Moreover the FSA considers that there is clear evidence that Swift Trade anticipated generated significant profits from this trading. Various internal communications demonstrate that Swift Trade knew that this trading activity would generate considerable income and thus the firm was keen to disseminate and direct this strategy .
- 5.45. In the light of the foregoing the FSA finds that Swift Trade’s activity did have a significant impact upon the market. The FSA considers that this behaviour would undermine the market as it would impact upon confidence in various aspects of the market including the validity of the orders entered on the order book, the liquidity of the order book, the integrity of the price formation process and the fairness of the market. The FSA notes that the LSE considers that layering is a major concern.

*The connection between Swift Trade and the UK*

- 5.46. The FSA agrees that Swift Trade had limited connections to the UK. However the FSA considers that it is not only lawful but also appropriate to bring action against Swift Trade for market abuse committed on markets in the UK notwithstanding the fact that it was an Ontario domiciled entity.

*Financial penalty*

- 5.47. The FSA considers, in the absence of any representations from Swift Trade either as to the size of the proposed penalty or its ability to pay, that a penalty of £8,000,000, as was proposed in the Warning Notice, is proportionate to the seriousness of Swift Trade’s misconduct taking into account all of the matters set out below.

## **Conclusions**

- 5.48. The FSA concludes that Swift Trade's conduct during the Relevant Period constituted deliberate market abuse. Swift Trade effected transactions and/or orders to trade within the terms of section 118(5) of the Act in that:
- (1) as an intermediary, it was effecting transactions on behalf of its customers; and
  - (2) as it was directing and controlling the trading, it was effecting orders to trade.
- 5.49. Further the FSA concludes that the transactions and/or orders to trade were not effected for legitimate reasons and were not in conformity with accepted market practices. The transactions and/or orders to trade gave, and were likely to give, a false or misleading impression as to the supply of, demand for or the price of qualifying investments. The transactions and/or orders to trade secured, and were likely to secure, the price of one or more such investments at an artificial level. The FSA also concludes that Swift Trade's conduct was not limited to its role as intermediary (which would in itself be sufficient to render Swift Trade liable to a penalty for market abuse). Swift Trade was directing and controlling the trading, which it funded and from which it made substantial profits. Accordingly the FSA finds that Swift Trade intended to manipulate the market and thereby to make a profit, to the detriment of other market participants.
- 5.50. The FSA considers that Swift Trade and Peter Beck have consistently sought to evade regulatory scrutiny and to disguise the true extent of Swift Trade's direction and control of the trading.
- 5.51. An analysis of the sanction that the FSA has decided to impose upon Swift Trade is provided below.

## **6. SANCTION**

- 6.20. The FSA's general approach in deciding whether to take action and determining the appropriate level of financial penalties is set out in Chapter 6 of the Decision Procedure and Penalties Guide ("DEPP"), which is part of the Handbook of Rules and Guidance. The FSA has also had regard to the provisions of the Enforcement Manual ("ENF"), which were in force for the early part of the Relevant Period.
- 6.21. The principal purpose of imposing a financial penalty is to promote high standards of regulatory conduct by deterring firms and approved persons who have breached regulatory requirements from committing further contraventions, helping to deter other firms and approved persons from committing contraventions and demonstrating, generally, to firms and approved persons, the benefit of compliant behaviour (DEPP 6.1.2G).
- 6.22. In enforcing the market abuse regime, the FSA's priority is to protect prescribed markets from any damage to their fairness and efficiency caused by the manipulation of shares in relation to the market in question. Effective and appropriate use of the power to impose penalties for market abuse will help to maintain confidence in the UK financial system by demonstrating that high standards of market conduct are

enforced in the UK financial markets. The public enforcement of these standards also furthers public awareness and the FSA's consumer protection objective, as well as deterring potential future market abuse.

- 6.23. In determining whether a financial penalty is appropriate and proportionate, the FSA considers all the relevant circumstances of the case. DEPP 6.5.2G sets out a non-exhaustive list of factors that may be of relevance in determining the amount of a financial penalty. In deciding the appropriate penalty, the FSA considers the factors outlined below to be particularly relevant:

*Deterrence: DEPP 6.5.2G (1)*

- 6.24. In determining the appropriate level of penalty, the FSA has had regard to the need to promote high standards of regulatory conduct by deterring those who have committed breaches from committing further breaches and to help to deter others from committing similar breaches.

*The nature, seriousness and impact of the breach: DEPP 6.5.2G (2)*

- 6.25. The conduct was deliberate and was undertaken to achieve a profit. It was repeated on many occasions and in many different shares over a 12-month period. It involved a significant number of individual traders and locations. It continued despite the repeated expression of serious regulatory concern. Indeed there has been a consistent pattern of seeking to evade regulatory scrutiny. The manipulative trading disrupted and distorted the price formation process for a prolonged period in a variety of FTSE 100 and FTSE 250 stocks. The conduct put at risk the orderliness of, and confidence in, the markets.

*The extent to which the breach was deliberate or reckless: DEPP 6.5.2G (3)*

- 6.26. Swift Trade's actions were deliberate and were taken with a view to making a profit. It failed to take any effective steps to prevent the manipulative trading during the Relevant Period despite the concerns expressed and the only meaningful controls introduced were implemented by Swift Trade's DMA provider. These controls, restricted Swift Trade's business as they reduced the ability for the manipulative trading to be conducted. Consequently Swift Trade moved to a new DMA provider without seeking to replicate those controls and without informing the new DMA provider of the controls or of the regulatory concerns expressed. Instead, far from putting in place any controls to restrict the abusive trading, Swift Trade instructed traders to trade in a way designed to avoid detection by regulators.

*The size, financial resources and other circumstances of the person on whom the penalty is to be imposed: DEPP 6.5.2G (5)*

- 6.27. The FSA is aware that Swift Trade has been dissolved; however the FSA has also been informed that there is money available to meet obligations that Swift Trade had accrued. Therefore, and in the absence of any submissions on this point on behalf of Swift Trade, the FSA has no verifiable evidence that the proposed penalty will cause Swift Trade serious financial hardship and therefore the penalty will not be reduced for this reason.

*The amount of benefit gained or loss avoided: DEPP 6.5.2G (6)*

- 6.28. Swift Trade made substantial profits in excess of £1.75 million from the trading.

*Difficulty of detecting the breach: DEPP 6.5.2G (7)*

- 6.29. Swift Trade sought to evade regulatory scrutiny by switching DMA provider and by modifying its trading technique during the Relevant Period. It also sought to distance itself from the trading and to disguise the true extent of its direction and control of the trading despite the close links it had with its customers, including Customer A and Customer B which were subject to the direction and control of Swift Trade and/or Peter Beck.

*Conduct following the breach: DEPP 6.5.2G (8)*

- 6.30. The manipulative trading continued throughout the Relevant Period despite concerns being expressed to Swift Trade repeatedly from March 2007 onwards. Swift Trade engaged with the investigators and responded to information requests but did not accept any responsibility for the manipulative trading or for the direction or control of the trading of Customer B. More recently Peter Beck has taken steps to dissolve Swift Trade following the issue of the Warning Notice which is conduct that is consistent with the pattern of previous attempts to evade regulators.

*Action taken by other regulatory authorities: DEPP 6.5.2G (11)*

- 6.31. In October 2002, Peter Beck and an affiliate of Swift Trade, Swift Trade Securities USA Inc, were jointly censured and fined USD 75,000 by the National Association of Securities Dealers for engaging in a deceptive trading scheme involving fictitious and non-bona fide wash transactions in a NASDAQ 100 Index Trading Stock.
- 6.32. In August 2009 the OSC reprimanded Swift Trade and Peter Beck for failing to disclose the true nature of their relationship with Customer A. The investigation preceding this reprimand led to the transfer of contracts from Customer A to Customer B.
- 6.33. Having had regard to all of the factors outlined above the FSA has decided to impose a financial penalty of £8,000,000.

## **7. DECISION MAKER**

- 7.20. The decision which gave rise to the obligation to give this Decision Notice was made by the Regulatory Decisions Committee.

## **8. IMPORTANT**

- 8.20. This Decision Notice is given to Swift Trade under section 127 and in accordance with section 388 of the Act. The following statutory rights are important.

## **The Tribunal**

- 8.21. Swift Trade has the right to refer the matter to which this Decision Notice relates to the Upper Tribunal (the “Tribunal”). Under paragraph 2(2) of Schedule 3 of the Tribunal Procedure (Upper Tribunal) Rules 2008, Swift Trade has 28 days from the date on which this Decision Notice is given to it to refer the matter to the Tribunal. A reference to the Tribunal is made by way of a reference notice (Form FTC3) signed on its behalf and filed with a copy of this Notice. The Tribunal’s address is: The Upper Tribunal, Tax and Chancery Chamber, 45 Bedford Square, London WC1B 3DN (tel: 020 7612 9700; email [financeandtaxappeals@tribunals.gsi.gov.uk](mailto:financeandtaxappeals@tribunals.gsi.gov.uk)). Further details are contained in “Making a Reference to the UPPER TRIBUNAL (Tax and Chancery Chamber)” which is available from the Upper Tribunal website:

<http://www.tribunals.gov.uk/financeandtax/FormsGuidance.htm>

- 8.22. Swift Trade should note that a copy of the reference notice (Form FTC3) must also be sent to the FSA at the same time as filing a reference with the Tribunal. A copy of the reference notice should be sent to Matthew Nunan at the FSA, 25 The North Colonnade, Canary Wharf, London E14 5HS.

## **Access to evidence**

- 8.23. Section 394 of the Act applies to this Decision Notice. In accordance with section 394, Swift Trade is entitled to have access to:

- (1) the material upon which the FSA has relied in deciding to give Swift Trade this notice; and
- (2) any secondary material which, in the opinion of the FSA, might undermine that decision.

- 8.24. A schedule of the material upon which the FSA has relied in deciding to give Swift Trade this Decision Notice was sent to it with the Warning Notice. There is no secondary material to which Swift Trade must be allowed access.

## **Third party rights**

- 8.25. A copy of this notice is being given to Peter Beck as a third party identified in the reasons above and to whom in the opinion of the FSA the matter is prejudicial. Mr Beck has similar rights to Swift Trade in relation to referral to the Upper Tribunal and access to material.

## **Confidentiality and publicity**

- 8.26. Swift Trade should note that this Decision Notice may contain confidential information and should not be disclosed to a third party (except for the purpose of obtaining advice on its contents). The effect of Section 391 of the Act is that neither Swift Trade nor Peter Beck nor any other person to whom this notice is given or copied may publish the notice or any details concerning it unless the FSA has published the notice or those details. The FSA may publish such information about

the matter to which a Decision Notice or Final Notice relates as it considers appropriate. Swift Trade should also be aware that any Final Notice may contain reference to the facts and matters contained in this notice.

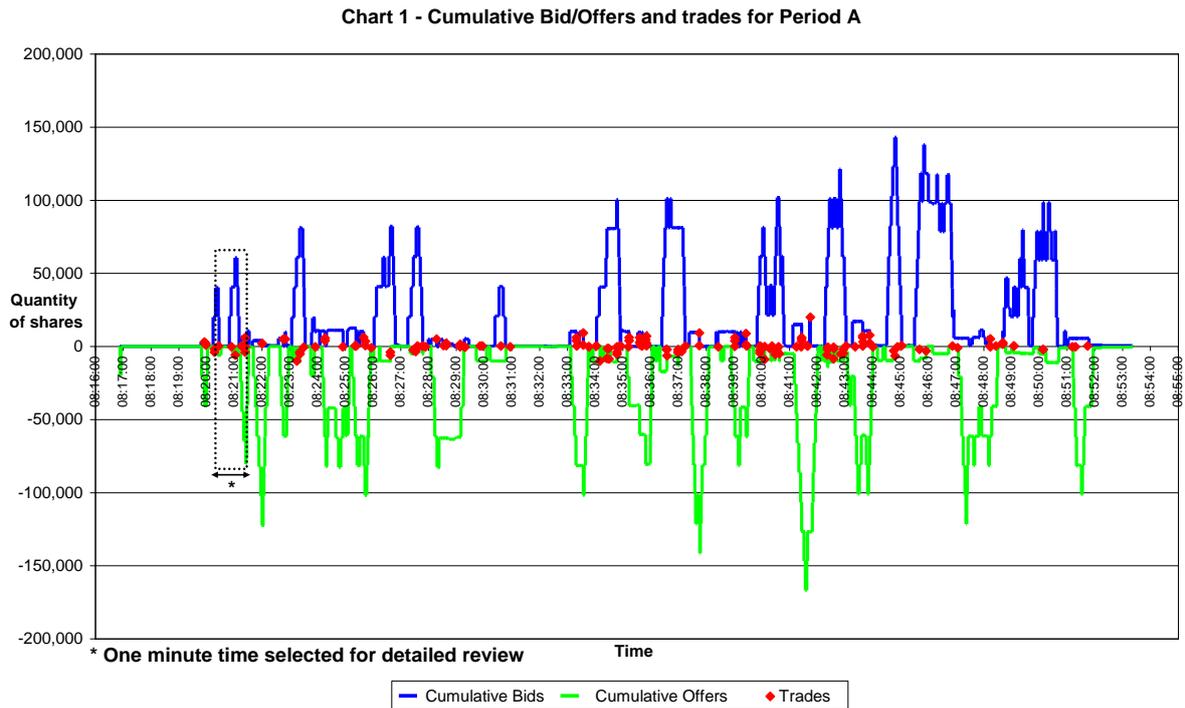
**FSA contacts**

- 8.27. For more information concerning this matter generally, Swift Trade should contact either Matthew Nunan (direct line 020 7066 2672) or Clare Hitchcock (direct line: 020 7066 1490) at the FSA.

**Martin Hagen**  
**Deputy Chairman, Regulatory Decisions Committee**

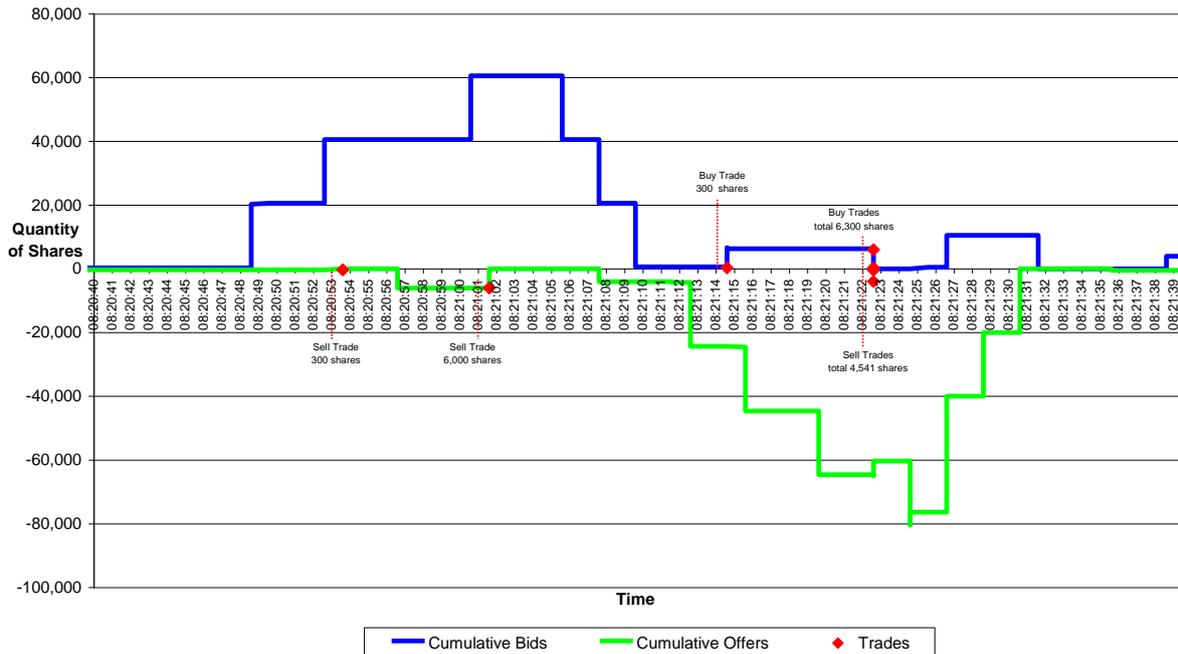
## Appendix 1

1. An example of the manipulative trading activity seen in Stock E on a date in January 2007 is set out below.
2. Chart 1 below shows Swift Trade's trading activity in Period A, the first of seven periods when it was active during the day. These periods showed greater price volatility than those when Swift Trade was not active. Cumulative bids are shown in blue, cumulative offers in green and executed trades in red. The scale on the Y axis (the vertical axis) shows the quantity of shares.



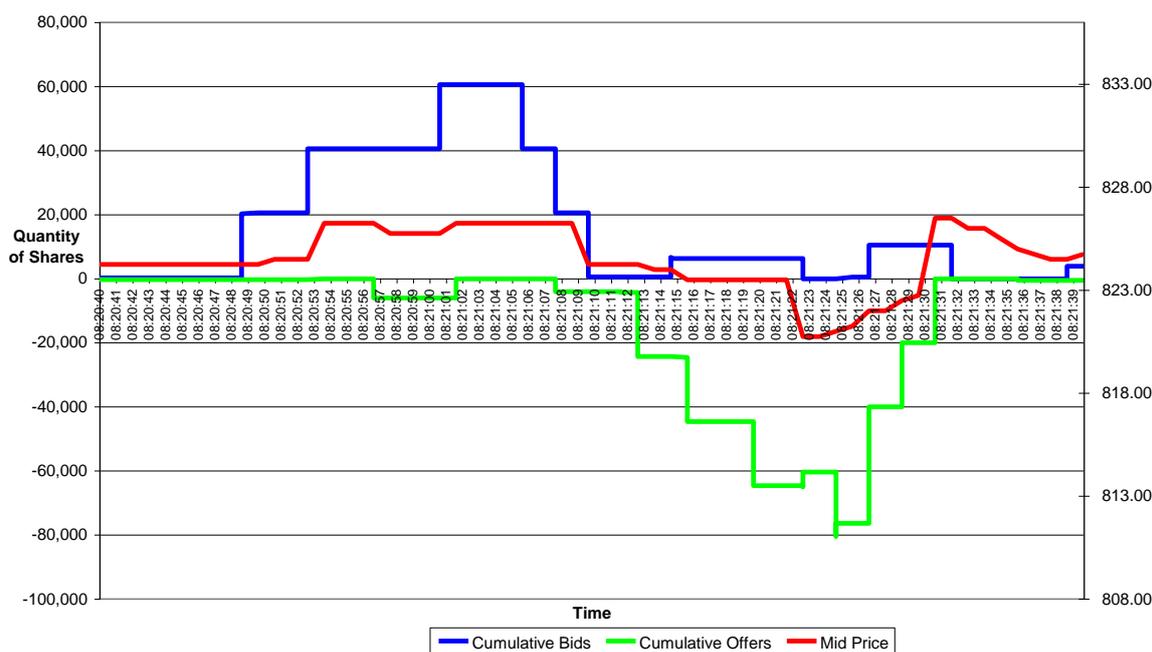
3. As seen in Chart 1, Swift Trade placed via its DMA provider a series of large orders on one side of the order book which were promptly cancelled and then re-entered on the other side of the order book. The catalyst for the cancellation of a series of large orders was a smaller trade executed on the other side of the order book, which suggests there was no intention to buy/sell the number of shares represented by Swift Trade's large orders.
4. A one minute time period shows a small fraction of the activity within Period A in greater detail. Chart 2 below shows Swift Trade's cumulative bids/buy orders (in blue), cumulative offers/sell orders (in green) and trades (in red) over a one minute period, from 08:20:40 to 08:21:40.
5. At the beginning of this one minute period, Swift Trade placed a series of three large bids at increasingly aggressive prices on the order book, totalling 60,000 shares with a consideration of approximately £500,000 (represented by the increasing blue line). At the same time Swift Trade placed an offer to sell 6,000 shares.

Chart 2 - Cumulative Bid/Offers with trades from 08:20:40 to 08:21:40



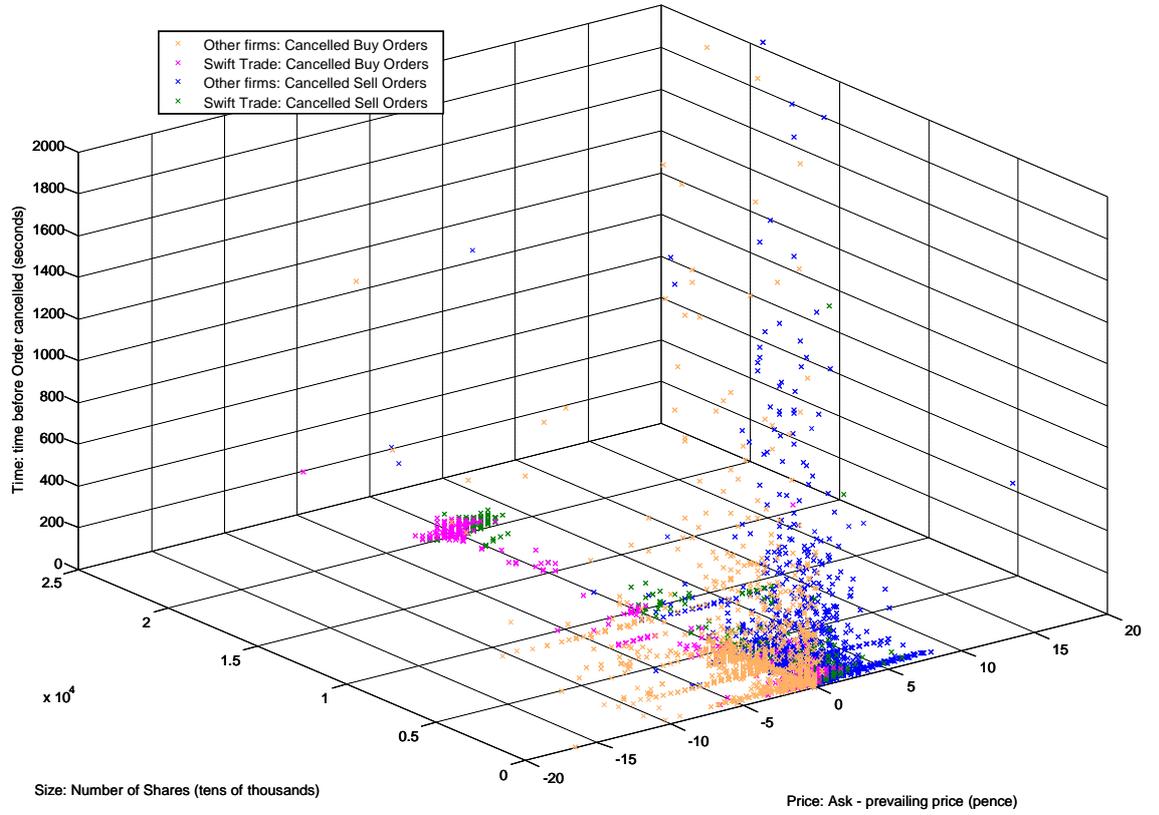
6. At 08:21:01, one second after the entry of the latest large bid, the offer for 6,000 shares traded at a price of 826p. Immediately after this, Swift Trade cancelled all of its large bids (the blue line returned to zero).
7. This pattern was then repeated on the other side of the order book. Swift Trade placed a series of four large offers at increasingly aggressive prices, totalling 80,000 shares. These are represented by the falling green line. At the same time Swift Trade placed an order to buy 6,000 shares (to cover the sale it made above). This order was executed at 08:21:23 at a price of 823p. This trading produced a gross profit of £180. Immediately after this, Swift Trade cancelled all the large offers (the green line returned to zero).
8. Chart 3 below shows Swift Trade's cumulative bids (in blue) and cumulative offers (in green) over the same one minute period together with the market mid-price i.e. the mid-point between the best bid and best offer prevailing in the market at the time (in red) on a separate scale (the 2<sup>nd</sup> axis on the right).

Chart 3 - Cumulative Bid/Offers & Best Buy/Sale Mid-Price from 08:20:40 to 08:21:40



9. The entry of the large orders by Swift Trade impacted the mid-price of the shares which oscillated between 826.25p and 821p. The initial entry of the large bids at 08:20:49 was followed by an increase in the mid-price a few seconds later. The large bids created the impression of high demand for the shares and prompted market participants to enter orders and/or trade in the same direction or to withdraw orders that were in the opposite direction.
10. The cancellation of the large bids from 08:21:06 onwards and the subsequent entry of the large offers from 08:21:13 onwards gave an impression of falling demand and increasing supply. This was followed by a fall in the mid-price a few seconds later.
11. The cancellation of the offers from 08:21:27 onwards suggested a reduction in supply and was followed by an upward reversal in the mid-price.
12. Swift Trade was able to benefit directly from the changes in price that followed the entry and deletion pattern of the large orders.
13. Swift Trade's trading in Stock E over the course of the day involved 19 different traders and 3 different office locations. Over the day, Swift Trade placed 491 orders for 20,000 shares in Stock E, only 3 of which were executed in whole or part. These large orders were deleted on average after 18 seconds.
14. Chart 4 below shows Swift Trade's activity in this stock compared to that of the market as a whole, and indicates that its combination of large orders of very short duration close to the touch price was highly unusual activity.

Chart 4: cancelled bids and offers



## Appendix 2

### Relevant Rules, Guidance and Other Regulatory Provisions

#### 1. Financial Services and Markets Act 2000

##### 1.1. Section 118 of the Act states as follows:

*(1) For the purposes of this Act, market abuse is behaviour (whether by one person alone or by two or more persons jointly or in concert) which--*

- (a) occurs in relation to--*
  - (i) qualifying investments admitted to trading on a prescribed market,*
  - (ii) qualifying investments in respect of which a request for admission to trading on such a market has been made, or*
  - (iii) in the case of subsection (2) or (3) behaviour, investments which are related investments in relation to such qualifying investments, and*
- (b) falls within any one or more of the types of behaviour set out in subsections (2) to (8)...*

##### 1.2. The relevant sub-section here is section 118(5):

*(5) The fourth is where the behaviour consists of effecting transactions or orders to trade (otherwise than for legitimate reasons and in conformity with accepted market practices on the relevant market) which--*

- (a) give, or are likely to give, a false or misleading impression as to the supply of, or demand for, or as to the price of, one or more qualifying investments, or*
- (b) secure the price of one or more such investments at an abnormal or artificial level.*

##### 1.3. Further relevant provisions are contained in section 118A of the Act (Supplementary provision about certain behaviour):

*(1) Behaviour is to be taken into account for the purposes of this Part only if it occurs--*

- (a) in the United Kingdom, or*
- (b) in relation to--*
  - (i) qualifying investments which are admitted to trading on a prescribed market situated in, or operating in, the United Kingdom,*
  - (ii) qualifying investments for which a request for admission to trading on such a prescribed market has been made, or*
  - (iii) in the case of section 118(2) and (3), investments which are related investments in relation to such qualifying investments.*

(2) *For the purposes of subsection (1), as it applies in relation to section 118(4) and (8), a prescribed market accessible electronically in the United Kingdom is to be treated as operating in the United Kingdom.*

...

(5) *Behaviour does not amount to market abuse for the purposes of this Act if--*  
(a) *it conforms with a rule which includes a provision to the effect that behaviour conforming with the rule does not amount to market abuse,*  
(b) *it conforms with the relevant provisions of Commission Regulation (EC) No 2273/2003 of 22 December 2003 implementing Directive 2003/6/EC of the European Parliament and of the Council as regards exemptions for buy-back programmes and stabilisation of financial instruments, or*  
(c) *it is done by a person acting on behalf of a public authority in pursuit of monetary policies or policies with respect to exchange rates or the management of public debt or foreign exchange reserves.*

1.4. Section 130A of the Act (Interpretation and supplementary provision) states as follows:

(3) *In this Part--*  
*"accepted market practices" means practices that are reasonably expected in the financial market or markets in question and are accepted by the [FSA] or, in the case of a market situated in another EEA State, the competent authority of that EEA State within the meaning of Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse),*  
*"behaviour" includes action or inaction,*  
*"dealing", in relation to an investment, means acquiring or disposing of the investment whether as principal or agent or directly or indirectly, and includes agreeing to acquire or dispose of the investment, and entering into and bringing to an end a contract creating it...*  
(4) *Any reference in this Act to a person engaged in market abuse is to a person engaged in market abuse either alone or with one or more other persons.*

1.5. The FSA has the power to impose penalties for market abuse pursuant to section 123 of the Act:

(1) *If the [FSA] is satisfied that a person ("A")-*  
(a) *is or has engaged in market abuse, or*  
(b) *by taking or refraining from taking any action has required or encouraged another person or persons to engage in behaviour which, if engaged in by A, would amount to market abuse, it may impose on him a penalty of such amount as it considers appropriate.*  
(2) *But the [FSA] may not impose a penalty on a person if, having considered any representations made to it in response to a warning notice, there are reasonable grounds for it to be satisfied that-*  
(a) *he believed, on reasonable grounds, that his behaviour did not fall within paragraph (a) or (b) of subsection (1), or*

- (b) he took all reasonable precautions and exercised all due diligence to avoid behaving in a way which fell within paragraph (a) or (b) of that subsection.*
- (3) If the [FSA] is entitled to impose a penalty on a person under this section it may, instead of imposing a penalty on him, publish a statement to the effect that he has engaged in market abuse.*

## 2. The Code of Market Conduct

2.1. The FSA has published The Code of Market Conduct (“the Code”), also referred to as MAR, pursuant to section 119 of the Act.

2.2. Section 122 of the Act sets out the effect of the Code:

- (1) If a person behaves in a way which is described (in the code in force under section 119 at the time of the behaviour) as behaviour that, in the [FSA’s] opinion, does not amount to market abuse that behaviour of his is to be taken, for the purposes of this Act, as not amounting to market abuse.*
- (2) Otherwise, the code in force under section 119 at the time when particular behaviour occurs may be relied on so far as it indicates whether or not that behaviour should be taken to amount to market abuse.*

2.3. The Code does not exhaustively describe all types of behaviour that may or may not amount to market abuse (MAR 1.1.6). The Code contains relevant examples of behaviour involving false or misleading impressions at MAR 1.6.2(3) and 1.6.2(4):

*MAR 1.6.2: The following behaviours are, in the opinion of the FSA, market abuse (manipulating transactions) of a type involving false or misleading impressions:*

- (3) painting the tape - that is, entering into a series of transactions that are shown on a public display for the purpose of giving the impression of activity or price movement in a qualifying investment; and*
- (4) entering orders into an electronic trading system, at prices which are higher than the previous bid or lower than the previous offer, and withdrawing them before they are executed, in order to give a misleading impression that there is demand for or supply of the qualifying investment at that price.*

2.4. Paragraphs 1.6.5 to 1.6.8 of the Code provide guidance on factors to be taken into account when considering whether behaviour is for “legitimate reasons”.

2.5. Paragraphs 1.6.9 of the Code provide guidance on factors to be taken into account when considering whether there is behaviour giving a false or misleading impression contrary to section 118(5).

2.6. Annex 2 to the Code (MAR 1 Annex 2) sets out accepted market practices (AMPs) which may provide a defence for market abuse (manipulating transactions). There are currently no relevant AMPs.

### 3. The Market Abuse Directive

- 3.1. The Market Abuse Directive (2003/6/EC) (the Directive) came into effect on 12 October 2004. Article 2 of the Directive defines “market manipulation”. Article 4 of implementing Directive 2003/124/EC sets out a number of non-exhaustive signals of false or misleading transactions which could, but do not necessarily, constitute market manipulation.
- 3.2. Paragraph 4.11 of the CESR Level 3 guidance on the Directive gives examples of types of practice which, in the view of CESR members, would contravene the prohibition on market manipulation contained in the Directive. The examples given for false/misleading transactions include the following:
- b) *Painting the tape. This practice involves engaging in a transaction or series of transactions which are shown on a public display facility to give the impression of activity or price movement in a financial instrument;*
  - d) *Placing orders with no intention of executing them. This involves the entering of orders, especially into electronic trading systems, which are higher/lower than the previous bid/offer. The intention is not to execute the order but to give a misleading impression that there is demand for or supply of the financial instrument at that price. The orders are then withdrawn from the market before they are executed.*

### 4. DEPP and EG

- 4.1. The Enforcement Guide (EG) and the Decision Procedures and Penalties manual (DEPP) published by the FSA set out the FSA’s policy with respect to the imposition and amount of penalties under the Act. Similar provisions were contained in Decision Making (DEC) and Enforcement (ENF) which were in force for part of the Period, until 27 August 2007.
- 4.2. Chapter 7 of the Enforcement Guide (EG) states that financial penalties and public censures are important regulatory tools. The effective and proportionate use of the FSA’s powers to enforce the requirements of the Act plays an important role in the FSA’s pursuit of its regulatory objectives. Imposing financial penalties and public censures shows that the FSA is upholding regulatory standards and helps to maintain market confidence, promote public awareness of regulatory standards and deter financial crime.
- 4.3. Chapter 6 of DEPP states that the principal purpose of imposing a financial penalty or issuing a public censure is to promote high standards of regulatory and market conduct by deterring persons who have committed breaches from committing further breaches, helping to deter other persons from committing similar breaches and demonstrating generally the benefits of compliant behaviour.
- 4.4. The FSA will consider the full circumstances of each case when determining whether or not to take action. A non-exhaustive list of factors which may be relevant for this purpose is set out at DEPP 6.2.1. Additional factors which the FSA may consider when deciding whether to take action for market abuse are set out at DEPP 6.2.2.

- 4.5. DEPP 6.3.2 sets out factors which the FSA may take into account when considering whether either of the two conditions in section 123 of the Act are met such that the FSA may not impose a penalty on a person for market abuse. These factors include the following: (1) whether the behaviour was analogous to behaviour described in the Code; (2) FSA guidance; (3) whether the behaviour complied with the rules of any relevant prescribed market; (4) the level of knowledge, skill and experience to be expected of the person concerned; and (5) whether the person can demonstrate that the behaviour was engaged in for a legitimate purpose and in a proper way.
- 4.6. DEPP 6.5 sets out factors that may be taken into account when deciding the appropriate level of financial penalty. These factors include the following:
- (1) deterrence;
  - (2) the nature, seriousness and impact of the breach, including the duration and frequency of the breach and whether it had an adverse effect on markets;
  - (3) the extent to which the breach was deliberate or reckless;
  - (5) the size, financial resources and other circumstances of the person on whom the penalty is to be imposed;
  - (6) the amount of benefit gained or loss avoided;
  - (7) the difficulty of detecting the breach;
  - (8) conduct following the breach and
  - (11) action taken by other regulatory authorities.

## 5. FSA statutory objectives

- 5.1. The FSA's statutory objectives include market confidence: maintaining confidence in the financial system. The FSA is required to have regard to the principles of good regulation in pursuing its functions, including the international character of financial services and markets and the desirability of maintaining the competitive position of the UK.

## 6. London Stock Exchange Rules

- 6.1. From 1 January 2007 to 21 October 2007, the key relevant LSE rule (and associated guidance) was Rule 3300 on "Misleading acts, conduct and prohibited practices". Its equivalent for the period from 22 October 2007 is Rule 1400. The guidance to Rule 1400 was amended following the publication of Stock Exchange Notice N78/07 on 3 December 2007. Throughout the Relevant Period the LSE rules required that all orders placed on the order book must be firm.
- 6.2. These rules are only directly applicable to LSE member firms and therefore do not apply directly to Swift Trade. However, they set out clearly the types of conduct prohibited by the LSE and are therefore of direct relevance to Swift Trade's behaviour. Furthermore, DEPP 6.3.2 includes as a factor the FSA may take into account in considering whether there are reasonable grounds under section 123(2) of the Act for not imposing a penalty for market abuse whether and if so to what extent the behaviour complied with the rules of any relevant market.