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More on “Who’s Spoofing Whom?”

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December 30, 2015

farmdoc daily (5):237

Recommended citation format: Peterson, P. "More on “Who’s Spoofing Whom?”" *farmdoc daily* (5):237, Department of Agricultural and Consumer Economics, University of Illinois at Urbana-Champaign, December 30, 2015.

Permalink: <http://farmdocdaily.illinois.edu/2015/12/more-on-whos-spoofing-whom.html>

A *farmdoc daily* [article](#) last week reviewed the recent conviction of Michael Coscia on six counts of spoofing and six counts of commodity fraud. Spoofing is a disruptive futures market trading practice defined as “bidding or offering with the intent to cancel the bid or offer before execution.” Coscia was the first trial of a criminal case involving spoofing, and it breaks new legal ground for certain types of trading behavior. Two earlier *farmdoc daily* articles ([May 6, 2015](#) and [May 13, 2015](#)) provided a detailed example of spoofing and examined the charges filed against Navinder Singh Sarao, a London-based trader, for actions that allegedly triggered the “flash crash” of the stock market in 2010.

Similar Methods, Similar Outcomes

Sarao is currently fighting extradition to the U.S. and therefore no trial date has been set. Both Sarao and Coscia relied on computer programs to submit and then quickly cancel orders to buy and sell, apparently in an effort to “trap” other traders. Because the methods they employed are virtually identical, Coscia’s conviction by a jury after just one hour of deliberation suggests a similar fate awaits Sarao. Further strengthening the case against Sarao are emails outlining his plans, providing critical evidence of his intent.

To this point the story is fairly straightforward: traders who use computer programs to submit or cancel multiple bids or offers in an effort to overload the price quotation system, to delay the execution of another person’s trades, to create the appearance of false market depth, or to create artificial price movements, risk prosecution for spoofing. Furthermore, because Coscia’s case showed that the design of the computer program can be used to prove a trader’s intent, those traders are likely to be convicted.

What if a trader doesn’t use a computer program to make trading decisions, but instead enters orders via point-and-click? This article describes a [third spoofing case](#) filed in late October against Igor Oystacher and his company, 3Red Trading.

Using “Avoid Orders That Cross”

Instead of using a computer program to identify trading opportunities, Oystacher made his own trading decisions and entered them manually. However, according to the CFTC complaint, he used “...a

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commercially available trading platform, which included a function called ‘avoid orders that cross.’ The purpose of this function is to prevent a trader’s own orders from matching with one another.” (p. 14).

This “avoid orders that cross” feature is important because you cannot trade (i.e., “cross orders”) with yourself. Rather than block a new order that conflicts with an existing order, the trading platform would cancel the existing order and immediately place the new order. Notice that this was off-the-shelf software available to anyone, not something designed by Oystacher for his own personal use.

Another important difference between Oystacher and the others is that Oystacher would place orders at the “best” (i.e., closest to being filled) bid or offer, not several ticks away as was done by Sarao and Coscia. Although there were other traders’ bids or offers at the “best” price in front of his, Oystacher’s orders were next in line to be filled at that price. This is unlike the orders placed by Sarao and Coscia, which required a price change before they would be executed. If Oystacher’s orders did not quickly result in a trade, he would reverse or “flip” his orders from the best bid to the best offer (or vice versa), using the “avoid orders that cross” feature.

Spoofing vs. Flipping

Yet another difference is in Oystacher’s orders and their timing. Readers will recall from the examples in the two *farmdoc daily* articles from May, and the *farmdoc daily* article from last week, that spoofing normally involves simultaneous orders on both sides of the market: a larger order on one side of the market that is designed to put pressure on prices and drive traders into a smaller order or “trap” on the opposite side of the market. Once other traders are in the trap, the spoofer then cancels the larger order; this relieves the pressure and allows prices to recover so the spoofer can take profits. The larger order might be held for a longer (Sarao) or shorter (Coscia) amount of time, but the timing of the larger and smaller orders overlaps.

In contrast, Oystacher had orders on only one side of the market at a time. When he would “flip” his order, all of the original buy (or sell) orders would be eliminated and new sell (or buy) orders would be created. In the two examples presented in the complaint, the new orders involved fewer contracts than the original orders that were eliminated, but the original and new orders never overlapped.

Market Impact

In addition, spoofing normally requires prices to change, which is how the spoofer makes a profit. Placing and cancelling the large “spoofer” order on one side of the market can cause price distortions, which is one of the reasons spoofing is illegal.

Oystacher used a different approach. The complaint against Oystacher makes no mention of profits, unlike the cases against Sarao and Coscia. Instead, it focuses on the impact of Oystacher’s large initial orders, which it says would “create the false impression of market depth and book pressure in a desired direction” (p. 15) and “deceptively encouraged other market participants (and their algos [i.e., algorithmic trading programs] programmed react to changes in book pressure) to enter orders on the same side of the market as the spoof orders.” (pp. 16-17).

According to the complaint, Oystacher never wanted these orders to be filled but “rather intended to cancel these orders at the time they were placed.” (p. 29). Furthermore, when Oystacher would “flip” his orders and move from one side of the market to the other, it happened very quickly, “before other market participants could assess and react to the disappearance of the false market depth and book pressure the spoof orders had created.” (p. 18). In other words, Oystacher’s actions out-smarted other traders’ computerized trading systems.

Still More on Spoofing

These differences between Oystacher and the other spoofing cases – using manual vs. automated order entry, using existing trading platform functionality vs. custom software to cancel and replace orders, placing orders “at the market” vs. “off the market,” using orders on only one side of the market at a time vs. both sides of the market simultaneously, and using methods that confused automated trading systems vs. moved the market price – all raise important questions. In our next installment we will further examine these differences and the economic vs. legal issues surrounding spoofing.

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