Circular

29 June 2021

Circular to intermediaries – Notification to the SFC of suspected ramp and dump scams involving market manipulation in the shares of companies listed on the Stock Exchange of Hong Kong

Background

The Securities and Futures Commission (**SFC**) notes with concern a recent increase in apparent market manipulative activities, in particular the rising number of suspected ramp and dump scams[1], often conducted using popular social media platforms. These activities seriously undermine market integrity and prejudice the interest of investors.

Curbing ramp and dump scams is a top enforcement priority and the SFC has taken enforcement action to tackle them. The SFC has also proactively warned the public about the increasing use of social media platforms to defraud investors[2].

Ramp and dump cases now account for a significant percentage of the SFC's market manipulation investigations, which have found that members of sophisticated and highly coordinated syndicates may be involved. Where possible, the SFC will take action to freeze the securities accounts suspected of being part of these scams. During the past year, we froze over $900 million involving more than 109 accounts.

The SFC's ability to take prompt action depends on the cooperation of intermediaries. We expect to receive full cooperation from intermediaries and their staff once they are approached by the SFC for information or documents related to a suspected ramp and dump scam.

These scams may be associated with red flags which should arouse the reasonable suspicion of intermediaries or their staff about potential market misconduct committed by their clients which, after careful assessment, may result in the prompt submission of a report to the SFC.

[1] A form of stock market manipulation. Fraudsters "ramp" up the price of a small counter and lure unwary investors to buy at an artificially high price. Fraudsters then sell or "dump" the stock to take profits causing the price to collapse. Most of the time, investors do not know the true identities of the people who urge them to buy the stock or the reliability of the information provided to them.

[2] In September 2020, the SFC launched a campaign to warn the public about the increasing use of social media platforms to defraud investors and called for the public to remain aware of online investment scams to avoid becoming a victim. See a special edition of Enforcement Reporter and the SFC's 24 September 2020 press release.

Purpose of this circular

This circular serves to –

- encourage intermediaries to provide information or documents which may facilitate the SFC's immediate assessment of the impact of potential market misconduct, in particular where a ramp and dump scam is suspected;
- remind intermediaries of their existing obligations under paragraph 12.5(f) of the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (**Code of Conduct**) to report market misconduct suspected to have been committed by their clients to the SFC in a timely manner; and
- provide intermediaries with guidance on red flags which may arouse the reasonable suspicion of intermediaries or their staff about suspected ramp and dump scams and warrant an assessment of whether the associated trading activities should be reported to the SFC under paragraph 12.5(f) of the Code of Conduct.

Response to regulator's preliminary inquiries

In its special edition of Enforcement Reporter in September 2020, the SFC explained that in a typical ramp and dump scam fraudsters dump most or all of their shares resulting in a collapse of the share price. The offloading can take place very quickly, causing the share price to plunge dramatically and victims to suffer significant financial losses.

On a daily basis, our surveillance team monitors trading on the Stock Exchange of Hong Kong Limited and Hong Kong Futures Exchange Limited and conducts preliminary inquiries into possible market manipulation or insider dealing. In the year ended 31 March 2021, our surveillance of untoward price and turnover movements resulted in 8,748 requests for trading and account records from intermediaries.

To ensure a prompt regulatory response to a sudden untoward price or turnover movement in our market, it is not unusual for the SFC to raise preliminary inquiries with intermediaries by phone or email (**Preliminary Inquiries**), followed by later notices issued under section 181 of the Securities and Futures Ordinance (Cap 571) (**SFO**) to request that more complete information be provided. The information collected from intermediaries assists the SFC in its assessment of whether a formal investigation is warranted.

The SFC encourages intermediaries to respond to the Preliminary Inquiries and provide assistance as quickly as possible. This may include sending high-level basic trading information by return to allow it to be assessed quickly.

Standards of conduct expected of intermediaries

Under paragraph 12.5(f) of the Code of Conduct, intermediaries are required to report to the SFC immediately upon the occurrence of any material breach, infringement or non-compliance of market misconduct provisions set out in Part XIII or Part XIV of the SFO which they reasonably suspect may have been committed by their clients, and to provide the relevant information and documents.

In the year ended 31 March 2021, the SFC received and assessed 288 notifications from intermediaries regarding suspicious equity and derivative trading.

The SFC wishes to remind intermediaries again of their reporting obligation upon becoming aware of any suspicious market misconduct, including ramp and dump scams, conducted by a client or a group of clients. The SFC expects that intermediaries should err on the side of caution and report suspicious activities to the SFC immediately.

In particular, the SFC wishes to clarify that the threshold for making notifications under paragraph 12.5(f) of the Code of Conduct is low. Intermediaries are not required to:

- identify which particular provisions in Part XIII or Part XIV of the SFO clients were suspected to have breached;
- work out exactly how these breaches were committed; or
- ascertain if profits were made or losses were avoided as a result of the suspected breach or the amount of such profits or losses.

Prompt reporting by intermediaries is crucial to enable the SFC to swiftly assess the impact of the suspicious misconduct and take necessary action to contain the damage (e.g., preventing the proceeds of potential crime from being siphoned away).

Guidance on identification and reporting of potential ramp and dump activities

To help fulfil their obligations under paragraph 12.5(f) of the Code of Conduct regarding suspected ramp and dump scams, we strongly encourage intermediaries and their staff to pay attention to red flags which may arouse the reasonable suspicion of these scams.

The following is a non-exhaustive illustrative list of red flags which, individually or collectively, may indicate a potential ramp and dump scam. Some red flags suggest that a ramp and dump scam may be in the planning phase, whilst others will only become clear when the price has collapsed. We expect intermediaries and their staff to assess whether the associated trading activities should be reported to the regulator whenever any of these red flags are identified.

- clients whose transaction amounts are generally incommensurate with their reported profiles. For example, a client, who is unemployed with no significant previous trading experience and has limited reported assets, conducts a large volume of trading in a stock in a short period of time;

- clients who regularly acquire shares through bought and sold notes or on a free-of-payment basis or who receive large third-party deposits in their accounts;

- clients who bought shares on a delayed settlement basis, following which the share price rose substantially during the delayed settlement period, and then gave instructions before the payment date to sell these shares;

- clients who bought shares in a particular stock towards the end of the trading day in a way that had the effect of substantially raising the closing price on a number of days, particularly when the company is a thinly-traded, small-cap stock with a highly concentrated shareholding and it has experienced a sustained price increase which cannot be explained by any corporate or sector-specific news;

- clients who sold a large volume of shares in a particular company shortly before a collapse of the share price which cannot be explained by any corporate or sector-specific news. It would be particularly suspicious if clients seek to receive the funds immediately following the selling instruction and before the completion of the normal T+2 settlement period;

- a group of clients, some of whom are identified from the trading behaviour set out above, traded in the same stock in the same direction, at more or less the same price or at the same time, and exhibit any of the following characteristics:

    - they have authorised the same third party to operate their accounts;

    - they have effected fund transfers amongst themselves;

    - they opened accounts on or around the same day, were served by the same account executive or referred to the intermediary by the same person at account opening; or

    - they share the same personal particulars such as telephone numbers or email addresses.

If any of the above red flags have been identified, staff should bring it to the attention of their firm's senior management which should then assess whether there is a reporting obligation under paragraph 12.5(f) of the Code of Conduct.

Cautionary statement

The SFC wishes to reiterate that it does not tolerate any form of market misconduct.

To protect investors and maintain the integrity of markets, combating ramp and dump scams and other types of market misconduct is a high priority for the SFC. All material issues and deficiencies identified on the part of intermediaries as well as their senior management in this regard will be investigated.

Should you have any queries on the contents of this circular, please contact Mr Jerry Tai at 2231 1566 or your case officer in charge.

Enforcement Division
Securities and Futures Commission

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