

INVESTIGATING CRIMES IN THE CAPITAL MARKETS

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Introduction: What are some of the Scams You have seen?

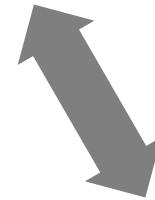
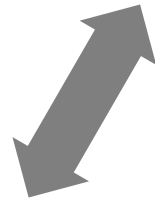


Fraud Detection – External Auditors



The Fraud
Triangle

Pressure



Rationalization



Opportunity

Every Security Market Has Fraud and Abuse



Every securities market has varying degrees of financial disclosure and

- ❖ Accounting fraud
- ❖ Insider trading and Market manipulation,
- ❖ Customer abuses by broker-dealers and investment advisors, and
- ❖ pyramid schemes

Result: Numerous Investment markets stagnated

What are Investment Portfolios



- Shares/Equities IPO
- Treasury Bonds/Bills
- Unit Trusts/Unit Linked Insurance Products
- Companies Treasury Departments
- Investment groups (Chamas), Merry Go Round
- Real Estate Portfolios
- Pension Funds/Annuities
- Others: Mergers & Acquisitions, Cytocurrency, Bank Deposits



TYPES OF MANIPULATIVE CONDUCT



Types of manipulative conduct may be categorized according to the methods used, the objectives of the underlying activity, and the parties involved.

A. METHODS

A number of the methods used include:

- ✓ **(Painting the tape)** Series of transactions displayed publicly giving an impression of activity or price movement. Also linked to **Wash sales**.
- ✓ **(Improper matched orders)** Both buy and sell orders are entered at the same time, with the same price and quantity by different but colluding parties

TYPES OF MANIPULATIVE CONDUCT



A. METHODS

- ✓ **(Advancing the bid)** Increasing the bid for a security to increase its price. Buying activity at increasingly higher prices. Securities are sold in the market (often to retail customers) at the higher prices (pumping and dumping)
- ✓ **(Marking the close)** Buying or selling securities at the close of the market in an effort to alter the closing price of the security or derivatives contract

TYPES OF MANIPULATIVE CONDUCT



A. METHODS

- ✓ (Squeeze) artificial prices - Taking advantage of a shortage in an asset by controlling the demand-side and exploiting market congestion.
- ✓ Dissemination of false or misleading market information through media, including the Internet, or by any other means. Aim: To move the price of a security, in a favorable direction to the position held or for a planned transaction.

TYPES OF MANIPULATIVE CONDUCT



B. OBJECTIVES

The objective of manipulative conduct will normally be to make money either directly through transactions, or by other means. E.g:

- ❖ Influencing the price or value of a security, so that the manipulator can :
 - buy at a lower price,
 - sell at a higher price,
 - influence takeover bids, or other large transactions, or
 - combat competitive transactions ;

TYPES OF MANIPULATIVE CONDUCT



B. OBJECTIVES

- ❖ Influencing the price of a derivative contract or the underlying asset ;
- ❖ Influencing the price of a security underlying an index ;
- ❖ Influencing the subscription price in public or non-public offerings ;
- ❖ Influencing the price/conversion ratio in connection with merger of companies
- ❖ Influencing the price of a security in connection with take-over offers

TYPES OF MANIPULATIVE CONDUCT



B. OBJECTIVES

- ❖ Influencing someone to subscribe for, purchase, or sell assets or rights to
- ❖ assets, or to abstain from doing so ;
- ❖ Influencing the accounts/balance sheet of institutional investors ;
- ❖ Influencing the limit for triggering forced sale by creditors ; and
- ❖ Influencing the impression of financial advice or placements.

Types Of Manipulative Conduct



C. PARTIES INVOLVED

Those in a position to effect a manipulation include:

- ✓ Issuers of securities ;
- ✓ Participants in the securities market, derivatives market or underlying cash market ;
- ✓ Market intermediaries ; and
- ✓ Any combination of the above acting in cooperation with one another

TOOLS FOR DETECTING MARKET MANIPULATION



a) Market Surveillance

- ☐ Filing of ownership and control of companies
- ☐ Surveillance systems

b) Internet and Other Media Surveillance

‘Lemon’s Problem’



- ❑ Investors don’t know which companies are truthful and which aren’t, so they discount the prices they will offer for the shares of all companies.
- ❑ Discounted share prices mean that an honest issuer can’t receive fair value for its shares, and has an incentive to use other forms of financing.
- ❑ Information Asymmetries.

Fraud Detection - Tips



- Tips are by far the most common method of initial fraud detection
- Tips should be independently investigated – internal auditor, IG, legal dept. or outside legal counsel

40%

- Number of fraud cases detected through tips

Types of Cases in 2017 in USA



- Issuer Reporting/Audit & Accounting-21%
- Securities Offering - 21%
- Investment Adviser/Company Violations - 18%
- Broker-Dealer - 12%
- Insider Trading - 9%
- Market Manipulation - 9%
- Public Finance Abuse - 4%
- Foreign Corrupt Practices Act - 3%
- Transfer Agent - 1%
- Miscellaneous - 2%

HOW TO INVESTIGATE



- ❖ Obtain all relevant records from the broker-dealer and individuals
 - Order tickets, confirmations, account statements, internal records, valuations, etc.
 - Organization charts, office location charts, personnel records, customer complaints, completed compliance forms, compliance and supervisory policies and procedures

How To Investigate



- ❖ Interview and/or take testimony:
 - Is the witness credible (customer/broker/supervisor)?
 - Is there a pattern with this person or entity?
- ❖ Review emails, text messages, and other communications

Fraudulent Statements or Omissions (1/2)



- I. Salespeople may know little or nothing about the company and the stock they are selling
 - ❖ Salespeople are often repeating a limited amount of information they have been given by the heads of the firm
 - ❖ Often working from a set sales pitch or script for the particular stock provided by the firm
 - ❖ Sales pitch may have little to do with realities of the company being pitched

Fraudulent Statements or Omissions (2/2)



II. Some examples of specific misstatements include:

- ❖ Lies about issuer's line of business, business transactions, products or financial condition
- ❖ Statements about the investment being safe, guaranteed, or risk-free
- ❖ False account statements or valuations

Unauthorized Transactions



- ✓ Broker commits fraud by executing trade in a customer account without the customer's authority
- ✓ Clear form of violation often seen in boiler room type situations
- ✓ Customer has or opens an account with the broker, or
- ✓ Broker obtains enough information from customer to enable him to open an account – Name, address, tax ID #
- ✓ Broker puts through trade for customer without customer consent and without customer knowledge

Unsuitable Transactions



- ❖ **Customer Specific Suitability:** – A broker can violate the antifraud provisions by recommending securities or a level of trading activity that is unsuitable for a customer in light of that specific customer's investment profile.
- ❖ **Reasonable Basis Suitability:** – A broker may violate the antifraud provisions if he or she recommends a security transaction or strategy without an adequate and reasonable basis.

Elements of Excessive Mark up Violation



A dealer commits fraud when it charges retail customers prices that are not reasonably related to the prevailing market price

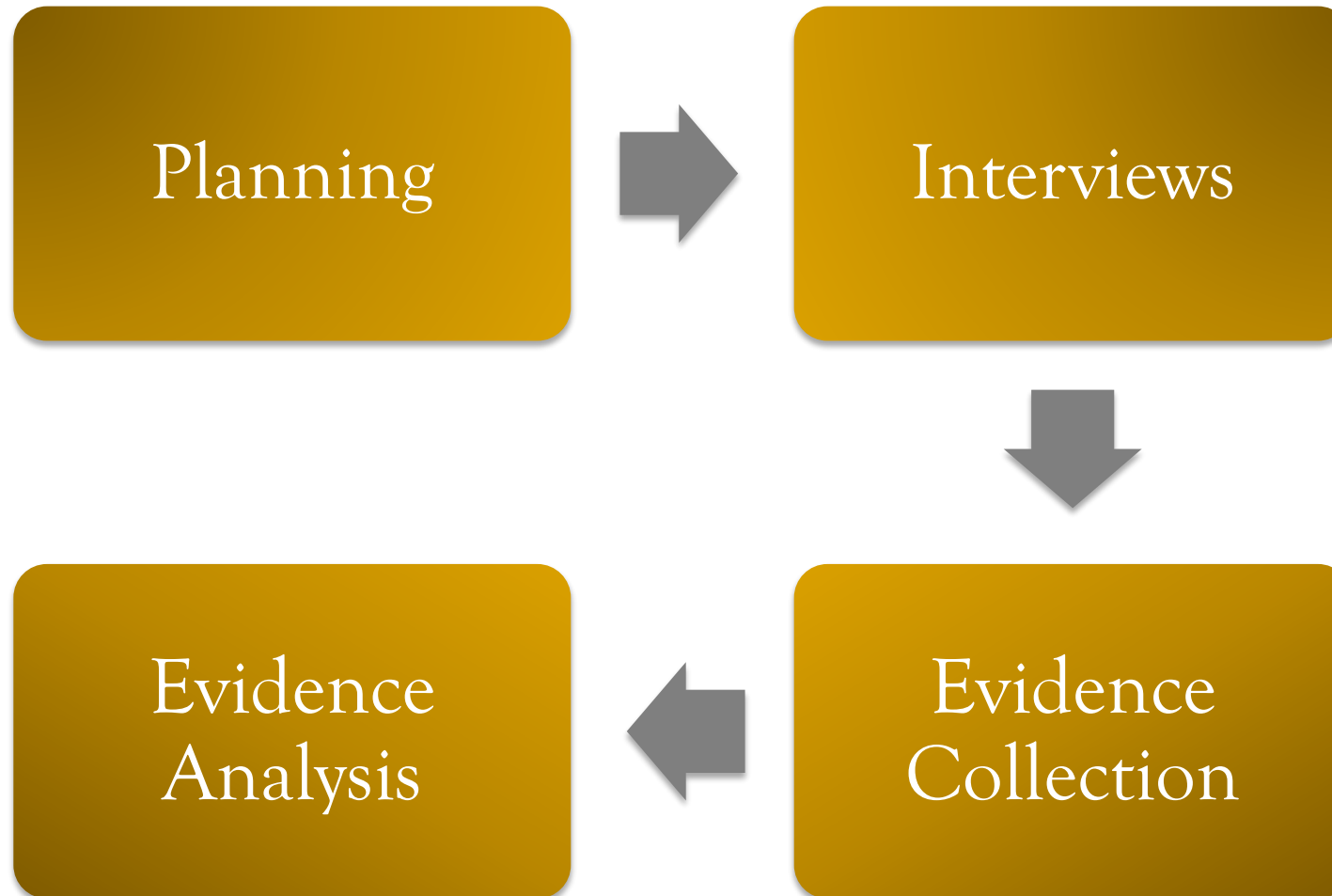
- Mark-ups of more than 10% over the prevailing market price have consistently been held to be excessive and, therefore, fraudulent – 5% or lower may be excessive depending in type of security
- Example: security costs firm \$10, firm charges customer \$13 = 30% mark up

Excessive Trading (“Churning”)



- Churning is a fraudulent practice in which a broker who exercises control over a customer's account engages in excessive trading in disregard of that customer's investment objectives for the purpose of generating commissions.
- Instead, the broker is trading for the purpose of generating commission's and lining his own pockets

Stages in Fraud Investigation



Follow the Money (1/2)...



Money flows should eventually lead to wrongdoers



May help uncover broader scheme



Legal owner not always the beneficial owner (e.g. Corporation, trusts)



Records of fund transfers across borders

Follow the Money (1/2)...



Prevent the dissipation of assets



Ensure that “crime does not pay”



Leverage for settlement or other resolution



Recompense injured investors

QUESTIONS??

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