Securities Regulation Daily Wrap Up, COMMODITY FUTURES—CFTC, FCA fine high-frequency trader Michael Coscia for spoofing in commodity futures contracts, (Jul. 22, 2013)

By John M. Jascob, J.D.

The CFTC has ordered high frequency trader Michael Coscia and his firm, Panther Energy Trading LLC (Panther), to pay $2.8 million for using a computer algorithm to illegally "spoof" trades in commodity futures contracts. The CFTC found that Coscia and Panther unlawfully placed and quickly canceled orders in exchange-traded futures contracts in energies, metals, and other commodities in order to give the market the false impression that there was significant buying interest, thereby suggesting that prices would soon rise. The CFTC's order requires Panther and Coscia to pay a $1.4 million civil monetary penalty and disgorge $1.4 million in trading profits, while banning Panther and Coscia from trading on any CFTC-registered entity for one year. Coscia's trading activity occurred over a two-month period in 2011 on CME Group's Globex trading platform (*In re Panther Energy Trading LLC and Michael J. Coscia*, July 22, 2013).

Separately, the market regulator in the United Kingdom, the Financial Conduct Authority (FCA), has fined Coscia approximately $900,000 for market manipulation resulting from a high frequency trading scheme on ICE Futures Europe. The FCA alleged that Coscia engaged in "layering" and manipulating the market by placing and rapidly cancelled large orders that he did not intend to trade, thereby harming other market participants. In addition to the fine, the FCA ordered disgorgement of approximately $1.3 million against Coscia and Panther and banned Coscia from trading on its exchanges for six months, The FCA found that Coscia's fine qualified for a 30-percent discount under the FCA's executive settlement procedures, however, because he agreed to settle at an early stage of the FCA's investigation.

Spoofing. According to the CFTC, Coscia and Panther placed relatively small orders to sell futures that they did want to execute, which they quickly followed with several large buy orders at successively higher prices that they intended to cancel. By placing the large buy orders, Coscia and Panther sought to give the market the impression that prices would rise from the significant buying interest, raising the likelihood that other market participants would buy from the small order Coscia and Panther were then offering to sell. Once the small sell order was filled, according to the plan, Coscia would then cancel the buy orders and quickly repeat the sequence in reverse by placing a small buy order followed by several large sell orders. The CFTC found that this back-and-forth trading activity allowed Coscia and Panther to profit many times over on executions of small orders in a broad spectrum of commodities, including energies, metals, interest rates, agricultures, stock indices, and foreign currencies.

Layering and market manipulation. The FCA found that Coscia used an automated algorithmic program that he had designed to place a series of connected orders with short intervals, which were a matter of milliseconds apart. The trading program was made of two “legs.” The first leg involved placing a small order on the order book around the level of the best price. Once the small order was in place, several large orders were placed on the other side of the order book at progressively improving price levels. The entire sequence of events was timed to last a total of approximately 300 milliseconds, after which the orders would all be cancelled immediately and simultaneously, if not previously executed. The second leg of the program involved following the same sequence in reverse on the opposite side of the order book so as to trade out of the position created by the previous leg.

The FCA found that Coscia’s large orders were highly unlikely to be executed due to their short resting time on the order book and inevitable cancellation once the small order was executed or they were partially executed. Accordingly, the large orders created false impressions of liquidity rather than genuine market supply and demand. The market participants who were most likely to trade with Coscia and be affected by his trading strategy were high frequency market participants or traders using algorithmic or automated systems rather than manual traders, the FCA observed. At least one

significant market participant withdrew from ICE Futures Europe directly as a result of Coscia's trading pattern, thereby reducing liquidity in the market, the FCA found.

Commissioner Chilton's concurrence. Although agreeing with the monetary penalty and disgorgement imposed by the settlement, CFTC Commissioner Bart Chilton stated that Coscia's conduct warranted the imposition of a much more significant trading ban in order to protect markets and consumers. In Chilton's view, Coscia's spoofing was a disruptive trading practice that represented an egregious violation of the Commodity Exchange Act. Chilton noted that these types of violations are becoming more common with the advent of high frequency traders, whom he has dubbed "cheetahs" due to their incredible speed.

Although commending cheetahs for their innovative strategies, Chilton said that regulators need to be firm and resolute when these traders violate the law. Without sufficient deterrents like meaningful trading bans, many will simply find other ways to get back to their market hunting grounds, Chilton said. In today's cheetah-trading world where identities can be cloaked behind technology, Chilton posited that a one-year trading ban might simply provide a nice sabbatical for a cheetah trader to work on a new program to unleash after the trading ban has expired.

Companies: Panther Energy Trading LLC

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