STOCK MARKETS PLAY 'WHACK A MOLE' WITH PUMP AND DUMP SCHEMES

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ABSTRACT

The surge, and then fall, of the price of shares in GameStop Corporation in early 2021 generated renewed attention to 'pump and dump' stock market manipulation schemes. In a practice known for centuries, the perpetrators of pump and dump schemes profit by artificially inflating the price of a security and then selling it before the security returns to a price which more closely reflects its underlying value.

In the GameStop saga, unlike other types of fraud, investors caught by the scheme appear to have garnered little sympathy from the public. It seems that this is because investors who purchase shares subject to pump and dump schemes frequently make purchasing decisions based on rumors or perhaps hope to ride the wave of the 'pump' and thereby 'get rich quick'.

Yet, regardless of one's view on the blamelessness or otherwise of investors in such schemes, a renewed focus by regulators and stock markets on 'pump and dump' schemes is necessary. Pump and dump schemes continue to be a scourge on stock markets around the world, and particularly on small cap markets which cater for listings of small to medium enterprises. The proliferation of pump and dump schemes in those markets impacts market integrity by discouraging investment and listings. Less investment in such enterprises can adversely impact both job creation and economic growth.

This article examines the problem of pump and dump schemes and the detrimental impact they have on the integrity of small cap markets. It then considers the challenges in eliminating pump and dump schemes from these markets before considering ways to stop such schemes and thereby enhance market integrity.

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INTRODUCTION

Early in 2021, the world was briefly distracted from the continuing coverage of the fight against the COVID-19 virus by another struggle. This was a battle over the price of shares in video game retailer GameStop Corporation ('GameStop'), with users of the social media website 'Reddit' on one side and hedge funds and short sellers on the other. Purchases by Reddit users, coupled with short sellers covering their positions by buying shares equaling those that had been borrowed to sell short in order to satisfy the sell orders, caused shares in GameStop to surge from $18 on 8 January 2021 to a high of $483 on 28 January 2021, before falling to $53 on 5 February 2021.[1]

Initially, financial commentators referred to this movement in the price of GameStop shares as a 'short squeeze', [2] which occurs when certain individuals intentionally purchase stock which they know to be shorted with the aim to increase the price and put pressure on short sellers. This increase in price forces short sellers to purchase stock to cover their positions, thereby further increasing the price. Eventually, when the inflated price is no longer supported by these machinations, the price will fall to a value closer to the underlying value of the stock.

However, some later commentary on the GameStop saga suggested that what really occurred was a pump and dump manipulation scheme, albeit an unusual one in that there did not appear to be collusion between Reddit users who were trying to encourage others to purchase the stock.[3] Others suggest it was not a pump

[1] *GAMESTOP CORPORATION GME*, NYSE, https://www.nyse.com/quote/XNYS:GME (last visited Jan. 18, 2023).

[2] Peter Cohan, *With 138% Short Interest, Board Change Sends GameStop Stock Soaring*, FORBES (Jan. 15, 2021), https://www.forbes.com/sites/petercohan/2021/01/15/with-138-short-interest-board-change-sends-gamestop-stock-soaring/?sh=7e0bfa9e6da8; Bob Pisani, *What pro traders, the Reddit crowd and regulators may do next in the GameStop short squeeze saga*, CNBC (Jan. 29, 2021, 8:12 AM), https://www.cnbc.com/2021/01/29/gamestop-short-squeeze-what-pro-traders-the-reddit-crowd-and-regulators-may-do-next.html; Hannah Murphy et al., *'Short squeeze' spreads as day traders hunt next GameStop* (Jan. 27, 2021), https://www.ft.com/content/acc1dbfe-80a4-4b63-90dd-05f27f21ceb2.

[3] Megan Leonhardt, *GameStop is being called a 'pump and dump' scheme—here's what you need to know,* CNBC (Jan. 28, 2021, 6:02 PM), https://www.cnbc.com/2021/01/28/gamestop-now-called-a-pump-and-dump-scheme-what-you-need-to-know.html; Dave Michaels & Alexander Osipovich, *GameStop Stock Surge Tests Scope of SEC's Manipulation Rules*, WALL STREET J. (Jan. 28, 2021, 7:49 AM), https://www.wsj.com/articles/gamestop-surge-tests-scope-of-secs-manipulation-rules-11611838175.

and dump scheme because there was transparency by social media users who purchased GameStop shares.[4]

Whether or not what happened to GameStop can be characterized as a pump and dump scheme, what is certain is that, like a traditional pump and dump scheme, some investors suffered significant losses when its stock price fell.[5] Yet, unlike other types of fraud, investors who lost money did not seem to win much sympathy.[6] This is perhaps because the GameStop saga displayed many of the telltale indicia of a pump and dump scheme, offering a potential explanation for the treatment of the scheme's investors. For example, pump and dump schemes are usually promoted on investor blogs and social media, as well as spam emails directed towards investors who perhaps have already shown an interest in similar stocks.[7] As such, those caught up in such schemes tend not to be those who research in depth the companies in which they invest. Rather, the victims of such schemes are frequently unsophisticated investors making investment decisions based on rumors or media hype, or because they think they will be able to profit by buying into the 'pump' and then, hopefully, bailing out before the share price falls.

As such, perhaps the obvious solution to the problem is to rely on investor education so that naïve investors do not get caught up in such schemes and lose money. Yet, educating investors is an inadequate solution to the issue because pump and dump schemes cause more harm than just the harm suffered by investors. Pump and dump schemes have a significant detrimental impact on the integrity of stock markets. Pump and dump schemes harm the integrity of those stock markets whose securities fall prey to the operators of these schemes. A proliferation of pump and dump schemes in a market dissuades investors from buying and selling securities on those markets. Usually, markets impacted by 114 are not large stock exchanges, but small cap markets that cater specifically for securities issued by small and medium enterprises ('SMEs'). Pump and dump schemes deter investors from investing in securities on these small cap markets, which reduces the ability of SMEs to use these public markets to access capital and grow their businesses. Given that SMEs are significant generators of job growth, the inability of SMEs to

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4 Emily Graffeo, *Former SEC Chair Jay Clayton says GameStop trading was not a pump-and-dump scheme and praises transparency from "Mr. Kitty,"* MARKETS INSIDER (Feb. 19, 2021, 10:07 AM), https://www.businessinsider.com/gamestop-trading-hearing-sec-clayton-pump-dump-roaring-kitty-transparency-2021-2.

5 Jason Koebler, *Random Man Files Class Action Lawsuit Against Roaring Kitty for GameStop Posts*, VICE (Feb. 17, 2021, 2:11 PM), https://www.vice.com/en/article/3anexn/random-man-files-class-action-lawsuit-against-roaring-kitty-for-gamestop-posts.

6 Paul Krugman, *Pumps and Dumps and Chumps*, *Opinion,* NEW YORK TIMES (Feb. 4, 2021), https://www.nytimes.com/2021/02/04/opinion/gamestop-stocks.html; Milton Ezrati; *The GameStop Stock Saga: A Postmortem,* FORBES (Feb. 7, 2021, 1:17PM), https://www.forbes.com/sites/miltonezrati/2021/02/07/the-gamestop-stock-saga-a-postmortem/.

7 FINRA Staff, *Wake Up and Smell the Pump-and-Dump,* YAHOO! FINANCE (Nov. 24, 2015), https://finance.yahoo.com/news/wake-smell-pump-dump-153000170.html.

attract investors by using small cap markets may adversely impact economic growth and job creation.

This article is focused on the threat that pump and dump schemes pose to the integrity of small cap markets and what can be done to solve this problem. As such, Part 1 defines a pump and dump scheme, outlines some common traits of pump and dump schemes, explains why they are a continuing problem for small cap markets around the world, and explores their detrimental impact on the integrity of these markets and why this is a problem for economic and job growth. Part 2 outlines the role of securities regulators as well as the markets themselves in tackling pump and dump schemes. Part 3, while not underestimating the considerable challenges facing securities regulators and the markets in thwarting pump and dump schemes, seeks to outline and embark upon a discussion of possible solutions to these challenges. The article then concludes by suggesting that there are ways to stop the proliferation of 'pump and dump' schemes, but that it requires a high level of commitment by the operators of small cap markets and securities regulators.

I. THE PROBLEM OF PUMP AND DUMP SCHEMES IN SMALL CAP MARKETS

A. What is a Pump and Dump Scheme?

Pump and dump schemes typically occur when individuals, already holding a large quantity of a particular security, manipulate the price of that security by artificially inflating the price. This artificial increase in the price of the security occurs because of information-based manipulation, trade-based manipulation, or a combination of the two. Information-based manipulation involves the spread of false or misleading positive information about the security. Trade-based manipulation entails generating interest in the security by manufacturing trading activity in that security. Trade-based manipulation is achieved by what is commonly called a 'wash sale', that is, where the buyer and the seller are the same person, or by 'matched orders', that is where the sales are prearranged between associates.

After the price has risen due to information-based manipulation or trade-based manipulation or both, and there is a high volume of purchase orders, the perpetrators sell or 'dump' the securities at a higher price. Without these artificial supports, the price falls and holders of the securities are left with what is almost invariably stock of very little value. Other terms used for pump and dump schemes are 'hype and dump', 'trash and dash', 'scalping', 'ramping' and 'painting the tape'. Less common is the 'slur and dump', which involves spreading negative, false, or misleading information with an aim to decrease the price of the security.

This would typically occur where the perpetrator was engaged in short selling the security in the hope that the price of the security would fall.[8]

Although pump and dump schemes have been around for a long time,[9] the opportunity to conduct pump and dump schemes has drastically increased because of the growth of the internet. During the latter part of the 20th century and early in the 21st century, perpetrators of pump and dump schemes would typically establish what were called 'boiler rooms' to conduct these schemes. 'Boiler rooms' are call centers where victims were frequently cold called and persuaded to buy securities.[10]

Today, the internet allows the spread of false and misleading information about securities to a wide audience at almost no cost, using mechanisms such as spam email, social media, blogs, press releases, and newsletters.[11] The internet also permits perpetrators of pump and dump schemes to be situated in any jurisdiction and to trade on virtually any market in the world, thereby assisting them to evade detection and prosecution. Furthermore, the reach of the internet and the growth of low commission brokers, or even no commission brokers, has created a large pool of investors and traders reading blog posts and similar sources and who may end up potential victims of pump and dump schemes.

B. Pump and Dump Schemes in Small Cap Markets

Although the GameStop pump and dump scheme created headlines, the most common securities subject to pump and dump schemes are not those of large established enterprises. Most frequently, the stocks subject to pump and dump schemes are microcap stocks, many of which are colloquially referred to as 'penny stocks'. Microcap stocks are inexpensive to purchase, thus perpetrators of pump and dump schemes can acquire a large quantity of securities at little cost, perhaps even acquiring most of the securities of a particular company for a few thousand

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[8] For a taxonomy of market manipulation schemes including the pump and dump see Talis J. Putnins, *An Overview of Market Manipulation* in, CAROL ALEXANDER & DOUGLAS CUMMING, CORRUPTION AND FRAUD IN FINANCIAL MARKETS: MALPRACTICE, MISCONDUCT AND MANIPULATION (Wiley & Sons Ltd, 2020).

[9] CHARLES MACKAY, EXTRAORDINARY POPULAR DELUSIONS AND THE MADNESS OF CROWDS: A MODERN-DAY INTERPRETATION OF A FINANCE CLASSIC (Infinite Ideas, 2009).

[10] Boiler rooms and pump and dump schemes probably entered the awareness of the general public as a result of the 2013 film "The Wolf of Wall Street" based on the activities of Jordan Belfort who operated these in the 1980s and was subsequently convicted for fraud and manipulation. *See* JORDAN BELFORT, THE WOLF OF WALL STREET (2007). For another example, see the case of Sandy Winick, a Canadian who ran boiler rooms in multiple countries which resulted in losses to investors of over US$140, *See* Bloomberg News, *Canadian penny stock 'kingpin' gets more than six years for US$140 million boiler room plot,* FINANCIAL POST (Aug. 17, 2016), https://financialpost.com/investing/global-investor/candian-penny-stock-kingpin-gets-more-than-six-years-for-us140-million-boiler-room-plot.

[11] FINRA Staff *supra* note 7.

dollars. Furthermore, unlike GameStop shares, the trading of microcap stocks does not take place on one of the larger exchanges such as the NYSE or NASDAQ. Instead, these types of securities are traded on microcap or small cap markets. In the United States, these markets, such as those operated by OTC markets group, are called alternative trading systems or over-the-counter markets.[12] In Canada, such markets are those operated by the Canadian Securities Exchange.[13] In Europe, these small cap markets are the multilateral trading facilities, frequently operated by companies that also operate larger exchanges.[14]

Another advantage in using the small cap markets for those conducting pump and dump schemes is that securities traded on these markets tend to be illiquid and thinly traded. Accordingly, as demand for a particular security escalates, the price of the security can rise exponentially. This can significantly amplify profits made by perpetrators when they sell or 'dump' their securities.

Furthermore, small cap markets usually have fewer listing requirements and less stringent continuous disclosure obligations compared to larger exchanges. This is intended to encourage, and make it cost effective, for small growing companies to have their securities listed. However, these simpler requirements can mean that there is less information available to both the market as well as investors to scrutinize the legitimacy, or otherwise, of the companies' business and its owners or directors.

C. Some Common Characteristics of Pump and Dump Schemes

Pump and dump schemes frequently exhibit certain similar traits. A few common themes can be identified:

1. Large Profits and the Involvement of Recidivists

Pump and dump schemes in small cap markets can generate large profits, often in the millions of dollars.

For example, in 2020 Roger Knox ('Knox'), a UK Citizen, pleaded guilty in a US court to charges related to his involvement in a number of pump and dump schemes generating net proceeds at an estimated approximate US$164 million. Knox and his associates, using a Swiss asset management firm, helped others conduct pump and dump schemes in more than 50 stocks. The firm assisted in the

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[12] *Our Company,* OTC MARKETS, https://www.otcmarkets.com/about/our-company (last visited Jan. 18, 2023).

[13] Niall McGee, *Burned investor's 'pump and dump' experience raises questions about IIROC*, THE GLOBE AND MAIL (Apr. 22, 2021), https://www.theglobeandmail.com/business/article-burned-investors-pump-and-dump-experience-raises-questions-about-iiroc/.

[14] For example, Euronext N.V. operates large exchanges such as those for Amsterdam, Brussels, Lisbon, Paris and Oslo but also Multilateral Trading Facilities such as Euronext Access: "Euronext", online. EURONEXT, https://www.euronext.com/en (last visited Jan. 18, 2023).

acquiring of large quantities of microcap securities on behalf of groups in the US and elsewhere, who secretly owned the securities through nominee shareholders. The groups would then orchestrate promotional campaigns to artificially inflate the price and trading volume of those shares. When the price had risen, the stock was sold. Knox, in return for a commission, arranged the funneling of proceeds of the schemes through a complex money transfer system that disguised the source and nature of the funds.[15]

The highly lucrative nature of these schemes is such that the people behind them are often recidivists. Having conducted these crimes before, they will continue to do so until they are not only caught but are also subjected to a penalty which makes profits attained through the scheme incommensurate with the risk. One example of a recidivist conducting these schemes is Sandy Winick ('Winick'). Winick, a Canadian, was prosecuted for conducting pump and dump schemes in the early 2000's on OTC Link, a trading facility run by OTC Markets Group Inc. The victims of the schemes were from 35 countries, and losses were estimated at US$140 million. For some time, Winick evaded being caught but was eventually located in Thailand and extradited to the US. He eventually pleaded guilty to several charges and was sentenced to six and a half years in prison. He had previously been banned by the SEC from selling penny stocks and was ordered to pay civil penalties to the SEC. He had also been banned from trading by the Ontario Securities Commission.[16] Before he was caught, he was recorded joking that he could continue operating under false names and shell companies even if he were banned for life by the SEC.[17]

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15 U.S. Attorney's Office, District of Massachusetts, *Founder of Swiss Brokerage Firm Pleads Guilty in Connection with Global Securities Fraud Scheme*, U.S. DEP'T OF JUST. (Jan. 13, 2020), https://www.justice.gov/usao-ma/pr/founder-swiss-brokerage-firm-pleads-guilty-connection-global-securities-fraud-scheme. Knox is due to be sentenced on 11 August 2021. *United States v. Roger Knox, United States v. Richard Targett-Adams*, U.S. DEP'T OF JUST. (Nov. 4, 2022) https://www.justice.gov/usao-ma/victim-and-witness-assistance-program/united-states-v-roger-knox-united-states-v-richard-targett-adams. An associate Morrie Tobin received a year in prison. It appears Tobin's sentence would have been much longer, but he cooperated with authorities, and it was his information that was the tip that resulted in U.S. investigation into the college admissions scandal. Janelle Lawrence, *College tipster who sparked U.S. sting gets a year for own crime*, BNN BLOOMBERG (Aug. 12, 2020), https://www.bnnbloomberg.ca/college-tipster-who-sparked-u-s-sting-gets-a-year-for-own-crime-1.1479207.

16 Bloomberg News, *supra* note 10. *See also* SEC Charges Penny Stock Company and Canadian Citizen with Illegal Stock Distribution Through Corporate Spinoffs, Litigation Release No. 21083 (June 12, 2009), https://www.sec.gov/litigation/litreleases/2009/lr21083.htm.

17 *Colt Curry Indicted in Securities Scheme,* SECURITIES LAWYER 101: SECURITIES LAWYER 101 BLOG (2013), https://www.securitieslawyer101.com/2013/sandy-winick/.

2. Any Small Cap Market is Potentially a Victim of Such Schemes

The international nature of securities trading is such that there are few barriers preventing trading across borders. As such, people who commit such crimes can utilize any small cap market in the world for their activities, regardless of where they are situated. They can readily change markets if they are stopped or if it becomes too difficult to continue to operate in a particular market.[18] Accordingly, it seems that all small cap markets in the world are potential targets for such schemes.

3. Complexity and Use of Nominee/Offshore Companies

To evade, or at least slow down, the detection of their scheme by authorities, those behind pump and dump schemes commonly use multiple nominee companies to conceal their involvement. Frequently, these companies are incorporated in what are, or are perceived to be, lightly regulated countries, commonly referred to as offshore jurisdictions. These are countries where there are no records kept of the beneficial owners of a particular company or it is widely believed that the authorities in the country will protect the privacy of those behind companies from disclosure to authorities in other countries.

Companies in these offshore jurisdictions are utilized to hold securities and then used for 'wash sale' or 'matched order' type trades. 'Matched order' trades are prearranged transactions between two entities whereas 'wash sales' trades are trades where there is no change in the beneficial ownership of the securities. These companies are also used to send funds to promotors who tout the security, and the companies may also be used to channel and disguise profits that have been made.[19] Those behind the schemes may also believe that the complexity of the web of companies involved will slow down detection. They may also believe, with some justification, that it will give them time to shift jurisdictions, and move their assets beyond the reach of authorities in the event that they are detected.

4. There is an 'Industry' of People Willing to Assist in Such Schemes

Perhaps also because of the lucrative nature of pump and dump schemes, there appears to be an industry of people who will assist in such schemes (whether

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[18] Niall McGee, *How the COVID-19 Pandemic Fueled a Boom in Canadian Stock Promotion Scams*, GLOBE AND MAIL (Dec. 30, 2020), https://www.theglobeandmail.com/business/article-how-the-covid-19-pandemic-fuelled-a-boom-in-canadian-stock-promotion/.

[19] SEC Obtains $58 Million Judgment against Perpetrator of International Pump-and-Dump Scheme Involving Marley Coffee, Litigation Release No. 23956 (C.D. Cal. Nov. 17, 2015), https://www.sec.gov/litigation/litreleases/2017/lr23956.htm (last visited Jan. 18 2023) (For an example of the perpetrators of pump and dump schemes utilizing multiple companies in offshore jurisdictions see Jammin' Java Corp. et al.).

knowingly or without asking too many questions), such as penny stock promotors, lawyers, brokers, and groups setting up shell companies and/or arranging transfers of funds.[20] Perpetrators also frequently use family, friends, and associates to hold securities, often to give the appearance to regulators that the ownership of the securities is not concentrated within a few individuals.

Some, such as the case of Knox referred to above, offer the coordination of pump and dump schemes as a 'product'. Another example is the case of Panayitis Kyriacou, who was employed at a U.K. based broker-dealer. He made at least $50 million from the pump and dump 'business.'[21] Kyriacou was recorded telling an undercover FBI agent that he was "involved in the whole aspect of these firms from the creation. . . through to the liquidation." In addition, he "put the management in place" for these companies and directed them to issue press releases of "news that's not really news" at "certain points in time."[22]

5. The Company Subject to the Pump and Dump Scheme is Purportedly Operating a Business Related to the Latest Investment Fad.

In order to attract investors to purchase the securities, and to perhaps add credence to the story that the price of the security can rise radically, instigators of pump and dump schemes frequently use the latest investment fads as the purported 'business' of the company.

For example, in 2020, the Alberta Securities Commission found that a company called Bluforest Inc. (Bluforest) was involved in a pump and dumpc scheme back in 2013. Bluforest,originally called Greenwood Gold Resources Inc. (Greenwood), was a gold mining exploration company that held a few mining claim options (which were subsequently terminated or lapsed). Around December 2010, Cem (Jim) Can, a Canadian resident, acquired a controlling interest in Greenwood, using companies incorporated in jurisdictions such as Belize and the British Virgin Islands. On June 5th, 2012, Greenwood was renamed Bluforest.

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20 *ASC fines Calgary lawyer $90,000 in market manipulation Case*, CALGARY HERALD (Mar. 12, 2019), https://calgaryherald.com/news/local-news/calgary-lawyers-settles-market-manipulation-case-with-asc (For an example of a lawyer who assisted in such a scheme, see the case of Norman Anderson who assisted in the Bluforest matter).

21 U.S. DEP'T OF JUST. U.S. ATT'YS OFF. EASTERN DISTRICT OF N.Y., FORMER BEAUFORT SECURITIES INVESTMENT MANAGER PLEADS GUILTY TO CONSPIRACIES TO COMMIT SECURITIES FRAUD AND TO DEFRAUD THE UNITED STATES BY FAILING TO COMPLY WITH FOREIGN ACCOUNT TAX COMPLIANCE ACT (Nov. 20, 2019), https://www.justice.gov/usao-edny/pr/former-beaufort-securities-investment-manager-pleads-guilty-conspiracies-commit.

22 SEC CHARGES U.K. BROKERAGE FIRM, INVESTMENT MANAGER, CEO, AND OTHERS FOR MANIPULATIVE TRADING IN THE U.S. MICROCAP STOCKS, *Litigation Release No. 24067,* U.S SECURITIES AND EXCHANGE COMMISSION (MAR. 16, 2018), https://www.sec.gov/litigation/litreleases/2018/lr24067.htm.

Bluforest was advertised to be in the business of carbon-offset marketing and claimed to have acquired hundreds of millions of dollars in Ecuadorian property rights for use in the evolving carbon credits market. In July 2013, Can pumped up the Bluforest share price through a promotional campaign with touts, such as it "has 342% upside," "the ONLY OTCBB Company to ever go public with over $695 million in net asset value," and it is "one of the largest forestry companies in the world" due to owning property valued at $697 million.[23] Bluforest had a market capitalization of almost $200 million at a time when the company had no business operations, employees, or income, and its assets comprised alleged carbon credit agreements with non-arm's length companies in Ecuador.[24]

By using the latest investment fad as the purported business of the company, from 2018 to 2020, there were many reports of pump and dump schemes in the cannabis business.[25] In 2020, with public attention focused on the COVID-19 pandemic, regulators detected a number of pump and dump schemes focused on pandemic-related businesses, involving tests, purported treatments, and protective equipment.[26]

D. The Impact of Pump and Dump Schemes

1. Impact on Investors

Pump and dump schemes cause serious harms to some investors. This is because when those behind the schemes sell their securities at a higher price than what they purchased it at and with the perpetrators no longer continuing to support that higher price, the value of the security plummets. Investors holding shares at that time end up with worthless securities and significant losses.

A study by Hackethal et al. analyzed 421 pump and dump schemes between 2002 and 2015. In part of their study, they examined 110,000 investors with a major German bank, finding that 6% of investors got caught by such schemes, losing an

23 *Id.*

24 *Id.*

25 Christina Sterbenz, *PENNY STOCKS: The Dark Side of the Legal Marijuana Boom*, BUSINESS INSIDER (Jul. 14, 2014), https://www.businessinsider.com/marijuana-penny-stocks-2014-7; Court Enters Judgements Against Promotors in Pump-And-Dump Scheme, Litigation Release No. 25087, (May. 7, 2021), https://www.sec.gov/litigation/litreleases/2021/lr25087.htm (For an example of a cannabis related pump and dump scheme see David N. Osegueda, et al.).

26 How the COVID-19 pandemic fueled a boom in Canadian stock promotion scams, *supra* note 18; *Look Out for Coronavirus-Related Investment Scams - Investor Alert,* INVESTOR.GOV (Apr. 13, 2021), https://www.investor.gov/introduction-investing/general-resources/news-alerts/alerts-bulleti Ns/investor-alerts/look-out. For an example see the case of Applied BioSciences Corp which switched its purported business in late March 2020 from cannabinoid-based products to pandemic related products Applied BioSciences Corp. SEC Obtains Final Judgment Against Company for Misleading Covid-19-Related Claims, Litigation Release No. 24977, (Dec. 7, 2020), https://www.se c.gov/litigation/litreleases/2020/lr24977.htm.

average of 30% of their investments.[27] They also found that each of the 421 pump and dump schemes caused a total average loss of at least €1.2 million.[28]

In addition, this same study considered the types of investors caught by pump and dump schemes. It found that, compared to the average investor, pump and dump investors tended to be those who held a greater number of stocks, a higher proportion of penny stocks, and a lower proportion of blue-chip stocks in their portfolios. This study also found that 11% of these investors placed money in four or more of these pump and dump schemes. This suggested that at least some investors may not be gullible nor fall prey to these schemes, but may actually be seeking them out as a gamble, no doubt hoping to sell before the stock price falls.[29]

2. Impact on Market Integrity

Although the losses incurred by investors because of pump and dump schemes are of concern, arguably of much greater concern is the impact of pump and dump schemes on the integrity and fairness of the securities markets.[30]

The prevalence of pump and dump schemes in a particular market seriously compromises the integrity of that market, because investors ultimately lose confidence in the market's fairness. If investors are harmed by a pump and dump scheme, they become more likely to lose trust in that market, and as a result, may no longer wish to trade in that market.

The Hackethal et al. study found that after investors fell victim to a pump and dump scheme, their behavior generally changed. They became less inclined to invest in small stocks, and some even stopped trading altogether for a period of time. The Hackethal et al. study also found that the effect was more pronounced for infrequent traders who were more likely to have been tricked into a pump and dump scheme, rather than for those investors who effectively gambled on pump and dump schemes. The study also found evidence that losing on a pump and dump scheme may have a lasting effect on the behavior of some investors who, even after three years, made less equity investments than before their loss.[31]

The conduct of investors leaving the market is consistent with the concept of loss aversion, demonstrated by several studies in behavioral finance literature. These studies tend to show that traders feel losses more acutely than profits, and

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27 Christian Leuz et al., *Who Falls Prey to the Wolf of Wall Street? Investor Participation in Market Manipulation*, ECGI WORKING PAPER SERIES IN LAW (Apr. 2019).
28 *Id.*
29 *Id.*
30 Janet Austin, *What Exactly Is Market Integrity: An Analysis of One of the Core Objectives of Securities Regulation*, 8 WM. & MARY BUS. L. REV. 215–240 (2016). (For an analysis of what is market integrity *see*, Janet Austin).
31 LEUZ ET AL., *supra* note 27.

that, as such, losses can have a disproportionate impact on investor preferences.[32] As investors leave a market, it can impact market liquidity, increasing the size of the bid-ask spread.[33] A larger bid-ask spread decreases the accuracy of prices, which also impacts the fairness of the market, since investors may end up paying too much for securities.[34]

Pump and dump schemes can even lead to such markets becoming unviable and needing to close. For example, the First Board of the Open Market in Germany closed in 2012, because of a prevalence of pump and dump schemes. The First Quotation Board, which was designed for smaller companies, had few listing and post-admission requirements. Overtime, it became clear to Germany's securities regulator, Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin), that majority of cases of market manipulation being investigated each year were pump and dump schemes occurring in this market.[35] These cases were frequently complex and difficult to investigate. They also had the potential to inflict substantial damage to investors, and often involved extensive cross-border activity, as many of the companies whose shares were used in this way came from abroad —particularly

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32 Amos Tversky & Daniel Kahneman, *Loss Aversion in Riskless Choice: A Reference-Dependent Model*, 106 THE QUARTERLY JOURNAL OF ECONOMICS 1039–1061 (1991); Michael S. Haigh & John A. List, *Do Professional Traders Exhibit Myopic Loss Aversion? An Experimental Analysis*, 60 THE JOURNAL OF FINANCE 523–534 (2005); Peter Locke & Steven Mann, *Do Professional Traders Exhibit Loss Realization Aversion*, SSRN ELECTRONIC JOURNAL (2000).

33 Jun Muranaga & Makoto Ohsawa, *Measurement of Liquidity Risk in the Context of Market Risk Calculation*, INSTITUTE FOR MONETARY AND ECONOMIC STUDIES BANK OF JAPAN, at 22 (1997).

34 Jack Sarkissian, *Spread, Volatility, and Volume Relationship in Financial Markets and Market Maker's Profit Optimization*, CAPITAL MARKETS: ASSET PRICING & VALUATION JOURNAL, June 23, 2016, at 28.

35 In 2005, BaFin reported that 55% of manipulation investigations were related to sham trading. See *See* BAFIN, ANNUAL REPORT 2005, at 158 (2006). These were transactions which are referred to as "matched orders," prearranged transactions between two entities, or were "wash sales," trades without changes in the beneficial ownership of the securities. Another quarter of manipulation investigations were related to informational offenses, that is, misleading or incorrect information or the concealing of information. It also reported that the transactions mainly impacted "illiquid equities or 'penny stocks' traded on the OTC market.". In 2006, BaFin reported that reports by investors in relation to market manipulation doubled and "related primarily to low-liquidity financial markets traded in the OTC market." *See* BAFIN, ANNUAL REPORT 2006, at 163 (2007). In 2007, it recognized the involvement of foreign companies in such schemes, noting that this "occurs when shares, mostly of foreign companies in the commodity sector, are included in . . . OTC trade[s] [on] German stock exchanges." BAFIN, ANNUAL REPORT 2007, at 173-74 (2008). By 2008, BaFin reported that "the significance of OTC trading for market manipulation remained consistently high" and that it was identifying "increasing levels of cross border manipulation in the German market." BAFIN, ANNUAL REPORT 2008, at 156, 162 (2009). In 2009, BaFin reported that "there has been a marked shift in the focus of BaFin's report analysis activities towards market manipulation. Sham actions, such as matched trades, were the focal point of these activities in 2009 . . . . The shift from insider trading to more market manipulation analyses is likely to be due to the fact that the current market environment makes it more difficult for potential insiders to exploit their insider information to their advantage." *See* BAFIN, ANNUAL REPORT 2009, at 171 (2010).

Switzerland and the United Kingdom.[36] Prompted by an onslaught of new incidents of suspected market manipulation, in December 2011, Deutsche Börse decided not to admit any new entities to the First Quotation Board, and subsequently closed it down in 2012.[37]

The First Quotation Board exemplifies the fact that, as detailed above, small cap markets are particularly vulnerable to pump and dump schemes. The impact of these schemes on small cap markets is of concern, because these markets can be critical to the growth of small to medium sized enterprises (SMEs). SMEs are significant creators of job growth in an economy. In the European Union in 2019, for example, SMEs accounted for 99.8% of all enterprises in the non-financial business sector (NFBS), generating 56.4% of NFBS value added and 66.6% of NFBS employment. In terms of NFBS employment growth, SMEs accounted for almost 68% of the increase from 2016 to 2018.[38]

For an SME, listing their securities on a small cap market provides them with access to equity capital to expand, develop, and ultimately create both wealth and jobs. Over time, as they grow, successful SMEs listed on small cap markets can 'graduate' to the larger boards, thus enabling further growth.[39] Because of this, many of the larger exchanges also operate small cap markets in order to foster the growth of such companies, with hopes of them eventually moving up to the larger exchanges.[40]

II. THE ROLE OF REGULATORS AND SECURITIES MARKETS IN ELIMINATING PUMP AND DUMP SCHEMES.

As referenced above, pump and dump schemes damage the integrity of small cap markets. This results in investors avoiding these markets, and therefore reducing market liquidity. This is significant, as creating liquidity is one of the biggest challenges for small cap markets.[41] Lower liquidity can influence other investors to shy away from investing in these markets, thereby creating a vicious

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36 S*ee* BAFIN, ANNUAL REPORT 2010, at 187–89 (2011).

37 See BAFIN, ANNUAL REPORT 2011, at 168, 195 (2012).

38 *Annual report on European SMEs 2018/2019Research & development and innovation by SMEs: Background Document*, EUROPEAN UNION EUROPEAN COMMISSION EXECUTIVE AGENCY FOR SMALL AND MEDIUM-SIZED ENTERPRISES (EASME) (Nov. 2019), http://op.europa.eu/en/publication-detail/-/publication/cadb8188-35b4-11ea-ba6e-01aa75ed71a1/language-en.

39 *An Overview of WFE SME Markets*, WORLD FEDERATION OF EXCHANGES (Oct. 2018), https://www.world-exchanges.org/our-work/articles/wfe-overview-sme-markets-report-october-2018.

40 For example, in 2016, 65 exchanges who were members of the World Federation of Exchanges had 36 SME platforms. *Market Infrastructures and Market Integrity: A Post-Crisis Journey and a Vision for the Future*, OLIVER WYMAN & WORLD FEDERATION OF EXCHANGES, https://www.oliverwyman.com/our-expertise/insights/2018/apr/financial-market-integrity.html.

41 WORLD FEDERATION OF EXCHANGES, *supra* note 39.

cycle. This, in turn, increases the cost of capital for listed firms.[42] A higher cost of capital can obviously inhibit or even prevent their future growth.

That being said, the inverse should also be true in that eliminating pump and dump schemes will enhance market integrity and thereby attract investors to the market.[43] It is, therefore, in the interests of small cap markets to eliminate pump and dump schemes. However, these markets need to be assisted in their endeavors by securities regulators, as well as by self-regulatory organizations, who supervise markets and broker-dealers.[44] While securities markets can refuse to list companies suspected of partaking in pump and dump schemes, or even remove them from the listings entirely, only the securities regulators and self-regulatory organizations can take significant action in deterring them from continuing their illicit activities.

Market integrity is essential for the efficient functioning of markets. Since efficient markets are so important to the economy, it follows that guarding integrity of markets, protecting investors, and reducing systemic risk form the three key goals of securities regulators around the world.[45] As referred to by the Directive of

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42 *Id*.

43 One study, albeit in a slightly different context, supports this hypothesis. Pump and dump schemes also frequently occur in the cryptocurrency markets. A study by Li et al. found that efforts by one cryptocurrency exchange to remove pump and dump schemes resulted in an increase in liquidity and the prices of the tokens. TAO LI, DONGHWA SHIN & BAOLIAN WANG, CRYPTOCURRENCY PUMP-AND-DUMP SCHEMES, (2021), https://papers.ssrn.com/abstract=3267041.

44 For example, the Financial Industry Regulatory Authority (FINRA) in the United States and the Investment Industry Regulatory Organization of Canada (IRROC) in Canada. Not all countries have delegated these functions to such self-regulatory organisations. For example, in Australia the Australian Securities and Investments Commission (ASIC) is the regulator and supervises markets and brokers.

45 IOSCO (the International Organization of Securities Commissions) states that the three key goals of securities regulators (IOSCO) are: protecting investors; ensuring that markets are fair, efficient and transparent; reducing systemic risk. *See About IOSCO*, INT'L ORG. OF SEC. COMMISSIONS, https://www.iosco.org/about/?subsection=about_iosco. All securities regulators adopt these principles as their mission although they may be framed slightly differently. For example, BaFin's objectives are "to ensure the transparency and integrity of the financial markets and ensure investor protection." *Securities Supervision*, BAFIN FEDERAL FINANCIAL SUPERVISORY AUTHORITY, https://www.bafin.de/EN/DieBaFin/AufgabenGeschichte/Wertpapieraufsicht/wertpapieraufsicht_node_en.html (Jan. 6, 2021). In relation to the Autorité des Marchés Financiers (AMF), the securities regulator of France, its mission is "to ensure the protection of savings invested in financial products, that investors are properly informed and the orderly operation of financial markets." *Our missions*, MF AUTORITÉ DES MARCHÉS FINANCIERS (September 2019), https://www.amf-france.org/en/amf/our-missions. The objectives of the Financial Conduct Authority of the UK (FCA) are to 1) protect consumers, by securing an appropriate degree of protection for consumers; 2) protect financial markets (by protecting and enhancing the integrity of the UK financial system; and 3) promoting competition (by promoting effective competition in the interests of consumers). *About the FCA*, FINANCIAL CONDUCT AUTHORITY (2016), https://www.fca.org.uk/about/the-fca. The goals of the US Securities and Exchange Commission are "to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation," *What We Do*, U.S. SEC AND EXCH. COMMISSION, https://www.sec.gov/about/what-we-do (November 2021).

the European Union that aimed to eliminate market abuse (such as pump and dump market manipulation):

> An integrated and efficient financial market and stronger investor confidence requires market integrity. The smooth functioning of securities markets and public confidence in markets are prerequisites for economic growth and wealth.[46]

Furthermore, ensuring the integrity of markets is one way in which regulators can work towards their second key goal: protecting investors. As demonstrated by Figure 1, a fair market, which protects investors by eliminating improper trading practices, leads to increased investor confidence and market participation. Greater investor participation improves price formation, thus promoting a fairer market with fairer prices.

Figure 1: The Importance of Market Integrity

[46] *Directive 2014/57/EU of the European Parliament and of the Council of 16 April 2014 on Criminal Sanctions for Market Abuse (Market Abuse Directive)*, EUROPEAN PARLIAMENT, COUNCIL OF THE EUROPEAN UNION (2014), https://eur-lex.europa.eu/eli/dir/2014/57/oj.

III. HOW TO STOP PUMP AND DUMP SCHEMES

According to the rational choice and routine activities theory, crimes generally only occur when three conditions are present:

a supply of motivated offenders;
the availability of suitable opportunities; and
the absence of capable guardians (such as market regulators).[47]

Given the significant sums of money that can be made from pump and dump schemes, there is likely to always be a supply of motivated offenders willing to perpetrate them. Therefore, to eliminate these schemes, the focus must first be on choking off suitable opportunities. In addition, the actions of the guardians, in this case the market regulators, must be such that perpetrators, in weighing the costs and benefits, realize that the former outweighs the latter. In simple terms, this means that there must be a high likelihood of both a perpetrator being caught, as well as the imposition of a significant penalty if the offense is proven.

A. Choking Off Opportunities for Pump and Dump Schemes

1. Small Cap Markets Taking Action to Stop Suspected Pump and Dump Schemes

In general, the operators of small cap markets are solely responsible for listing and removing companies. Therefore, in order to deter pump and dump schemes, operators must be vigilant in exercising these powers and refusing to list such companies in addition to quickly removing companies being used for pump and dump schemes.

Small cap markets usually have lower listing and fewer stringent continuous disclosure requirements, mainly to keep compliance costs low so that SMEs can afford to list their securities on their markets. Unfortunately, this also means that there is less information on which to scrutinize the bona fides of companies being listed, as well as the people behind these companies. It can thus

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[47] Lawrence E. Cohen & Marcus Felson, *Social Change and Crime Rate Trends: A Routine Activity Approach*, 44 AMERICAN SOCIOLOGICAL REV., 588–608 (1979). Although these theories have been criticized because much crime may not be rational and offenders do not engage in cost/benefit analysis, there is some evidence that these theories do hold true in relation to white collar and internet crime. *See*, e.g., Xuesong Hu, Xin Wang & Baohua Xin, *Insider Trading: Does Being a Neighbor of the Securities and Exchange Commission Matter*?, 38 MANAGERIAL AND DECISION ECONOMICS, 144–165 (2017).; Travis C. Pratt, Kristy Holtfreter & Michael D. Reisig, *Routine Online Activity and Internet Fraud Targeting: Extending the Generality of Routine Activity Theory*, 47 JOURNAL OF RESEARCH IN CRIME AND DELINQUENCY, 267–296 (2010).; and Michael L. Benson, Tamara D. Madensen & John E. Eck, *White-Collar Crime from an Opportunity Perspective, in* THE CRIMINOLOGY OF WHITE-COLLAR CRIME, 175–193 (Sally S. Simpson & David Weisburd eds., 2009).

be difficult to identify companies which may be exploited for pump and dump schemes. However, there are ways in which operators can detect such companies. Given the similar characteristics of many of these schemes, there may be 'red flags' indicating which companies are likely to be used in this way. For example, one red flag may be a change of business into what seems to be the latest investment fad. Such an approach might well have detected Bluforest as likely to be used for a pump and dump scheme. Markets need to maintain a comprehensive internal list of such red flags, as well as have the power to demand additional information from 'flagged' companies.

These markets must also be vigilant in warning potential investors if they suspect that a company may be subject to such a scheme, even before this allegation can be proven. For example, the OTC Markets Group has a suite of marketplace designations and informational icons warning investors of the risks associated with some companies. These are publicly available on the company's quote page and distributed to broker-dealers and compliance departments.[48] For instance, OTC will put a skull and cross-bones icon next to a company if there is a concern that it may be subject to "a spam campaign, questionable stock promotion, known investigation of fraudulent activity. . ., regulatory suspensions, or disruptive corporate actions."

Sometimes the refusal to list, remove, or warn against companies may result in damage to stockholders. However, the broader interests of protecting the integrity of the market should arguably prevail. As such, it may be necessary to limit the number of people who can file lawsuits due to the exercise of those powers.

2. Small-Cap Markets Must Share Information and Intelligence, As Well As Encourage Relevant Organizations to Assist Them in This Work.

Given the tendency of those behind pump and dump schemes to jump to another small-cap market if it becomes too difficult to list or maintain a listing in one market, it is essential for small-cap markets across the world to work together. They need to be able to share possible red flags, as well as other intelligence and information, so that other markets are unavailable to perpetrators of such schemes.

The idea of small-cap markets working together to share intelligence may be somewhat counterintuitive, since these markets are technically competitors. After all, companies have a choice as to where they list their securities. Therefore, a market may think that it will be to its competitive advantage by working alone to improve the integrity of its own market, through clamping down on pump and

[48] *Investor Protection*, OTC MARKETS, https://www.otcmarkets.com/learn/investor-protection (last visited Jan. 18, 2023).

dump schemes. While this may be true in the short term, the situation is akin to a classic "prisoner's dilemma" in those markets; acting in their own self-interest will not produce the optimal outcome in the long run. It is only when the markets all work together that it is likely the scourge of pump and dump schemes will cease. Otherwise, as the title to this article suggests, small-cap markets will play a continuous game of 'whack a mole', stopping one pump and dump scheme in one market, only to see new variations continuously pop-up in other markets, as perpetrators continue to circle the globe looking for new opportunities.

Markets could enter into bilateral agreements to share intelligence with each other. There are also two existing organizations which could take the lead to facilitate the sharing of intelligence, as well as work to coordinate the efforts of markets to rid themselves of pump and dump schemes. These are the Intermarket Surveillance Group (ISG)[49] and the World Federation of Exchanges.[50]

The ISG is an information-sharing cooperative whereby members share information in relation to market surveillance, pursuant to an information sharing agreement. Its members consist of exchanges and self-regulatory organizations.[51] The role of the ISG, as stated on its website, is:

"to provide a framework for the sharing of information and the coordination of regulatory efforts among exchanges trading securities and related products to address potential intermarket manipulations and trading abuses."[52]

The ISG meets twice a year, has several subgroups, and has the capacity to form further special subgroups to address specific issues of importance.[53] Given the problem of pump and dump schemes to small-cap markets, the ISG should develop a subgroup dedicated to sharing information and intelligence about this issue. It also needs to devote resources to increasing its membership, as quite a few important small-cap markets are not yet members.[54]

Another organization that could play a role in facilitating the exchange of information between markets in relation to pump and dump schemes is the World Federation of Exchanges ('WFE'). The WFE states that it is the global industry group for exchanges and clearing houses, and its mandate is to contribute to "the development, support and promotion of organized and regulated securities markets

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49 *Overview*, Intermarket Surveillance Group, https://isgportal.org/overview (last visited Jan. 18, 2023).

50 World Federation of Exchanges, https://www.world-exchanges.org/ (last visited Jan. 18, 2023).

51 Intermarket Surveillance Group, *supra* note 49.

52 *Id.*

53 *Id.*

54 *62 Active Members,* Intermarket Surveillance Group, https://isgportal.org/public-members (last visited Jan. 11. 2022). For example, the OTC Markets Group and the Canadian Securities Exchange are not listed as members. For a critique of the ISG, *see* Janet Austin, Insider Trading and Market Manipulation: Investigating and Prosecuting Across Borders 246-247 (Edward Elgar Publishing 2017).

in order to meet the needs of the world's capital markets in the best interests of their users."[55] Although the work of the WFE tends to be more focused on communication and research, it seems that facilitating the exchange of information between small-cap markets could fall within its mandate. However, like the ISG, it may also need to promote more outreach initiatives, as membership is not universal in relation to small-cap markets.[56] Using its platform to assist such markets to eliminate pump and dump schemes may well encourage such membership.

B. Increasing the Likelihood that Perpetrators of Pump and Dump Schemes Will Be Caught and Penalized

The prospect of markets working together to stop the listing of securities which may be subject to a pump and dump scheme is not likely, on its own, to be a permanent solution to the problem. Meaningful deterrence is necessary to effectively eliminate pump and dump schemes. Securities regulators need to swiftly detect, investigate, and ultimately prosecute the individuals behind such schemes. If proven, heavy penalties need to be imposed to deter these people from continuing in their activities. Regulators also need to concentrate their intelligence-gathering and investigative resources on recidivists and those working in, what can be loosely referred to, as the pump and dump industry.

Detecting, investigating, and prosecuting these cases presents significant challenges. This is due to the complex nature of these matters, as well as the fact that perpetrators of these schemes intentionally try to obfuscate their activities behind numerous companies in different countries. However, if regulators devote resources to these matters, it is becoming increasingly possible to obtain positive results. This is due to, inter alia, developments in detection mechanisms, as well as the fact that regulators are becoming more accustomed to working with their counterparts in other countries in the pursuit of their enforcement endeavors.

1. Information gathering to detect and investigate pump and dump schemes

The sources of information available to regulators which can be used to detect these schemes, as well as the people behind them, have been increasing over recent years. Some regulators are also developing more sophisticated systems to

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[55] *About Us*, THE WORLD FED'N OF EXCHANGES, https://www.world-exchanges.org/about (last visited Jan. 18, 2023).

[56] For example, the OTC Markets Group and the Canadian Securities Exchange are not members. Membership & Events, THE WORLD FED'N OF EXCHANGES, https://www.world-exchanges-org/membership-events#member-list (last visited Jan. 18, 2023).

analyze the information they collect.[57] Set out below are some of the developments in this area:

a. Market Surveillance

Market surveillance systems operated by trading venues, self-regulatory organizations, and, in some cases, the regulators themselves, are becoming more sophisticated.[58] In addition, regulators and self-regulatory organizations also receive numerous reports of suspicious transactions from financial institutions. These are usually the result of compliance systems required to be operated by market participants, such as banks and brokers. In Europe, for example, pursuant to the market abuse directives[59] and regulations,[60] market intermediaries are required to report suspicious trades and have compliance systems in place to detect market manipulation, including pump and dump schemes. European regulators are also required to forward a copy of any suspicious report to all other supervisory authorities of organized securities markets within the EU who may be affected by the report.[61]

b. Whistleblowers

Regulators are also increasingly recognizing that whistleblowers are an important way to detect all types of offenses, including pump and dump schemes. Accordingly, many regulators have been ramping up their capacity to receive this information, and are developing ways to incentivize whistleblowers to come forward. These incentives can include protection against retaliation, granting anonymity, and offering financial incentives.[62] The US Securities and Exchange Commission, for example, offers an award of between 10% and 30% of monetary sanctions over $1 million if the information leads to a successful enforcement

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57 For example, within its Market Abuse Unit, the SEC established its Analysis and Detection Center to engage in data analysis. Todd Ehret, *SEC's advanced data analytics helps detect even the smallest illicit market activity*, REUTERS (Jun. 30, 2017), https://www.reuters.com/article/bc-finreg-data-analytics-idUSKBN19L28C. In Canada, securities regulators are developing the Market Analysis Platform, a data repository and analytics system. CAN. SEC. ADM'RS, A COLLABORATION TO PROTECT INVESTORS AND ENFORCE SECURITY LAW 5 (2020), https://www.securities-administrators.ca/uploadedFiles/General/pdfs/CSAEnforcementReport2019-20.pdf.

58 See NASDAQ, *Nasdaq Trade Surveillance (SMARTS)*, https://www.nasdaq.com/solutions/nasdaq-trade-surveillance; B-NEXT, *Market Surveillance,* https://www.b-next.com/market-surveillance/ for example systems available.

59 Directive 2014/57/ of the European Parliament and of the Council of 16 April 2014 on criminal sanctions for market abuse (market abuse directive), 2014 O.J. (L 173) 179.

60 Commission Regulation 596/2014, 2014 O.J. (L 173) 1.

61 *Overview*, *supra* note 49.

62 *See*, SULETTE LOMBARD, VIVIENNE BRAND, & JANET AUSTIN, CORPORATE WHISTLEBLOWING REGULATION: THEORY, PRACTICE AND DESIGN (2020).

action.[63] These financial incentives have dramatically increased the number of tips the Commission receives each year;[64] furthermore, the number of tips it has received in relation to market manipulation has almost doubled since the program began.[65]

Whistleblowers can reveal misconduct that regulators would not have otherwise known about, and can point them towards the most incriminating pieces of evidence. This can result in a much stronger case which, in turn, can make for a quicker and stronger enforcement response. Offering whistleblowers financial incentives may be particularly effective in attracting information in relation to pump and dump schemes because of the sizable amount of fraud, as well as the large number of people who tend to be involved. The more people who are involved and the greater the amount of the fraud, the more likely it is that someone will 'break ranks' and blow the whistle in the hope of obtaining a large award.

c. Breaking through the complexity of bank accounts and nominee companies

In relation to the use of nominee companies in offshore jurisdictions, securities regulators increasingly have access to mechanisms enabling them to obtain information about these companies, as well as the people behind them.

Almost all securities regulators around the world are members of The International Organization of Securities Commissions (IOSCO).[66] IOSCO's "Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information" (MMoU), to which most members are signatories, enables securities commissions to obtain a variety of information. This includes data onfunds and assets transferred into and out of bank and brokerage accounts, the beneficial owners of such accounts, and information identifying people who beneficially own or control companies.[67]

Currently, there is also a global movement led by some governments and international organizations, such as Transparency International, which is reducing

63 U.S. SEC. & EXCH. COMM'N, *Office of the Whistleblower*, https://www.sec.gov/whistleblower.

64 The number of tips the SEC's Office of the Whistleblower has received has increased 130% since the start of the program. U.S. SEC. & EXCH. COMM'N, 2020 ANNUAL REPORT TO CONGRESS WHISTLEBLOWER PROGRAM, 2 (2020), https://www.sec.gov/files/2020%20Annual%20Report_0.pdf.

65 From 457 in 2012 to 942 in 2020. *See id.* at 28; U.S. SEC. & EXCH. COMM'N, ANNUAL REPORT ON THE DODD-FRANK WHISTLEBLOWER PROGRAM, 11 (2012), https://www.sec.gov/files/annual-report-2012.pdf.

66 OICV-IOSCO, *supra* note 45.

67 OICV-IOSCO, *Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information (MMoU)*, https://www.iosco.org/about/?subsection=mmou. *See* JANET AUSTIN, INSIDER TRADING AND MARKET MANIPULATION: INVESTIGATING AND PROSECUTING ACROSS Borders (2017), Chapter 6 at 184, 210, for a more detailed discussion of the MMoU.

the ability of individuals to hide behind nominee companies.[68] This is leading to more countries requiring registries setting out who are ultimate beneficial owners of legal entities. In 2016, the UK Government was the first to do this, by establishing a public registry of beneficial ownership information for all UK companies. The EU followed with the 4th and 5th Anti-Money Laundering Directives, requiring EU member states to set up such registries.[69] In the United States, on January 1, 2021, Congress passed the Corporate Transparency Act, which requires most legal entities within the United States to disclose beneficial ownership information to the Federal Government.[70] The Federal Government in Canada is also planning to set up a public registry disclosing the beneficial owners of companies.[71] The list of countries introducing such registries is likely to grow over time. Securities regulators and IOSCO should add their voices to this movement and push for this change.

2. Closer Links Between Regulators, Markets, and Self-Regulatory Organizations

Given the ability of those who engage in pump and dump schemes to spread their activities across different countries, it is critical that securities regulators work closely with their international counterparts if they are to successfully prosecute the architects of these schemes. In recent years, there has been significant progress relating to such cooperation. IOSCO's MMoU allows regulators to obtain and share information, as well as gather evidence from outside their jurisdiction; and its use has been accelerating in recent years.[72] More recently, IOSCO has been pursuing a new initiative: its Enhanced Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information

68 *See, e.g.*, TRANSPARENCY INTERNATIONAL, *Hundreds of academics, civil society groups and business leaders join…* (Feb. 24, 2021), https://www.transparency.org/en/press/ungass-2021-hundreds-join-petition-to-end-anonymous-shell-companies.

69 Theo Van der Merwe, *Beneficial ownership registers: Progress to date*, U4 ANTI-CORRUPTION RESOURCE CENTRE (Apr. 8, 2020), https://www.u4.no/publications/beneficial-ownership-registers-progress-to-date.pdf.

70 Corporate Transparency Act of 2019, H.R. 2513, 116th Cong. (2019), https://www.congress.gov/bill/116th-congress/house-bill/2513.

71 TRANSPARENCY INTERNATIONAL CANADA, *MEDIA RELEASE: Commitment to fight money laundering ("snow-washing") in 2021 federal budget enthusiastically applauded by civil society organizations* (Apr. 19, 2021), https://transparencycanada.ca/news/civil-society-coalition-enthusiastically-applauds-canadas-commitment-to-fight-snow-washing-in-2021-federal-budget.

72 OICV-IOSCO, *supra* note 67. *See* also Roger Silvers, *Cross-border cooperation between securities regulators*, 69 JOURNAL OF ACCOUNTING AND ECONOMICS 101301 (2020), which demonstrates that the MMoU reduces the cost of liquidity in the capital markets of participating countries.

(EMMoU)[73]. The EMMoU further facilitates cross-border enforcement efforts by securities regulators by, for example, having one securities regulator freezing assets of a suspect upon the request of another country's regulator[74]. There are also multiple bilateral MoUs between securities regulators in relation to enforcement cooperation; and the number of these continues to grow.[75]

As regulators become more accustomed to working together, it is possible to form specific groups to coordinate a quick response to thwart pump and dump schemes. For example, Canadian securities regulators are part of what is called the Cross Border Market Fraud Initiative. This is a multi-jurisdictional group created by the Alberta Securities Commission comprising securities regulators and markets from Canada, the US, and Germany. They work together, along with law enforcement agencies, to coordinate a response to a particular threat of a pump and dump scheme by, for example, issuing cease trade orders and freezing assets.[76]

3. Meaningful Penalties for Offenses Involving Pump and Dump Schemes

It is important that governments, securities regulators, and self-regulatory organizations around the world carefully examine the penalties that are set for this type of fraud. Given the very significant sums of money that can be made, the impact on the integrity of the markets and their potential impact on the economy and jobs growth suitable penalties will necessarily involve the ability to impose significant prison terms while stripping the perpetrators of the proceeds of their crimes. It is also critical that, when offenders are sentenced, courts and tribunals exercise their powers to impose meaningful penalties which specifically deter repeat and new offenders.

Although the establishment of penalties for offenses is within the control of each country, others can contribute to the setting of such penalties. Markets and self-regulatory organizations could lobby governments to prescribe penalties that will have a meaningful deterrent effect. At the international level, organizations such as IOSCO or the G20 could take the lead in this area.

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[73] OICV-IOSCO, *Enhanced Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information (EmmoU),* https://www.iosco.org/about/?subsection=emmou

[74] *Id.*

[75] For a list and discussion of these bilateral MoUs, *see* Roger Silvers & Rachel Hayes, *Global cooperative networks as a solution for cross-border issues in securities law enforcement* (Working Paper).

[76] CAN. SEC. ADM'RS, *supra* note 57, at 6.

CONCLUSION

Pump and dump schemes continue to plague the small-cap markets, affecting their integrity which, in turn, is to the detriment of the economy. Ridding the markets of these schemes is not easy. However, there are ways in which the number of these schemes and their impact can be significantly reduced.

As outlined above, the solution is ultimately multi-faceted. Small-cap markets must make this a priority by working with each other and working closely with those regulators responsible for their supervision. Securities regulators, in turn, must commit resources to the problem, utilize multiple mechanisms to break through the complexity of such schemes, and work tirelessly together to bring the perpetrators to justice. Clearly the challenges are not easy, but the rewards in terms of the flow on effects of enhanced market integrity and improved access to capital by SMEs surely makes the effort worthwhile. In the end, what is really at stake is facilitating the nascent stages of growth for new business enterprises that will, in turn, provide employment opportunities and growth for the economy.