A look at stock market scams using the latest technology

August 12 2015

Stock scams are about as old as the market itself, but the combination of worldwide information technology and automated programs that can make thousands of trades in a second has created new paths for potential frauds. The U.S. government says alleged scammers have used methods including rapid trades, fake regulatory filings and news reports to get an advantage and make profits. Here are a few examples:

— In May 2010 the Dow Jones industrial average plunged 600 points in about five minutes and closed with a loss of 348 points. Regulators said the dive was triggered by a computerized selling program, and in April 2015 the U.S. government filed criminal charges against British futures trader Navinder Singh Sarao. The U.S. Department of Justice said Sarao used an automated trading program to manipulate the market and charged him with fraud and commodities manipulation. Sarao has said he was merely good at his job.

— Shares of Avon Products rose as much as 20 percent in May after a false Securities and Exchange Commission filing said an investment firm wanted to buy the cosmetics retailer for $8 billion. That was a big premium for a company that had struggled with falling sales and reduced revenue. In May the SEC sued a Bulgarian man, Nedko Nedev, and said he and five others violated securities laws by creating fake takeover offers. The SEC said Nedev also made fake bids for Rocky Mountain Chocolate Factory in 2012 and insurer Tower Group International in 2014.

— In July, Twitter's stock climbed as much as 8.5 percent after a fake story said the short messaging service received a $31 billion buyout offer. That, too, was a significant premium to Twitter's market cap at the time, and it came as investors worried about Twitter's losses and its user growth. The story appeared on a website that mimicked the business news page of Bloomberg. Twitter shares returned most of those gains after Bloomberg said the story was a fake.

— The same month, two men were arrested in Israel and accused of trying to cheat millions of people by driving up the price of penny stocks with sending false and misleading spam emails. A U.S. citizen was also being sought. The charges included conspiracy and securities fraud, and the SEC said the men ran at least 20 stock promotion websites. The scam was a pump-and-dump scheme designed to drive up the price of the stocks so the promoters can sell them at an inflated price before the truth comes out and the prices fall again.

— On Tuesday the U.S. government said a group of hackers and securities brokers broke into the computer systems of three companies that publish news releases and traded on the information in hundreds of press releases before the public saw them. The Justice Department says the group had members in Ukraine and the U.S., and it made $30 million over the years from trading shares of heavy machinery maker Caterpillar, Invisalign braces maker Align Technology, and other companies based on the unpublished releases.

Robert Heim, a former lawyer at the SEC, said these kinds of schemes will probably persist because news spreads so fast over social media and traders have to react so quickly. He compared the fake offer for Twitter to a pump and dump fraud as well.

"Instead of having a room full of cold callers calling up investors and pitching a stock, now people can set up a website in a day or so, often on their own, and publish a fake news story to be able to trade on the securities before the truth comes out."

Automated trading programs that act based on increased trading volume and prices can magnify the effect of the scams, he added. Heim said retail investors should be careful and make sure news stories are verified before they made trades based on them.