

Cybertrading: Financial Markets and the Internet¹

Simon Temple

Senior Investigator, Australian Securities & Investments Commission

INTRODUCTION

The Internet has become an important tool for investors. It provides a wealth of easily accessible information on any topic imaginable and a large portion is dedicated to financial markets and investment. Unfortunately, the Internet has also become a tool for unscrupulous operators who use it to defraud others.

This article will give some insight into the impact of the Internet on financial markets and the dangers that lurk in cyberspace.

FRAUD ON THE INTERNET

Much of the fraud committed via the Internet is not new. It is simply a case of traditional offences finding a new home. There are however, some new challenges for law enforcement to overcome.

Affordability and accessibility

Access to the Internet is cheap. It costs little or nothing to set up a web site and email address. Once on the web anyone can reach out to the world. Rapid developments in technology have meant that even the most basic web site can look very professional. Gone are the days when a fraudster needed to rent an office, fill it with books and furniture, hire a secretary and wear an expensive suit to create an impression of authenticity. Nowadays, a carefully designed web site can create the appearance of all that and more, without the expense, and without the need for the perpetrator to have personal contact with potential victims.

¹ This is an edited version of a paper that was presented at the 3rd Symposium of the Australian Law Librarians' Group, Sydney, July 19-21, 2000.

Anonymity

An entire fraud – from the initial contact to the final transfer of funds – can be conducted electronically from the safety of the home or office. Internet fraudsters often attempt to hide their true identity by falsifying personal details, incorrectly setting time and date information or forging data such as the ‘sender’ field of an email. In addition, the sheer volume of material being sent around the world can at times cause problems for investigators trying to identify specific data.

Despite what most people believe, the Internet isn’t actually anonymous. Various methods are used by law enforcement agencies to successfully track down suspects. The key, in many cases, is initiating an investigation quickly.

The borderless and global nature of Internet crime

Consider the problems when the perpetrator of a fraud resides in one country, uses an Internet Service Provider (ISP) located in another country, and defrauds people residing in a number of other countries around the world. Who is going to investigate the crimes? Who has the necessary jurisdiction and powers to obtain the evidence?

Law enforcement agencies and governments throughout the world have recognised this as probably the most significant challenge and steps are taken to overcome it. In the meantime, many countries have ‘mutual assistance agreements to facilitate access to documentation and residents of other countries. The process may be slow at times, but it is often very effective in bringing offenders to justice.

Speed and immediacy of transactions

Data can be sent from one side of the world to the other in seconds. Similarly, financial transactions can pass from country to country in the blink of an eye. Unfortunately, tracing of funds and data is more time-consuming as procedures and protocols must be followed.

Lack of collateral information

Traditional evidence such as documents, fingerprints, handwriting and witness identification are often absent in an Internet fraud. Investigators rely heavily on transmission records and data collected by intermediaries such as ISP's and telecommunication carriers to follow the trail back to a suspect.

FINANCIAL MARKET PARTICIPANTS

In recent years, the number of Australians who directly or indirectly own shares has grown substantially. This is due to a number of high profile company floats such as Telstra, NRMA, Woolworths and the TAB as well as compulsory superannuation legislation.

A survey conducted by the Australian Stock Exchange (ASX) indicates that more than 53% of the Australian adult population own shares directly or indirectly (ie indirectly via a managed fund or personal superannuation). This ranks Australia number one among similar economies worldwide in terms of the proportion of the population who own shares.²

About 42% of Australian shareholders have a share portfolio valued at \$10,000 or less. This indicates that relatively inexperienced 'mum & dad' investors make up a large proportion of Australian shareholders. With so many small investors having an interest in the financial markets, ensuring market integrity and fair play is vital.

FINANCIAL INFORMATION ON-LINE

Growth in the number of new investors has led to significant increases in demand for on-line trading and investment advice as more consumers become comfortable with the concepts associated with the Internet and the financial markets. The accessibility of the Internet means that, from the comfort of the lounge room or office, vast amounts of information can be accessed on just about every aspect of the financial markets.

² ASX Share ownership Survey 2000

Aside from the traditional, licensed financial advisors and stockbrokers offering on-line facilities, there are a number of other Internet based services that provide investors with access to vast quantities of information. Listed below are some of the most common sources of financial information and some of the potentials for abuse which exist:

Newsgroups

A newsgroup is an electronic discussion about a particular subject consisting of contributions written to a central Internet site and redistributed through a worldwide network of news discussion groups. Newsgroups dedicated to discussion of financial markets feature prominently.

Most newsgroups are unmoderated which means that no one checks the material posted to the newsgroup. As a result, newsgroup postings often contain false or misleading information.

Bulletin Board Services

Bulletin boards on the Internet are, in some ways, similar to newsgroups in that boards are dedicated to subjects including the financial markets. It is most common to access a bulletin board via a web site. Bulletin boards usually have a moderator who regularly reviews the postings and removes those deemed inappropriate.

Postings to a bulletin board can reach a very wide audience because once posted, they remain on the board until removed by the moderator or site operator. Anyone who visits the web site hosting the bulletin board can view previous postings.

Despite the fact that bulletin board services usually have moderators, they are a favoured place for market manipulators to ply their trade because they have the potential to be read by many people.

Internet Relay Chat

Internet Relay Chat (IRC) allows participants to 'talk' in real time with anyone else logged into that forum at the time. There are dedicated forums in IRC for discussion about various financial topics. Unlike bulletin board systems, IRC cannot be read after the event. Nevertheless IRC is also a favoured haunt for market manipulators.

Email and 'spam'

Most people know what email (electronic mail) is. 'Spam' is the term given to unsolicited commercial email – those emails that come from someone you don't know, offering anything from adult services to financial advice. Spam emails are regularly sent in batches of up to 200,000 at a time.

Despite the fact that the email originated from an unknown source, many recipients make financial decisions based on the 'information' it contains. This is often because they are convinced by the apparent authenticity. For example, an email may appear to have been sent to the recipient by mistake, and contains a message from 'John' (who works at xyz company) telling 'Steve' (his friend) that the company is about to be taken over and recommending Steve buy some shares. In the face of this apparent good fortune, the recipient makes his or her own purchase of the named shares. The sender has achieved his objective.

Web sites

Many web sites are created for the specific purpose of spreading false or misleading information about companies in order to move the price of shares up or down. A web site may look and 'feel' professional and authentic but behind it lurks a conman hoping to convince visitors to buy or sell the target shares.

Bulletin board systems, newsgroups and IRC are good places to see what other people think of specific shares. Web sites and email can also contain worthwhile information. Remember though, the financial circumstances of the individuals giving the opinions are not likely to be the same as yours and so the information should be independently verified before being relied upon.

CYBERCRIME IN FINANCIAL MARKETS

Unlawful conduct committed via the Internet is, by and large, the same as that committed in the 'real world'. The most common offences committed in relation to financial markets are share price manipulation, unlicensed financial advice and illegal fundraising

Share price manipulation

- *Pump and dump*

This is where the perpetrator purchases a quantity of shares in a relatively thinly traded stock, then uses the Internet to spread false and misleading information to convince others to purchase that stock. The information usually consists of very positive 'rumours' such as an impending takeover by a larger company. The additional demand for the stock causes the price to rise. The perpetrator sells at a higher price and ceases the 'promotion'. When the information is found to be false, the price usually falls back, resulting in losses for those who bought on the strength of the false information

- *Trash and cash*

The opposite of 'pump and dump'. The perpetrator disseminates false negative information about a stock, causing the share price to fall at which point the perpetrator buys. When he ceases issuing the negative information, the price usually rises back to its original value resulting in a profit for the perpetrator.

- *Insider trading*

The term applied when an employee misuses information. For example, an employee of a small company about to be taken over by a much bigger competitor passes on this information to a select group of investors. They purchase the stock and make a profit when the share price rises after the take over is announced to the market

Unlicensed financial advice

Anyone who conducts a financial advice business or claims to be a financial advisor is required to hold a Financial Adviser's License or an authority from a license holder. Licensed Advisors undergo specific training and clients of licensed advisors have access to dispute resolution schemes in the event of problems. The

licensing requirement does not prevent individuals discussing financial markets and giving their own opinions, provided the person does not state or imply that they are a licensed advisor or an authorised representative.

In all cases, knowingly giving false or misleading information about securities is unlawful

ASIC offers a number of free services that can help investors. A register of licensed investment advisers and deals is available on the ASIC consumer protection home page www.fido.asic.gov.au and details about licensed advisers and deals are also available from the ASIC infoline on 1300 300 630

Illegal fundraising

The laws relating to raising money from the public are complex. In general, anyone seeking to raise money must provide specific information to the potential investor, and in most cases, needs to have lodged information with ASIC prior to approaching potential investors.

Many of these schemes get investors to draw in family and close friends and then exploit these relationships of trust. Promoters offer extraordinarily high returns (up to 1000% pa) on the basis that they know the 'secret' of how banks create wealth. The schemes tend to have overseas promoters and claim overseas trustees or guarantees. They don't have prospectuses and little – if any – other documents. Sometimes they explicitly state they are not a security offering, in an attempt to escape prosecution.

Other schemes

There are many other offers floating about on the Internet including:

- *High yield investment schemes* offering very high returns. One fundamental principal of investment is 'higher return equals higher risk'. Any investment offering high returns with low risk should be scrutinised in great detail.
- *Pyramid schemes*, also known as 'multi-level marketing'. Such schemes typically require an 'investor' or 'purchase' which is given to earlier

participants. The new investor is supposed to receive payment from future investors. Virtually all pyramid schemes are illegal in Australia.

- *Exotic schemes*, such as the well publicised 'Nigerian Letters' which offered a huge return for participants who allowed their bank accounts to be used to hide money supposedly misappropriated from one government authority to another

REGULATION OF FINANCIAL MARKETS

ASIC

The Australian Securities and Investment Commission (ASIC) is one of three Commonwealth government bodies that regulate financial services and is the single national regulator of Australia's 1.1 million companies.

ASIC regulates the advising, selling and disclosure of financial products and services to consumers so they have adequate information, are treated fairly and have adequate avenues for redress. ASIC protects markets and consumers from manipulation, deception and unfair practices and is also the Corporations Law watchdog, promoting honesty and fairness in securities and futures markets and in company affairs.

The broad outcome the Government expects ASIC to deliver is 'a fair and efficient market characterised by integrity and transparency and supporting confident and informed participation of investors and consumers'.

The ASIC web site (www.asic.gov.au) and the ASIC consumer information website (www.fido.asic.gov.au) are invaluable tools for anyone considering an investment. The site offers pointers on how to avoid scam, pitfalls and other potentially expensive mistakes in investing, superannuation, insurance and other financial products, using what ASIC digs up in its investigations and inspections. It has a complete list of prospectuses, details on every licensed investment adviser and everyone who has been banned. The site provides guidance on how to make a complaint if something goes wrong, and contains all the industry codes of conduct that back up basic consumer rights.

Fido also hosts the ASIC Gull Awards, a monthly competition for the most outrageous tales of money and deceit.

CONCLUSION

For beginner and veteran investors alike, the Internet really is a unique resource, providing access to an endless amount of previously inaccessible information. However, the most important thing to remember is that unscrupulous people do lurk on the Internet, and you should carefully scrutinise everything you read, particularly when it comes to investing. With common sense and reference to information provided by agencies such as ASIC, financial market participants can go a long way to ensuring their investments are safe.

If you would like to contact Simon Temple you can do so by telephone on (02) 9911-2294 or by email at simon.temple@asic.gov.au.



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