Market Abuse Case Studies

John Gorman III - Primary Market Manipulation

Market Abuse Case Study No: 004	**Name:** John Gorman III
Alleged Offence: Primary Market Manipulation in Bond Issuer Swaps	**Detection Control:** Front Running V2 (Deal Specific Facilitation)

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Civilian Authority:
Commodity Futures Trading Commission (CFTC)

Alleged Offence:
Primary Market Manipulation in Bond Issuer Swaps

Detection Control:
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Overview

On the 1st February 2021, the CFTC filed a complaint at the U.S. District Court (Southern District of New York) against John Gorman III, a U.S. dollar swaps trader for Nomura based in Tokyo. The complaint alleges that Gorman engaged in a scheme to deceive and manipulate the price of U.S. dollar interest rate swap spreads to benefit Nomura in an interest rate swap transaction associated with a bond issue (an "issuer swap") that was being priced at the time by Nomura (his employer).

The alleged market abuse occurred shortly after midnight in Tokyo on the 4th February 2015, corresponding to the morning of the 3rd February in New York. On this date, a 10-year $1bn bond issuance was being priced together with a related interest rate swap that the bond issuer had agreed to transact with Nomura.

The pricing methodology/formula for the interest rate swap had already been agreed and would be based upon the prevailing price of 10-year U.S. dollar swap spreads. Furthermore, a particular pricing screen (the “19901” screen) of a Swap Execution Facility (“SEF”) was to be used to reference the prevailing 10-year swap spreads price. This screen showed live prices, and it was agreed that during a pricing call (where the swap rate would be set), Gorman would communicate the live swaps spread price from this screen. The CFTC alleges that Gorman manipulated this price (the 10-year swaps spread) on the 19901 screen via multiple swap spreads transactions in the minutes and hours prior to the call.

Transaction Details and Related Comms

The CFTC’s allegations are based upon Gorman’s pattern of transactions and orders prior to the pricing call and his related communications.

In particular, the CFTC alleges that Gorman made the following trades prior to the swap price fixing, which occurred about 20 seconds after the trade at 1:24 am JST in a pricing call:

- 12:45 am JST: Gorman sold @ 13.25
- 1:13 am JST: Gorman sold @ 13.5
- 1:16 am JST: Gorman sold twice @ 13.5
- 1:20 am JST: Gorman sold @ 13.75
- 1:24 am JST: Gorman sold at 13.5

In each case, the transaction was a 10-year swap spreads trade executed on the same SEF as referenced in the pricing formula (allegedly to achieve the maximum level of price manipulation for the issuer swap fixing). The court filing also indicates sizes of $50m for each individual transaction (where specified). Assuming this size is roughly applicable to each transaction, this would imply Gorman sold about $300m in 10-year swap spreads prior to the price-fixing of the issuer swap.

In relation to Gorman's communications, the CFTC asserts that these show the clear intent of Gorman to manipulate the issuer swap price fixing. The CFTC highlights various communications, including the following:

- At 12:51 am JST, Gorman told the head of the swaps desk in New York that he thought he could move the screen down to 13.25 ("I will get the print at 13.25").
- At 12:53 am JST, the swaps desk head told Gorman not to "waste too many bullets" – this is not to sell too much – trying to get the price to 13:25 and that there was a "solid bid for spreads".
- In response at 1:07 am, JST Gorman said, referring to the upward movement of the market, which was unfavourable to the bank, "I hate pricing these when momentum is against us. Takes all the fun out of it".

The Alleged Harm

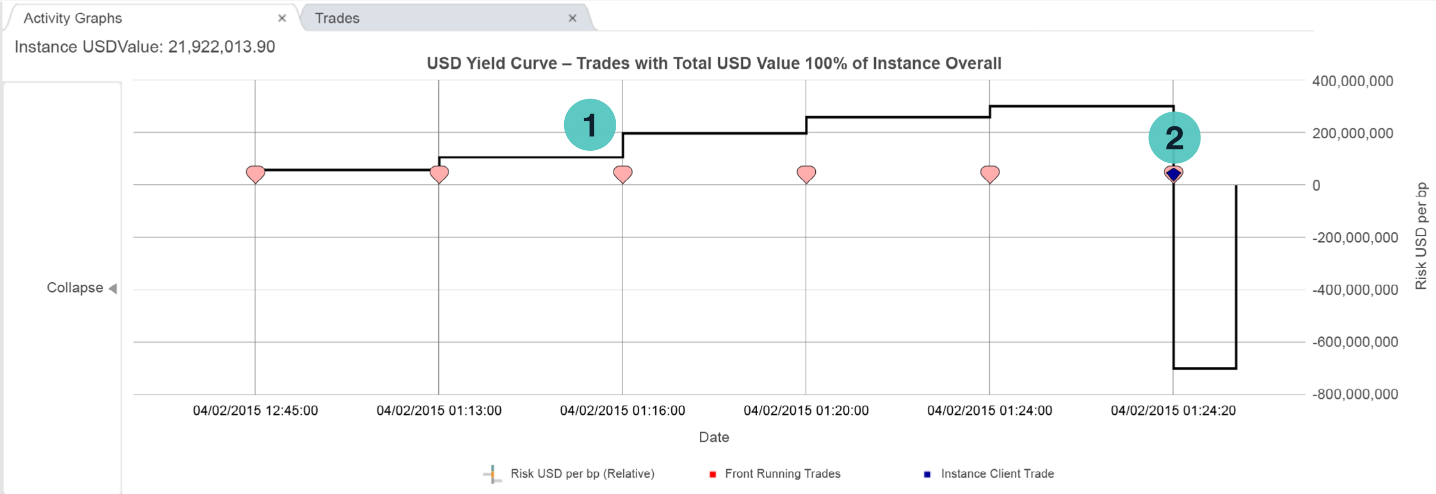
During the alleged market manipulation period, the CFTC describes how the market in 10-year swap spreads moved higher (from 13bps to 13.75bp), with the issuer swap price fixing occurring when the market was at 13.5bps. The increase in the market price happened despite the c. $300m of 10-year swap spreads that Gorman sold (due to the significant amount of buying interest at the time from the rest of the market).

It is, therefore, unclear if Gorman's was successful in moving the price in Nomura's favour and to what extent. One estimate is that he managed to move the market 0.25bps lower (as the market was 13.75 right before his final trade, and the price fixing occurred immediately after using a 13.5bps reference price).

As the 10-year issuer swap would have had a DV01 slightly below $1m per bp, every 0.25bps of price manipulation would have benefited Nomura by approximately $250k in P&L at the detriment of the issuer.

However, the CFTC's case relies not on whether Gorman was successful but rather on his intent. They assert that he is guilty of market manipulation because his trading activity and communications show a clear intent to commit market manipulation.

Detecting Primary Market Manipulation in MAST



This scenario has been mocked up and run through MAST. The graph screenshot shows how MAST illustrates the changing risk position within the instance.

1. The line graph and associated red markers show the build-up of the interest rate risk position trading activity prior to the pricing call.
2. The victim trade is highlighted by a blue diamond and shows a corresponding fall in the interest rate risk position when the issuer swap is executed at 01:24:20 JST.

Activity Graphs | Trades

Show Relevant Trades Show All Trades

Trade Date	Client Instrument ID	USDValue	Trade Designation	Amount
04/02/2015 12:45:00	USD 10Y Swap	5,944.70	Front Running	50,000,000
04/02/2015 01:13:00	USD 10Y Swap	32,342.18	Front Running	50,000,000
1 04/02/2015 01:16:00	USD 10Y Swap	107,773.84	Front Running	100,000,000
04/02/2015 01:20:00	USD 10Y Swap	54,571.55	Front Running	50,000,000
04/02/2015 01:24:00	USD 10Y Swap	57,174.70	Front Running	50,000,000
2 04/02/2015 01:24:20	Issuer Swap	257,806.97 3	Instance Client	-1,000,000,000

The trade screenshot shows how MAST illustrates the key trading activity within the instance.

1. The trader executed five trades prior to the swap price fixing which exerted downward pressure on the rate used for the swap price fixing.
2. The swap price fixing occurs at 01:24.20 JST using the price visible on the live screen.
3. MAST calculated the harm from the market impact of the front running trades on the issuer swap and assigned a USDValue of $257,806.97.

How MAST recognises Primary Market Manipulation

Where pre-hedging of a customer order is not permitted (for example, a related transaction in a primary market deal), MAST analyses the trader's activity prior to the execution of the customer's order. MAST uses its Market Impact Model (MIM) and General Market Model (GMM) to determine and quantify whether the trader's activity is likely to have affected the market and corresponding execution price of the customer order.

Where the trader's activity is expected to have affected the order execution price, MAST will express the gain to the trader as a USD Value. An alert will be generated when the materiality score (USD Value) exceeds a pre-set threshold amount.

MAST's MIM & GMM models evaluate cross-product market impact (meaning that the impact of futures trades on swap market prices is covered). Furthermore, evaluation of the market impact on the customer's order considers the timing and size of trades.

Advance your surveillance function

Detect cross-product abuse, reduce false positives, and prioritise high-risk alerts.

Reach out to learn more.

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