**ISSN No.: XXXX-XXXX**

**FinnRebus Quarterly**
[A Peer-Reviewed Journal of Law, Economy & Development]
www.finnrebus.com : Email: Support@finnrebus.com

# ARTIFICIAL CREATION OF VOLUME IN STOCK MARKET

**Akshit Awasthi***

***Abstract***

*Artificial creation of volume in stock market leads to market manipulation which is increasing with each financial year passing by. The SEBI Data indicates towards the number of entities being held over last 6 months in the matters related to creation of artificial volume, and the number is increasing gradually. The present legal framework empowers SEBI to enforce the rules mentioned under various regulations. However, the problem of volume manipulation in stock market persists and thrives.*

*The present work explores the problem of artificial creation of volume in the stock market, and examines the reasons behind the same.*

**Keywords**: Artificial Creation of Volume, Stock market, SEBI, Securities etc.

**Citation:** Awasthi, Akshit. "Artificial Creation of Volume in Stock Market in India". *FinnRebus Quarterly* 1.1. (2022): 23-29

## Introduction

In term of Securities Market, the expression 'volume' indicates the amount of asset or security that changes ownership over a period of time. This period of time can be a day, a month, a year or even an hour. Stock trading volume would refer to the number of shares of security traded over a period of time. More active the share more will be the volume. Volumes are helpful to confirm a trend. High Volume means today's volume is greater than volume of last 10 days. Low volume means today's volume is less than average volume of last 10 days. For example: If I buy 200 shares of ABC company and sell 100 shares to X and 100 shares to Z then the volume created is 200. I and X AND Y together created a volume of 200.

Artificial creation of volume means dealing with non-genuine trades in a particular period of time. It is when a large number of fraudulent trading has happened which led to fictitious creation of volume. High volume is seen as sustainability. People tend to invest more in such stocks which show higher volume since more active the stock more is the investment in future in it. Hence many people tend to use fraudulent and manipulative manner in order to create volume. There are various manners through which artificial volume is created such as circular trading, market manipulation, large amount of reversal of trades, etc.

Reversal trades are considered as those trades in which an entity reverse his/her buy or sell positions in a contract with subsequent sell or buy positions with the same counterparty during the same day. These reversal trades are deemed to be unusual when they are in large amount and are repetitive. When these reversal trades are not in normal course of business and lack basic trading rationale, and thus lead to false or misleading appearance of trading in terms of generation of creation of artificial volume in stock market these trades are called deceptive and manipulative in nature. Such Reversal trading is generally done in illiquid stock options.

We can observe various cases on daily basis in which SEBI identifies many such persons who are held for artificial creation of volume. SEBI during a given investigation period undergoes various processes so as to assess the truth and collects proof of such violation. SEBI has framed different regulations to stop this but still it is happening. Mostly it is happening by using reversal trades.

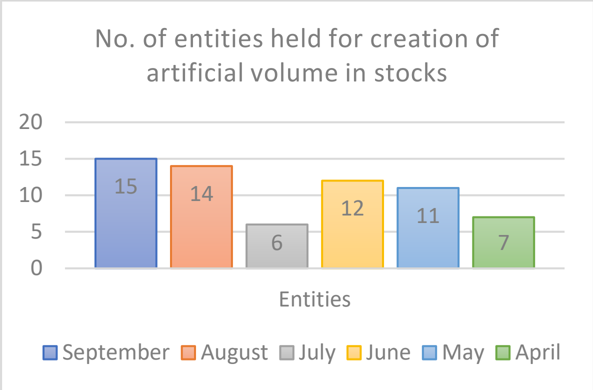
## Market Manipulation by artificial creation of volume

Market manipulation via artificial creation of volume is done usually in following manner:

(i) the isolated trade and reversal in the same option,
(ii) the same counter party being involved in both the trades,
(iii) the dates of the trade being the same,
(iv) the gap between the trade and the reversal being very short,

(v) the substantial difference in the buy and sell rate within such short span of time and
(vi) the high volume of trade in turn creating an artificial volume.

SEBI has framed SEBI (PFUTP) Regulations, 2003, under which Regulation 3 and 4 prohibits manipulative, fraudulent and unfair trade practices. There has been constant increase in cases where no. of entities is being held for PFUTP regulations 3 and 4 violations in relation to creation of artificial volumes in stock options.




The above data [1] of last 6 months i.e. April- Sep 2021 shown can be simplified below:

| Month | No. of Entities held |
|---|---|
| September | 15 |
| August | 14 |
| July | 6 |
| June | 12 |
| May | 11 |
| April | 7 |

The above data comprises of Adjudication orders passed against entities by A.O. who were held under PFUTP Regulations and penalties were imposed against them.

**Responsibilities of Intermediaries**

Securities and Exchange Board of India (Intermediaries) Regulations, 2008 Schedule III mentions the Code of conduct for Intermediaries. Regulation 16 of the Intermediaries Regulations, 2008 talks about mandatory following of the code of conduct Specified in the Schedule III. The Code of Conduct provides the efforts to protect interests of Investors and to render best possible advice to the clients. It also mentions about rendering high standard of service and maintaining due diligence while exercising its duties. It mentions about observing fairness, integrity and professionalism while executing its actions. Similar such code of conduct is also mentioned in Stock Broker Regulations,1992 with respect to Stock Brokers. ***In Re v. Vertex Spinning Ltd***[2] involved artificial creation of volume wherein Enquiry Report revealed that the stock broker was involved in artificial creation of volume by fake trading in a synchronised manner. The registered Stock broker also did not exercise due skill, care and diligence expected from stock-brokers in terms of Regulation 7 read with Clause A (1) to (5) of Code of Conduct specified under Schedule II of SEBI (Stock Brokers) Regulations, 1992(hereinafter referred to as "Stock Brokers Regulations"). Hence the Stock broker was debarred from dealing with stocks and accepting new clients for 3 months and penalties were also imposed.

Hon'ble SAT in the case of ***Triumph International Finance Ltd. v. SEBI***[3] was dealing with a similar case of creation of artificial volume. The question that arose before tribunal for consideration was– could it be said that the appellant who was a broker was innocent and whether such large number of trades could have matched on the screen without the knowledge and active involvement of the appellant as a broker. The tribunal answered that "it has to be in the negative. It is the broker who plays a pivotal role in synchronizing the trades with the counter broker and match the same through the exchange mechanism by punching the buy and sell orders simultaneously. It is true that the brokers act on the advice of their clients but it is they who actually implement the game plan."

Intermediaries have the duty to follow the code of conduct and act with due care and diligence while dealing with stocks on behalf of their client. They also have the duty to give best advice to their clients and protect interests of clients as well as the investors. Hence, they have dual obligations.

SEBI data shows increasing cases of Market Manipulation which lead to artificial volume. SEBI has a solid surveillance system which was established in 1999. SEBI conducts investigation if it has reasonable ground to believe that any person has violated SEBI (Prohibition of Fraudulent and Unfair Trade Practices) Regulations, SEBI (Prohibition of Insider Trading) Regulations, etc. The investigation is initiated by SEBI on the basis of reference which it receives from sources such as SEBI's Integrated Surveillance Department, other operational departments within SEBI, exchange reports, external government agencies, media reports, complaints etc. SEBI data shows interesting trends in the investigations in cases that took place.

During 2019-20 cases taken up for investigation were 161 and cases completed were 170 while during 2020-21 no. of cases taken up for investigation were 94 and cases completed were 140. So, a decrease of 26.27% in number of new investigations taken up by SEBI.

Another interesting trend was relating to nature of investigations cases[4] taken up.

| Particulars | Investigations Taken Up | |
|---|---|---|
| | 2019-20 | 2020-21 |
| Market manipulation and price rigging | 35 | 41 |
| 'Issue' related manipulation | 2 | 0 |
| Insider Trading | 49 | 30 |
| Takeovers | 2 | 3 |
| Miscellaneous[1] | 73 | 20 |
| **Total** | **161** | **94** |

During 2020-21, 41 cases (43.6 per cent) taken up by SEBI for investigation were related to market manipulation and price rigging, 30 cases (31.9 per cent) pertained to insider trading.

During 2019-20, 35 cases pertained to market manipulation which amounted to 21.73 % of cases. Hence, we can observe that how the percentage of investigation cases pertaining to market manipulation have increased by nearly 22 % in a year.

Now if we look towards the SEBI data regarding the nature of investigations completed, we find that During 2020-21, 46 cases (32.9 per cent) completed were related to market manipulation and price rigging, 40 cases (28.6 per cent) pertained to insider trading, four cases (2.9 per cent) pertained to takeovers, two cases (1.4 per cent) pertained to 'issue' related manipulation and 48 cases (34.3 per cent) pertained to other violations of securities laws.

| Particulars | Investigations Completed | |
|---|---|---|
| | 2019-20 | 2020-21 |
| Market manipulation and price rigging | 39 | 46 |
| 'Issue' related manipulation | 1 | 2 |
| Insider Trading | 57 | 40 |
| Takeovers | 1 | 4 |
| Miscellaneous* | 72 | 48 |
| Total | 170 | 140 |

During 2019-20 percentage of investigations completed relating to market manipulation is 22.9 % but during 2020-21it is 32.9%. Hence increase of 10% in investigations completed by SEBI.

SEBI also have regulatory actions initiated.

| Regulatory Action Approved by Competent Authority | Number of Entities | |
|---|---|---|
| | 2019-20 | 2020-21 |
| Adjudication proceedings | 1,294 | 1,283 |
| Proceedings under Section 11 of SEBI Act | 678 | 253 |
| Administrative warning | 69 | 214 |
| Enforcement actions under Summary Settlement | 20 | 9 |
| Prosecution Proceedings | 10 | 3 |
| Proceedings under Intermediaries Regulations | 0 | 1 |

## Role of Registrar to an Issue and Share Transfer Agent

Registrar to an Issue and Share Transfer agents have the duty to maintain records for at least 14 months.[5] The Code of conduct specified for Registrar to an Issue and Share transfer agents requires them to observe due care and diligence while exercising their duties. They also have duty to make reasonable efforts to avoid misrepresentation and ensure that the information given to investors is not misleading[6]. As per SEBI[7] data no. of Adjudication orders passed against Registrar to an issue in 2019-20 were 2 while that in 2020-21 was just 1. In Oct 2021 SEBI cancelled registration of Sherapo Services as an RTA as it was not maintaining proper records. In addition, Sharepro Services processed requests for issue of duplicate shares without checking the genuineness of such requests. It was discharging its functions as an RTA without exercising due care and diligence and was acting in a manner which was grossly unprofessional and thoroughly prejudicial to the interest of the investors.[8]

## Role of Compliance officers

Every intermediary has to appoint a compliance officer who is responsible for monitoring the compliance of the Act, rules and regulations, guidelines etc. issued by SEBI or Central Government for investor protection. The compliance officer is responsible for various activities such as compliance of policies, coordination with stock exchanges and SEBI, comprehensiveness and authenticity in information being filled with SEBI. In July 2021 ***in the matter of Franklin Templeton*** SEBI not only docked the top officials and fund managers of Franklin Templeton Investment but also docked fund's chief compliance officer a sum of Rs. 50 lakhs because it didn't exercise due care and diligence and didn't ensure proper care and judgement while exercising its duties.

## Role of Depositories

Depositories act as a link between Stock exchanges and investors by employing various intermediaries known as Depository Participants (DP). When a trade occurs, depositary transfer the ownership from one person to another. But sometime the trades are reversal trades and which lead to artificial creation of volume, most of the time the DPs know about such misleading situation and are aware of it but they don't act in professional manner. Hence Depositories must be more aware of such misrepresentation and must be vigilant enough to stop such intermediaries and issue certificate only after due inquiry. In 2015 SEBI has directed depositories to "freeze all the securities held by the promoters and directors of the listed companies that are not in compliance with the provisions of Sebi circular."[9]

Acc to CDSL data as on March 2021 no. of DP restrained by CDSL in 2020-21 were 66 which were just 43 in 2019-21.[10]

**Enforcement actions taken by SEBI**

During 2019-20 Prohibitive directions issued under Sec 11 of the SEBI Act 1992, were issued against 766 entities, adjudication orders were passed against 1818 entities, followed by prosecutions filed against 94 entities while conviction by courts was just against 66 entities.[11]

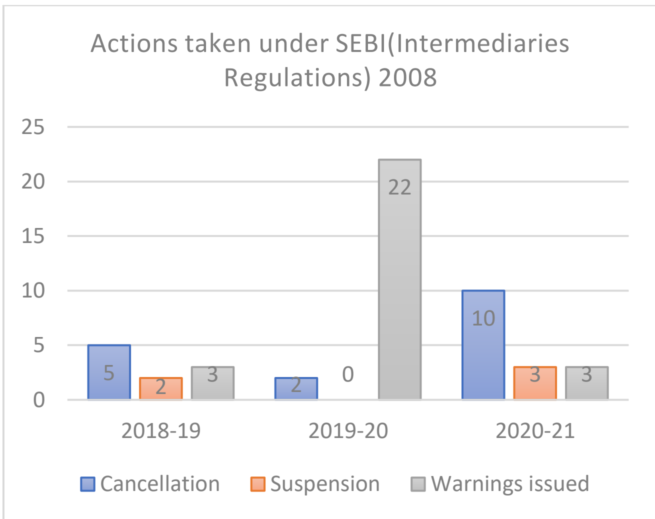
During 2020-21. Prohibitive directions issued under Section 11 of the SEBI Act 1992, were issued against 984 entities, adjudication orders were passed against 2,050 entities, followed by prosecutions filed against153 entities while conviction by courts was just against 6 entities.[12] There are multiple examples of cases where tribunals and A.O. have passed orders based on circumstantial evidences against intermediaries and other entities related to cases of artificial creation of volume in stock market.

Hon'ble Supreme Court in SEBI ***v Kishore R Ajmera***[13], wherein it was held that "in the absence of direct proof of meeting of minds elsewhere in synchronized transactions, the test should be one of preponderance of probabilities as far as adjudication of civil liability arising out of the violation of the Act or provision of the Regulations is concerned. The conclusion has to be gathered from various circumstances like that volume of the trade effected; the period of persistence in trading in the particular scrip; the particulars of the buy and sell orders, namely, the volume thereof; the proximity of time between the two and such other relevant factors. The illustrations are not exhaustive..."

The Hon'ble Supreme Court further held in the same matter that – "It is a fundamental principle of law that proof of an allegation levelled against a person may be in the form of direct substantive evidence or, as in many cases, such proof may have to be inferred by a logical process of reasoning from the totality of the attending facts and circumstances surrounding the allegations/charges made and levelled. While direct evidence is a more certain basis to conclude, yet, in the absence thereof the Courts cannot be helpless. It is the judicial duty to take note of the immediate and proximate facts and circumstances surrounding the events on which the charges/allegations are founded and to reach what would appear to the Court to be a reasonable conclusion therefrom. The test would always be that what inferential process that a reasonable/prudent man would adopt to arrive at a conclusion." Thus, factors have to be considered in totality for a view to be taken in this matter; isolated factors don't convey the full picture.[14]

The Hon'ble SAT order in the case of ***Ketan Parekh vs. SEBI***[15], wherein the Hon'ble SAT has held that - "The nature of transactions executed, the frequency with which such transactions are undertaken, the value of the transactions, the conditions then prevailing in the market are some of the factors which go to show the intention of the parties. This list of factors, in the very nature of things, cannot be exhaustive. Any one factor may or may not be decisive and it is from the cumulative effect of these that an inference will have to be drawn."

Therefore, based on the above cited cases we can determine that even though there are no direct evidences available to determine there is artificial creation of volume the same can be concluded via the irresistible inference drawn from the meeting of minds or any other circumstantial evidences.




**Fraudulent and Unfair Trade Practices**

SEBI has put in place a framework to prevent the occurrence of fraudulent and unfair trade practices in the form of the SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market), Regulations, 2003 (PFUTP Regulations). The PFUTP Regulations are amended from time to time and the last amendment was done on October 19, 2020 During the year, SEBI has taken up 41 new cases related to Fraudulent and Unfair Trade Practices (FUTP) violations, while it has also completed 46 cases related to FUTP violations. Details of FUTP cases completed during the year 2020-21 are given below:

| TYPES OF FUTP CASES | NO. OF CASES TAKEN UP | NO. OF CASES COMPLETED |
|---|---|---|
| PRICE AND VOLUME MANIPULATION | 34 | 37 |
| FRONT RUNNING | 1 | 2 |
| OTHERS | 6 | 7 |
| TOTAL | 41 | 46 |

## Enquiry Proceedings against Intermediaries

These are the proceedings which are initiated against registered intermediaries and it involves two step process. In the first step, enquiry proceedings are conducted, and in the second step, proceedings are conducted before Whole Time Member of SEBI on the basis of recommendation of enquiry officer. Acc. To SEBI Data During 2019-20, SEBI initiated 19 enquiry proceedings and conducted 196 enquiry proceedings. As on March 31, 2020, 101 enquiry proceedings were pending. During 2020-21, SEBI completed adjudication proceedings against 2,050 entities involving 440 cases. The proceedings were completed through 714 adjudication orders against 1,905 entities and 45 settlement orders against 145 entities. During 2020-21 SEBI completed adjudication proceedings against 901 entities for engaging in fraudulent and unfair trade practices. Penalties worth 405.56 crore was levied for such violations. Enquiry and Adjudication proceedings against various intermediaries during 2019-20 is given below:

| **Particulars** | **Enquiries conducted** | **Adjudication orders passed** |
|---|---|---|
| Registrar to an Issue/ STA | 4 | 2 |
| Merchant Bankers | 0 | 7 |
| DP | 0 | 1 |
| Brokers | 178 | 66 |
| Sub-brokers | 4 | 4 |
| Mutual Fund /AMC | 0 | 2 |
| Investment Advisor | 0 | 1 |
| Debenture Trustees | 0 | 2 |
| Credit Rating Agencies | 0 | 3 |
| Depository | 0 | 2 |
| Portfolio Managers | 0 | 3 |
| **TOTAL** | **186** | **92** |

Enquiry Reports submitted and Adjudication orders passed against various intermediaries during 2020-21 is given below:

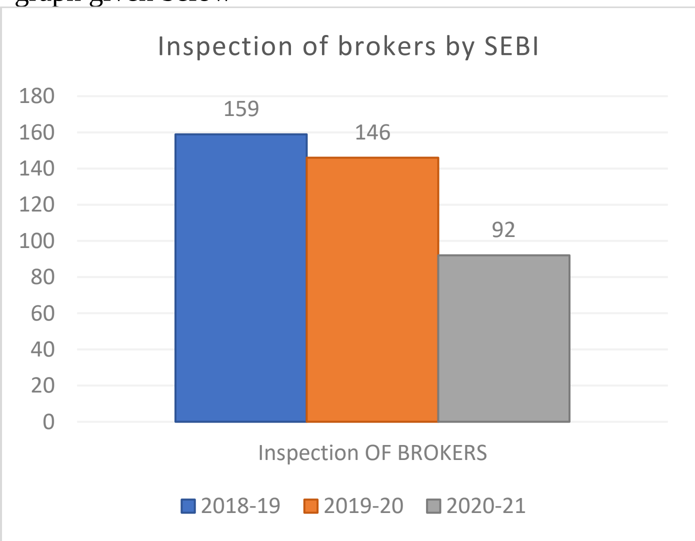
| **Particulars** | **Enquiries Conducted** | **Adjudication orders passed** |
|---|---|---|
| Registrar to an Issue and Share Transfer Agents | 2 | 1 |
| Merchant Bankers | 4 | 3 |
| Brokers | 88 | 72 |
| Investment Advisors | 2 | 2 |
| Underwriters | 1 | 1 |
| Others | 19 | 17 |
| **TOTAL** | **116** | **96** |

We can observe how the number of enquiries completed and adjudication order passed have decreased over the year. There can be variety of reasons for it. But one of the reasons can be the decrease in number of inspections this year by SEBI and respective stock exchanges.

## Inspections of Brokers and other Intermediaries

Under Sec 11(2)(i) SEBI Act 1992, SEBI has the power to conduct inspection of any entity associated with securities market including intermediaries. With a view to ensure compliance of SEBI regulations, SEBI conducted inspection of various intermediaries registered with SEBI. During 2020-21, 92 trading members/ clearing members (TM/CM) and 58 depository participants (DPs) were inspected.

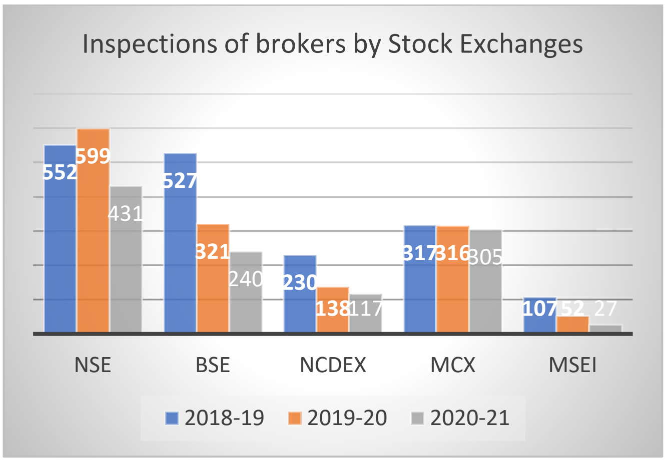
An interesting trend can be identified by the graph given below




From the above graph we can analyze how over the years the inspection by SEBI have decreased. In 2018-19 no. of inspections by SEBI was 159 which has decreased to 92 in last financial year of 2020-21 i.e. 23.9% reduction in no. of inspections. In the above graph brokers include equity, equity derivatives and commodity derivatives brokers.

**Inspections by Stock Exchanges**

In addition to the joint inspections with SEBI, the stock exchanges also carried out inspections[16] as per the policy framed by them in consultation with SEBI.




Thus, we can observe that except NSE in 2019-20 there has been fall in no. of inspections by all the stock exchanges.

**Appeals to Higher Judicial and Quasi-Judicial Bodies**

During 2020-21, 545 appeals were filed before the Securities Appellate Tribunal (SAT). A total of 236 appeals were dismissed (ruled in favour of SEBI) while 69 were allowed (ruled against SEBI). As on March 31, 2021, 632 appeals were pending before the SAT.

| Particulars | 2018- 19 | 2019-20 | 2020-21 |
|---|---|---|---|
| Appeals Pending at the beginning of the year | 217 | 79 | 79 |
| Appeals Filed during the year | 400 | 30 | 45 |
| Appeals Dismissed | 138 | 17 | 36 |
| Appeals Remanded | 21 | 6 | 2 |
| Appeals Allowed | 25 | 8 | 9 |
| SEBI Orders Upheld with Modifications | 25 | 21 | 8 |
| Appeals Withdrawn | 29 | 8 | 7 |
| Appeals Pending at the end of the year | 379 | 79 | 32 |

During the financial year 2020-21, 545 new appeals were filed as compared to 630 appeals in the last financial year. An increase was observed in dismissal of appeals (in favour of SEBI) as compared to the year 2019-20, as a total number of 236 appeals were dismissed out of the total 392 appeals disposed of by Hon'ble SAT (i.e., in about 60 per cent appeals, orders of SEBI were upheld). A total of 69 appeals were allowed (against SEBI) by the Tribunal in the financial year 2020-21, as compared to 78 appeals in the same category in the last financial year. Similarly, a decline was observed in the number of SEBI Orders upheld with modification, wherein the number has reduced to 38 appeals as compared to 121 appeals in the year 2019- 20. Further, 17 appeals were withdrawn during the financial year 2020-21.

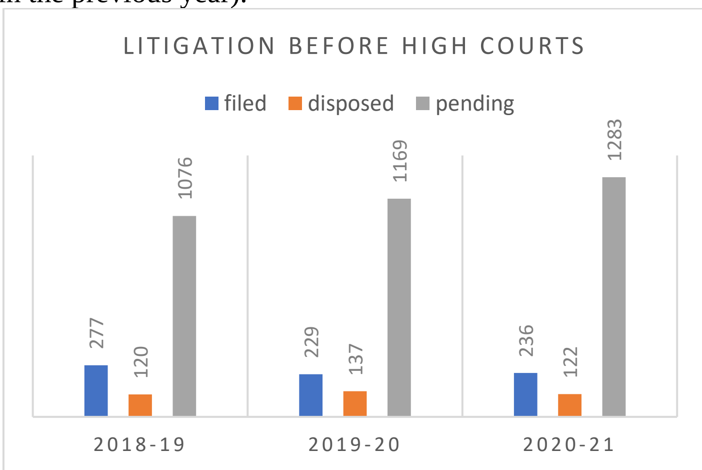
Around 60 % of the total disposed cases pertained to the violation of the SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003, of which 65 % were decided in favour of SEBI.

Thus, we can say that out of the total appeals in SAT i.e. 630 no. of disposed cases were 392 and no. of dismissed cases were 236. 60% of total disposed cases were PFUTP cases which is roughly 235. Also, most of the PFUTP cases were ruled in favor of SEBI. PFUTP cases comprises mainly of volume manipulations cases i.e. artificial creation of volume. Acc. to SEBI data on analysis we can deduce that out of 235 PFUTP cases 152 cases were in favor of SEBI and 83 were in favor of the party. Hence most of the cases were ruled in favor of SEBI.

**Appeals in various High Courts and Hon'ble Supreme Court**

During 2020-21[17], 977 cases were filed and 646 cases were disposed of across various judicial forums. As on March 31, 2021, 3,818 cases were pending at different stages before various judicial forums.

As on March 31, 2021, there were 1,283 cases pending before the High Court (compared to 1,169 cases in the previous year). [18]




The Honourable Supreme Cour[19] had 356 cases pending as of March 31, 2021 (compared to 291 pending in the previous year). Cases filed by SEBI in 2020-21 were 58 while cases filed by parties were 39. During 2019-20[20] appeals filed to Supreme court by SEBI against SAT orders were 32 while suits filed by parties were 19. In comparison to this, appeals filed against SAT orders in SC by SEBI were 7 while that of parties were 13. So, an increase in number of appeals against SAT orders.

## Conclusions

Artificial creation of volume in stock market leads to market manipulation which is increasing with each financial year passing by. But if we look at SEBI Data, we can clearly see that the number of entities being held over last 6 months are also increasing gradually. The percentage of investigation cases taken up have been increasing by 22% over a year. There is also an increase of 10% in investigations completed by SEBI related to volume manipulation. The present legal framework empowers SEBI to enforce the rules mentioned under various regulations. SEBI took 34 cases during 2020-21financial year and completed 37 case related to volume manipulation. But still the problem of volume manipulation in stock market persists and thrives. Moreover, no. of entities against whim enforcement action and adjudication orders have been passed have also decreased drastically over a year. Most of them are stock brokers dealing with market manipulation.

One of the major reasons could be the decreasing frequency of inspections by SEBI and stock exchanges. There has been 23.9%fall in the no. of inspections of stock market intermediaries by SEBI over a span of 2 financial years.

There is also another factor that the no. of cases in HCs, SAT and Hon'ble SC are pending. There is a huge pendency at various HCs and SC. Out of the disposed cases by SAT in 2020-21 60% were related to artificial creation of volume. Most of these cases were ruled in favour of SEBI. Thus, we can observe that although the judicial setup is prudent and gives a very less chance for escape due to its strict mannerism of deducing facts and coming to conclusion which can be seen through the no. of cases ruled in favour of SEBI it still lacks the speedy disposal of cases.

There is an increasing rate observable of filing cases against SAT orders in SC which is leading to more pendency. The interesting fact is that most of these appeals are filed by SEBI. So, SEBI is determined enough to penalise the culprits. There can be a change which can be suggested as follows:

- Increased inspection by SEBI of various intermediaries
- Increase in the surveillance and inspection by various stock exchanges
- A need for revamping surveillance mechanisms by respective stock exchanges to tackle abnormal manipulative behaviour
- A stricter regulatory setup for various intermediaries for curbing market manipulation
- Speedier disposal of cases at various forums

***

## End Note

* Akshit Awasthi, LLM (2021-22), HPNLU, Shimla.
[1] SEBI Handbook of Statistics
[2] WTM/ AB /EFD-1/DRA-4/21/2020-21
[3] Appeal No. 35/2002
[4] SEBI Annual Report 2020-21
[5] Regulation 15 SEBI(Registrar to an Issue and Share Transfer Agents) 1993
[6] SCHEDULE III of SEBI(Registrar to an Issue and Share Transfer Agents) 1993
[7] SEBI Annual Report 2020-21
[8] https://economictimes.indiatimes.com/markets/stocks/news
[9] Supra
[10] www.cdslindia.com
[11] SEBI Annual Report 2019-20
[12] SEBI Annual Report 2020-21
[13] AIR 2016 SC 1079
[14] Ibid
[15] Appeal no. 2/2004
[16] SEBI Annual Reports
[17] SEBI Annual Report 2020-21
[18] SEBI Annual Report 2020-21
[19] SEBI HANDBOOK of Statistics
[20] SEBI Annual Report 2019-20