Oct. 2016 Vol. XI No. 2 IMPACT FACTOR 4.173 (ISI) 3.860 (COSMOS) ISSN (P) : 0973-4503 (E) : 2454-1702 RNI : UPENG 2006/17831

http://EconPapers.repec.org/RePEc:jct:journl:v:11:y:2016:i:2:p:64-74
https://ideas.repec.org/a/jct/journl/v11y2016i2p64-74.html
http://jctindia.org/oct2016/v11i2-8.pdf

Pages 64-74

Frauds in Indian Capital Market- A Study

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Abstract

India has witnessed major financial frauds almost every year since 1990s. There is well documented history of frauds in the financial markets starting from the (in)famous securities scam by Harshad Mehta (1992),MS Shoes (1995), CRBhansali(1996),Ketan Parikh Scam(2001),DSQ Software Scam (2001), IPO Demat Scam(2006),Vanishing Companies (2007),Satyam (2008), Home Trade (2010),Sahara India pariwar Investor fraud (2010), Home Trade(2010),ULIP Misselling(2011),Saradha Group Financial Scandal (2013), NSEL Scam (2013), PACL ponzi scheme scam(2014). Scams have led to regulatory reforms, forming new institutions and strengthening the institutional framework. This paper studies the role of stock exchanges and SEBI to protect investor interests and to promote fair and orderly securities markets. The study attempts to examine the role of SEBI by ensuring the integrity of markets by detecting market frauds on a proactive basis, investigating abusive, manipulative or illegal trading practices in Indian Securities Markets. The role of market surveillance in ensuring integrity of markets by enabling a safe and sound environment is further examined in this paper.

Keywords: *SEBI, Market Integrity, Stock market fraud, Market surveillance*

1. INTRODUCTION

India's capital markets have a long history dating back almost 140 years. Although India has witnessed financial frauds and market abuses almost every year since 1990s. Over the years, price discovery has become more efficient, transactions have become faster, safer and cheaper, number of investors have risen and markets have become globalized (ISMR, 2015). According to SEBI report, the Indian securities market is often considered as one of the most developed and highly respected markets across the globe (SEBI Annual Report, 2015). Historically scams, frauds, market abuses have led to regulatory reforms, forming new institutions including SEBI, NSE and strengthening the regulatory frame work. Many studies (Sabarinathan, 2010; Shah, 1999; Shah and Thomas, 2000; Gokarn, 1996) document the institutional improvements in India's securities market, Role of SEBI, design of the market, risk management practices and market microstructure. SEBI was established 26 years ago with multiple objectives of investor protection, regulation and development of securities market in the after math of a securities scam in 1992 (in) famously known as Harshad Mehta Scam (Gokarn 1996). Indian Markets evolved from a highly controlled merit based regulatory regime to market oriented disclosures based regulatory regime. Various measures were introduced for the betterment and advancement of the Indian Securities Market with the establishment of SEBI and due to its proactive monitoring & nurturing of markets.

However, Indian markets also witnessed whole history of financial frauds starting from the securities scam (1992) to the NSEL (2013), Saradha Scam

(2013). This has continued despite the introduction of electronic trading and operators in the market exploited loopholes and regulatory arbitrage by resorting to innovative ways of market manipulation practices (IIAS 2013). In this paper, we try to identify and classify various kinds of financial frauds and malpractices. We examine various aspects of capital market frauds and regulatory actions taken by SEBI and its proactive role in market surveillance. This paper analyses both primary market frauds, secondary market frauds. Instances of fraud including 1) Accounting frauds 2) Promoter - Broker - operator nexus 3) Demat scams 4) GDR frauds 5) Insider trading 6) IPO frauds 7) Market Manipulation 8) Mis-leading disclosures 9) Mis-selling ULIPs 10) Ponzi schemes 11) (unfair) buy backs 12) Violation of take over guidelines are described in detail.

There are various studies (Ray 2014; Chauhan., etal 2012; Singh 2014; USAID 1999; Ortenblad 2001; NCFM 2009; Cuming & Johan 2007) that has examined the role of regulatory provisions on the functioning of Securities market.

However no attempt seems to have been made to take stock of the various types of market abuses and malpractices in Indian securities market and the regulatory responses by SEBI and surveillance mechanisms by stock exchanges (TCS ,2015; OICV - IOSCO, 2009).

2. LITERATURE REVIEW

There are extensive studies, reports and books available on Indian Stock market and scams and financial frauds. We have reviewed some literature pertaining to the topic under study. The relevant literature is reviewed on basis of books, periodicals, newspapers and websites. The detailed review is given below:

Sabarinathan (2010) documents that SEBI has come up with a number of initiatives for regulating and developing Indian securities market and improving its safety and efficiency. This paper titled "SEBI's regulation of the Indian securities market : A critical review of the major developments" identifies the major interventions of SEBI. The researcher concludes that there has been an all – round improvement in the institutional frame work of India's securities trading.

Goyal (2004) examines the functioning of the reformed Indian regulatory structure in the context of basic principles of regulation and also with special reference to regulatory requirements of capital markets and features of Indian markets. The researcher opines that SEBI contributed to implementing world class technology and processes in the markets. The paper enumerates the pluses and misuses of regulation in the context of India's capital market development. It further argues for the role and importance of small investor, small firm and start – ups, where by the small investor, who tends to buy and hold, lends stability to the market.

Shah & Thomas (2001) discuss the policy reforms in their paper titled "Policy issues in the Indian securities market". Their research deals with key policy issues confronting securities markets like payments system, prudential regulation of banks in connection with loans backed by securities as collateral and questions of governance and policy formulation.

Shah (1998) comprehensively document the institutional change in India's capital markets. The shift in India's economic policy regime, away from direct influences upon resource allocation by the state, towards a greater role for markets is emphasised in this paper. One major plank of these reforms has been an attempt at developing financial markets as an alternative vehicle in capital allocation.

Rajan & Shah (2005) in their paper entitled "New Directions in Indian financial sector policy" elaborate on the success of the financial sector reforms in India. The sophisticated market design, wide-spread retail participation and resilient liquidity of equity spot and derivatives market is highlighted in this paper. The researchers point out main directions of reform and tackles questions including,how should India's financial system grow to meet Industry's needs. This paper also high lights new concepts of market design in the period from 1994 - 96 in terms of electronic trading, clearing corporation, depositors etc.

Narayanan (2004) in the paper titled "Financial market regulation security scams in India with historical evidence and the role of corporate governance" deal with how the financial markets are susceptible to manipulation due to information asymmetry. The author argues that security scams and financial scandals involved the manipulation of huge amounts of money. These manipulators had a comprehensive knowledge of the system's working and opportunistically manipulated it. The researcher opines that the occurrence and reoccurrence of such security scams and financial scandals can be attributed to a failure of corporate governance in finance.

3. OBJECTIVES OF THE SUDY

1. To delineate different forms of financial market frauds in India.
2. To examine the role of SEBI in protecting market integrity.

4. TAXONOMY OF MARKET ABUSE & FINANCIAL FRAUDS IN INDIA

1. **Classification of different types:** We categorise different forms of Market abuse and financial frauds into 12 types which are enumerated below. These include both primary market and secondary market related.

1. Accounting frauds
2. Promoter - Broker - operator nexus
3. Demat scams
4. GDR frauds
5. Insider trading
6. IPO frauds
7. Market Manipulation
8. Mis-leading disclosures
9. Mis-selling ULIPs
10. Ponzi schemes
11. (unfair) buy backs
12. Violation of take over guidelines

Table 1

Type of Market abuse	Name of Scam (year)	Operational Mechanism	SEBI's Regulatory Action
1. ACCOUNTING FRAUDS	SATYAM COMPUTERS (2009)	Satyam faked figures of cash and bank balances, understand liabilities and over stated debtor's position in collusion with auditors	Sebi bans Raju, others for 14 years, asks 10 entities to return Rs.1800 Cr. for making illegal gains from insider trading.
	DIAGEO INDIA (2009)	Senior Management involved in inflating sales, inflated expenses on promotional activities and siphoned off the money.	Diageo wrote off almost Rs.100 Cr. The MNC parent company did not legally pursue the case.
	REEBOK INDIA (2012)	MD & COO siphoned off the company's money by creating ghost distributors across the country by generating forged bills	Management was jailed for 10 months granted bail in July 2013.
	VIKAS METAL & POWER (2012)	Curious case as management reported a robbery at the plant to the tune of Rs.179 Cr. Police believe that thieves were propelled by promoters to carryout wrongful activities	Company is in default to bankers market price down from Rs.29.5 to Rs.0.60

2. PROMOTER – BROKER – OPERATOR NEXUS 1. Operators open an account with brokerage firm/s with nationwide presence. 2. Promoters transfer a large chunk of shares to the accounts of operators through off market transactions. 3. Operators create artificial liquidity through circular trading. 4. Once the desired price is achieved, the shares are transferred back to the promoters' account	a) SANJAY DANGI (2010)	Circular trading in shares of Ackruti city, Welspun corp, Murli industries, Brushman India, Granules India. Colluding with market operators to ramp up their stock prices.	SEBI banned Dangi and 24 group entitles and individuals from the stock markets in 2010. In 2013, SEBI imposed a penalty of Rs.12 lakh for charges of fraudulent activities
	b) PENNY STOCKS BUBBLE	A promoter of a company, which is practically dormant wants to get out of his holding. The promoter goes to a broker and settles a deal. Using circular trading these shares get off loaded.	SEBI and exchanges shifted the stocks to trade – to trade segment and imposed lower price bands.
	c) DINESH SINGHANIA	Attracting promoters facing a financial crunch. The operator targets market savvy promoters who want to keep their share price at good levels.	
3. DEMAT SCAM (2004-2005)	IDFC IPO Scam (2005)	Roopalben Panchal and associates, Ahmedabad opened thousands of fictitious benami demat and bank accounts being the same address with Karvy stock broking Ltd., After allotment, the fictions investors transferred shares to financiers, who then sold these shares on listing day	Roopalben and other members were found guilty of cornering shares by SEBI in 18 IPOs during 2003-2006 using multiple and fictitious demat accounts. Disgorgement order for a total of Rs.36 Cr.
	YES BANK IPO Scam (2005)	Modus Operandi same as above	
	SUZION ENERGY IPO (2005)	Dhaval Mehta used 21,692 fictitious account to corner 3.7% of total shares	SEBI levied a penalty of Rs.1 cr. Debarred another player for 1 year.
	Jet Airways IPO (2005)	Key operators used 1,186 fictitious accounts to corner 0.5% of issue. Key operators used 12,853 fake	24 entities famed from primary and secondary market DPS, financiers, three banks famed.
	NTPC IPO (2004)	Accounts to corner 1.3% of retail investors allotted	DPs, financiers, three banks fined.

4. GDR FRAUDS	Seven companies (2011) Asahi infrastructure & projects Ltd IKF Technologies Ltd., Avon Corporation Ltd, K Sera Sera Ltd CAT Technologies Ltd Maars Software Ltd Cals refineries Ltd	These companies had issued large amount of GDRs to FIIs and sub – accounts through initial sub-accounts between 2007 and 2009. GDRs were mostly issued at a premium to the prevail market price of their underlying shares in India. A chain of – Facilitating the GDR issue, arranging for investors, and then providing an exit for these investors in the Indian markets through a chain of known stock brokers. These brokers would eventually exit their positions by selling the shares in the open market to investors who would be lured by sudden surge in volumes.	SEBI barred seven companies from dealing with Indian equities or any instruments. Banned 10 entities from dealing in markets. NSDL, CDSL asked to freeze the beneficial a/c s of the owners or the entities concerned.
5. INSIDER TRADING	HUL – BBLIL (1998)	The case involved HLL purchasing 8 lakh shares of BBLIL from UTI at Rs.350 per share,prior to its public announcement related to the merger of the two companies.	SEBI directed HLL to compensate UTI to the extent of Rs.3.04 Cr. Final verdict is pending in Bombay HC.
	Rakesh Agarwal V/s SEBI (2001)	ABS industries' MD Rakesh agarwal purchased his own company's shares from the market through his brother-in-law prior to the take over deal between ABS and Bayer.	SEBI directed Agarwal to deposit Rs.34 lakh to compensate ABS investors and initiated adjudication proceedings. Case settled through consent order.
	Rajiv Gandhi, Wock hardt (2006)	CFO charged for insider trading for buying shares on the basis of unpublished price – sensistive information (UPSI) i.e., Wockhardt's financial result	SEBI imposed a monetary penalty on Gandhi and debarred from securities market for 18 months. SAT upheld SEBI's order.
	Reliance Petro Investments Ltd (2007)	RPIL is charged with insider trading in securities of IPCL on which RPIL was a promoter (46%)	SEBI charged Rs.11 Cr penalty on RPIL
	Ranbaxy Insider Trading case – Independent Director VK Kaul (2008)	VK Kaul alleged to have traded in shares of ORCHID chemicals (OPCL). VK Kaul was aware of Rs.200 Cr strategic investment by Rambaxy's arm Solrex in OPCL (UPSI)	SEBI imposed a penalty of Rs.50 lakh on VK Kaul.

6. MARKET MANIPULATION Kinds of market manipulation: (a) Pools (b) Churning (c) Stock bashing (d) Pump and dump (e) Runs (f) Ramping (g) Wash trade (h) Bear raid	Harshad Mehta (1992)	Mehta was accused of manipulating the phenomenal rise in BSE index in 1992. He took advantage of many loop holes in the banking system & drained off funds from inter-bank transactions.	Mehta and his brothers were arrested by CBI in Nov 1992. In Sept 1999, Bombay HC convicted and sentenced his to 5 years imprisonment. He died on 31st of Dec 2001 while in prison.
	Ketan Parekh (2001)	KP took advantage of low liquidity in stocks (Aftek Infosys, DSQ software, Global Tele systems, Himachal Futuristic communications, Pentamedia Graphics, Satyam computers, Silverline Technology,	KP was arrested in March 2001. SEBI banned KP from trading in exchanges Ltd 2017. Many reforms were instituted in the financial system.
		SSI, Zee Tele films, Pritish Nandi communications) – known as K – 10 stocks and started investing heavily in them ramping up prices to bizarre levels, aided by rise of stock markets from Jan 1999	
	SUNIL MEHTA (2009)	Sunil Mehta and his associates were involved in Synchronized and circular trading that created artificial values in scrips of 12 Co's and influenced this share price.	SEBI banned Sunil Mehta from securities market for a period of seven years. SEBI also orderd monetary penalties on Sunil Mehta.
7. MISLEADING DISCLOSURES	Aditya Infosoft Ltd (2004)	AIL was illiquid and suddenly the scrip increased from Rs.4.32 to Rs.10.5 per share. Promoters disclosed false info in its quarterly updates.	SEBI banned promoters from Securities market for three years.
	Zenith Infotech Ltd (2011)	ZIL approved a board proposal to raise upto Rs.15 bn to redeem FCCBs maturing that year and the next. Company defaulted on its FCCB repayment obligation.	SEBI barred the promoters of the company from accessing the capital markets on grounds of frauds misleading and inadequate disclosures. SAT however set aside SEBI's order.
	Zylog systems Ltd (2012)	ZSL's scrip saw a sharp fall in price from Rs.300.5 to Rs.76.4 a fall of 75% in 32 trading days. Promoters of ZSL submitted incorrect information to SEBI/ Stock exchanges	SEBI banned promoters from buying, selling or dealing with the company's shares.

	Bank of Rajasthan (2013)	BOR promoters, the Tayal family acted in concert with 114 other entities and misguided investors about the share holding pattern of the bank.	SEBI fined the promoters of BOR and other front entities.
8. MIS-SELLING ULIPS	The UTI scam	US-64 scheme was not covered under SEBI regulation. Huge amounts of UIT's funds were channelled into the infamous Ketan Parikh, K – 10 list of stocks. UTI also invested in what turned out to be Junk bonds. Small investors best huge amount of money.	Former UTI chairman and two EDs were arrested. Government came out with a rescue package and change of management is 2001.
9. PONZI SCHEMES	1) CR BHANSALI (CRB) (1996)	CRB's meteoric rise in the early 1990s coincided with the NBFC sector. CRB had a dream run from 1992 to 1996 collecting money from public through fixed deposits, bonds and debentures CRB floated around 133 subsidiaries and unlisted companies. Most of the money was transferred to these dummy companies.	CRB was charged in 1997. Crb went to Jail in 1997. Where abouts after getting fail not known now.
	2) ANUBHAV PLANTATIONS SCAM (1998)	Anubhav Plantations owned 2,600 acres of land on which teak sapless were planted and insured. The deal was to invest money and own a part of the land. Anubhav Schemes became ven popular. They were found to have duped investors of over Rs.400 crore.	C. Natesan, the promoter was arrested in October 1998 and spent 8 years in Jail.
	3) Home Trade.com (2002)	The company tried to sell a financial product that no body could figment. It was maste made by Sanjay Agarwal, broker Ketan Sheth, Nand Kishore trivali and Baluchan Rai (Hongkong based NRI). The scam involved cooperative Banks. The scam threw light on the opacity of investments by co-operative banks and PF organisation. The sums involved in excess of Rs.400 Cr.	Sanjay Agarwal, CEO of Home trade was arrested in May 2002 along with his associates for dupling investors of villians of rupees.

	4) Other instances of Ponzi schemes City Lemouzine (India) (2002-2008) Total 4U (2009) Speak Asia (2010) GOLDSUKH (2011) Abhinav Gold (2011) Shivraj Puri From Citi Bank India (2011) EMU farming (2012) The Sahara case (2010 – on going) Saradha case (2013)		
10. (UNFAIR) BUY BACKS	Sterlite industries Ltd (2002)	Sterilite used provisions of section 391 of companies Act 1956 to buy back shares. SIL confused may investors by sending cheques. Under the buyback scheme 35.8% of share capital, were repurchased by the company and extinguished .Promoter's stake in the company increased from 43.1% to 67.3%.	SEBI moved Bombay HC requesting a stay on the buy back. HC rejected SEBI's contention
	Godrej Industries Ltd (2002)	GIL used Section 391 of the companies Act 1956 for buy back scheme. GIL sought a negative consent from investors for its buyback offer.	
11. (Unfair) DELISTING	FRESENIUS	In order to meet SEBI's minimum public share holder limits Fresenius went for OFS and promoters divested 9% from their holding of 90%	SEBI put restrictions on the dealings. Regulation 17 of SEBI (Delisting of equity shares) Regulations 2009 were invoke.
12. VIOLATION OF TAKEOVER GUIDELINES	Reliance Industries Ltd (2011)	RIL increased its stake in L & T to over 10% and then sold the entire lot to Aditya Birla Group (Grasim). RIL failed to inform L & T when its stake in the company crossed 5%.	SEBI has conformed and held RIL guilty of violation of disclosure norms under SEBI takeover code. RIL was fixed by SEBI.

	MARG INFRASTRUCTURE LTD	MARG's promoters announced a voluntary open offer to acquire up to 7.65 mn equity shares of the company at Rs.91/share. SEBI detected that the company had violated the takeover code which prevents acquisition of shares in excess of 5% a year. This triggered the mandatory open offer	SEBI directed the promoters of the company to raise the offer price four times due to repeated violation of the takeover code. As against a voluntary open offer at Rs.91, the promoters are resumed to make a mandatory open offer at Rs.360.
	Titan International (2012)	In Aug 2012, Titan International made an open offer for acquisition of Titan Europe. As a consequence take over regulation were triggered (in directly) with regard to wheels India as well.	SEBI agreed to close the case under consent mechanism for a penalty of Rs.19 lakh paid by Titan International.

Source : Author's Compilation and IIAS (2013)

2. **SEBI's Regulatory Actions:** SEBI has undertaken lot of surveillance actions and punitive steps to punish the market manipulators on a proactive basis. This enables ensuring integrity of markets with a safe and sound environment.

Table 2
Surveillance action during 2014-15 Vs 2013-14

Nature of Action	2013-14		2014-15	
	NSE	BSE	NSE	BSE
Scrips shifted to Trade to trade segment	586	1509	472	1371
No. of scrips in which price band were imposed (2%, 5%, 10%)	1093	2002	889	3604
Preliminary investigation taken up (Snap)	56	792	53	1325
Rumours verified	116	122	187	191

Source : SEBI Annual Report, 2015

Table 3
Major Surveillance orders during 2014-15

Particulars	No. of entity barred in interim order
L & T Finance Holdings Ltd	1
Mansoor Rafiq Handa and Firoz Rafia Handa	2
Astra Zeneca Pharma India Ltd	1
Gammon Infrastructure projects Ltd	1
Kelvin Fincap Ltd	44
Rasoi proteins Ltd – GDR issue	10
Transgene Biotek Ltd	6
Moryo Industries Ltd	99
First Financial Services Ltd	152
Radford Global Ltd	108
Cals refinery Ltd	8 (4 warned)
Kamalakshi Finance Corp Ltd	33

Source : SEBI Annual Report, 2015

Table 4
Trends in investigations

Period	Cases taken up	Cases completed*
2013-14	108	120
2014-15	70	122

**Includes cases pending from previous years*
Source : SEBI Annual Report, 2015

Table 5
Category-Wise Nature investigations

Particulars	Investigation taken up		Investigation completed	
	2013-14	2014-15	2013-14	2014-15
Market manipulation & Price rigging	67	41	73	86
Issue related Manipulation	6	3	12	3
Insider trading	13	10	13	15
Takeovers	6	3	6	3
Miscellaneous	16	13	16	15
TOTAL	108	70	120	122

Source : SEBI Annual Report, 2015

Table 6
Type of Regulation action taken during 2014-15

Regulation actions taken	No. of entities
Suspension	1
Warning issued	41
Prohibitive directions issued under section 11 of SEBI Act	1620
Cancellation	0
Administrative warning/ warning letter issued	274
Deficiency observations issued	94
Advice letter issued	139
Total	2169

Source : SEBI Annual Report, 2015

Table 7
Status of Court Cases where SEBI was a party (Subject Matter)

Subject	Filed during 2014-15	Disposed during 2014-15	Pending as on March 31, 2015
Issue and Listing	60	11	112
Take over	12	6	20
Secondary Market	2	2	37
Mutual fund	1	0	5
Collective investment schemes	63	47	178
Surveillance & Investigations	8	8	37
Stock broker registration fee	1	0	47
Depository participants	1	2	2
Intermediaries	10	4	17
Cases relating to investor complaints	22	16	169
Right to information	1	0	6
General services department	0	0	8
Miscellaneous	56	35	218
TOTAL	237	131	856

Source : SEBI Annual Report, 2015

5. CONCLUSIONS

1. Financial frauds occur in India with alarming regularity. It's difficult to regulate against occurrence of fraud, but try to minimize its negative impact.
2. In India, scams have led to regulatory reforms, including forming institutions like NSE, SEBI.
3. Increased co - ordination between various regulators like SEBI, Dept of company affairs, Ministry of Finance, RBI is needed.
4. The surveillance system of regulatory authorities need to be strengthened.
5. It is necessary to administer and implement existing rules more effectively and in a timely manner.

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