Equi Corp Associates
Advocates & Solicitors

Investment Frauds by Investment Advisers

Equi Corp Associates, Advocates & Solicitors

TRANSACTION | ADVISORY | LITIGATION

Noida, Delhi-NCR, INDIA

admin@equicorplegal.com | +91 8448824659

www.equicorplegal.com

Today driven by the promise of higher returns than the saving accounts or fixed deposits, most of the small and retail investors are moving their investments under the guidance of Investment Advisers.

*"**Investment Advisers**" means any person, who for consideration, is engaged in the business of providing investment advice to clients or other persons or group of persons and includes any person who holds out himself as an investment adviser, by whatever name called.*

Investment Advisers who make public appearance or make recommendations or offer an opinion concerning securities or public offers through public media while making recommendations through public media are required to comply with the relevant applicable laws.

*What is an Investment Advice: - "**Investment Advice"** is an advice relating to investing in, purchasing, selling or otherwise dealing in securities or investment products, and advice on investment portfolio containing securities or investment products, whether written, oral or through any other mean of communication for the benefit of the client and shall include financial planning.*

Failure to accomplish returns and events like ponzi schemes, dubious high return schemes etc. have sharply focused attention once again on fiduciary duties investment advisers owe to the retail & small investors.

*In 2013, to regulate the provision of investment advisory services, SEBI (Investment Advisers) Regulations 2013 ("**IA Regulations**") was enacted where every person who acts as an investment adviser to register itself under the IA Regulations unless the person is exempted from the registrations under the IA Regulations which includes but not limited to insurance agents, registered stock brokers etc.*

Investment Advisers are the fiduciaries and decision-making authority, on behalf and for the benefit of their customers i.e. beneficiaries, and are subject to highest standard of care. The fiduciary relations involve transfer of discretionary power and investment of funds on behalf of the customers. Retail & small investors usually rely on transactional decisions made by the Investment Advisers, as they attribute significant value to the trust and good faith shared in such relationships.

Due to current technical and financial nature of the market, the dependency of the retail & small investors has grown large on their Investment Advisers which raise the question of accountability & regulatory policy, as any fault on the part of the Investment Adviser can impact or loose the hard-earned money of the retail and small investors.

With the emergence of fintech based Investment Advisers such as Robo Advisers, Discount Brokers, Online Financial Advisers etc. have created a larger vacuum for the accountability, as they are been viewed as specialist in providing services of an 'execution only' & do not influence their clients' decision making process.

Beside the registered Investment Advisers, there are several companies which are neither registered nor approved by SEBI or any other Regulatory Body, had come up like mushrooms in different parts of India. They are giving their 'so called expertise' without having requisite qualification & experience which results only in losing money by the retail & small investors.

Few common frauds by the fraudulent investment advisers:

a. ***Tips & Recommendation Fraud: -*** *One of the most widely used and most common fraud, where the fraudulent investment adviser tries to attract the investors by convincing them that they can provide a profit as much as 25% per month or double the investment in a year or so. Also, they confirm the investors over 90% accuracy on their tips & recommendation and claim to give more than 25%-30% monthly return to their previous clients. And, to gain confidence of the clients, these fraudulent investment advisers give 3 days' trial period, where during the trial period, results are 100% accurate. Seeing these trial period, the investors subscribe to the recommendation plan of these fraudulent investment advisers. Now let us see how these fraudulent investment advisers are able to provide 100% accurate recommendations during the trial period. Suppose these fraudulent investment advisers agree to give a trial period for 3 trading day. That is, they agree to give 1 recommendation to buy or sell a stock for 3 trading day. But there is a hidden side to this scheme that the investors do not know. During these 3 days, the fraudulent investment advisers don't send tips to just 1 person but to thousands of people.*

i. ***Day1:*** *On day 1, this fraudulent investment adviser sends messages to sell a stock to 500 people and to buy to other 500 people for the same stock. Obviously, either the stock will go up or go down (they generally choose a volatile stock so that the probability of stock not changing price is zero). Therefore, on day 1, they have sent a successful tip to 500 people. They, discard the other 500 people for whom the tip didn't worked.*

ii. ***Day2:*** *On day two, they again send message to sell another stock to 250 people and buy the stock to other 250 people. Obviously, again one group will receive correct recommendation. They again discard the other group whom they sent wrong tip.*

iii. ***Day3:*** *On last day of tip, they send buy suggestion to 125 people and sell suggestion to other group of 125 people. Hence, 125 people will receive a correct tip for three consecutive days.*

Now, these 125 people will now think that all the recommendations provided by these fraudulent investment advisers for 3 continuous days are correct and most of the people out of 125 will subscribe to the tips and recommendation plan and become victim of one of the most common fraud in Indian investment market. Soon, after subscribing to the tips from these Investment Advisers, the investor starts losing money. The tips aren't working anymore. Overall, these people lose money apart from paying a heavy registration fee for taking tips & recommendations.

b. ***Pump & Dump:-*** *Pump and Dump is a micro-cap stock (penny stocks) fraud, where the investment advisers try to inflate the price of these micro-cap stocks by providing misleading information to investors. They try to increase the price of these penny stocks by giving the fake news.*

For example, If the investment advisers want to increase the price of XYZ microcap stock, then they will send messages like a big company is taking over a that stock; or that micro-cap stock is giving a bonus of 1:1; or A large-cap is buying 50% stake of that micro-cap stock etc.

The investment advisers want the retail & small investors to buy the shares of these stocks as much as possible. Let us see what the main aim of these investment advisers is.

- *First, these investment advisers buy a cheap penny stock at a large volume.*
- *Then they send fake messages or emails to millions of investors recommending them to buy that stock.*
- *Those who take this news as true, start buying stocks of these companies.*
- *Because of this increased demand, the price of that stock starts increasing.*
- *When the share price reaches a good price, then these investment advisers sell their stocks and get good returns.*

After selling their stocks at high prices, these investment advisers then stop sending email/messages to the people. Moreover, the price of these stocks becomes very volatile, as they are not worth that high price. Hence, soon the price of these stocks falls heavily and the retail investors lose their money. SEBI has time and again taken action against Investment Advisers to protect the interest of small & retails investors. Few of the leading cases are:

a. *SEBI has issued order against three illegal investment advisors –Rishabh Jain, Ubaidur Rahman and G. Kadar Hussain. The trio has been alleged for a fraud of over INR 10 Cr and SEBI has directed them to cease and desist from acting as an investment advisor. The action comes after SEBI received an email complaint on December 18, 2015 from National Stock Exchange of India Ltd. (NSE). The trio lure small and retail investors by promising assured monthly income with unbelievable returns of 300-800% on buying and selling of securities based on the tips provided by them.*

b. *SEBI has imposed a penalty of ₹ 10 lakh on two individuals- Mansoor Rafiq Khanda and Firoz Rafiq Khanda for providing unregistered investment advisory services through WhatsApp messages while promising guaranteed returns.*

At present, hundreds of the retail & small investors, have already lost their investments on false hope & mirage shown by their Investment Advisers. They are still waiting for the recovery of their dues.

Now the most important question which arises before retail & small investors:-

Do the retail & small investors who invest under the guidance of such Investment Advisers has any legal right against any wrong/loss making advisory?

Under the present IA Regulations and other applicable laws, the small and retail investors can approach SEBI for recovering of its losses or they may move to Consumer Disputes Redressal Commission (depending upon the facts of the dispute). However, depending upon the nature of investment advisory, there are several other legal recourses which can be initiated against such fraudulent investment advisers.

To know further details about investment frauds & for recovery of your investment from the Investment Advisers, and for any other legal query, please connect with us at admin@equicorplegal.com / +918448824659


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Equi Corp Associates, Advocates & Solicitors

1st Floor, NBBC, Inox Towers, Tower-B, Plot No.17,

Sector-16 A, Film City, Noida-201301

Connect with us: admin@equicorplegal.com | +91 1204797509 | +918448824659

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