INSIDER TRADING AND ITS REGULATORY FRAMEWORK IN INDIA

Trisha Lesley, Master of Laws (LLM) at Pondicherry University

ABSTRACT

Insider trading basically refers to the buying, selling or trading of shares or other securities of a listed company using unpublished price sensitive information that can affect the stock price that has not been disclosed yet, curbing these activities is in the need of the hour for a firm's prosperity, the researcher aims to establish and study the role and impact of Insider trading on the Indian capital market and provide ways by which Insider trading can be better curbed in the Indian sub continent. The paper aims at the following pointers in order to provide the reader with a holistic view of the insider trading practices:

1. To find whether the Indian regime is successful in curbing insider trading malpractices

2. To provide a brief comparative analysis between various other countries with established legislative regime curbing such malpractices

3. To identify the lacunae in the existing Insider trading regime and provide plausible solutions to curb the loopholes

To understand the efficacy of the Indian legislations in curbing these malpractices, one has to understand the basic nitty-gritties of insider trading vis a vis the Indian economic market, thus the paper will also aim at achieving the following definitions:

1. What activities will constitute Insider Trading?

2. Whether the law of the land curbing these malpractices are sufficient and exhaustive?

3. What are the general practices perused by other developed countries to curb such malpractices?

4. What are the major legislative framework curbing Insider trading in the Indian sub-continent?

5. What are the penalties provided under the legislative framework for Insider trading?

HYPOTHESIS

The need of the hour is the continuous adaptation and modification of the present laws in order to make the practice of insider trading more deterrent so that insiders are prohibited from indulging into such malpractices, thereby securing and boosting the confidence of investors in the Indian securities market.

INTRODUCTION

The securities market must be treated like Caesar's wife they must not only be above suspicion but must also be perceived to be so

Insider trading, also known as insider dealing, is the illegal activity of workers, directors, executives, and promoters of a firm selling or buying securities such as equity and bonds. The stock market regulator Sebi (the Securities and Exchange Board of India) has forbidden firms from purchasing their own shares from the secondary market in order to discourage such conduct and encourage fair trading in the market for the benefit of common investors. Insider trading is defined as the purchase, sale, or trade of a listed company's shares or other instruments (such as bonds or stock options) utilising unpublished price-sensitive information (UPSI) that can affect the stock price but has not yet been released. An 'insider,' according to the Sebi, is someone who has access to price-sensitive information regarding a company's shares or securities. Anyone who has been involved with the company in some capacity in the six months leading up to the insider trade is considered an insider.

That person could be a company employee, director, relative, banker, or legal counsel, or even a stock exchange official, trustees, employees, or an asset management company (AMC) that worked with the firm.

A piece of exclusive information about a company's stock prices, quarterly results, acquisition transactions, mergers, or any other sensitive activity that has not been released with the general public is referred to as UPSI. Insiders who acquire access to the UPSI engage in unlawful commercial activities for personal benefit.

For example, a firm director contacts a buddy about an unannounced agreement, and the latter passes the information on to his colleagues, who then purchase the company's stock. Sebi may then charge the manager, his friend, and his coworkers with violating the PTI (Prohibition of

Insider Trading) Regulations. Insider trading is regulated in India by the Securities and Exchange Board of India (Sebi) under the Insider Trading Regulations, 2015. In fact, the market regulator has the authority to levy fines.

Insiders benefit from buying or selling hidden securities before they fluctuate in price because they have access to exclusive and exclusive knowledge about the issuer of a particular asset or stock.

Insider trading jeopardises capital market integrity. In the stock market, symmetric information levels the playing field by allowing investors to compare and contrast their interpretations and analyses of events. Insiders, on the other hand, have an unfair advantage over regular investors when trading on UPSI. Unsuspecting retail investors, many of whom may have spent time and effort in selecting stocks for investing may end up at the losing end of a trade. Investors lose faith in the stock market if they assume insider trading is common, whether they are typical retail investors or overseas investors. Insider trading must be dealt with harshly in order to increase retail involvement in the stock market.

CHAPTER I: REGULATORY FRAMEWORK AND DEVELOPMENT OF THE INSIDER TRADING REGULATIONS

1. Who is an Insider?

Before attacking the definition of Insider it is pertinent to understand the term Connected person defined in the Securities and Exchange Board of India (prohibition of insider trading) regulations, 2015, section 2 clause (d):

connected person- 6 months, contractual/fiduciary/employment relationship, director/officer/employee, professional/business relationship, UPSI

sub caluse ii- Immediate relative, holding/associate/subsidiary co./intermdiaries, invsetment/trustee/asset management co., official of stock exchange, memeber of B.OD, member of pub. fin. inst.,banker, HUF/immediate relative>10% OF interest in holding co.

immediate relative (sub clause iii)- spouse/parent/sibling and child- dependent, depends for decisions

According to the Securities and Exchange Board of India (prohibition of insider trading) regulations, 2015, section 2 clause (g):

"insider" means any person who is: i) a connected person; or

ii) in possession of or having access to unpublished price sensitive information;

it is further provided under the note's clause, generally available information is intended that anyone in possession or has access to UPSI should be considered as an Insider, regardless of how such possession of information was received. And onus of proof will be on the person levelling such charge of insider trading. This is an important clause under which, the entire portion of insider can be well received.

2. What activities constitute Insider Trading?

According to the Securities and Exchange Board of India (prohibition of insider trading) regulations, 2015, section 2 clause (l):

"trading" means and includes subscribing, buying, selling, dealing, or agreeing to subscribe, buy, sell, deal in any securities, and "trade" shall be construed accordingly

Under the operation portion of the section, it is provided that trading will include dealing in securities, it will include a wider range of activities

The particular act of trading will include, trading of UPSI which is further defined under 2 clause (n) of the regulations: "unpublished price sensitive information" means any information, relating to a company or its securities, directly or indirectly, that is not generally available which upon becoming generally available, is likely to materially affect the price of the securities and shall, ordinarily including but not restricted to, information relating to the following: –

(i) financial results; (ii) dividends; (iii) change in capital structure; (iv) mergers, de-mergers, acquisitions, delistings, disposals and expansion of business and such other transactions; (v) changes in key managerial personnel.

Further it is intended that such information is not generally available and if it is likely to materially affect the price upon coming into the public forum.

3. Other important PIT regulations

SEBI (Prohibition of Insider Trading) Regulations (2015) seem to be more optimistic, pragmatic and substantially in line with the global perspective to insider trading. They also seem to be equipped to strengthen superior compliance and prosecution. It has improved the insider trading norms with clarity in the definitions and concepts of insider trading. It has widened the scope of who is a connected person and also clearly detailed about the UPSI. It has imposed restrictions on communication and trading by insiders. Insiders with price-sensitive information can trade with pre-scheduled trading plan, which has to be disclosed to the public six months in advance. Under **Regulation 5(2)(ii),** insiders are not allowed to trade 20 days prior to the interim financial results and two trading days after such announcements (even under trading plan). The initial disclosures of holdings have to be made to the stock exchange by the promoter/director within seven days of their appointment with the company. Under continual disclosures, **Regulation 7(2)(a)** made it mandatory for every listed company's promoter/employee and director to disclose the number of shares/ derivatives purchased or sold within a period of three months valuing INR 10 lakh or more and report within two trading days. It has formulated minimum standards for the code of conduct to regulate, monitor and

report trading by insiders. SEBI is empowered to investigate any complaint received from the investors, intermediaries or any other individuals on any matter having a bearing on allegations of insider trading.

SEBI (Prohibition of Insider Trading) Regulations (2015) ban an insider from dealing on his/her behalf or on behalf of any other individual in the securities of a firm listed on any stock exchange when he/she is in ownership of UPSI. Additionally, it also prohibits any insider from communicating, recommending or providing (directly or indirectly) any UPSI to any individual who, while in the ownership of such UPSI, should not trade in securities. Price-sensitive information means any information that is related directly or indirectly to a business concern, and if published, is expected to substantially affect the price of the securities of a company. It includes information such as the financial results, dividends, change in capital structure, mergers, de-mergers, acquisitions, delisting, changes in key management personnel and disposals and expansion of business. The penalties upto INR 25 crore or three times of the amount of profits made out of fraudulent and unfair trade practices or 10 years imprisonment can be imposed.

4. Penalty – framework by the SEBI regulations

Section 15G of the SEBI Act, 1992 imposes penalty of at least rs 10 lakhs, which may extend to Rs 25 Crores or three times of profits made from insider trading

Section 24 of SEBI act, 1992 even goes to the extent of imprisonment upto 10 years or fine upto 25 crores or both for any offences pertaining to contravention of the provisions of the act.

NAME OF THE COMPANY	VIOLATION	ACTION TAKEN BY SEBI
Multi Commodity Exchange (MCX) and Financial Technologies (Now, 63 Moons)	13 individuals including promoters and KMP traded in the shares of MCX and FTIL based on UPSI	Impounded 126 crore benefitted from trading Not to dispose of or alienate any of their assets till the penalty is credited to an escrow account

Piramal Enterprises Ltd	Directors did not announce the mandatory closure of trading window	Has imposed a fine of 6 lakh on them.
Mahindra & Mahindra Ltd	Failure in disclosure of sale of shares to Stock Exchanges	Has imposed a fine of 5 lakh on HR manager who failed to disclose
Satyam Computer Services Ltd	Failure to announce the mandatory closure of trading window during UPSI activity	Barred Ramalinga Raju and four others from accessing securities markets for 14 years in 2014

5. Companies Act on Insider Trading (Anil Kumar Manchikatla, 2018)

The Companies Act of 2013, passed also devised the code of conduct for the administration of these regulations. The listed companies are guided by clause 36 of the listing agreement of the stock exchanges, which states that the issuer will inform the stock exchanges, immediately on events such as "closure on account of power cuts, lockouts and strikes, and all events that have posture on the operations/performance of the firm as well as price sensitive information together at the period of happening of the event and consequently after the end of the event to facilitate the shareholders and the public to assess the position of the issuer and to avoid the creation of a false market in securities."

In section 195 of the Companies Act, 2013 (prohibition of insider trading on securities) it is stated that insider trading is an act of buying, selling, subscribing or agreeing to subscribe in the securities of companies directly or indirectly by the key management personnel or the director of the company and sensibly to have anticipated access to UPSI.

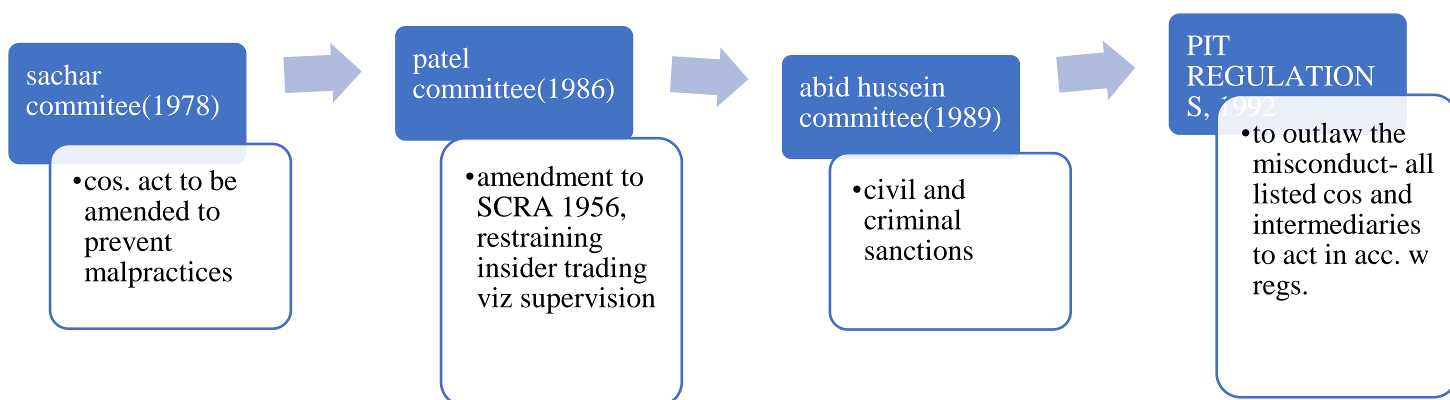
6. History and development of Insider trading laws in India

This can be dated back to the 1940s where the structural formation government committees such as the Thomas committee in 1948 coined the way, thereafter provisions for insider trading was included in the companies act of 1956 under sections 307 and 308, which required shareholding disclosures by the directors and managers of the company. Due to inefficiency

and inadequacy the Sachar committee, 1979; the Patel Committee, 1986 and the Abid Hussain Committee, 1989 proposed the first recommendations to formulate and create a separate legislation for insider trading.

The concept as such was developed in the 80s and 0s and came to be known and observed extensively in the Indian Securities market. The regulations needed more stricter rules to follow, thus resulting in the innovation of the SEBI (Insider Trading) Regulations in the year 1992, which were amended in the year 2002, which was called as SEBI (prohibition of Insider trading) regulations, 1992.

- The Sachar committee- postulated that company employees like directors, auditors, company secretaries etc. may have access to UPSI that can be perused to manipulate and misuse. The committee recommended amendment to the Act of 1956 to further restrict and prohibit the dealing of employees or insiders. Penalties were also encouraged by this Committee.
- The Patel committee- the report defined insider trading, wherein it means trading in the shares of the company by the persons who are in the management of the company or are close to them on the basis of undisclosed price sensitive information regarding the working of the company, which is available to them but not available to others.
- The Abid Hussain Committee – this committee recommended that that insider trading activities may be penalized by civil and criminal proceedings and also provided suggestions to the SEBI to better the regulations and codes to prevent any kind of unfair dealings.



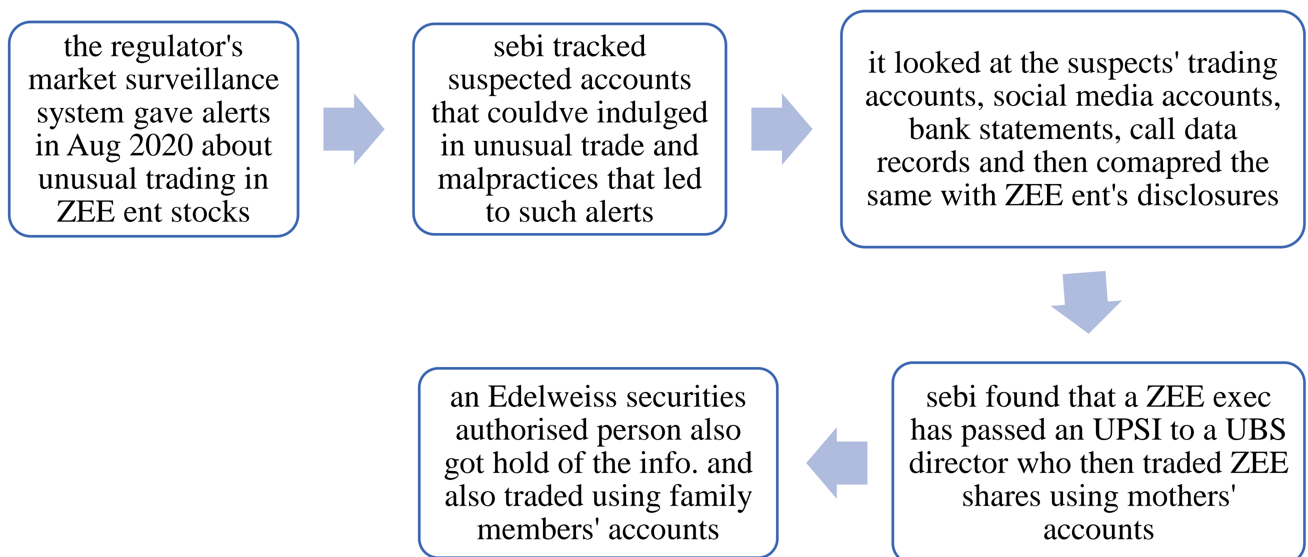
CHAPTER II: THE INDAIN REGIME ON INSIDER TRADING SO FAR

How SEBI finds out Insider trading?

a. Via market surveillance and investigation system:

The Exchange shall provide adequate and effective surveillance and monitoring mechanism for the purpose of activities which are doubtful in nature in the market, activities involving market manipulation, price rigging in order facilitate free and fair trade in the market. The **Integrated market surveillance scheme-** formed in the year 2006 comes in handy during such malicious practices in action. In India the stock exchanges have been entrusted with such role and they hav primary onus on undertaking such market surveillance activities. The investigations taken up by SEBI include- market manipulation and price rigging, issue related manipulation, insider trading, takeovers and miscellaneous; wherein investigations under Insider trading is prominent.

Case study: the case of ZEE insider trading scam



b. Via social media

Case study: insider trading in the fidelity group

In the year 2020, SEBI passed an order pertaining to fidelity group where they tied the two accused to an online matrimonial platform. It is seen that social media sites such as Facebook, Instagram, matrimonial sides are increasingly serving as evidence to SEBI for charging under Insider Trading. The same is perused when the regulator is unable to find anything via

traditional modes such as KYC documents or bank account transactions, as people with knowledge are able to evade prosecution. Sebi's whole time member passed an order in an insider trading case based on a facebook post in the year 2018. Insider trading cases are hard to prove since the investigating officer has to establish a connection between the one selling the illegal information and the one who traded on the information. Insider traders peruse unpublished price sensitive information, not available to public to their advantage, *"The offenders are increasingly getting smart and leaving no trail in the conventional channels," said a regulatory official. "Hence the regulator is forced to explore new methods to bring them to book.",* as quoted by a SEBI official. (associates, 2017)

But there are certain criticisms to it:

- Market participants and legal experts said social media connections may not be accurate to prove insider trading situations
- Social media can be easily manipulated and fabricated. Partner of Khaitan and Co., Mr Tomu Francis quoted *that "Such an approach in this day and age may not work because social media is all pervasive and a mere connect may not necessarily entail access, especially when people connect on social media for myriad reasons such as business networking and shared interest."*
  - unique nature of social media is that it can be manipulated or falsified, creating hurdles for admissibility whilst not compounded with other evidences
- Social media feeds can be perused only when it is relevant, it has to be in the issue in trial or is relevant to any fact in issue in the trial. (abhirami, 2018)

c. Suspecting related party transactions

Sebi sniffs out unusual and prolonging transaction made by family members, recently in the month of March such a situation occurred. Wherein sebi probed certain investment bankers for alleged insider trading. It is a known fact that investment banker due to their nature of work are the helm of affairs, with access to ready available UPSI information. They have access to information such as pricing in share sales or deals made by companies. An unaddressed and unknown mail was sent to sebi in the technological capital of India, Mumbai. Atleast two leading domestic investment banks are learnt to have received queries from sebi in this matter. It is seen that a newly developed **state of the art Artificial intelligence based surveillance system of sebi** has posed to have the capability of capturing such indirect insider trading transactions.

d. Role of SEBI (PIT) Regulations, 2015

d.1 disclosures under SEBI (PIT) Regulations, 2015

this is formulated as per the regulation 8 of the code of fair disclosure and regulation 9 of the code of conduct regulations, these regulations ensure that information is formulated and is published and is confirmed with the stock exchange.

- A code of conduct to be formulated by each co. to maintain people who will have access to UPSI
- Intermediaries and fiduciaries to promptly inform the stock exchange where alleged securities are traded, regarding violations relating to code of conduct as maybe prescribed by the Board.
- Regulation 7- exclusively deals with disclosures talks about—initial disclosures; continual disclosures, disclosures by other connected persons.
- All disclosures are now automated under regulation 7(2) of the PIT regulations- system driven disclosures- this will include trading in equity shares and equity derivative instruments that is futures and options of the listed company by the entities.

d.2 informant scheme under the PIT regulations

an informant is defined under regulation 7A clause (b) this includes- who voluntarily submits, information to Board relating to violation of Insider trading laws that has occurred or yet to occur.

He will be awarded with a reward as provided under regulation 7A (k). the informant will further provide such original information under a certain format provided under the regulations provided under Schedule D (form for informant's voluntary information disclosure to be submitted to the board). the regulation also ensures that such informant is protected against acts of retaliation and victimization as provided under regulation 7I.

CHAPTER III: SHORTCOMINGS OF THE INSIDER TRADING LAWS IN INDIA

SEBI has time and again encountered difficulties in establishing and proving a case beyond reasonable doubt in case of criminal proceedings to convict the person/s accused of insider trading, substantially owing to the lack of evidence.

1. Fraud to be established beyond reasonable doubt

In the case of **Rakesh Agarwal vs SEBI,** the Managing Director of ABS limited was involved in negotiations with one Germany company named Bayer A.G, it was regarding taking over the former by the latter. Hence Bayer was in hold of UPSI. It was alleged by the SEBI that prior to the acquisition itself the MD had purchased shared of BS company via his relation. The so bought shares were tendered and made an offer thereby making a substantial profit. Bayer AG had further acquired ABS. by dealing in the shared of ABS through his connection while the information regarding the acquisition of 51% stake by Bayer was not public, the appellant had been convicted in violation of the insider trading regulations. The MD argued the said activity was in the company's best interests. He desperately wanted this deal to click and pursuant to Bayer's condition to acquire at least 51% shares of ABS, he tried his best at his personal level to supply them with the requisite number of shares, thus, resulting in him asking his brother-in-law to buy the aforesaid shares and later sell them to Bayer. On an appeal to the Securities Appellate Tribunal (SAT), Mumbai, the Tribunal held that the part of the order of the SEBI directing Rakesh Agarwal to pay Rs. 34,00,000 couldn't be sustained, on the grounds that Rakesh Agarwal did that in the interests of the company (ABS), as is mentioned in the facts above. (ICSI, 2022).

2. Ineffective investigative mechanism

Reuters revealed that Whatsapp has been utilized to flow UPSI identifying the quarterly numbers of 12 companies, only before a couple of days before the declaration of these numbers. SEBI due to ineffective investigative mechanism was unable to establish as to who was the connected person and how the leak had occurred.

There is inadequacy in the investigative mechanism of SEBI this can be accounted to the following reasons:

Inadequate staffs, requirement for skilled and expertise manpower, power to tap phone calls, lack of application outside the territory of India, lack of anticipatory action

Let us compare and contrast study with other jurisdiction for this purpose:

Position in US

In Securities and exchange commission (SEC), the SEC has almost one employee for each listed company. In important sectors such as corporate finance, responsible to check the veracity of bank statements of listed entities, SEC has more than 15 times as many employees as SEBI.as compared to SEBI, SEC of United States is a much powerful body which has better personnel with human resources as well as strong infrastructure to detect and analyse insider trading. The SEC has a strong regime of 4000 people where SEBI has a paltry amount of mere 700 people in various offices.

3. Lack of application outside the territory of India:

Under the Indian regime there is no such rule about authorization of criminal endorsement outside the country. For example in a recent Factorial capital management case, SEBI has seeked out the help of Hong Kong, Singapore, Mauritius to help them out to get primary information on insider trading probe. It is noted that it is difficult to get information from these jurisdictions, and information can be seeked only via bilateral or multilateral MOUs. Queries which were mailed to Hong Kong regulator was remained unanswered thus proving the lack of information required in a short time frame by the Indian regime. (kumar, 2018)

4. Insider trading laws in other countries:

4.a) in their EC directive the preamble itself preaches that there must be smooth operation of the secondary market with respect to securities and the rules must inspire the confidence of investors in the market. The directive also states that, each member state shall prohibit any person who by virtue of his membership of the administrative, management or supervisory bodies of the issuer, or by virtue of his holding in the capital of the issuer, or because he has access to such information by virtue of the exercise of his employment, profession or duties; possesses inside information "from taking advantage of that information with full knowledge of the facts by acquiring or disposing of for his own account or for the account of a third party, either directly or indirectly, transferable securities of the issuer or issuers to which that information relates."

4.b) the Law in UK: the law revolving insider trading involved in the UK in the year 1980 with the introduction of Company securities insider dealing act, 1985. Under UK regime only individuals can be held liable whereas in India both individuals and corporations can

be held liable. The advantage in UK, is that even in any unforeseen event or even the slightest of doubt can be held reason for insider trading. Even when the information is made available in market and even if no undue exploitation has taken place, the person is punishable under the law.

CONCLUSION

The law in the US is the most aggressive, and it adopts two major approaches to deal with insider trading that is :

a. The traditional theory :

The theory rests on two propositions namely, that there is a relationship giving access to confidential information to be used for corporate purposes. Second, it is inherently unfair for a person to take advantage of that information knowing it is not public. In United State vs O Hagan it is established that the duty that is owed by the person who has such information is to its shareholders, that relationship gives rise to a duty to disclose from taking unfair advantage of uninformed shareholders. The classical theory widens the ambit as to who can be the one in possession of such information

b. The misappropriation theory:

The premise is based on a fiduciary turned trader's deception of those who entrusted him with access to confidential information. There must be a fiduciary type duty, between the person who trade and the source of information and trading must be in breach of duty not to misuse such information. Accordingly the mere giving of such information will not be sufficient.

The lesson from the US regime is that they are more aggressive in nature and thus they also bring in a corporate outsider into the ambit of breach of duty and insider trading. Hence, **in India too such an approach can be perused practically in order to ease out the cumbersome process of investigation.**

The problem of territoriality: as already addressed India lacks extra territoriality reach and hence when the insider is involved with foreign stock exchanges it is a cumbersome process of relying on other nationalities inorder to form substantive material to punish such person. In the US the laws provides a breather, as Rule 105-b applies where the fraud is achieved by the use of any means or instrumentality of interstate commerce or of the mails or of any facility of any national securities exchange. *Insider dealing abroad may be subject to US jurisdiction if the fraud has an effect on the US securities market.*

To shift the onus of proof on to the defendant this indeed is an useful guideline, as SEBI at most times has been seen breaking their heads to gather corroborative evidence, is SEBI could

just establish prima facie that insider trading has indeed occurred and then the shift of proof moves on to the defendant such an approach has the following positives:

- Would reduce the cost of enforcement
- Leads to more effective enforcement where offenders will not go scot free because of insufficient evidence
- Would act as a deterrent as companies would be doubly careful to ensure that they refrain from insider trading

Apart from the already mentioned lacunaes, it is high time that the investigative measure are widened and more no. of personnel are employed to act in accordance. It is also evident that there is an apparent dearth of empirical studies on this issue in the emerging markets in general, and an important emerging market like India in particular. There are a limited number of studies dealing with this issue in the Indian context. For example, Jain and Sunderman (2014) have examined the role of insider trading around mergers, Khanna and Palepu (2000), Sarkar and Sarkar (2000) have examined the impact of insider trading on the market value of the firm. The study conducted by Chauhan et al. (2014) was based on the proprietary data of NSE. Since the data used in the study is not in the public domain, its implications for investors are very limited. Various dimensions of the insider trading remain under-explored in the Indian context. Further, the direction of insider trading strategies and its utility to ordinary investors and effect of insider trading regulations on the pattern of insider trading is largely unexplored. Specifically, the broad-based market outcome of the insider trading and patterns in insider trading needs further examination by expanding the dimensions used for finding the patterns. Therefore, an apparent gap regarding empirical findings on various dimensions of insider trading is observed.

REFERENCES

PRIMARY SOURCES:

REPORTS AND STATUTES:

The Abid Hussein Committee report.

The Companies Act (2013).

Corporate Governance: An Emerging Scenario, published by National Stock Exchange (2010).

Indian Securities Market, A Review (2013), published by National Stock Exchange of India Ltd (NSE).

The Patel committee report.

The Sachar committee report.

SEBI (Prohibition of Insider Trading) Regulations (1992).

SEBI (Prohibition of Insider Trading) Regulations, 2015.

SEBI (Prohibition of Insider Trading) (Amendment) Regulations (2002).

SEBI Annual Report, 2009-2010. S

SEBI Annual Report, 2012-2013.

JOURNALS AND ARTICLES:

abhirami. (2018). *INSIDER TRADING LAWS IN INDIA - PERTINENCE AND PROBLEMS* (5 ed., Vol. 4). INTERNATIONAL JOURNAL OF LEGAL DEVELOPMENTS AND ALLIED ISSUES. Retrieved from https://thelawbrigade.com/wp-content/uploads/2019/05/Abhirami-Arya.pdf

2. Anil Kumar Manchikatla, R. H. (2018). Insider trading in India – regulatory enforcement. *Journal of Financial Crime, 24*(1), 48-55.

3. associates, n. d. (2017). *Insider Trading regulations a primer.*

4. ICSI. (2022). *guidance note on prevention of insider trading.*

5. kumar, M. a. (2018). *An Empirical Analysis of Legal Insider Trading in India.* Mangalore: thesis paper, mangalore university.