
THE SINGLE MOST IMPORTANT THING YOU NEED TO KNOW ABOUT INSIDER TRADING AS A TOOL FOR INVESTMENT PROTECTION UNDER INVESTMENT LAW

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“Fair markets are not just about efficiency - they are about trust.”

— Mary Jo White

ABSTRACT

Insider trading continues to be a contentious issue in securities regulation, situated at the crossroads of market efficiency, equity, and safeguarding investors. It entails the utilization of material non-public information (MNPI) by insiders, tippees, or fiduciaries to obtain an unfair edge in securities dealings, thus compromising the idea of a “level playing field.”

This research analyses insider trading regulation as a crucial mechanism for safeguarding investors within investment law. It examines theoretical reasons for prohibition, encompassing fairness, fiduciary duty, and misappropriation theories, while also considering the economic discussion on market efficiency. The study additionally examines how insider trading affects price discovery, capital costs, and investor trust.

Examining global trends and the Indian context, especially the SEBI (Prohibition of Insider Trading) Regulations, 2015, this study assesses enforcement methods, detection challenges, and new risks in the digital age like algorithmic trading and information dissemination through social media.

The study asserts that, despite some constraints, regulating insider trading is crucial for upholding market integrity and safeguarding investors, highlighting the importance of technological progress and improved global cooperation

Keywords: Material Non-Public Information (MNPI), Information Asymmetry, Market Integrity, Investor Protection, Fairness Theory, Fiduciary Duty, Misappropriation Theory, SEBI (Prohibition of Insider Trading) Regulations, 2015, Disclosure Requirements

Introduction

Financial markets operate effectively solely when participants engage under conditions of fairness, transparency, and equal information access. Insider trading, which is the buying or selling of securities using material non-public information (MNPI), fundamentally contests these core principles. Legal insider trading, when properly disclosed, is a valid aspect of market operations; however, illegal insider trading disrupts fairness by enabling insiders, tippees, and fiduciaries to misuse private information for their own profit.

The consequences of this behaviour reach far beyond single exchanges. Insider trading creates information imbalances in securities markets, eroding investor trust and deterring involvement, especially from retail investors. When market players believe that the system favours a select few, the credibility of the whole financial system becomes questionable.

The ban on insider trading is thus based on various theoretical rationales. The fairness theory highlights equal access to information, while the fiduciary duty and misappropriation theories concentrate on violating trust and confidential relationships. Concurrently, the law and economics viewpoint presents a counterpoint, indicating that insider trading could improve market efficiency by hastening price discovery. This conflict between efficiency and fairness persists in influencing regulatory strategies globally.

Insider trading presents significant risks from an investor protection perspective, such as distorted price discovery, higher capital costs, and diminished market involvement. In reaction, legal systems in various jurisdictions—like the United States, the European Union, and India—have gradually built strong regulatory frameworks. In India, the SEBI (Prohibition of Insider Trading) Regulations, 2015, alongside later amendments, demonstrate an increasing dedication to protecting investor interests via improved disclosure standards, monitoring systems, and enforcement authority.

Introduction to insider trading

Insider trading involves the buying or selling of securities by those who have material non-public information (MNPI) concerning a company. Information is deemed material if it can considerably influence the price of securities, and non-public if it is not accessible to the

broader investing public¹. Instances comprise unreported financial outcomes, mergers, acquisitions, or significant policy choices. The improper use of this information results in a market disparity that benefits individuals with exclusive access.

Insider trading can generally be divided into permissible and prohibited types. Legal insider trading happens when corporate insiders, like directors or employees, buy or sell shares while adhering to regulatory disclosure obligations. Conversely, unlawful insider trading occurs when MNPI is utilized to obtain unjust gains or evade losses, breaching fiduciary responsibilities and securities regulations.

The main participants are insiders, like company directors, officers, and staff; tippees, who obtain information from insiders; and fiduciaries, who have an obligation of trust and confidence. Liability frequently reaches beyond direct participants to those who indirectly gain from disclosed information, highlighting the broad reach of contemporary insider trading regulations.

In the end, insider trading compromises market integrity by providing an unequal informational edge to a limited group. This undermines the essential principle that all investors should function on a level playing field, thus jeopardizing the integrity of financial markets.²

Insider Trading and market integrity.

Market integrity relies on the idea of a “level playing field,” ensuring that all participants can access relevant information equally. Insider trading disturbs this balance by enabling select individuals to utilize confidential information before it is made public. This imbalance leads to inherent inequity in the securities market.³

Information imbalance is a key issue in financial markets. When insiders take advantage of MNPI, everyday investors rely on insufficient or obsolete information to make choices. This results in a misallocation of resources, since stock prices fail to accurately represent all available information, which distorts market efficiency.⁴

¹ SEBI (Prohibition of Insider Trading) Regulations, 2015, Reg. 2(1)(n).

² SEC v. Texas Gulf Sulphur Co., 401 F.2d 833 (2d Cir. 1968).

³ OECD, *Insider Trading and Market Manipulation Report* (2003).

⁴ Akerlof, G. A., “The Market for Lemons” (1970).

The effects reach investor trust and involvement. Retail investors, essential to capital markets, might exit if they believe the system is unfair. A decrease in participation limits market liquidity and obstructs capital formation, ultimately impacting economic growth.

Therefore, insider trading jeopardizes trust, a critical component for the operation of capital markets. Regulatory action is required not only to penalize misconduct but also to maintain systemic trust and guarantee enduring viability.

Theoretical Justifications for Prohibition

Multiple theoretical frameworks support the ban on insider trading. The fairness theory posits that all investors must have the same access to important information. Insider trading breaks this principle by favouring insiders over regular market participants, thus leading to inequality.

The fiduciary duty concept emphasizes the connection between insiders and the corporation or its shareholders. Insiders are given access to sensitive information and are anticipated to act in the company's best interests. Utilizing this information for personal benefit represents a violation of fiduciary responsibility.⁵

The misappropriation theory, established in U.S. law, holds individuals accountable for improperly using confidential information acquired from any source, not just the business whose securities are involved.⁶ This theory expands the range of insider trading regulation by focusing on fraudulent behaviours.

Nonetheless, a debate on economic efficiency persists. Certain experts suggest that insider trading could improve market efficiency by rapidly reflecting information in prices. Some argue that the lasting damage to investor confidence surpasses any temporary efficiency improvements, warranting stringent regulation.

Insider Trading as a Threat to Investor Protection

Insider trading poses a direct risk to investor protection by restricting equal access to vital information. Retail investors, without insider relationships, face a fundamental disadvantage.

⁵ *Chiarella v. United States*, 445 U.S. 222 (1980).

⁶ *United States v. O'Hagan*, 521 U.S. 642 (1997).

This breaches the fairness principle inherent in securities regulation.

It also results in price discovery distortion, which is the mechanism through which markets assess the fair value of securities. When transactions are swayed by unpublished information, prices represent insider insights instead of accessible public data, diminishing transparency.

Another notable effect is the rise in capital costs. When investors recognize increased risk stemming from unethical practices, they seek higher returns as recompense⁷. This increases the expense of obtaining funds for businesses, which ultimately impacts enterprise expansion and economic progress.

Robust insider trading rules can reduce these risks by promoting transparency and responsibility. Proper enforcement safeguards investors while boosting market trust, resulting in reduced capital expenses and heightened investment.

Evolution of Insider Trading Laws

Worldwide, regulations on insider trading have developed considerably over time. In the United States, laws developed through court interpretations of the Securities Exchange Act of 1934. The United Kingdom and European Union subsequently created legal frameworks prioritizing transparency and disclosure.

In India, the regulation of insider trading started with the formation of the Securities and Exchange Board of India (SEBI) in 1992. The first regulations were established in 1992 and subsequently updated with more detailed rules in 2015, aligning with global best practices.⁸

Different committees have played a role in shaping Indian insider trading regulations. The Abid Hussain Committee and subsequently the Justice N.K. Sodhi Committee significantly contributed to enhancing the regulatory framework through suggestions for more stringent definitions and enforcement procedures.⁹

The evolution signifies a slow transition toward stronger investor protection, harmonizing Indian regulations with international norms. Ongoing modifications reflect adaptability to new

⁷ SEBI Annual Report (various years).

⁸ SEBI Act, 1992.

⁹ Justice N.K. Sodhi Committee Report (2013).

market issues and technological progress.

Legal Framework in India

The main legal structure regulating insider trading in India is the SEBI (Prohibition of Insider Trading) Regulations, 2015. These rules outline important terms like “insider,” “connected individual,” and “unreleased price sensitive information (UPSI).” They forbid trading in UPSI as well as sharing that information.¹⁰

The rules establish compliance obligations for businesses, necessitating the creation of a code of conduct, upkeep of organized digital records, and reporting responsibilities for insiders. These actions are intended to avert the inappropriate use of private information and improve clarity.

Recent changes, including those concerning 2024 updates, have enhanced the structure by tightening disclosure regulations, broadening the definition of connected individuals, and refining monitoring systems. The implementation of technology-based oversight signifies a forward-thinking regulatory strategy.¹¹

In general, the Indian legal system shows a solid dedication to safeguarding investors and maintaining market integrity. By conforming to international standards and consistently adapting, it aims to tackle new challenges within a more intricate financial landscape.

Regulatory Mechanisms, Enforcement & Critical Analysis

The regulation of insider trading is the cornerstone of modern capital markets. It seeks to balance the information asymmetry between corporate insiders and the general public to ensure "market integrity." Below is a comprehensive analysis of the regulatory landscape as of 2026.

Regulatory Mechanisms for Investor Protection

The main objective of insider trading regulations is to guarantee that no individual has an "unjust advantage." This is accomplished via Disclosure Requirements, which compel companies to promptly inform stock exchanges of any Unpublished Price Sensitive

¹⁰ SEBI (Prohibition of Insider Trading) Regulations, 2015.

¹¹ SEBI (Amendment) Regulations, 2024.

Information (UPSI)¹². Making information accessible eliminates the "insider" advantage, enabling retail investors to trade fairly.

To avoid opportunistic trading during critical times (such as prior to earnings announcements), regulators enforce Trading Window Restrictions. These windows are "closed" for insiders—such as directors and essential staff—typically from the conclusion of a quarter until 48 hours after the financial results are released. This mechanical obstacle stops even the semblance of improvised trading.

In the background, the Code of Conduct & Compliance Officers function as the internal law enforcement. Each publicly traded company is required to designate a Compliance Officer responsible for overseeing the "pre-clearance" of transactions by appointed individuals¹³. Moreover, Whistleblower Mechanisms have emerged as the strongest resource for regulators; by 2026, SEBI and the SEC have broadened "Informant Rewards," offering substantial financial incentives for workers to anonymously report internal infractions.

Role of Regulatory Authorities

In India, SEBI functions with extensive authority to investigate and make decisions. With the 2026 amendments, SEBI's "Structured Digital Database" (SDD) enables tracking of UPSI through digital "paper trails."¹⁴ SEBI adopts a "strict liability" approach, where merely having information during trading frequently suffices to constitute a violation, irrespective of intent.

In contrast, the SEC in the USA predominantly depends on the "Misappropriation Theory." The US regulatory framework is generally viewed as more adaptable yet prone to litigation, characterized by a complicated interaction between the SEC (civil) and the Department of Justice (criminal). In contrast to SEBI's role as a comprehensive regulator, the US model necessitates the SEC to establish a "breach of duty" or a "personal benefit" acquired by the tipper, which demands a greater level of evidence than in India.¹⁵

¹² Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015, Reg. 2(1)(n) (definition of UPSI) & disclosure obligations.

¹³ SEBI (Prohibition of Insider Trading) Regulations, 2015, Reg. 9 (Code of Conduct; role of Compliance Officer; pre-clearance requirements).

¹⁴ SEBI Circular on Structured Digital Database (SDD), 2019 and subsequent amendments.

¹⁵ *Dirks v. SEC*, 463 U.S. 646 (personal benefit test).

The decade of the 2020s has experienced an increase in International Coordination. As money travels quicker than legislation, regulators now use the IOSCO Multilateral MoU to exchange banking and brokerage data internationally¹⁶. This worldwide network complicates the ability of insiders to conceal illegal profits in offshore tax havens.

Enforcement & Penalties

Enforcement is divided into Civil and Criminal Liabilities. Civil penalties typically consist of fines that may reach three times the profit gained or loss prevented. Criminal prosecution, while less common due to the increased burden of proof, can lead to incarceration for as long as 10 years in both India and the United States¹⁷.

Disgorgement is a distinctive and powerful mechanism, serving as the legal "clawback" for unlawfully acquired profits. In contrast to a fine, which serves as a punishment, disgorgement aims to restore the market to its previous condition by taking away the precise profit the offender earned. These resources are frequently redirected into Investor Protection and Education Funds (IPEF).

Significant actions in India involve the Abhijit Rajan (2022) case, where the Supreme Court stated that "motive" may serve as a defence if the transaction was essential (such as in debt restructuring). In 2025-26, SEBI's actions against "influencers" and front-running in mutual funds (including the Quant Mutual Fund and IEX leak investigations) indicate that no organization is too big to avoid examination¹⁸.

Challenges in Enforcement

The most significant challenge is the complexity in identification and evidence. Insider trading seldom presents a "smoking gun." The majority of trades are carried out via Intermediaries (such as friends, family, or shell companies) to conceal the link to the insider. Establishing that a particular phone call or encrypted message included UPSI—and wasn't merely a casual

¹⁶ International Organization of Securities Commissions (IOSCO), Multilateral Memorandum of Understanding (MMoU).

¹⁷ Companies Act, 2013 (India) & U.S. federal criminal securities fraud provisions (imprisonment penalties).

¹⁸ SEBI enforcement orders in Quant Mutual Fund and Indian Energy Exchange (IEX) investigations (2025–26).

conversation—continues to be a legal challenge¹⁹.

The emergence of Digital Tools has made this even more complex. Insiders currently utilize disappearing messaging applications such as Signal or Telegram, rendering it virtually unfeasible for regulators to trace the communication chain. Although regulators possess access to "call data records" (CDR), they frequently do not have the power to intercept real-time encrypted data, resulting in a continual gap in the evidential chain²⁰.

Ultimately, Cross-Border Transactions continue to protect sophisticated offenders. Although MoU's are in place, the actual procedure for compelling a foreign bank to freeze assets or provide data is frequently hindered by diplomatic bureaucracy, causing the trail to become inactive before the regulator can act²¹.

Insider Trading in the Digital Era

We are now in the era of Algorithmic Trading and Data Breaches. High-frequency trading (HFT) bots can respond to leaked data in milliseconds, far ahead of when a human regulator might even notice the irregularity. "Data scraping" from private servers or cloud breaches has also resulted in a new group of "accidental" insiders who discover information via cyber-vulnerabilities²².

Social media and Information Flow have obscured the distinctions of what defines "public" information. A tweet by a CEO or a confidential memo on a Reddit thread can cause significant market fluctuations²³. Regulators currently employ "Social Media Surveillance Labs" to track sentiment and detect "coordinated pumps" potentially driven by insider information.

The necessity for regulatory changes is critical. The 2026 scenario indicates that regulators are shifting towards "Technology-Neutral" legislation. Rather than concentrating on how the information was disseminated, they emphasize the imbalance it caused. Regulations are being revised to address "shadow trading"—when an insider buys or sells a rival's shares based on

¹⁹ General principles of insider trading enforcement relying on circumstantial evidence (as recognized in securities law jurisprudence).

²⁰ Indian Telegraph Act, 1885 & regulatory use of Call Data Records (CDR) in investigations.

²¹ IOSCO and Financial Action Task Force (FATF) reports on cross-border enforcement challenges.

²² SEC enforcement trends relating to cybersecurity breaches and insider trading.

²³ Academic and regulatory studies on social media's impact on securities markets (e.g., SEC reports on market manipulation).

information related to their own firm²⁴.

Comparative Analysis: India vs. US vs. EU

Feature	SEBI (India)	SEC (USA)	EU (MAR)
Primary Rule	Strict Liability (Possession = Guilt)	Breach of Fiduciary Duty	Market Abuse Regulation (Broad)
Tippee Liability	Broadly defined: anyone in possession	Requires proof of "Personal Benefit"	Strict: knowledge of information is enough
Criminality	Possible, but rare in practice	Frequent coordination with DOJ	Mandatory criminal sanctions in some states

The Indian Model could be considered the most "insider-unfriendly" as it imposes a significant obligation on the accused to demonstrate their innocence once possession of information is established. The US approach offers greater protection for defendants' rights while offsetting this with proactive "bounty" initiatives for whistleblowers. The EU Model is the most comprehensive, viewing insider trading as a component of a broader "Market Abuse" framework that also encompasses price manipulation.

Critical Evaluation

The main question is: Is prohibition overly harsh or essential? "Law and Economics" scholars occasionally contend that insider trading enhances market efficiency by quicker reflection of information in prices. Nevertheless, this "efficiency" is achieved at the expense of Fairness. If retail investors believe the system is unfair, they will pull out their funds, creating a "market of lemons" dominated by the unscrupulous²⁵.

A significant deficiency exists in existing laws concerning "non-trading" insiders. For example, when an insider abstains from selling due to positive news, they have gained from their

²⁴ SEC v. Panuwat (development of "shadow trading" doctrine).

²⁵ The Market for Lemons (concept explaining how information asymmetry leads to market failure).

discretion. Existing laws only penalize active trading, allowing "passive" insider benefits to remain mostly unregulated²⁶.

In summary, the existing regulations serve as an essential defence, yet they tend to be reactive. They penalize the "dumb" insiders who trade under their own names but often overlook the "smart" ones who utilize intricate offshore setups and encrypted technology²⁷.

Suggestions & Reforms

To remain at the forefront, regulators need to transition to AI-driven Detection Tools. Machine learning models are now able to detect "anomalies" in trading actions that are not apparent to humans²⁸. Through the examination of years' worth of trading data, AI can identify an insider's "signature" prior to the trade's finalization²⁹.

Enhanced Transparency Standards ought to involve immediate trade reporting by KMPs (Key Managerial Personnel). Rather than a 48-hour wait, trades should be revealed immediately. Additionally, Global Harmonization is essential; establishing a "Global Securities Police" or a centralized database of prohibited individuals would stop offenders from relocating their activities across different jurisdictions³⁰.

Ultimately, we require a "Reverse Onus" for significant transactions. For transactions exceeding a specific limit, the responsibility should consistently fall on the trader to demonstrate they lacked UPSI, instead of the regulator having to show that they did³¹. This would greatly raise the "cost of deception" for major institutional players

Conclusion

Insider trading laws are an essential part of investment regulation, acting as a crucial

²⁶ SEBI (Prohibition of Insider Trading) Regulations, 2015 (focus on "trading" as the actionable offence; absence of explicit provisions on abstention).

²⁷ Global regulatory observations on use of encrypted technologies in financial misconduct (SEC, FATF, IOSCO reports).

²⁸ Machine Learning applications in financial market surveillance (RegTech literature; SEBI & SEC discussion papers).

²⁹ SEBI and SEC reports on algorithmic surveillance and anomaly detection in trading patterns (RegTech/ SupTech initiatives).

³⁰ IOSCO policy discussions on cross-border regulatory cooperation and global harmonization of securities enforcement.

³¹ Comparative securities law scholarship on "reverse burden of proof" in financial regulation (discussed in anti-money laundering and tax law frameworks).

mechanism for safeguarding investors and maintaining market integrity. Trading using non-public material information leads to market distortions, compromising fairness and equal information access.

Although arguments for economic efficiency provide a different viewpoint, they do not tackle the decline in investor confidence. Conversely, theories of fairness, fiduciary duty, and misappropriation offer a more robust foundation for regulation, promoting fair participation, precise price discovery, and lower capital costs.

In India, the regulatory structure has been reinforced by SEBI's initiative, which includes requirements for disclosure, limitations on trading, and the use of technological tools. Nonetheless, challenges in enforcement remain, especially in identifying complex violations that include intermediaries, encrypted messages, and international transactions.

In summary, the regulation of insider trading is not just a ban but a vital tool for safeguarding investors. Its sustained effectiveness relies on continuous reforms, such as AI-based monitoring, increased transparency, and improved global collaboration