

# **INSIDER TRADING AN UNETHICAL PRACTICE: WITH SPECIAL REFERENCE TO INDIAN SECURITIES MARKET<sup>1</sup>**

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## **Abstract**

*Insider trading is buying or selling of securities by a person who is part of or connected with the company. Law does not ipso facto prohibit trading of securities by insider but prohibits when he trades the securities by using unpublished price sensitive information. The Insider gains the profit by buying the securities or averts the losses by selling the securities as per the information which is beneficial for his own interest. The person who gets price sensitive information could potentially make larger profit than their fellow investors. The material information is that of any information which could substantially impact the decision of investor to buy or sell the securities. The Unpublished/Non-published information is information that is not available legally to the outside world or public. The insider trading generally takes place in publicly traded companies/listed companies' securities by someone who has non-public material information about that stock. Insider trading is legal or illegal it depends upon information which will affect the fluctuation in the securities of the company on the recognized stock exchange.*

*The Securities and Exchange Commission (SEC) in U.S., Financial Conduct Authority (FAC) in U.K., and Securities and Exchange Board of India (SEBI) in India made stringent regulations to prohibit insider trading with an object of protecting the interests of investors in the Securities market with regard to the publicly traded companies where the minority shareholders mostly*

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*affected from insider trading. In U.K, U.S and India the insider trading is a serious white color crime which affects the nation's economy in general and genuine investors in particular.*

*In keeping into consideration, the above objectives, the researchers wish to throw some light on the Concept and historical perspective of Insider trading. The researchers focus on various dimensions of national and international perspective pertaining to the insider trading. The researchers concentrate on legal framework and enforcement of insider trading in U.K., U.S., and India. Further the researchers want to mention the judicial contours and finally give the conclusive remarks and suggestions.*

**Key Words:** Insider Trading, Price Sensitive Information, Securities Exchange Board of India

## **Introduction**

Securities market plays a significant role in the economy of the Nation in general and corporate sector in particular. The securities market is part of financial market and includes the Primary market and secondary market. The primary market deals with the fresh issue of securities to the investors where the secondary market facilitates trade the securities on recognized stock exchanges issued in the primary market. The transactions of selling and buying of securities in secondary market take place between investors and investors through the stock brokers. The performance of primary market depends upon the performance of the secondary market. The Securities and Exchange Board of India regulates both the primary market as well as secondary markets. As far as the public issue is concern the Company as to fulfill various provisions of SEBI Act and relevant Regulations pertaining to the public issue by the corporation, which admits its securities on recognized stock exchange or it desirous to place its securities on any one of the recognized stock exchanges in near future.

Insider is a person who is an access to the un-published price sensitive information of the Corporation.

He may be director, senior officer or individual who is have nexus to the Unpublished price sensitive information. According to Regulation 2 (g) of “SEBI (Prohibition of Insider trading) Regulations, 2015<sup>2</sup> Insider means any person who is:

- (i) A connected person or
- (ii) In possession of or having access to unpublished price sensitive information”

According to the SEBI regulations Insiders maintains the “Unpublished price Sensitive Information”. Specific information needs to be used only for the Legal purpose and in compliance with the any law or requirement of regulations. Apart from the specific legal purpose, the specific information shall not be shared with anyone else.

Insider trading is the trading of the securities of the corporation by individuals with potential access to un-published price sensitive information which highly fluctuate the stock of the corporation. The insider who has the price sensitive information will take advantage of gaining the profit or averting the losses by selling and buying the securities for his own benefit. At present the insider trading is on the Main street level rather than at the Wall Street level. Buying, selling and dealing in securities of any corporation is a legal activity for everyone. When it comes to the insider such as directors, managers and employees of a corporation can also buy or sell the securities subject to fulfilment of the provisions and the SEBI Act as well as Regulations. The SEBI Regulations clearly provides that it will be considered illegal if the insiders of Publicly Traded Company trade on the basis of price sensitive undisclosed/unpublished/non-published price sensitive information to make profits or avert losses. The insiders of the company is expected to trade in securities in order to maintain positions for a long period of time. Trading securities frequently or entering into reverse transactions at small intervals is considered as insider trading. This type of activity taken by the

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<sup>2</sup> SEBI (Prohibition of Insider Trading Regulations), 2015, Regulation 2(g).

insiders of the company shall be liable for the legal consequences under the relevant SEBI regulations. The regulator is the key watch dog for the controlling of these types of activities.

Patel committee in its report in the year 1986 defined, 'insider trading' as, "which generally means trading in the shares of a company by the person 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 they possess but which is not available to others".

### **Insiders of the Company**

Insiders in the companies means not only those persons who are directly connected with the company because of their position but those persons who are connected to or deemed to be connected with the company and have reasonable connection with "Unpublished price sensitive information" of the company. The following persons come under the ambit of insiders:

- Merchant Banker, Debenture Trustee, Stock Brokers;
- Accountancy firms, Law firms and financial Consultants;
- Subsidiary of a company and relatives of connected persons;
- Asset Management Company;
- Shareholders and employees of the company;
- Independent Directors/Non-executive directors, it includes a person who is a person connected six months prior to an act of insider trading;
- Registrar and Share Transfer Agents;
- Portfolio Manager, Investment advisers;
- Trustee and Investment Companies.

### **Unpublished Price Sensitive Information**

It is the information which is with the Company and is accessible to insider but has not been made to public. In other

words, “the Prince sensitive information means any information which relates directly or indirectly to a company and which if published is likely to materially affect the price of securities of company”. This information will be having impact on the securities prices and leads to fluctuation in the secondary markets. The “unpublished price sensitive information” which is not in the public domain or the securities market is not aware of it. The person who is having this “unpublished price sensitive information” may use for gaining the profits or avert the losses according to the situation. The scope of such information is having highest sensitive value in the course of the administration of the company and affects directly or indirectly on the prices of the securities. The scope of such information may include:

- Business development and reconstruction of the company.
- Information relating to existing and future contracts.
- Legal consequences and future litigation of the company.
- Proposed change in the structure of the share capital of the Company.
- Change in the board of directors and change in the senior officials.
- Information on Dividend declaration.
- Information relating to the quarterly and yearly results of the company.
- Issue of securities or buy-back of securities of the Company
- Information relating to Inorganic reconstruction such as Amalgamation or Mergers or Take-over etc.
- Information relating to part or whole winding up of the company.
- Any significant changes in policies, plans or operations of the Company

## **History behind the Regulatory Framework of Insider Trading in India**

In India Insider trading was unhindered in its 125-year-old stock market till about 1970. It was in the late 1970s this practice of insider trading was recognized as unfair. The first attempt to curb insider trading was made in India in the year 1948 by appointing the Thomas Committee. As per the Committee recommendations there were certain provisions incorporated in the Companies Act 1956. Sections 307 and 308 of the “Companies Act 1956” emphasize on various disclosures by directors and managers, but it was not effective to stop insider trading.<sup>3</sup>

Following the recommendations by the committees, the SEBI made regulations pertaining to Prohibition of Insider trading by exercising its powers conferred on them under section 30 read with section 11 of “Securities Exchange Board of India Act, 1992”. Later the “Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations 1992” has been replaced by the “Securities Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015”. Prior to these regulations there were no specific provisions in India for prohibition or prevention offence of insider trading. Prior to the regime of the present SEBI regulations there were highest instances in the cheating small investors in the secondary market by using the techniques of Insider Trading. Simply the insiders which gives tips to the near ones in terms of that they take gifts. The famous tipper theory involved in these types of activities. The tipper for the tip in concern gives the information to the tippee.

## **Legal Framework on Insider Trading in India**

Due to rapid increase in the fastest growth of financial markets in India at par with the economies of the world, the financial crimes also associated with the Securities market. In order to

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<sup>3</sup> The Companies Act, 1956, Sec 307, 308.

repose the confidence of the common investor in its securities market, the Government of India made certain specific laws and regulations. One of the current regulations which deals with prohibition of insider trading is that “SEBI (Prohibition of Insider Trading) Regulations, 2015” apart from some stringent provisions under SEBI Act, 1992. These Acts and Regulations made an attempt to curb insider trading was in the shaping of a disclosure requirement regarding shareholdings of Directors of the company. Considerable progress has been made since passing of these Acts and Regulations.

The objective of the “SEBI (Prohibition of Insider Trading) Regulations, 2015<sup>4</sup> is to prevent Insider Trading by prohibiting trading, communicating, counselling or procuring ‘unpublished price sensitive information’ relating to a company to profit at the expense of the general investors who do not have access to such information”.

As per Sub-regulation 4 of Regulation 9 of the aforesaid regulation, promoters are included in the definition of “Designated Person”. This regulation further covers the board of directors, compliance officer, employees of listed company, CEO, other managerial and secretarial staff who have access to unpublished price sensitive information<sup>5</sup>.

The Companies Act, 2013 provides under section 195 that, “no person including any director or Key Managerial Personnel of a company shall enter into insider trading”. In this context “Unpublished price sensitive information (UPSI) means any information, which relates directly or indirectly, to the company or its securities, that is not generally available which upon becoming generally available, is likely to materially affected the price of the securities of the company”<sup>6</sup>.

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<sup>4</sup> The objective of SEBI (Prohibition of Insider Trading) Regulations, 2015

<sup>5</sup> The SEBI (Prohibition of Insider Trading Regulations), 2015, regulation 9(4).

<sup>6</sup> The Companies Act, 2013, Section 195.

The “unpublished price sensitive information” includes the following:<sup>7</sup>

- Financial results of the company.
- Dividends which include both interim and final.
- Material events in accordance with the listing regulations/agreement.
- Change in capital structure.
- Mergers and acquisitions.
- Change in board or key managerial personnel.

The Indian Stock market had the history of over hundred years old, the insider trading was outlawed, when the stock market was liberalized following the end of “License Raj”. In the year 1992, the SEBI Act and Regulations were passed to prevent insider trading. There are certain Committees which worked on with a view to prevent and prohibit the insider trading in India. The following committees which recommended the policies need to be taken for the prevention of Insider trading in the companies.

### **The Sachar Committee (1979)**

This committee mentioned in its report that the company key managerial persons such as directors and other officers may have some price sensitive information that could be used to change or malpractice the stock prices which may cause financial losses to the retail investors. The committee further recommended that the amendments to Companies Act to incorporate the provisions relating prohibition of Insider trading which need to contain huge penalties and punishments.

### **The Patel Committee (1986)**

This committee recommended that there is need of amendments in “Securities Contracts (Regulations) Act, 1956”

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<sup>7</sup> SEBI (Prohibition of Insider Trading) Regulations, Regulation 2(1) (n).



to make all the stock exchanges which will control the insider trading and unfair stock dealing. This committee further suggested that heavy fines shall need to be imposed along with the imprisonment. Further stated that the gains from Insider trading also need to be recovered from the persons involved in the particular activity.

### **The Abid Hussain Committee (1989)**

This committee recommended that the activities of insider trading may be penalized in terms with both civil and criminal proceedings and further suggested that the Securities Exchange Board of India needs to formulate the regulations and relevant governing codes to prevent unfair dealings in securities market.

### **The Sodhi Committee (2013)**

This committee made a range of recommendations with regard to the legislative framework for prohibition of Insider trading in India. It further suggests that we need a combination of principle-based regulation and rules that are backed by principles.

### **The Viswanathan Committee (2017) on Insider Trading**

This Committee has made recommendations to reduce the malpractices and prohibit the benami transactions in the securities to reduce the financial malpractice. Further the committee recommended for the two different codes for prohibition of Insider trading. Out of that the first one is relating to minimum standards need to be placed for the listed companies to deal with the Inside information. The second one is relating to put standards on market intermediaries and related persons on handling of price sensitive information.

## **International Perspective of Insider Trading**

The researchers would like to focus some of the dimensions pertaining to insider trading regulations in U.K and U.S to prohibition of insider trading.

### **United Kingdom Legal Framework on Insider Trading**

U.K has developed strict regulation against insider trading recently but has a very low enforcement rate. The Financial and Services Markets Act, 2000 has been repealed by the Finance Act, 2012 and “Criminal Justice Act, 1993” provide the statutory framework for insider trading. The Criminal Justice Act prohibits dealing in securities on the basis of insider information or price sensitive information and market malpractices can incur custodial sentences of up to 7 years and fine which is unlimited<sup>8</sup>.

### **United States Legal Framework on Insider Trading**

The United States is the strict implementer for the protection of investors from insider trading. After the Great Depression of 1929, it was the first country that formally enacted a legislation to control insider trading and prevent the malpractices through the Securities and Exchange Act, 1934. This Act has incorporated the Securities Exchange Commission (SEC) to prevent insider trading in the United States of America. Further the legislations relating to “The Insider trading sanction Act of 1984” and “The Insider Trading and Securities Exchange Act of 1988” also governs the provisions relating to prohibition of Insider trading.

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<sup>8</sup> The provisions under U.K Criminal Justice Act, 1993.

## **Judicial Contours**

Judiciary plays a significant role in prohibiting the insider trading both in India and abroad. The researchers would like to focus some land mark judgments pertaining to the insider trading.

### *Salman v. Securities Exchange Commission*

This case has delivered the jurisprudence relating to giving insider information to the family members and on the basis of that information trading in the securities which is completely prohibited in the United States of America. The American Supreme Court held that this type activity is enough to convict the accused.

### *Dirks v. Securities Exchange Commission:*

In this case the United States Supreme Court propounded the “tipper – tippee” theory on Insider trading. On the basis of tip given by the tipper which means violation of fiduciary duty of the insider for providing the sensitive information, that would lead to liability from the “tippee” side who provides a personal benefit to the tipper.

### *Mr. Raja Ratnam and Rajat K. Gupta case*

In this case the SEC which alleged that Rajat tipped his business associate Rajaratnam relating to price sensitive information available at Goldman Sachs Group on Berkshire hatchway investments. Rajaratnam who used sensitive information and traded in securities made a reasonable profit. On the basis of this activity the securities exchange commission raised an allegation. The court held that the activities taken by both the person in this case is violation of securities law and Insider trading regulations.

### *Rakesh Aggarwal v. SEBI*

In the present case the Securities Appellate Tribunal ordered for the compensation on promoters who traded in the securities on the basis of “unpublished price sensitive information”.

Further the Tribunal held that acting against the objectives of the Securities Exchange Board of India Act, 1992 and insider trading principles is prohibited. The SEBI need to control these types activities.

*Samir.C.Arora v. SEBI*<sup>9</sup>

The present case is important in prohibition of Insider trading at the companies. The case observed the Jurisprudence on the circumstances which are leading to the Insider trading and its related activities. Further in this case the board which held that the activities come under the Insider trading.

### **Cases under Spotlight**

*Cyrus Mistry's case*

In the recent days this case became familiar on effect of this regulations. The case came to the lime light due to the sharing of material information with the insiders which is not to be done as per the SEBI, 2015 regulations. The case also got familiarity towards the role of corporate governance in India.

*Uday Kotak Committee (2017)*

The SEBI committee on governance of companies, in its report, had proposed that, “any material information be shared with a promoter or promoters or a group having shareholding of more than 25 per cent in the company, who is in direct or indirect control of the shareholders or has nominated a director on the board of director of the listed company”.

The above said committee further specified certain conditions for disclosing of the unpublished price sensitive information and proposed several amendments in the Indian jurisprudence towards the decreasing of cases relating Insider trading.

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<sup>9</sup> (2002) 38 SCL 422

## **Conclusion and Suggestions**

The Indian jurisprudence on laws relating to prohibition of insider trading is well regulated after the “SEBI (Prohibition of Insider trading regulations), 2015”. Prior to these regulations the complaints and cases relating to insider trading received by the regulator on the basis of price sensitive information used to be operated by connected persons in the companies. The present regulations is working towards complete prohibition of Insider trading. The penalties and other liability provisions under the regulations is creating impact on the connected persons in the companies on the involvement in Insider trading. On the other side some flaws like absence of criminal punishments in the present regulations on comparison with the developed jurisdictions like United States of America and United Kingdom is affecting the actual objectives of the Prohibition of Insider trading regulations. In this sense some more criminal liability measures required under the present regulations in order to further decrease of Insider trading. In lieu of this some of the suggestions in relation to further strengthening of the prohibition of insider trading regulations include:

- a) Incorporation of criminal liability measures under the “SEBI (Prohibition of Insider trading regulations), 2015”.
- b) Requirement of the provisions relating to Prohibition of Insider trading under the Companies Act, 2013 and specific watch dog mechanism in relation to listed companies.
- c) Incorporation of the provisions relating to duty of the stock exchanges in the case of Insider trading under the Securities contract regulations Act, 1956.
- d) Need to be clear about the role of stock exchanges in the case of prohibition of Insider trading.

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