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## PERTINENCE AND PROBLEMS OF INDIA'S INSIDER TRADING LAWS

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**Abstract:** *Appropriate regulation is necessary to ensure the securities market operates fairly and equally, even while unethical practices like insider trading undermine the integrity of trading. Numerous frauds and scams over the nation has frequently exposed regulatory framework chaos the gaps in the legislation. In order to address these actions that attract investors losing faith and enthusiasm in the securities industry, the Securities Exchange Board of India (SEBI) has developed a number of guidelines and laws to prevent such wrongdoings. This essay aims to educate readers about insider trading and the detrimental effects it has on the markets. To this end, the author will utilize case studies in addition to the legal position for that specific matter. To preserve the authenticity of the market for securities It's critical that insider trading gets punished. There are strict restrictions in place to penalize players who engage in these kinds of activity since insider trading upsets market equilibrium and provides an unwarranted benefit for those engaging in insider trading. Insider trading and its methods were established by a number of legislations, and it has offered a range of sanctions to stop insider trading. In 1992, the SEBI released the SEBI (Prohibition of Insider Trading) Regulations, 1992 ("1992 regulations"), which have since been revoked. The "2015 regulations"—the Insider Trading) Regulations, 2015—have been implemented action to address the inadequacies of the prior regulations and to limit the danger of insider trading, an illicit practice employed by certain vested interests in the corporate world to satisfy their personal financial expectations by supplying data (price-sensitive, unpublished-private data) that have the potential to cause significant shift in the share value. Essentially, insider trading is the purchase and sale of shares based on significant and private knowledge that is not typically made public but is revealed by an insider with the malicious intent of making illicit riches.*

**Keywords:** Insider Trading, Securities Exchange Board of India (SEBI), Stock Exchange, Scam, SEBI (Prohibition of Insider Trading) Regulations, 1992, SEBI (Prohibition of Insider Trading) Regulations, 2015

### I. INTRODUCTION

Insider trading refers to unethical behaviour by individuals who have a direct relationship or affiliation with a firm or corporate entity. These individuals take advantage of their position to obtain unpublished, price-sensitive information about the worth of shares, among other things<sup>1</sup>. To put it simply, the phrase "insider trading" refers to trading using confidential knowledge, or knowledge that has not been made public as of yet. Insider trading, however, is separated into two categories: legitimate and illicit. Corporate insiders, who are defined as officers, directors, and workers who purchase and sell stock in their own company, are the primary perpetrators of legal insider trading. However, we are particularly worried about the unlawful nature of insider trading, such as in situations where confidential information is released or leaked without consideration for

<sup>1</sup> A.K Pathak and Banu Pratap Singh, "Insider Trading in India; An analysis with special reference to V.K. Kaul Case", Company Law Journal, Vol.4, 2013, p. 40-48

the requirements of the financier. Insider trading is defined by a dictionary as "trading to one's benefit through having inside knowledge of understanding<sup>2</sup>.

Insider trading typically entails the act of purchasing, selling, or subscribing to the company's securities, if any unpublished price-sensitive information is in their hand's details ('UPSI') regarding the business<sup>3</sup>. Since the insiders are betraying the trust or fiduciary obligation they owe to the shareholders, trades in the company's own shares that these insiders make on the basis of important non-public information are deemed fraudulent. The corporate insider, just by consenting to employment, has agreed in writing to prioritize the interests of the shareholders above their own, in things pertaining to the business. If an insider purchases or sells a stock based on breaching his agreement with the owners by utilizing company-owned information.

Therefore, insider trading occurs when a business insider or any other individual with a fiduciary duty to the company uses material non-public information to trade company shares. It refers to trading the company's shares for profiting from or preventing losses due to pricing manipulation by management personnel of the business or are associated with them, based on UPSI concerning the operations of the business which they own but which others cannot access, the majority of the world's nations with reputable stock exchanges have made this forbidden<sup>4</sup>. The justification for the ban on insider trading is "the clear intention to prevent, to the greatest extent possible, insider dealing and the obvious need and understandable concern about the damage to public confidence which insider dealing is likely to cause<sup>5</sup>."

## **II. RESEARCH PROBLEM**

The idea of better understanding insider trading in the Indian setting is at the heart of the research problem. The goal of the study is to identify the trends in insider purchasing and selling in different styles. Is it possible for insiders to fabricate unusual profitability and feasibility of investing in insider trades as a strategy to be adopted by the outsiders. The main goal is to become more knowledgeable about the short- and long-term impacts of insider trading on the overall market. Regulations pertaining to insider trading change over time, revealing the effects of those changes.

## **III. RESEARCH QUESTIONS**

1. What factors determine insider trading, and is there a pattern to them?
2. What is the Indian insider trading industry's information content?
3. Does insider trading portend future spikes or busts in the market?
4. How effective is SEBI's regulatory system, and what part does it play in monitoring and implementing laws against insider trading?

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<sup>2</sup> Rakesh Agarwal v. SEBI (2004) 1 Comp LJ 193 (SAT)

<sup>3</sup> SEBI v. Mefcom Capital Markets Limited

<sup>4</sup> Udai Khanna, "The Concept of Insider Trading: A Comprehensive Study", Company Law Journal, Vol.3,2016, p.33-46

<sup>5</sup> Attorney General's Reference No.1 of 1998, In re (1990) 3 Comp LJ 9 (CA)

#### **IV. RESEARCH OBJECTIVES**

1. To determine what factors, contribute to insider trading.
2. To evaluate insider trading's information content.
3. To provide a thorough examination of the issues and relevance of India's current legal framework in order to contribute to the scholarly and policy conversation on insider trading.
4. To examine the impact of regulatory changes or reforms on insider trading practices and market behavior in India.

#### **V. RESEARCH METHODOLOGY**

This research work is analytical and doctrinal. The researcher has read numerous books, journals, Web references, electronic journals, papers, etc. The pertinent information is gathered from secondary sources.

#### **VI. LITERATURE REVIEW**

##### **1. Article: Regulation of Insider Trading in India: Dissecting the Difficulties and Solutions Ahead<sup>6</sup>**

**Author: Roopanshi Sachar & Dr. M. Afzal Wani**

The authors begin by defining insider trading as the use of privileged information for trading in shares and securities for the purposes of gain or to avoid a loss at the expense of the uninformed general public. They argue that insider trading is morally and legally reprehensible and that it undermines the integrity of the financial markets. The authors then discuss the difficulties in regulating insider trading in India. They note that insider trading is difficult to detect and prove, as it often involves the use of confidential information that is not available to the public. They also point out that insider trading is often carried out by well-connected individuals who have access to privileged information and can use their influence to evade detection and prosecution. Despite these challenges, the authors argue that there are several solutions that can be implemented to regulate insider trading in India. They suggest that the government should strengthen the legal framework for insider trading by introducing stricter penalties and increasing the resources available for enforcement. They also recommend that the government should promote greater transparency in the financial markets by requiring companies to disclose more information about their operations and financial performance.

One of the limitations of the article is that it focuses primarily on the legal and regulatory aspects of insider trading in India. While this is an important aspect of the issue, it is not the only one. The authors do not address the cultural and social factors that contribute to insider trading in India. For example, they do not discuss the role of social networks and personal relationships in facilitating insider trading. Nor do they address the cultural norms that may encourage individuals to engage in insider trading. Another limitation of the article is that it does not provide a detailed analysis of the effectiveness of the current regulatory framework for insider trading in India. While the authors suggest several solutions for improving the regulation of insider trading, they do not provide evidence to support the effectiveness of these solutions.

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<sup>6</sup> Journal On Contemporary Issues of Law (JCIL) Vol. 2 Issue 11

## 2. Article: Critical Analysis on Law's Relating to Insider Trading in India<sup>7</sup>

**Author: Kartikeya Gulati**

To increase the confidence of both domestic and foreign investors that their money is safe in a fair and transparent securities market, India's status as a global economic force, among other things, demands the need for a comprehensive regulatory framework for its securities market. Indian securities market has been quite concerned as a result of recent big price swings in shares of publicly traded firms during periods of mergers and acquisitions and unlawful trading based on unreported price sensitive information. It turns into a horrible crime when the fiduciaries who manage businesses for the interest of the shareholders obtain unjust enrichment at the expense of the business and its shareholders. Despite the fact that insider trading is a global phenomenon, a study by the IMF reports that it is relatively high in countries such as India, China, Russia, etc., resulting in high volatility in share prices. Indian studies also have reported that insider trading activity is observed amongst companies belonging to the same business group prior to merger announcements. One of the most difficult challenges facing Indian regulators is compliance.

The article highlights the prevalence of insider trading in India, particularly in the context of mergers and acquisitions. The author notes that illegal trading based on unpublished price-sensitive information has caused significant price fluctuations in public companies' shares, leading to concerns about the integrity of the Indian securities market. The article emphasizes the importance of preventing insider trading, as it can result in fiduciaries gaining unjust enrichment at the expense of the company and its shareholders. However, one limitation of the article is its focus on the regulatory framework for insider trading in India, without providing a broader context for the issue. The article does not discuss the global phenomenon of insider trading or provide a comparative analysis of insider trading regulations in other countries.

### **EVOLUTION OF INSIDER TRADING LAW IN INDIA**

India was quick to acknowledge the damage that insider trading can do to the financial markets, corporate governance in India, and the rights of public shareholders. The Thomas Committee was established in the year as the first real attempt to control insider trading, 1948 saw the evaluation, among other things, of international insider trading restrictions by this committee. Securities Exchange Act 1934 Following the Thomas recommendation, Committee<sup>8</sup>, the Companies Act of 1956 was amended to include sections 307 and 308. This shift cleared the path for some required disclosures from management and directors, but wasn't particularly efficient in attaining the goal of stopping insider trading.

Consequently, in order to suggest policies for limiting insider trading in India, the Sachar Committee and the Patel Committee were established in 1978 and 1986, respectively. Insider trading was described by the Patel Committee as "the trading in the shares of a firm by the individuals who are close to or in the company's management based on confidential, price-sensitive knowledge that they own about how the business operates but that others cannot access. The Sachar Committee and the Patel Committee had both suggested, among other things, the passing of a distinct legislation to prevent insider trading.

Abid Hussain Committee: Abid Hussain Committee was established in 1989 with the recommendation that an individual found guilty of insider trading face both civil and criminal penalties. Among the Abid's proposals was a special statute to combat insider trading. Also, the Hussain Committee. Based on the suggestions put forth by these committees, a the "SEBI (Insider Trading) Regulations, 1992," a comprehensive piece of legislation, was released and introduced as a force. In 2002, this rule underwent significant revisions and was called the SEBI (Prohibition of Insider Trading) Regulations, 1992. The Insider Trading Regulations have undergone five amendments since that time, with the most recent one occurring in 2011 was the year. But as of right moment, the SEBI (Prohibition of Insider Trading) Regulations, 1992 been revoked, taking effect on

<sup>7</sup> International Journal of Legal Science and Innovation, Volume 3, Issue 4, Page 961 – 973

<sup>8</sup> P.J Thomas, "Report on the Regulation of the Stock Exchanges in India – 1948", available at: <http://www.sebi.gov.in/History/HistoryReport1948.pdf>

May 15, 2015, and new regulations have since entered into the picture. Insider trading is currently regulated by SEBI, the market watchdog both the Insider Trading Regulations and the Act.

The requirement to amend the insider trading laws stemmed from the fact that more than 23 years had passed since SEBI released the Regulation, which was becoming inadequate given that since 1992, the listed companies, Overall, the economy and trading system saw persistent changes. These developments included the shortcomings in the 1992 Regulation that negatively impacted investors' rights, corporate administration norms, undermining public confidence in Indian financial marketplaces.

### Negative Consequences of Insider Trading

Insider trading is a dishonest practice in which the other stockholders suffer greatly from the lack of crucial insider non-public information. The following are a few more drawbacks of insider trading:

- **Insider trading is a prevalent evil in the stock market that is deceptive to investors at the time of purchase.** Because it is unfair to individuals who do not have access to price-sensitive information, it is both deceptive and illegal. When someone uses others to the risk of purchasing at a higher price by using such information to make money or incurring a greater loss.
- **Insider trading undermines public and investor confidence:** Insider trading has the potential to undermine the trust of regular investors and the general public. An excessive number of insider trading scandals in a short amount of time may irritate investors and leave them wondering how they can make any money in the stock market if they are continuously disadvantaged by dishonest insiders.
- **The industry as a whole is impacted and the company's reputation is in jeopardy.** When insider trading is discovered and exposed, corporations frequently endure a great deal of bad press. Such unfavorable press and the ensuing harm to one's reputation probably discourage wise trading. Additionally, the executives of companies with greater reputational capital have more to gain and more to lose from bad press decrease in insider trading. It is important to remember that even one person's actions might could harm a company's standing.
- **Damages the capital market's efficiency, fairness, and integrity:** Trading on insider information, particularly when it's done illegally, can seriously impair the capital markets' efficiency and fairness.

### Unpublished Price Sensitive Information<sup>9</sup> & Generally Available Information

By specifying that UPSI is any information pertaining to a firm or its securities, whether directly or indirectly, that is not generally available which, upon becoming accessible is anticipated to have a significant impact on the stocks' price and will consist of: cash flow; dividends; shifts in the capital structure; mergers, demergers, purchases, delistings, sales, and corporate expansion and such as additional transactions, major managerial personnel changes, etc.

### DISSECTING THE LACUNAS OF INDIAN INSIDER TRADING LAWS

The regulation of insider dealing has proven to be the most challenging of all the challenges that the Indian securities market regulator must deal with. Reconsideration of the regulation is prompted by experience with it, which has earned it the harsh moniker of "the unwinnable war."<sup>10</sup> India is among the numerous nations that infrequently uphold the laws against insider trading that are the statutes<sup>11</sup>. The fact that the SEBI has not taken any significant action aside from starting investigations, and that too, frequently only after the media has brought up the issues<sup>12</sup>.

<sup>9</sup> Clause (n) of sub-regulation (1) of regulation 2

<sup>10</sup> A.M. Louis, "The Unwinnable War on Insider Trading" Fortune 72 (1981)

<sup>11</sup> Mark Miller, "The Insider: Parasite or Legitimate Profit-Maker?", online available at [ccs.in/internship\\_papers/2002/29.pdf](http://ccs.in/internship_papers/2002/29.pdf).

<sup>12</sup> Naresh Kumar, "How Effective Are the Insider Trading Regulations?" 75 Corporate Law Adviser 35 (2006).

Most of the time, instances of insider trading are undetected, and even when they are, the prosecution is unable to prove its case against the accused. Even though many situations may have been looked into. Since 1992, the success percentage of prosecutions by SEBI has been extremely low. When someone is found guilty in the end, Certain restrictions, prohibitions, or even simple warnings were given out. Occasionally, SEBI released orders of consent. However, no one was imprisoned because all cases that were found guilty resulted in sanctions.

Insider trading is therefore a hugely lucrative business with little possibility of legal repercussions in India. However, there are several western nations that are far ahead of India in this area. A clear example of this kind of success has been Raj Rajaratnam's and Rajat K's conviction. This is hardly the only instance where regulatory bodies have been successful in other nations, but the list includes many more. Given these circumstances, it is obvious to speculate that there must be certain shortcomings or flaws in India's current legal system, whether in terms of legal action or implementation.

The issue with insider trading cases in India has been the absence of up-to-date, cutting-edge, and technologically sophisticated monitoring and surveillance systems, which are essential for apprehending the perpetrator. In this regard, SEBI lacks technological skills. An important factor that hinders the investigation's efficacy in this field is handicap in a way. Conversely, the US stock exchanges and SEC have extremely powerful surveillance system to detect insider trading and look into it. Despite the fact that SEBI and SEC have each achieved a completely automated monitoring system for their respective capital markets, the United States has a superior market monitoring and surveillance system that gives them a competitive advantage in identifying cases of insider trading.

The globe has become a global village as a result of the globalization of economies, and insider trading has begun to cross national boundaries. In this sense, Indian law is outdated since it does not apply outside of India, i.e., additional territorial use. The primary goals of uses of extraterritorial National laws have safeguarded resident investors' rights and domestic markets from foreign participants' behavior<sup>13</sup>. There is no framework in Indian law for penalizing or even initiating an investigation against a foreign individual who has engaged in insider trading. The Regulation makes no mention of the application of criminal sanctions against a foreign company's director that is listed on a domestic Exchanges that have engaged in insider trading will be subject to an extraterritorial application of this Act<sup>14</sup>, as the SEBI Act does not apply to territories outside of India. Many industrialized nations, such as the United States of America, have laws that extend beyond their borders applied to transactions involving a foreign element.

The direction of insider management has proven to be the most problematic of the many concerns that the controller of the securities displays in India has to deal with. Experience with this kind of control has given to the harsh moniker of "the unwinnable war," which makes people reevaluate the situation<sup>15</sup> India is among the several countries that formerly maintain the insider trading regulations that are currently in effect<sup>16</sup>. It includes sincere concern that the SEBI has not only started testing but has also done very little else just following the media's raising of the issues<sup>17</sup>.

### **SEBI (Prohibition of Insider Trading) Regulations 2015 and its implications upon Insider Trading**

The previously stated Act defines "insider," defining who is deemed to have access to price-sensitive information that has not been released. Additionally, the concept of "connected person" expands on a company's members. Individuals are in possession of such data, the comprehensive roster includes anyone

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<sup>13</sup> George C. Nnona, "International Insider Trading: Reassessing the Propriety and Feasibility of the U.S. Regulatory Approach" 27 North Carolina Journal of International Law and Commercial Regulation 196 (2001).

<sup>14</sup> Amit Kumar Pathak, "How to Tackle Insider Trading in India: An analysis of current law and regulation through judicial decision" online available at <http://corporatelawreporter.com/2012/03/28/tackle-insider-trading-india-analysis-current-laws-regulations-judicial-decissions/>.

<sup>15</sup> A.M. Louis, "The Unwinnable War on Insider Trading" Fortune 72 (1981)

<sup>16</sup> Mark Miller, "The Insider: Parasite or Legitimate Profit-Maker?", online available at [ccs.in/internship\\_papers/2002/29.pdf](https://ccs.in/internship_papers/2002/29.pdf).

<sup>17</sup> Naresh Kumar, "How Effective Are the Insider Trading Regulations" 75 Corporate Law Adviser 35 (2006).

who throughout six months before to the occasion been connected to the business, either directly or indirectly, in any capability, such as by regular interactions with its officers or by holding any employment, fiduciary, or contractual relationship, or through serving as an officer, director, or staff member of the organization or has any position, including one in a business or professional capacity, "temporary or permanent," it clarifies the situation fairly clearly because possessing such a position of authority, the individual may influence the markets by using the secret, very significant knowledge it held. The aforementioned individual utilizes it exclusively to speculate on share prices and earn unjustified profits. In order to avoid being found guilty of insider trading, the apprehended individual must demonstrate that they did not engage in these illegal activities. However, it should be noted that such data may be disclosed in a "need to know" foundation, in support of a justifiable goal, or to fulfil legal requirements thereby granting specific legal exclusions to such information exchange.

The aforementioned regulations' 3(5) is particularly significant since it now requires the Board of Directors to have an accurate digital database structure of all the insiders engaged, upheld and examined internally. Appropriate Fair Disclosure and Conduct Guidelines have been designed to guarantee that trading by individuals with access to confidential price-sensitive. In order to maintain oversight over the securities market, information is strictly regulated and monitored crazy conjectures.

## RELEVANT CASES

**Hindustan Lever Ltd. ('HLL')** and **Brook Bond Lipton India Ltd. ('BBIL')**, both owned by Unilever, Inc. UK, were under the same management in *Hindustan Lever Ltd. v. SEBI*<sup>18</sup>, one of the first cases in which SEBI initiated action on the grounds of insider trading. Two weeks before the public announcement, in March 1996, HLL acquired 0.8 million shares of BBIL from UTI. Following the announcement, BBIL's share price surged, leading to resulting in UTI losses. SEBI found HLL responsible for insider trading. SEBI claims that HLL benefited from having access to all sensitive information; however, the Securities Appellate Tribunal (or "SAT") overturned the decision, stating that the data did not relate to price after it was becoming public information due to media reports about it. Because of this instance, in order to specifically provide certain speculative media reports, SEBI revised the Regulations (paper or digital) would not be regarded as the disclosure of information that is price-sensitive.

Mr. Dilip Pendse was a director of Niskalp Investments and Trading Co. Ltd., a Tata Finance Ltd. company, and of Tata Finance Ltd. in the **Dilip Pendse v. SEBI**<sup>19</sup> case. Talaulikar served as director of the aforementioned businesses as well. TFL revealed a rights dispute between 30-4-2001 as well as 30-3-2001. It was noted that TFL subsidiary Niskalp has experienced severe losses that did not appear in the offer letter. Mr. Talaulikar moved his household shares on 4/4/2001 at a premium price, despite owning UPSI, resulting in losses for Niskalp. While in control of UPSI, it was claimed that Mr. Pendse had facilitated the transfer of shares and provided counselling. But according to SAT, since both Mr. Pendse and Mr. Talaulikar are insiders and professionals, Mr. Talaulikar didn't need Mr. Pendse's guidance. Pendse as claimed, and since Mr. Talaulikar was Niskalp's director at the time, he is accountable the moment the money was moved.

In the Satyam Case, a top Satyam Computer Services official was fined INR 5, 00,000 by SEBI in 2011 for failing to close the trading window on time. The company's compliance officer, G. Jayaraman, is accused of neglecting to shut the trading window during the announcement about Satyam's purchase of Maytas and its subsequent cancellation in December 2008. Additionally, he did not shut the window prior to the aforementioned admission made by the then-chairman Ramalinga Raju committed a huge swindle in January 2009. Since Jayaraman did not close, SEBI claims the window for trading Even though they were aware of UPSI, it caused some workers and clients to sell the shares during the supposed period of no trading.

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<sup>18</sup> (1998) 3 Comp LJ 473 (SAT)

<sup>19</sup> Appeal No. 22 of 2008

## SUGGESTIONS

The current paper offers a thorough examination of insider trading in the Indian context from several angles on its effects on the market. The study's findings support the notion that a number of variables influence insider sales and acquisitions. Several of these elements are common investment techniques employed by the market attendees. As a result, market players can predict the path of insider trade in accordance with these criteria.

The current study's limitations provide room for more research. The recently enacted SEBI (Prohibition of Insider Trading) Regulations, 2015 may be taken into consideration in future research endeavors. The latest SEBI regulations outlined several categories of insiders, such as the immediate relatives of directors and employees, as well as the immediate Family member, important manager, promoter, director, and promoters Direct Family Member. Subsequent research can evaluate the profitability of every category of insiders and the knowledge they provide to assess the effects of the shift in insider trading policies.

## CONCLUSION

In an effort to increase local investor trust and draw in the global investing community, foreign regulators have placed a premium on the enforcement of insider trading laws. Thus, SEBI's role should now be limited to that of a regulator. Particular Courts might be set up to handle cases quickly and efficiently. Listed businesses in addition to Organizations' now need to create internal policies and procedures to stop insider trading by partners, staff members, directors, and others. Legislation pertaining to insider trading has historically found to be ineffectual, hard to implement, and little affected the securities markets.

The majority of financial regulations must be updated frequently to reflect the dynamically changing nature of the market. Insider trading operates similarly. In order to eliminate the gaps and shortcomings included in the 1992 Regulations, SEBI has completely redesigned the framework that insider dealing within India. Therefore, under the 2015 standards, necessary modifications like as expanding the concept of "insider," tightening the guidelines for "connected persons," Among other things, simplifying disclosure events and getting rid of unnecessary clauses have been presented. A unique feature of the Regulations i.e., legislative notes interspersed within provisions will be an effective tool for interpretation of these Regulations going forward.

To maintain fair playing fields in the securities market and protect investors' interests, it can be further said that SEBI completely redesigned the framework for regulating insider trading, which is believed to be a pervasive issue in India. The Indian capital market will receive a much-needed boost from this SEBI action, which would also enable more economic viability. Nevertheless, further investigation reveals that some of the suggested and the fresh ideas brought forward by the 2015 Regulations are unclear.