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CRITICAL ANALYSIS ON INSIDER TRADING

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Abstract

This abstract is on the **Topic-Critical Analysis on Insider Trading**, under Guidance of my Faculty Mentor Dr. Meenu Sharma, Assistant Professor-II, Amity University.

The paper aims to critically examine the concept of insider trading in India. The act of trading in securities while having access to unpublished information that, if published, could impact the price of the securities in the market. Insider trading is the pre-eminent malpractice in the financial market, despite being heavily regulated, it is the most challenging to detect.

To overcome this challenge, SEBI has been actively taking measures and framing regulations to curb insiders and thereby increasing transparency in the capital markets. SEBI's regulation on Insider Trading 2015 is one of them, this regulation prohibits trading on basis of price-sensitive information which is generally not available to the public, and if disclosed would affect the price of securities in the market. Over the years, laws for prevention of insider trading have evolved, putting increased onus on companies and organizations to protect price sensitive information.

Further, reviews insider trading provisions in the Companies Act primarily Section 64 and 65 of Companies (Amendment) Act 2017 omitted Sections 194 and 195 respectively of Companies Act 2013 relating to prohibition on insider trading.

In conclusion, this paper also deals with issues with respect to insider trading in our country, how this concept has eventually evolved, emerging trends and the measures been taken to regulate it.

Key words: *Insider Trading, Unpublished Sensitive Information, Securities Exchange Board of India, Companies Act 2013, SEBI (Prohibition on Insider Trading) Regulations 2015*

I. Introduction

The concept of Insider Trading has emerged as one of the most alarming issues in the securities markets across the world. The phrase "insider trading" by its name itself describes that it is the act of dealing in securities by an individual(s) having means or direct control over the unpublished material information that could influence the value/price of those securities if published in the public domain.

Insider trading is usually performed by those individual(s) who have unique access to the pivotal material information in connection with the company that usually relates with its stocks or any other information that may not be readily available in the public domain.

Insider Trading is considered as immoral or unethical simply because “it entails taking advantage of confidential information (UPSI) not available in the public domain and not accessible to the general public. This can create an unjust benefit¹ for individuals who have access to such information, as they can make investment decisions based on such UPSI.”

The²Securities & Exchange Board of India (SEBI) is the regulatory body in our country that acts as a watchdog over the commission of offences of Insider Trading as it affects the securities market at large. In other terms, it is³“trading in securities by insiders who are in possession of or have access to unpublished price-sensitive information (UPSI).” The act of Insider Trading in India is considered illegal and can result in hefty penalties as well as imprisonment in some cases.

The provisions related to Insider Trading has been laid down in the⁴Securities & Exchange Board of India Act, 1992(SEBI Act) and⁵SEBI (Prohibition of Insider Trading) Regulations 2015. In addition to this, the Companies Act also deals with the provisions of Insider Trading. From time to time, numerous amendments have been made to these regulations to broaden their scope and make them more dynamic.

II. Regulation relation to Insider Trading in India

As discussed above, SEBI is the regulatory body that assures in the fair dealing in all kinds of securities is properly maintained and act as a custodian to the securities market. One of the vital functions of SEBI is to protect the interest of the investors in the securities market, to regulate the stock market through such regulations and most importantly, is to prohibit fraudulent and unfair trade practices relating to securities markets.

The first attempt to regulate insider trading in the country was led under the⁶Thomas Committee, headed by P.J. Thomas and the report under his leadership was called ‘Report on Regulation of Stock Market in India.’ Pursuant to the recommendation of the Thomas Committee,⁷sections 307 and⁸308 were introduced in the Companies Act 1956.

The⁹Patel Committee in 1986 defined “Insider Trading”

The Report under the chairmanship of G. S. Patel was titled ‘Report of High-Powered Committee on Stock Exchange Reforms 1986’. It defined Insider Trading as “*trading of shares of a company by the persons who are in the management of the company or are close to them on basis of undisclosed price sensitive information regarding the working of the company, which they possess but which is not available to others.*”

The recommendation of the committee was to treat insider trading as a punishable offence.

The securities market needed a more comprehensive legislation to regulate the practice of Insider Trading in the country, thus resulting in the formulation of the¹⁰SEBI (Insider Trading) Regulations 1992, which were amended in the year 2002. However, with the ever-changing business landscape and dealings in the securities markets, SEBI constituted a new Committee presided by the Retired Chief Justice of the High Court of Karnataka, N.K Sodhi, and notified the¹¹SEBI (Prohibition of Insider Trading) Regulations 2015. The new regulations promised

¹ Robert W. McGhee & Walter E. Block, “An ethical look at insider trading,” Insider Trading: Regulatory perspectives, ICAFI university press, 2007.

² Constituted on the Resolution by Department of Economic Affairs No.1 (44) SE/86.

³ Anil Kumar, “An Empirical study of Legal Insider Trading in India,” SSRN, July 2018, available at -[Determinants of Legal Insider Trading: Empirical Evidence from India by M Anil Kumar, Rajesh H. Acharya: SSRN](#)

⁴ SEBI Act, 1992, No 15, Acts of Parliament, 1992

⁵ SEBI (Prohibition of Insider Trading) Regulations, 2015, Notification No. LAD-NRO/GN/2014-15/21/85.

⁶ P.J Thomas, “Report on the Regulation of the Stock Exchanges in India – 1948”, available at:

<http://www.sebi.gov.in/History/HistoryReport1948.pdf>

⁷ Sec. 307 of CA, 1956.

⁸ Sec.308 of CA,1956

⁹ Report of the High Powered Committee on Stock Exchange Reforms 1986, G. S Patel, 1986, available at - Report of the High Powered Committee on Stock Exchange Reforms | [Expert Committee on Companies and MRTP Act Report of the High-Powered Expert Committee on Companies and MRTP Acts | INDIAN CULTURE.](#)

¹⁰ SEBI (Insider Trading) Regulation 1992, available at - SEBI | SEBI (Prohibition of Insider Trading) Regulations 1992.

¹¹ SEBI (Prohibition on Insider Trading) Regulations 2015, available at -

https://www.sebi.gov.in/sebi_data/attachdocs/1421319519608.pdf.

over the regulation of the securities market and power to enact laws/ regulations regarding the issue of Insider Trading.

V. SEBI (Prohibition of Insider Trading) Regulation 2015

The said regulations were brought into force by SEBI on 15th January 2015 under the recommendation of Sodhi Committee to prevent commission of insider trading, promote fair trading in securities and ensuring an equal opportunity for all investors in the market is been made. The said regulations apply to all kinds of securities listed on any recognized stock exchange.

The SEBI (Prohibition of Insider Trading) Regulation 2015 clarified who would qualify to be a ‘connected person’ and defined ‘Unpublished Public Sensitive Information’.

¹⁷Regulation 2(d) of the Insider Trading Regulations 2015 defines “*Connected Person as any individual who was associated with the company in some form whether directly or not, permanent or not, in any capacity that allows them to access UPSI*”.

¹⁸Regulation 2(g) of the said regulation defines “insider as any person who, is or was connected with the company or is deemed to have been connected with the company and who is reasonably expected to have access to UPSI in respect of securities of a company, or has received or has had access to such UPSI.”

¹⁹Regulation 2 (n) relates with defining “Unpublished Public Sensitive Information as sensitive information that concerns the functioning or management of a company or its securities, whether it has the potential to affect it directly or not, is known to very few who have access to it, and when published publicly has the power to influence the value of the securities and includes information like – dividends, financial results, change in a key managerial position or capital structure, etc.”.

Regulation 3 states that “no insider shall communicate, procure from or cause the communication provide, or allow access to UPSI to any person, relating to a company or securities listed or proposed to be listed, except where such communication is in furtherance of legitimate purposes”. The regulations, no-where defines what shall constitute as ‘legitimate purpose’ and often leads to confusion as to what acts would or would not fall under this exception. Whereas, Regulation 4 puts a prohibition on the Insider not to deal on the stock exchange if he/she is in possession of UPSI of a company.

In the present context, there are few other sections that deal with Insider Trading alongside with the SEBI (Prohibition on Insider Trading) Regulations 2015 which are Section 11, Section 12A, and Section 15 G of the SEBI Act 1992.

Section 11 of the Act lays down an exhausted list that defines various functions of SEBI, which read as the “*Board to protect the interests of investors in securities and to promote the development of, and to regulate the securities market, by such measures as it thinks fit*”.

Section 12A talks about the “*Prohibition of manipulative and deceptive devices, insider trading and substantial acquisition of securities or control. The section reads as follows:*

“No person shall directly or indirectly--

(a) use or employ, in connection with the issue, purchase or sale of any securities listed or proposed to be listed on a recognised stock exchange, any manipulative or deceptive device or contrivance in contravention of the provisions of this Act or the rules or the regulations made thereunder;

(b) employ any device, scheme, or artifice to defraud in connection with issue or dealing in securities which are listed or proposed to be listed on a recognised stock exchange;

(c) engage in any act, practice, course of business which operates or would operate as fraud or deceit upon any person, in connection with the issue, dealing in securities which are listed or proposed to be listed on a

¹⁷ Regulation 2(d) of SEBI (Prohibition of Insider Trading Regulations)2015

¹⁸ Regulation 2(g) of SEBI (Prohibition of Insider Trading Regulations)2015

¹⁹ Regulation 2(n) of SEBI (Prohibition of Insider Trading Regulations)2015

recognised stock exchange, in contravention of the provisions of this Act or the rules or the regulations made thereunder;

(d) engage in insider trading;

(e) deal in securities while in possession of material or non-public information or communicate such material or non-public information to any other person, in a manner which is in contravention of the provisions of this Act or the rules or the regulations made thereunder;

(f) acquire control of any company or securities more than the percentage of equity share capital of a company whose securities are listed or proposed to be listed on a recognised stock exchange in contravention of the regulations made under this Act.”

Section ²⁰12A of the Act puts an obligation and prohibits on any individual whether directly or indirectly to not to engage in insider trade practices. The sub-clause (e) of this section puts a restriction on the dealing of securities while having access to UPSI. This prohibition applies to dealing in securities whether on one’s behalf or someone else.’

Penal provision prescribed for an offence of Insider Trading has been provided under ²¹Section 15G of the Act which read “*as punishes any insider who either by himself or on behalf of another person, trades in a company listed on the stock exchange on the basis of UPSI, or communicate such UPSI to any person which would not happen in the ordinary course of business, or counsels/procures for any other person to trade securities based on UPSI and makes them accountable for Insider Trading. SEBI can penalize for an amount up to 25 crores INR or thrice the amount of the earnings made, or whichever is more.*”

VI. Emerging trends of Insider Trading in India: Way Forward

Insider trading is the pre-eminent malpractice in the financial market, despite being heavily regulated, it is the most challenging to detect. Over the past years, there have been several emerging issues related to insider trading in India and SEBI has been actively investigating and prosecuting cases of insider trading, which has resulted in several high-profile convictions.

Insider trading is one of the most debatable facets of securities regulation. Proving insider trading can be a difficult and challenging task, as it involves establishing a connection between the insider's actions and the material information they possessed during trading. Additionally, the burden of proof rests with the prosecution, which can make it difficult to secure a conviction and prove an offence of insider trading.

In our country, there is a lack of awareness and education among investors and market participants about insider trading and its implications. This makes it difficult to detect and prevent insider trading, leading to a diminishing confidence of investors in the market. And hence, there is a need for stronger regulations, better education, and increased awareness to prevent insider trading and maintain the integrity of the securities market.

The ²²company managements must create awareness amongst the insiders of the company about the relevant laws and requirements to ensure due compliance with it. “*Training for company employees on the rules and regulations surrounding insider trading, as well as training for investors on how to identify and avoid insider trading. Educational initiatives can also raise awareness about the negative impact of insider trading on the economy and encourage individuals to report suspicious activities to regulatory bodies.*”

It can be observed from the ²³Annual Reports released by SEBI, that the reporting of Insider Trading offences has reduced over the years, but it is difficult to ascertain whether the Regulations have worked to trim down the number of active cases or Insiders have evolved their strategy to avoid the watchful eyes of SEBI. SEBI in its reports have ascertained that “*To tackle this, whistleblower protection can aid in determining and prosecuting*

²⁰ Sec 12A of SEBI Act, 1992.

²¹ Sec 15G of SEBI Act, 1992.

²² Roopanshi Sachar & Dr. M. Afzal Wani, “REGULATION OF INSIDER TRADING IN INDIA: DISSECTING THE DIFFICULTIES AND SOLUTIONS AHEAD” 2 (JCIL) 5 Issue 11(2016)

²³ SEBI Annual Report, 2021-2022, available at [SEBI | Annual Report 2021-22](https://www.sebi.gov.in/annual-report-2021-22)

cases of Insider Trading. Whistleblower protection can encourage individuals to come forward with information about insider trading and increase the chances of detecting and preventing the practice.”

If an individual is found guilty of insider trading in India, the individual shall be liable to pay hefty fines as well as they may face imprisonment as per the SEBI (Prohibition on Insider Trading) Regulations 2015. In furtherance SEBI can also initiate civil proceedings against the individual and order disgorgement of any profits made from the insider trading. And SEBI, also has power to initiate criminal prosecution under Section 24 of SEBI Act 1992.

In addition to this SEBI, the Ministry of Corporate Affairs and the Central Bureau of Investigation also have the authority to investigate and prosecute insider trading cases in India. Overall, insider trading can be viewed as a white-collar crime.

One of the major concerns that SEBI should address is that under the SEBI (Prohibition of Insider Trading) Regulation 2015 sharing of Undisclosed Public Sensitive Information for legitimate purposes is valid however, under these regulations, there is no where defined what shall constitute ‘legitimate purpose’. This often leads to confusion and conflict as to what acts would or would not fall under this exception.

In respect of punishments, the Courts can approach a stricter route and award heavy amount of penalties. A more-stricter approach is a way forward and it will result in a sense of fear in the minds of any potential offenders abstain them from committing insider trading in near future.

Also, there is no extraterritorial application of the Insider Trading laws in India, so if any foreign national commits an offence relating to insider trading in India, SEBI lacks jurisdiction to impose charges on that individual, which is not the case in foreign countries like US where they have the clause for extraterritorial application in their laws.

In addition to this, SEBI must also establish a timeline to conclude its investigation while dealing in matters of insider trading, bound itself to complete the investigation within a reasonable amount of time.

It is unlikely that the insider trading is to ever be fully eliminated/ wipe off from the securities market, however to deal with the issue of insider trading it shall require a multi-dimensional management that includes introduction of stricter regulatory measures, education and training, transparency in the market to reduce its occurrence and protect the investors as well as the securities market. By taking steps to strengthen enforcement mechanisms, increase penalties, and educate investors, it can result in creating a more transparent and ideal dealings in the securities markets.

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