

DE JURE NEXUS LAW JOURNAL

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INSIDER TRADING

Introduction-

In simple terms, insider trading means buying or selling a security, in breach of a fiduciary duty or other relationship of trust and confidence, while in possession of material, non-public information about the security.

Insider trading is defined as using unpublished price sensitive information to deal in securities of a company for one's own benefit. In India, insider trading was earlier governed by SEBI through its Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 1992. On the other hand, in November 2014, SEBI issued a new Regulation called **Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015** [1] for Prohibition of Insider Trading.

Under these regulations (SEBI) an "Insider" is defined as: "any person who is connected, or in possession of or having access to unpublished price sensitive information. Now, what is price sensitive information? Price sensitive information means any information which is directly or indirectly connected or related to the company and if such information is published is likely to materially affect the price of securities of the company.

The person is known as an insider if- He has access to Material Non-Public Information About Company, and he holding more than 10% of voting shares.

Forms of Insider Trading-

- Members of Organisation- Employees or members of publicly traded companies are in a key position to access information that would not otherwise be available to the general public.
- Government Officials- officials of different government agencies can gain access to confidential information through the execution of their duties. They may conduct insider trading with this information.
- Professional / Consultants- Bankers, Lawyers, paralegals, and brokers are but a few of the consultants who have access to confidential documents of their corporate clients.

[1] SEBI- <https://www.sebi.gov.in>

- Friends/ family of employees- corporate employees often share information within their own circles that is not shared with the Stock Market and the general public.

Legal and Illegal Insider Trading-

The term “Insider Trading” includes both legal and illegal conduct. Legal Insider Trading is when corporate insiders, officers, directors, employees, and large shareholders, buy and sell stock in their own companies. When corporate insiders trade in their own securities, they must report their trades to the Securities and Exchange Commission. Many investors and traders use this information to identify companies with investment potential, the theory being, if the insiders are buying the stock, they must know more about their company than everyone else.

The Illegal Insider Trading- The more infamous form of insider trading is the illegal use of non-public material information for profit. It's important to remember this can be done by anyone including company executives, their friends, and relatives, or just a regular person on the street, as long as the information is not publicly known.

Why Is Insider Trading Illegal?

The reason insider trading is illegal is that it gives the insider an unfair advantage in the market, puts the interests of the insider above those to whom he or she owes a fiduciary duty, and allows an insider to artificially influence the value of a company's stocks. In most countries, some kinds of trading based on insider information are made illegal by making rules to prohibit or criminalize insider trading.

-Unfair for other investors- Insider trading is seen as unfair to other investors in the stock market, who do not have access to the information. The investor with the non-public information could potentially make far larger profits from the stock market than a typical investor could not make.

-Morally wrong and un-ethical terms- It is a morally wrong and unethical way of trading in the stock market. All investors should get equal opportunities to trade with the same piece of information about the company.

Why to Control Insider Trading?

To protect general investors- The manipulation of the market by using insider trading generally causes great losses to a company, thus leading to a loss for investors or great profit only for the insiders. It steals away the possibility of earning profit from an investor.

To protect the interest and reputation of the company- once a company faces a problem of insider trading, investors tend to lose confidence in the company and stop investing in the company and also selling all the stocks of the company.

To maintain confidence in the stock exchange operations- with SEBI also regulating all the trading, if any insider gets a chance to get past the laws, it decreases the investors' confidence in the stock exchange operation itself.

To maintain Public Confidence in the financial system as a whole- the Indian financial market is still very low in the domestic investment rate. To have a healthy economy, a proper financial system is a must and for that, confidence in the market is of utmost importance.

Penalties for Insider Trading-

Section 15G in the Securities and Exchange Board of India Act, 1992- SEBI Act provides penalties for insider trading, as high as Rs 25 Crore or three times the amount of profits made out of insider trading, whichever is higher. The Act also prescribes that insider trading is punishable with a prison term of up to 10 years.

According to the Securities and Exchange Commission in the US, a conviction for insider trading may lead to a maximum fine of \$5 million and up to 20 years of imprisonment.

Relevant Case Laws-

Hindustan lever Limited V. SEBI (1998)- it was held by appellate authority that, if leading financial newspaper had reported the possibility of a merger, it cannot be alleged later that the information about the merger was price sensible information. The reason is that the possibility of the merger would be presumed to be known to the public after the publication of the news of the merger, as a fall out of this case, SEBI amended its regulation in 2002 to specifically provided that speculative reports in print and electronic media shall not be considered as published information (i.e. they will be considered as unpublished.)

Note- price sensitive information is provided in definition 2(m) of the amended regulation.
[^{II}]

Rakesh Agrawal v. SEBI (2003) - In this case, Rakesh Agrawal was the managing director of ABS Company Pvt. Ltd. The ABS Company was in negotiation with Bayer A.G. which was based in Germany. Rakesh Agrawal thus had access to unpublished information of the Bayer's company. It was alleged by the SEBI that the brother-in-law of Rakesh Agrawal had purchased some shares from ABS and tendered the shares to Bayer in the open offer. This resulted in substantial gains by the ABS Company. After Bayer company overtook the ABS Company. The 51% of shares that were acquired by the Bayer Company were not public, thus ABS was an insider. Therefore the appellant acted in insider trading and acted in violation of regulation 3 and 4 of the SEBI Act.[^{III}]

Indiabulls Insider Trading Case- In this case, the executive director of Indiabulls was accused of making Rs. 87 lakhs unlawfully by trading in Indiabulls when they had access to unpublished secret information of sale of land and property privately which is the subsidiary

[^{II}] (1998) 18 SCL 311 MOF

[^{III}] (2004) 1 CompLJ 193 SAT, 2004 49 SCL 351 SAT

of Indiabulls venture limited. According to the regulator, the executive director of the Indiabulls venture limited was in the management committee of the Indiabulls, therefore she was an insider and her husband too was an insider. These unlawful gains were made in the year 2017-19.

The SEBI ordered that strict criminal action be taken against the IVF and both the executive director of the company and her husband has to impound Rs. 87.4 lakhs both jointly and severally. It was further directed that no debts shall be made without the prior permission of SEBI. This case is one of the latest case law which is related to insider trading.

Recent Amendments in the insider trading laws-

On August 21, 2019, SEBI approved the SEBI (Prohibition of Insider Trading) (Third Amendment) Regulations, 2019 (Amendment) to bring amendments in the SEBI (Prohibition of Insider Trading) Regulations, 2015 (Insider Trading Regulations) to introduce an informant mechanism for limiting insider trading and safeguarding the interests of the investors.

-Inclusion of the new term 'Informant' which is given under Section 7A (b) of the amended Act 2019. According to this section, an informant can be any person who informs the SEBI regarding disclosure of any secret information of the company or has a belief that such insider trading is about to occur.

-It should be necessary that the informant voluntarily submits this information without any pressure, coercion, or any relation to central or public authority.

-There is a new word that is included under the new amended act which is 'Original Information' given in Section 7A (h) of the amended act. Original information means any independent knowledge or information which is not known to the board which is not frivolous or irrelevant or which is related to the violation of the insider trading laws.

-The person who gives original information to SEBI regarding insider trading in a company need not be disclosed and his identity is protected or should be kept confidential by the SEBI under the I cases. No one can compel that person to reveal his identity.

-One important thing is to be noticed that information provided by any informant should not be irrelevant, frivolous, or vexatious. The informant must adhere to all the guidelines and litmus tests laid down by SEBI. If any mischievous activity is found by SEBI then the informant would be held liable and has to pay the penalty.

-In the recent amendments, the informant has legal remedies in case the employer of the company threatens or coerces the informant into revealing original information to the SEBI.

If such victimization, blackmailing be found by the SEBI then the employer will be held liable or will be suspended, penalized, or also will be criminally liable. Any act or agreement which prohibits any informant or restricts him to give original information in the SEBI regarding insider trading is void and also that act is prohibited by the SEBI.

-The informant is entitled to get a reward not exceeding Rs. 10 lakhs rupees for telling and giving the original information to SEBI. It is given in Section 7D of the Act. It is up to the discretion power of the SEBI to decide the amount of the reward on the recovery of such information by the informant. [IV]

Conclusion-

SEBI has significantly revamped the insider trading regulatory framework in India with a widened scope on who is considered an insider and a connected person. The new regulations appear to be promising, more practical, and largely in line with the global approach to insider trading. They also seem to be equipped to ensure better compliance and enforcement. Insider Trading is perceived to be a deeply rooted problem in India and the new Regulations will ensure a level-playing field in the securities market while securing the interests of investors at large.

According to statistics, it is noticed that insider trading has been significantly reduced in the past few years. It is due to the strict and haste action by the SEBI and strict norms and guidelines laid down by the SEBI. in the SEBI prohibition of insider trading regulation has been successfully implemented or able to curb insider trading or not.

[V] SEBI Amendments, 2015- <https://www.sebi.gov.in>