Insider Trading in India: A Corporate Fraud

Dr. Varsha Agarwal,
Assistant Professor & Research Coordinator,
Department of Management,
Center for Management Studies, JAIN (Deemed-to-be University), Bangalore, India
Email ID: varsha_a@cms.ac.in

***ABSTRACT:** This paper initially begins with discussing the term "Insider Trading", and how does it play a crucial role in market inefficiency. The said term as it is quite evident, means, an unfair practice of collecting material or secret information, which is obviously known to less number of people, from any of the insider member of the company, who is closely related to the company affairs, and trading while making profits out of that secret information, is known as "Insider Trading". Further, this paper titled "Insider Trading in India: A Corporate Fraud" deals on to dwelling into the debatable topic that, whether such type of practices of insider trading, be made legal or should be banned forever. The paper concludes while discussing about the various guidelines, regulations, provisions and measures, which are adopted and laid down by SEBI, for curbing the rise of such an evil and fraudulent practice of insider trading in India.*

***KEYWORDS:** Company Law, Corporate Fraud, Insider Trading, India, SEBI.*

INTRODUCTION

Insider trading is that kind of transaction or practice which include individuals or natural person, termed as "Insiders", being an employee of a public company or corporation with an access or right of an entry to secret or non-public material or information related to the company. Using such sort of an information efficiently, by the insiders involved in such evil and fraudulent practice, has made the practice of insider trading illegal, which results in loss of confidence amongst the other investors of the company. Moreover, on the other hand, the market will become inefficient while operating, if the evil practice of insider trading is made legal[1].

The said term as it is quite evident, means, an unfair practice of collecting material or secret information, which is obviously known to less number of people, from any of the insider member of the company, who is very closely related to the company affairs, and trading while making profits out of that secret information, is known as "Insider Trading"[1].

To worsen the conditions of the market or to make it inefficient while operating in the commercial sector, insider trading plays a very vivacious and dynamic role. The weak form of the market is directly reflected, by the prevalence of an evil practice of insider trading in the commercial sector, wherein, the secret information regarding the company's operations, which is only known to some close employees of the company, is extracted by the 'Insiders' of the company, in order to earn profits outside the company[1].

The prevailing illegal and fraudulent practice of insider trading results in negligence with respect to fair play in the market, as it effects the working and operations in the market, because an information to one person, acts as an advantage to him while operating in the market, hence, that person gets a upper hand in dealing under stock markets, as compared to another person, which sometimes results in loss of interest amongst the small and big investors of stock market[1].

Insider Trading creates a great impact and effect on global commercial and capital market. The mechanism or the whole process of insider trading begins, when the 'insider', who possess some sort of secret information, which is material in nature, and known to less number of people, which is initially spreads like fire amongst the group of people, which is then used or implemented in action, in order to play with the prices of the stock, by buying and selling the same in the market[1].

The practice of "Insider Trading" is obviously prohibited and offensive under section 195 of The Company's Act, 2013 along with Section 15 (g) of SEBI Act. The practice of "insider trading" usually means, gaining some sort of monetary benefits or profits, with just having information in hand, which is not in knowledge of other key characters or investors of the trading. Such sort of an evil and illegal practice of insider trading, is generally executed and implemented to earn huge ratio of monetary profits, with only having material information in hand, which is not known to public at large[1].

The punishment provisions are also laid down under The Company's Act, 2013 and the SEBI Act, which lays down the penalty in the form of imprisonment of five years and cash penalty of five lakh rupees, which may be extended up to twenty-five crores or the three times of the profit earned through insider trading, whichever is higher[1].

Section 2(e) of SEBI (Prohibition of Insider Trading Regulations) 1992, defines the term "Insider Trading". It simply implies to denote that, an 'insider' is trading or dealing in the operations of the company in the corporate sector market. In other words, it is defined as the period of time, wherein 'insiders' or the person who is closely connected with the company affairs, possess some sort of sensitive and delicate information, which is used for gaining monetary benefits[2].

An "insider" is defined as a person who is or was closely connected or associated with an organisation or concerned company or on the other hand, is believed or supposed to have a close connection with an organisation or concerned company and is practically expected or anticipated to have in possession to some sort of the sensitive or material information, which is totally prohibited or restricted from publishing amongst the public at large, as it will be against the company policies and will be violating the security exchange transactions of an organisation[2].

Section 2(ha) of SEBI (Prohibition of Insider Trading Regulations) 1992, defines the term "Price sensitive information", as any sort of information which is directly or indirectly related to the concerned company or an organisation, and which will surely affect the prices of the future stakes of the company, if published amongst the general public at large[2].

Insider trading is not just a theft or stealing of crucial or sensitive material information related to the company's affairs, but it's more than that. Through the prevalence or rise of such practices in the commercial sector, it's never easy to look out or find, who is the guilty person, and who is the victim person on the other hand, behind such a shameful and fraudulent act. The practice of insider trading, has its own merits and demerits. In recent decades, the practice of Insider trading has surely achieved the badge or tag of bad name, as it is an unethical, evil and fraudulent practice done globally, and has affected the operations of global commercial markets. The press officials usually describes the practice of insider trading as an evil practice, wherein parties involved only think about their self-profit margins and benefits[2].

Essentially, insider trading means, operating in the stock market of the company, based on the secret and confidential or sensitive information in hand, which is directly related to the affairs of the company, and is not out in public domain yet. On the other hand, if such sort of any information is published, it would definitely cause a drastic issue and barrier for the company's financial growth, as such information will create a vivacious impact on the company's financial assets[3].

An 'insider' is an individual who is in possession or has received some sort of sensitive information, out of which profits or benefits can be yielded or on the other hand, it is quite obvious that he or she is so well and closely connected with the affairs of the company, that he or she might be having some sort of secret or sensitive information. For example, if the chief instructor or executive of an organisation or a company, has some sort of price sensitive information, and before any such information comes in the public domain or become free to access for large masses of public, the insider purchases the shares in that company, and thereafter makes that information public, in order to increase the prices of stock held herein by the company. Hence, by doing such an act, he will be liable and guilty for committing a corporate fraud of insider trading[3].

The practice of insider trading, is generally a violation of trust and the duty which is fiduciary in nature, and such a breach of trust is usually committed by the management of the company and its team working in the company, those who are well and closely connected and involved in the affairs of the company. An insider is in possession of trust and duty of fiduciary nature, whenever he receives the sensitive or delicate information about the operations of the company. This breach or violation of duty and trust begins altogether when an insider is in possession of that sensitive and unpublished information, and when he misuses that sort of an information in malafide intentions and actions. Therefore, such a fraudulent act of insider trading amounts to illegality and breaking of rules and regulations. But, such an act can also be treated as legal activity or trading, if it is performed or implemented within the ambit of company policies and government regulatory bodies[3].

Hence, such type of activities and trading are strictly prohibited, and the main idea or motive behind such a prohibition is the concern or an alarm of distress and apprehension amongst the public at large, that it might cause a sheer impact on the small and big investors, ultimately resulting in the growth of the company in the commercial sector. In order to curb or control such rise in an evil practice of insider trading, SEBI should deal with such type of fraudulent corporate dealings very strictly and sternly, or else they will fail to maintain and promote healthy relations amongst the corporate sector. Hence, if such type of trading is not controlled, it will surely create a drastic impact on the inflow and outflow of funds and investments and will depict the market of Indian securities in a negative manner amongst the foreign investors[3].

Research Question

- Is Insider Trading legal in India?
- What is the role of SEBI in curbing or controlling the practice of Insider Trading in India?
- What are the legal mechanisms or regulatory measures related to Insider Trading in India?

DISCUSSION

The term "Insider Trading", has been described in a great detail within Securities Exchange Board of India (Prohibition of Insider Trading) Regulations, 1992. It clearly denotes that, operating for the companies funding and assets in the share market, wholly and solely based on the piece of sensitive, delicate and unpublished information, which is clearly not in knowledge of others, and making profits or monetary benefits, out of such information, is known as "insider trading".

The person trading for the securities of the company, on the basis of just a piece of information, is known as an, 'insider'. An insider is known as a person, who with the help of his inter-company connection and relations, makes an arrangement of some secret information, which is clearly not published for public domain, and takes out benefit out of that information, while making profits in the share market, creating a scenario of unfair play in the market.

Hence, in order to avoid such practices in the market, and to keep each and every investor in the market at an equal footing, there is a dire need of introducing some sort of regulatory measures and forces within the company itself, by the company itself, in order to result for fruitful growth of the company in the commercial market, and inviting foreign investment and in-flow of stocks and assets.

The main motive or intention behind the introduction or adoption of some sort of regulatory measures for curbing or controlling insider trading, is to assure fair trading, instead of an unfair module of trading, in order to provide each and every investor, be it small or big investor equal opportunity to trade and earn profit ratio while trading in the commercial stock market. This will surely create a levelled field of play to all the participants of market trading.

In simple terms, the corporate fraud named "Insider Trading", means, trading done by the team members itself, acting as 'insiders', included in the management of an organisation or a company, or the employees of the company, which are very well and closely connected with the management of the company, truly and wholly based on the piece of secret and sensitive information, they possess, which needs to be kept secret and avoid disclosing in the public domain. Hence, such sort of an act discloses the unfair play module, as one trader has an advantage over the other traders, resulting in breach of trust or fiduciary duty imposed on the employees of the company[5].

The mode of operation of trading under "insider trading" begins when 'insiders' initiates the trading within the stock market of the company, while showing himself superior amongst others, while possessing a piece of secretive information, which can yield him a bunch of monetary profits and benefits, if implemented at correct time and situation. Firstly, the insider, buys the stock of the company on the basic existing price, he then, having that piece of information, spreads that amongst the selective other traders, which brings the rise in price of shares of the stock of a particular company, and after taking the price up of that company, insider tries to sell his share in the stock of that company, and following the leads of the insider, every other investor tries to sell their share, resulting in decrease in the price of shares in the company. This leads to the decrease in the price of the share in the company, bringing it back to its basic value and the company comes back at the earlier existing position, making loss to the other small and genuine investors[5].

While discussing about the issue of rise in the activity of insider trading, there also arise the question of concern of controlling and curbing the insider trading. The critiques always post a question in mind, that, why there is a need to control Insider Trading. This section of the paper totally discusses about the same. There is a dire need of controlling the prevalence rise and existence of insider trading in the current commercial market. The main reason is to protect the interest of other general and genuine investors, which do not possess any sort of secret information, on the basis of which they usually trade in the stock market of the company[6].

The other subsidiary reason in order to control the rise of insider trading is to protect the reputation and goodwill of the company in the global commercial share market. If a company goes through the insider trading within the company, by the company's employees itself, acting as "insiders", the image of the company comes at stake and investors often lose their zeal and interest in investing or buying the shares of the same company, as they don't want to attach their name with the company having bad goodwill[6].

The main rationale or motive behind making such activities totally prohibiting, is to avoid making the market inefficient while operating in the commercial market. Moreover, such a criminal and fraudulent act appears to be biased amongst the investors, as benefit for one section or group of investors, is the loss of other sections or groups of investors, as they do not possess any sort of sensitive and secret information, on the basis of which trading can be implemented and operations can be performed. Hence, if the conditions of the market are rectified, it can result in the growth of the company within the global commercial markets, resulting in the boost amongst the investors in the market[6].

Using such sort of an information efficiently, by the insiders involved in such evil and fraudulent practice, has made the practice of insider trading illegal, which results in loss of confidence amongst the other investors of the company. Moreover, on the other hand, the market will become inefficient while operating, if the evil practice of insider trading is made legal. Insider Trading is that kind of transaction or practice which include individuals or natural person, termed as "Insiders", being an employee of a public company or corporation with an access or right of an entry to secret or non-public material or information related to the company[6].

Such sort of an evil and illegal practice of insider trading, is generally executed and implemented to earn huge ratio of monetary profits, with only having material information in hand, which is not known to public at large. The weak form of the market is directly reflected, by the prevalence of an evil practice of insider trading in the commercial sector, wherein, the secret information regarding the company's operations, which is only known to some close employees of the company, is extracted by the 'Insiders' of the company, in order to earn profits outside the company[6].

The practice of "insider trading" usually means, gaining some sort of monetary benefits or profits, with just having information in hand, which is not in knowledge of other key characters or investors of the trading. The mechanism or the whole process of insider trading begins, when the 'insider', who possess some sort of secret information, which is material in nature, and known to less number of people, which is initially spreads like fire amongst the group of people, which is then used or implemented in action, in order to play with the prices of the stock, by buying and selling the same in the market[6].

In recent decades, the practice of Insider trading has surely achieved the badge or tag of bad name, as it is an unethical, evil and fraudulent practice done globally, and has effected the operations of global commercial markets.

The press officials usually describe the practice of insider trading as an evil practice, wherein parties involved only think about their self-profit margins and benefits. Through the prevalence or rise of such practices in the commercial sector, it's never easy to look out or find, who is the guilty person, and who is the victim person on the other hand, behind such a shameful and fraudulent act. The practice of insider trading, has its own merits and demerits.

This breach or violation of duty and trust begins altogether when an insider is in possession of that sensitive and unpublished information, and when he misuses that sort of an information in malafide intentions and actions. Therefore, such a fraudulent act of insider trading amounts to illegality and breaking of rules and regulations. An insider is in possession of trust and duty of fiduciary nature, whenever he receives the sensitive or delicate information about the operations of the company.

In order to curb or control such rise in an evil practice of insider trading, SEBI should deal with such type of fraudulent corporate dealings very strictly and sternly, or else they will fail to maintain and promote healthy relations amongst the corporate sector. An insider is known as a person, who with the help of his inter-company connection and relations, makes an arrangement of some secret information, which is clearly not published for public domain, and takes out benefit out of that information, while making profits in the share market, creating a scenario of unfair play in the market.

The prevailing illegal and fraudulent practice of insider trading results in negligence with respect to fair play in the market, as it effects the working and operations in the market, because an information to one person, acts as an advantage to him while operating in the market, hence, that person gets a upper hand in dealing under stock markets, as compared to another person, which sometimes results in loss of interest amongst the small and big investors of stock market.

The practice of insider trading, has its own merits and demerits. In recent decades, the practice of Insider trading has surely achieved the badge or tag of bad name, as it is an unethical, evil and fraudulent practice done globally, and has affected the operations of global commercial markets. Insider trading is not just a theft or stealing of crucial or sensitive material information related to the company's affairs, but it's more than that.

Through the prevalence or rise of such practices in the commercial sector, it's never easy to look out or find, who is the guilty person, and who is the victim person on the other hand, behind such a shameful and fraudulent act.

Essentially, insider trading means, operating in the stock market of the company, based on the secret and confidential or sensitive information in hand, which is directly related to the affairs of the company, and is not out in public domain yet. On the other hand, if such sort of any information is published, it would definitely cause a drastic issue and barrier for the company's financial growth, as such information will create a vivacious impact on the company's financial assets.

CONCLUSION & IMPLICATION

The practice of Insider Trading results in making the market conditions inefficient, as there is no room of playing or operating fairly in the market, because there is always sometime, somewhere and someone at advantage, during trading in stock market, because of in possession of sensitive and unpublished information, through which the insider can earn and make large amount of profit.

Such type of practices should be banned and totally abolished within the era of Indian commercial markets, this can create a problem or hindrance while trading for the small and big investors, as they will lose their zeal or interest in trading within the stock market.

Standards or bars of high ethical and professional values and behaviour be adopted and set up by the managing team of any organisation, in order to curb or control the rise of such evil and fraudulent act of insider trading. Moreover, some sort of voluntary initiative or steps should be taken by the directors, executives and other senior management team members, in order to control the increase of such sort of fraud or criminal theft of information and utilising it for self- profits and benefits.

Hence, with the rise in practice of insider trading in the commercial market, it has cause a serious disadvantage to the small and genuine investors, as witnessing such a fraudulent and evil practice they are losing their interest of investing money in the Indian commercial markets. On the other hand, to control the rise of such a criminal theft of the information and utilizing it for making large amount of profit, SEBI has initiated number of efforts and steps, while making certain required amendments within the existed regulation to make it more stringent and effective.

REFERENCES

[1] L. Mehta and Gurkirat Singh, "Insider Trading Should Be Legal or Illegal," *Imp. J. Interdiscip. Res.*, vol. 3, no. 4, 2017.

[2] S. GUPTA, "Insider Trading Regulations: A Small Debate," *Int. J. Res. Humanit. Soc. Sci.*, vol. 2, no. 4, 2014.

[3] A. N. Singh, "Insider trading- Analysing the Indian Perspective."

[4] D. S. Singh and Mrs. Preetinder kaur, "INSIDER TRADING: A CASE STUDY OF LARSEN & TOUBRO AND DLF," *Int. J. Mark. Financ. Manag.*, vol. 3, no. 10, 2015.

[5] M. Jain and Lavanya Srinivasan, "Insider Trading in India - A Zero Tolerance Event."

[6] P. K. M. Pandya, "The Concept of Insider Trading in India," *INDIAN J. Res.*, vol. 2, no. 8, 2013.