INSIDER TRADING - A MATTER OF DEBATE

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ABSTRACT

Insider trading means dealing in securities of a company based on unpublished price sensitive information by persons who could be privy to such information, and use it to secure a price advantage, as compared to general investors. Such dealing erodes the investors' confidence in the integrity of management and is unhealthy for the capital markets. With an aim to guard the interests of general investors, the Securities Exchange Board of India (SEBI) had formulated the SEBI (Prohibition of Insider Trading) Regulations, 1992. In today's day, business is expanding in the global markets and with it there is considerable amount of growth in the financial markets- Bond market, share market, derivative market and other markets. And with the increase in such trading, there has been a development in one particular form of trading- Insider Trading.

KEYWORDS

Securities, Insider, Code of Conduct, Unpublished Price Sensitive Information

HISTORICAL EVOLUTION OF INSIDER TRADING

Insider Trading has been around the United States from 1792. Hence, Laws against Insider Trading was formed strictly in the United States of America. Therefore, it is very important to understand Insider Trading from American point of view. The market crash in 1929 due to prolonged "lack of investor's confidence" in securities market followed by the Great Depression of US Economy, gave rise to the enactment of the Securities Act of 1933. The foundation of Insider Trading law was laid down by the Supreme Court of US in Strong vs Repide. Statutory Insider Trading Laws were first passed in the year 1933 and the Securities Exchange act in 1934. The second act created SEC (Securities Exchange Commission) to regulate the secondary trading of securities. These Acts were meant to create more transparency among the investors and placing due diligence on the preparers of the documents containing detailed information about the Security.

In 1984, the case of Dirks vs SEC, no one was termed liable of Insider Trading as they disclosed the information for exposing a fraud and for no personal gains. This gave rise to the concept of "constructive insiders". Constructively Insiders are Lawyers, Investment Bankers and others who receive confidential information from a corporation while providing service to the corporation. In the United States vs Carpenter, 1986, the Supreme Court cited that the usage of Inside Information received by virtue of confidential relationship must not be used or disclosed and by doing so, the individual gets charged for Insider Trading.

In 1997, O'Hagans Case, the court recognised that a company's information is its property:" A Company's confidential information qualifies as property to which the company has a right of exclusive use. The undisclosed misappropriation of such information in violation of fiduciary duty constitutes fraud akin to embezzlement-the fraudulent appropriation to one's own use of money or goods entrusted to one's care by another."

Insider Trading in India:

1. In 1948, First concrete attempt to regulate Insider Trading was the constitution of Thomas Committee. It helped restricting Insider trading by Securities Exchange Act, 1934.
2. In 1956, Sec 307 & 308 were introduced in the Companies Act, 1956. This change made it mandatory to have disclosures by directors and officers.
3. 1979, the Sachar Committee recognized the need for amendment of the Companies Act, 1956 as employees having company's information can misuse them and manipulate stock prices.
4. 1986, Patel committee recommended that the Securities contracts (Regulations) Act, 1956 be amended to make exchanges reduce Insider Trading.
5. 1989, Abid Hussain Committee recommended that the Insider Trading Activities be Penalized by civil and criminal proceedings and also suggested that SEBI formulate the regulations and governing codes to prevent unfair dealings.
6. 1992, India has prohibited the fraudulent practice of Insider Trading through "Security and Exchange Board of India (Insider Trading) Regulations Act, 1992. Here, a person convicted of Insider Trading is punishable under Section 24 and Section 15G of the SEBI Act, 1992.
7. 2002, the Regulations were drastically amended and renamed as "SEBI (Prohibition of Insider Trading) Regulations, 1992.

INSIDER TRADING – An Introduction

"Insider Trading" means and includes subscribing, buying, selling, dealing, or agreeing to subscribe, buy, sell, deal in any securities, by an Insider in any manner in the Company's securities on the basis of confidential information i.e., "unpublished price sensitive information (UPSI)" used to make profit or avoid loss in the transactions in securities of the Company, before such information is in the public domain. Insider trading is trading in stock market while having a potential access to private, non-public information of a company. If the trading is done without any profit to the trader and loss to the company, while not taking advantage of the non-public information, it can be legal. Insider trading generally refers to fraudulent practices resorted mainly by top management of a Company that is listed in recognised Stock Exchange. Insider trading is a globally acknowledge problem that needs to be addressed soon to avoid major economic crisis.

What is meant by Securities? "Securities" means any of the following instruments issued, or to be issued or created, or to be created, for the benefit of the Company:

a. shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of like nature of the Company.
b. rights or interests in the above.
c. such other instrument recognized as securities and issued by the Company from time to time.

At present equity shares of the Company, being the only instrument from above, are treated as securities for the purpose of the Code. Code is a set of rules and regulations which is required to be followed by the Company and 'Insider'. The Board of Directors of the Company has adopted a Code of Conduct for Prevention of Insider Trading. "Insider" means a person who is or was either a Director or a Designated Person of the Company, or Connected Person with whom the Company has, directly or indirectly, a professional or business relationship, because of which he may reasonably be expected to have access to or be in the possession of Unpublished Price Sensitive Information (UPSI) and such person shall be considered as insider for a period of six (6) months after his ceasing to have any aforesaid relationship with the Company. UPSI means any information which relates to the following matters or is of concern, directly or indirectly, to the Company, and is not generally known or published by the Company, but which if published or known, is likely to materially affect the price of securities of the Company:

(i) Periodical financial results of the Company (quarterly, half- yearly and annual).
(ii) Intended declarations of dividend (interim and final).
(iii) Changes in Capital Structure like issue of securities by way of rights/ bonus etc. or buy-back of securities.
(iv) Any major expansion plans or execution of new projects.
(v) Acquisition, Amalgamation, mergers, de-merger, delisting or takeovers.
(vi) Disposal of the whole or substantial part of the Company's business.
(vii) Change in Key Managerial Personnel.
(viii) Order book / major orders1 received by the Company.

(ix) Any significant changes in nature of business, policies, plans or operations of the Company.

The SEBI Act was enacted in the year 1992 to provide a regulatory framework to promote healthy trading and protect investors' interest to ensure growth of securities market. Under Section 11(1) & 11(2) of SEBI Act and Section 30, SEBI has the legal power to intervene and prevent insider trading while the said sections also implement further regulations to limit illegal activities. The first case regarding violation of insider trading regulation was registered against Hindustan Lever Limited in India.

OBJECTIVES & RESEARCH METHODOLOGY

Insider trading is an extremely complex issue and it is almost impossible to get rid of it because it evolves from a very basic human instinct i.e., greed. One who is having insider information and arrive at a decision of future profit or reduction of loss by discounting such information, it is extremely difficult for him to keep himself abstained from trading based on that information. Present effort is an endeavour to understand the magnitude of this problem and regulatory practices that exist to combat it. The research paper is purely based on secondary data obtained from various articles, reports and publication of the Government of India in its official Gazette.

INSIDER TRADING – A Debate

The smooth operation of the securities market and its healthy growth and development depends on a large extend on the quality and integrity of the market. Such a market can alone inspire confidence in investors. Insider trading leads to lose of confidence of investors in securities market as they feel that market is rigged and only the few, who have inside information get benefit and make profits from their investments. Thus, process of insider trading corrupts the 'level playing field'. Hence the practice of insider trading is intended to be prohibited in order to sustain the investor's confidence in the integrity of the security market. The first country to tackle insider trading effectively however was the United States. In the USA, the Securities and Exchange Commission is empowered under the Insider Trading Sanctions Act, 1984 to impose civil penalties in addition to criminal proceedings. Most countries have in place suitable legislation to curb the menace of insider trading. In India, SEBI (Insider Trading) Regulations 1992, framed under Section 11 of the SEBI Act, 1992, are intended to prevent and curb the menace of insider trading in Securities.

Now SEBI has with effect from 20th February 2002 amended these Regulations and rechristened them as SEBI - Prohibition of Insider Trading Regulation, 1992. These Regulation have been further amended in November 2002. Insider Trading Regulations have been tightened by SEBI during February 2002. New rules cover 'temporary insiders' like lawyers, accountants, investment bankers etc. Directors and substantial shareholders have to disclose their holding to the company periodically. The New Regulations have added relatives of connected persons, as well as, the companies, firms, trust, etc.in which relatives of connected persons, bankers of the company and of persons deemed to be connected persons hold more than 10%. The definition of relative under the New Regulations are in line with that of the Companies Act, 1956, which ranges from parents and siblings to spouses of siblings and grandchildren. The term "connected person" is defined to mean either, i) a director or deemed to be a director, ii) occupies the position as an officer or an employee or having professional or business relationship whether temporary or permanent, with the company.
Thus, there are two categories of insiders:

(i) **Primary insiders**, who are directly connected with the company and secondary insiders who are deemed to be connected with the company since they are expected to have access to unpublished price sensitive information.

(ii) The **secondary insider**, who would have traded with an unfair informational advantage, may escape from being caught simply because there can be no trace of how he derived this information in the first place. insider by reason of his connection with the company.

In reality, much of the flow of the price-sensitive information often does not operate by way of such established networks of relational links between individuals. Very often, such price-sensitive information is communicated and spread out through very loosely connected and informal networks of

brokers, clients and even between friends and through electronic networks etc. or an elaborate nexus of company official, brokers, traders. These individuals are very often privy to strategic policy decisions or developments that may influence the valuation of a company's scrip on the bourses.

REGULATION OF INSIDER TRADING IN INDIA

a) Securities and Exchange Board of India Act, 1992 - Based on the suggestions of various Committees, the Government of India set up the Securities and Exchange Board of India (SEBI) as the first statutory regulatory body to regulate the securities markets post the reforms of 1991. A notification was issued on 12th April, 1988 and SEBI was constituted as an interim administrative body to function under the overall supervision of Ministry of Finance, Government of India. However soon a need for an enactment of legislation supporting it arose for: (1) giving SEBI powers to issue Regulations for the sector and to supervise based on the Regulation so formulated; (2) authorizing to carry out investigation, adjudicate and impose fines and other penalties; (3) enforcing credibility of the regulatory process of SEBI by placing appeals processes by courts that have specialized domain knowledge to review regulatory action (Securities Appellate Tribunals). All this called for a special enabling and empowering legislation that catered to all the above needs and thus SEBI was made statutory body in 1992 by enactment of Securities and Exchange Board of India Act, 1992 with effect from 30th January, 1992.

Section 11 of the SEBI Act, 1992 describes the power and functions of the Board. Under Section 11 (1) of the Act, it is the duty of SEBI to protect the interest of the investors in securities and to promote the development of, and to regulate the securities market by such measures as it thinks fit. Under Section 11 (2) (g), prevention of insider trading has been specifically mentioned as one of its duties.

After the Amendment of 2002, Section 12-A of the Securities and Exchange Board of India Act, 1992 explicitly prohibits insider trading in securities of companies listed in stock exchanges. Section 12-A of the Act reads:
"No person shall directly or indirectly –
(a) Engage in insider trading;
(b) 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"

Violation of Section 12-A attracts civil penalty under Section 15-G of the Act up to twenty-five crore or three times the amount of profits made out of insider trading, whichever is higher. Insider trading is also a punishable criminal offence under Section 24 of the Act with imprisonment for a term which may extend to ten years, or with fine, which may extend to twenty-five crore rupees or with both.

Under Section 11 C of the Act, SEBI is empowered to undertake an investigation where the Board has reasonable ground to believe that the transactions in securities are being dealt with in a manner detrimental to the investors or the securities market or any intermediary or any person associated with the securities market has violated any of the provisions of this Act or the rules or the Regulations made or directions issued by the Board under it. In respect of public companies about to be listed on stock exchanges, the Board may under Section 11 (2A) of the Act undertake investigation of books and records etc. if it believes that the company has been indulging in insider trading.

b) SEBI (Prohibition of Insider Trading) Regulation, 1992

The increased instances of insider trading in a rapidly advancing securities market in India required a more comprehensive legislation to regulate insider trading. Section 30 of the SEBI Act, 1992 empowers SEBI to make Regulations consistent with the Act and Rules made there under to carry out the purposes of the Act, by notification to be published in the Official Gazette of India. In exercise of this power, SEBI framed the SEBI (Insider Trading) Regulations, 1992. The Report on whose recommendations the SEBI (Prohibition of Insider Trading) Regulation, 1992 was introduced, was the Abid Hussain Committee Report in 1989 which suggested that SEBI should formulate Regulations and governing codes to prevent unfair dealings.

The Securities Appellate Tribunal in Alpha Hi-Tech Fuel Ltd. v. SEBI summarized the intention of these Regulations as follows:

"The primary object of the regulations is to ensure that no person trades in the securities market while in possession of unpublished price sensitive information which may give him an extra advantage over the other investors. In other words, the regulations ensure to provide a level playing field to all the investors who come to trade in the securities market."

c) High Level Sodhi Committee

Since the enactment of SEBI (Prohibition of Insider Trading) Regulation, 1992, SEBI's efforts have been persistently focused on development and regulation of the Indian capital market to boost the investors' confidence. In November, 2014, India's market capitalization crossed USD 1.6 trillion, making it world's ninth largest economy by market capitalization28. Though the laws relating to insider trading had undergone much evolution by way of amendments, the requirement of introducing a new set of Regulations could be attributed to the fact that more than 23 years had passed since SEBI issued the Regulation in 1992. It was noticeably turning inadequate with regard to drafting, interpretation, and over time. More importantly, since the year 1992, the listed companies had endured changes in India as had the stock markets and the Indian economy as a whole. The lacunae emerging in the Regulation of 1992 in light of these changes had a harmful effect on the rights of shareholders, corporate governance norms thus injured the overall confidence in Indian financial markets. Thus, SEBI thought it was needful that a new legal regime be introduced to plug the loopholes in the legal framework and also limit the misconduct practiced in the stock market. To ensure this, a systematic review of the existing law was called for and SEBI, therefore, constituted the High Level Sodhi Committee to undertake a comprehensive review of the existing Regulations. SEBI, in order to modify the law on insider trading, constituted an 18-member High Level Committee under the Chairmanship of Justice N. K. Sodhi, former Chief Justice of the High Courts of Kerala and Karnataka and Former Presiding Officer of Securities Appellate Tribunal, to review the existing Regulations with its first sitting on 12th April, 2013. At the outset, the Committee decided to invite public comments on any and every aspect of the Regulation which enabled a review of all aspects of the SEBI (Prohibition of Insider Trading) Regulations, 1992 including those where it was felt the provisions are inadequate. The Committee released its recommendations in a comprehensive report dated 7th December, 2013 along with a draft of the proposed Regulations. Its Report attempted to line up Insider Trading Regulations in India with international best practices while adapting the same to Indian conditions and keeping in mind the requirements of the Indian capital market and its investors. While making its suggestions, it stressed on making this arena of regulatory intervention more predictable, accurate, unambiguous and clear by recommending a combination of principles based regulations and rules backed by principles.

d) SEBI (Prohibition of Insider Trading) Regulation, 2015

The Report of the Sodhi Committee was discussed and approved by the SEBI in its meeting held on 19th November, 2014 and formed the basis for introduction of the SEBI (Prohibition of Insider Trading) Regulations, 2015. Exercising its power under the SEBI Act, 1992, SEBI came up with the Regulation of 2015 on 15th January, 2015 which replaced the earlier Regulations governing insider trading in India. These Regulations came into force on 120th day of publication in the official Gazette i.e., 15th May, 2015. The Press Release that accompanied the 2015 Regulations stated that the primary objective for the introduction of the Regulation has been to strengthen the legal and enforcement framework, align Indian regime with international practices, provide clarity with respect to the definitions and concepts, and facilitate legitimate business transactions. It seeks to (a) address the inadequacies of the Regulation of 1992; (b) establish a legal structure which conforms to global best practices; and (c) consolidate the changes effected by circulars, notifications, amendments of enactments and judicial precedents concerning securities laws in India since 1992.

India has put great efforts in the enactment of Insider Trading. SEBI- to be at par with international standards of Insider Trading Laws has modifies the laws on Insider Trading under the chairmanship of Justice N. K. Sodhi and drafted the "Prohibition of Insider Trading Regulations, 2015."

Salient features of the Regulations are:

1. Every connected person is an Insider. The term includes Relatives and public servants also who have expected to have access to UPSI.
2. Definition of UPSI has changed. Any information not generally available to public, which when available may materially affect the price of the securities are included in UPSI. For e.g.: Financial results, Dividends, Change in Capital structure, Mergers, demergers, acquisitions, delisting, disposals and expansion of business, changes in key managerial personnel, etc.
3. Trading Plans are novel concepts introduced in the regulations wherein Insiders who are liable to possess UPSI all-round the year are permitted to formulate trading plans with appropriate safeguards.
4. Every listen company must formulate and publish a code of practices to be followed for safe and fair disclosures UPSI in accordance to principles set out in Schedule A to the Regulations.
5. Notional trading windows are set to 48 hours after the UPSI information becomes public.
6. Due diligence may be conducted when the Board is of the opinion that the merger or transaction is in the best interest of the company.

Exceptions to Insider Trading - The distinction between legally permitted trading and illegal insider trading must be carefully understood. It is but natural for an Insider to know some inside information of a company which is expected of their job. It would be violation of human rights and would defy the logic freely tradable securities if Insiders are not permitted to trade for themselves. That would be unreasonable. It would be irrational to stop promoters of a company from dealing in their securities. Thus, the restriction on the corporate insider is directly or indirectly using the price sensitive information that they hold to the exclusion of the other shareholders in arriving at trading decisions. There is absolutely no restriction on insiders in trading in securities of the company if they do not hold any price sensitive information that the public is not already aware of. During the short while promoters and insiders can use the information to their advantage by guessing market reaction to the news or information.

CONCLUSION

The new 2002 regulations in India have further fortified the 1992 regulations and have increased the list of persons that are deemed to be connected to Insiders. Listed companies and other entities are now required to frame internal policies and guidelines to preclude insider trading by directors, employees, partners, etc. In the past, it has been observed that insider trading legislation is ineffective and difficult to enforce and has little impact on securities markets. Low enforcement rates and few convictions against insiders have been cited as evidence of this ineffectiveness. Irrespective of whether or not the SEBI was bestowed with wide ranging powers, it has been a clear failure when it came to the task of administering the law. The importance of policing insider trading has also assumed international significance as
overseas regulators attempt to boost the confidence of domestic investors and attract the international investment community. So, SEBI now should take the role of a regulator only. Special Courts could be set up for faster and efficacious disposal of cases. India has put her best foot forward in making a move towards the enactment of the Regulation of 2015 with an aim to align its laws on insider trading with that of the developed countries. It is certainly a praiseworthy effort in course of renovating the legal regime to address challenges and deficiencies of Regulation of 1992. It introduces stricter and more determined provisions along with plethora of new concepts for improving the level of protection granted to the investors with an aim to change the deteriorating scenario. The Regulation seems to be headed towards making the stock market more business friendly, providing much-needed flip to Indian capital market and facilitating further economic buoyancy. It appears to be hopeful, more realistic, and based on the global approach to insider trading due to which it seems to be more equipped to ensure better compliance and enforcement. It seems to be effective on paper and seems that it shall achieve its intention of deteriorating the widespread insider trading activities; however, the truth may not get revealed unless the case-law develops on it and till then it will be difficult to predict the practical implication of the Regulation as their viability would solely depend upon their implementation. Though it is sincerely hoped that the Regulations would change the deteriorating scenario, at the end of the day, only time can tell how the Regulation will work out.

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