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Company Law Research Paper

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Topic- Insider Trading
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Abstract

Insider trading was recognized as an unfairness and a crime against shareholders and markets as a whole just around thirty years ago in many industrialized countries. In the not-too-distant past, insider knowledge and its use for one's own financial gain were considered advantages of high office and achievement. The iconic expression "the crime of being something in the city" was first used in 1973 by the Sunday Times of the United Kingdom to express this feeling. It meant that insider trading was once considered acceptable and that a rule prohibiting it was equivalent to a law against great achievement. The word "insider trading" has several meanings and implications, encompassing both authorized and forbidden activities. Every day, business insiders—officers, directors, or employees—buy or sell stock in their own companies within the bounds of company policy and the regulations controlling this activity. This is known as insider trading, and it is legal. To the detriment of the information's source and ordinary investors who purchase or sell stock without the benefit of "inside" knowledge, trading occurs when people with access to confidential information about significant events use that knowledge to their advantage and make profits or prevent losses on the stock market. The Securities and Exchange Board of India, India's capital markets watchdog, hosted an international symposium on capital market laws approximately eight years ago. This article will only cover India, but it will make references to other countries to provide readers with a deeper understanding of the subject. The study would extensively emphasize the key difficulties, and the researcher would attempt to develop answers related to these issues. Additionally, an effort would be made to comprehend the pertinent laws pertaining to this subject, and the researcher would endeavor to identify any gaps in these regulations.

The following persons or groups are regarded by SEBI as engaging in insider trading. Anybody who fits into one of these categories should therefore refrain from trading stocks for the company for which they have an insider classification.

close family members of those with connections or insiders, A holding company or affiliated business that is directly connected to the other corporation, A senior executive from one of the parent company's holding companies, An employee of a stock exchange or clearing house, Board members of asset management firms or trustees of mutual fund management firms, a chairman or member of the board of a publicly traded financial institution

INTRODUCTION

The trading of bonds, stocks, derivatives, and other products is increasing as a result of the growth of the business sector in international markets. In recent times, insider trading has gained popularity as a type of trading. Insider trading refers to the act of buying and selling of a publicly traded company's stock by someone with no public, materials information about that company. Non public, material information that could substantially impact an investor's decision to buy or sell a security that has not been made available to the public.[1] All price-sensitive information must be kept confidential by directors and employees. Price-sensitive information must be handled according to the "need to know" principle, with access granted only to those employees who need it in order to carry out their responsibilities. It is against the law for anybody to directly or indirectly encourage the buying or selling of securities based on this information. This form of insider trading is illegal and has stern penalties, including potential fines and imprisonment. Insider trading is a common fraudulent technique that many companies listed on reputable stock exchanges use, and it needs to be looked into immediately. This is a global phenomenon that requires careful monitoring; if it is not reined in, it could lead to a number of economic problems. Situations such as the increasing wealth gap, stock market volatility, and recessions fall under this category.

The Securities and Exchange Board of India (SEBI) actively discourages insider trading in order to foster fair trading in the stock market for the benefit of average investors. Insider trading is the improper trading of listed companies' securities on the open market by people who, as a result of their employment, have access to confidential business information. Choosing which company's securities to invest in can depend heavily on this proprietary knowledge. Insider trading, put simply, is when a person purchases or sells stock based on knowledge that the wider public is not aware of. The Securities Exchange Board of India (SEBI) regulates market activity and keeps an eye on securities trading. In addition to overseeing the stock market through suitable rules, SEBI is responsible for protecting the interests of investors in the securities market as the regulatory agency for all Indian stock exchanges.

[1] Investopedia, www.investopedia.com , (last visited 28 feb 2024)

Through the implementation of diverse preventive measures, SEBI carries out its regulatory function in the share market, consequently fostering investor confidence. After going through several revisions, the 1992 regulations were finally superseded by new ones in 2015.

Types of Insider Trading

In the equities markets, insider trading has long been a problem. It is regarded as a serious transgression of corporate ethics and a danger to the public's confidence in stock exchanges in developed countries across the globe. It needs to be regulated by law as a result. Insider trading is not always regarded as illegal.

It is lawful for insiders to buy and sell business stock. Every day, thousands of reports about insider trading are submitted. No laws are broken as long as the insider trades on information that is generally known to the public. Based on confidential knowledge, illegal insider trading may involve "tipping" this kind of information. It is forbidden, for instance, if the CEO sells before telling the public that the firm won't get a big contract. Illegal insider trading is difficult to prove, though.

The capacity to process faulty information. To be effective and efficient, investors must be able to conduct trades with low transaction costs. Everyone agrees that accurate securities valuation is beneficial to businesses and society.
Based on the complete disclosure of all pertinent information, the market establishes the "correct" valuation for an asset. The logical distribution of capital investment and less volatility in asset prices are two benefits of precise securities valuation for society. Furthermore, correct securities pricing lowers corruption by lowering investor apprehension and permitting better oversight of management effectiveness. People who are intimately associated with businesses are a major source of market instability.

Careful understanding is required to distinguish between trade that is deemed to be legal insider trading and trading that is not. It is natural for someone working for a corporation who has insider knowledge to come upon internal information.
It would be against the logic of freely tradable stocks and insiders' human rights to prevent them from engaging in personal trading. A restriction like that would be considered irrational. Prohibiting firm promoters from engaging in transactions involving their securities would also be nonsensical.

As a result, the restrictions placed on corporate insiders are linked, either directly or indirectly, to the way they use the price-sensitive knowledge at their disposal to keep other shareholders out of trading choices. Insiders are not completely prohibited from trading the company's securities if they do not possess any knowledge that could influence prices and are not known to the general public. Promoters and insiders can quickly take advantage of the knowledge by forecasting how the market will respond to news or information.

Justification for Prohibiting Insider Trading

Given India's prominence as a major global economic force, the country's securities market requires a strong regulatory structure. In order to give trust to both domestic and foreign investors that their money is safe within an equitable and transparent securities market, this framework is necessary.

Significant swings in the share prices of public firms after mergers or acquisitions, along with illicit trading based on materially false information that affects price, have recently beset the Indian securities market. This has caused a great deal of anxiety in the Indian stock market.
It is a heinous crime when fiduciaries tasked with managing businesses for the interest of shareholders acquire unfair enrichment at the expense of both the business and its shareholders. Although insider trading is an international issue, the International Monetary Fund (IMF) found that it is more common in nations like China, India, and Russia, which causes more volatility in stock prices.

Ensuring fair transactions in the securities market by mandating the disclosure of important information that influences market trading has been the main goal of all nations that have enacted laws against insider trading. Insider trading has been reported in India prior to merger announcements between companies in the same industry group.

Therefore, in order to stop manipulators and fraudsters from taking advantage of the knowledge asymmetry, it is essential to put in place suitable legislation and a strong enforcement system. Since promoting market efficiency is the main goal of regulation and policy, it follows that evaluating the effect of insider trading on market efficiency is essential. Insider trading exhibits bias, especially with respect to speculators who make market investments in anticipation of a rise in share value.

It is a commonly known and accepted fact that the overall quality and integrity of the securities market play a major role in the market's smooth and effective operation as well as its strong growth and development. It is only in this kind of market that investors can truly feel secure and confident.
Insider trading, as it is widely known, is the trading of securities by persons who, as a result of their positions within a firm or their professional activities, have knowledge of confidential, price-sensitive information. As a result, these people use this confidential knowledge to support their securities purchases or sales. They therefore make use of this information to make money or stay out of trouble.

The more advantageous use of information is known as insider trading. Withholding this information from the public shareholders undermines the market's effectiveness. As a result, information will become less accessible in the market, giving insiders the opportunity to take full advantage of the information.
Transparent information sharing is essential to the functioning of the capital market, yet insider trading erodes

investor trust in the fairness and integrity of the securities market. Thus, the main goal of any capital market regulation system should be to stop these kinds of transactions.

The justification for the ban on insider trading stems from the evident need and reasonable apprehension about the possible damage that such actions could do to public trust and the public coffers. The obvious goal is to discourage insider trading as much as possible. Insider trading is simply lying when people with access to confidential information use it to their advantage when interacting with other people. In addition to negatively affecting the business's profitability, allowing a small group of people with access to unpublished price sensitive information to use it against others may jeopardize the integrity of the financial system.

Widespread market instability and manipulation will be viewed negatively by investors, who will withdraw their money from these markets. Investors won't be drawn to any market that lacks fairness in its transactions or that is unable to properly monitor unfair trading in companies. Insider trading is regulated and tracked by a number of laws in different jurisdictions because it is impractical to outright forbid insiders from trading shares.

Insider Tradings' Negative Effects

Insider trading is an unfair conduct in which other shareholders suffer a major disadvantage because insiders have access to vital non-public information that other shareholders do not. One might list a number of additional disadvantages of insider trading.

- Insider trading is an example of the pervasive evil that exists in stock markets. Since it creates an unfair scenario for those who don't have access to critical knowledge regarding market prices, it is considered fraudulent and illegal action. When someone uses this intelligence for financial advantage, it puts other people at risk of making expensive stock purchases or suffering significant losses.
- Insider trading has the potential to erode public and familiar investor confidence. Many insider trading incidents in a short period of time might demoralize investors and make them wonder how they can make money on stock investments if dishonest insiders are always putting them at a disadvantage.
- When corporations uncover and reveal insider trading activity, they often face severe negative press. Sensible trading may be discouraged by the bad press and ensuing harm to their reputation. Additionally, leaders of firms with greater reputational capital are more vulnerable to the negative consequences of bad press, which could result in them making less money from insider trading. It is important to recognize that even one person's actions can negatively impact a company's reputation.
- The fairness and efficiency of financial markets can suffer significant damage from trading based on inside information, especially when it comes to unlawful insider trading.

Legal Provisions

Article 19 (1) (g) of the Indian Constitution confers upon every citizen the fundamental right to engage in any profession or carry out any occupation, trade, or business.[1] However, it is essential to note that this fundamental right is subject to reasonable restrictions as stipulated in Article 19(6).[2] These reasonable restrictions empower the state to enact legislation to prevent unfair trade practices.

The Rajasthan High Court highlighted in M/S Eskay KNIT (India) Ltd and Ors v. Union of India and Ors[2] that illicit insider trading techniques are dishonest. Therefore, under clause (6) of Article 19, the state is authorized to pass legislation to stop these kinds of dishonest business practices. Though the Indian Constitution may only cover a small portion of illegal insider trading, it is important to understand that these same constitutional protections strongly oppose this unfair trade conduct.

The recommendations made by several committees and the urgent need to develop the securities market led to the creation of the SEBI (Insider Trading) Regulations in 1992. An important turning point in the prevention of insider trading and the improvement of market transparency was reached with the implementation of these measures. They also gave the SEBI more power to control the market in a more effective and efficient manner. However, the regulations had significant flaws that frequently led to beneficial outcomes for violators, such as a lack of resources, insufficient penal measures, improper staff training, and difficulties with implementation.

The SEBI published an Amendment to the SEBI (Insider Trading) Regulations 1992 on February 20, 2002. The SEBI (Prohibition of Insider Trading) Regulations 1992, which superseded the SEBI (Insider Trading) Regulations 1992, will now be known as the revised regulations. A Model Code of Conduct for the Prevention of Insider Trading for Listed Companies and a Model Code of Corporate Disclosure Practices for the Prevention of Insider Trading are among the provisions of the updated regulations. Companies must create an internal code of conduct in order to avoid insider trading and the improper use of confidential, price-sensitive information by their officers, directors, and designated staff, as per the updated regulations. A senior employee must be designated as a "Compliance Officer" by all listed companies.

The SEBI (Prohibition of Insider Trading) (Amendment) Regulation, 2008's changes can be summed up as follows:

- The term "Insider" now has a new definition and a broader definition. From now on, anyone with knowledge of or access to confidential, price-sensitive information will be called a "Insider."

[2] Ipleaders, www.ipleaders.com, (last visited 21 feb 2024)

• Since this is open to interpretation, it is not necessary for this person to be connected. The intermediary's "code of internal procedures and conduct" shall adhere to the integrity of the Model Code as outlined in Schedule I of these Regulations and be comparable to it. In addition, the intermediary in question is responsible for guaranteeing adherence to these regulations.

• Assume that a person owns more than 5% of the shares or voting rights in a publicly traded corporation. If that is the case, they have two working days from the time they receive news of the allotment of shares or the acquisition of shares or voting rights to reveal how many shares or voting rights they have in the company.

• A listed company's directors and officers are also required to provide the company with Form B within two working days of taking on their roles. This form must include information about the number of shares or voting rights held, as well as any positions taken in derivatives by the directors and their dependents.

• Previously, there was a four-working-day deadline and no requirement to disclose such individuals' stakes in derivatives.

• Any person who is an officer or director of a publicly traded firm is required to reveal how many shares or voting rights they own overall, as well as any modifications to their ownership or voting rights. The business and the appropriate stock exchange, where the securities are listed, must be notified of this information. Form D should be used to submit the data.

• Moreover, if after the last disclosure made in accordance with sub-regulation (2) or this sub-regulation, there has been a change in the holdings of the individual and their dependents, as defined by the company.

• The modification must also be notified if it's worth above Rs. 5 lakhs, 25,000 shares, or 1% of all voting or shareholding rights, whichever is lower. It is significant to remember that the individual was not required to reveal the shares that their dependents owned in the past. The deadline for submitting the necessary documentation has been shortened to two working days in Regulations 13(5) and (6). The previous deadlines were four and five days, respectively.

The Committee proposed a combination of principles-based regulations and rules backed by guiding principles in order to accomplish this. The Committee produced a thorough report in December 2013, outlining many changes that had to be made to the current legal system. Consequently, the Committee's report served as the basis for the 2015 Insider Trading Regulations.
It is anticipated that these legislation will enhance the power of the Securities and Exchange Board of India (SEBI) in its capacity as the market regulator, facilitating the more efficient handling of the widespread problem of insider trading.

Insider trading is primarily forbidden by Section 11(2) E of the Companies Act, 1956 for the following reasons:

- To give each market player equal opportunity and to guarantee
- justice and openness in all dealings

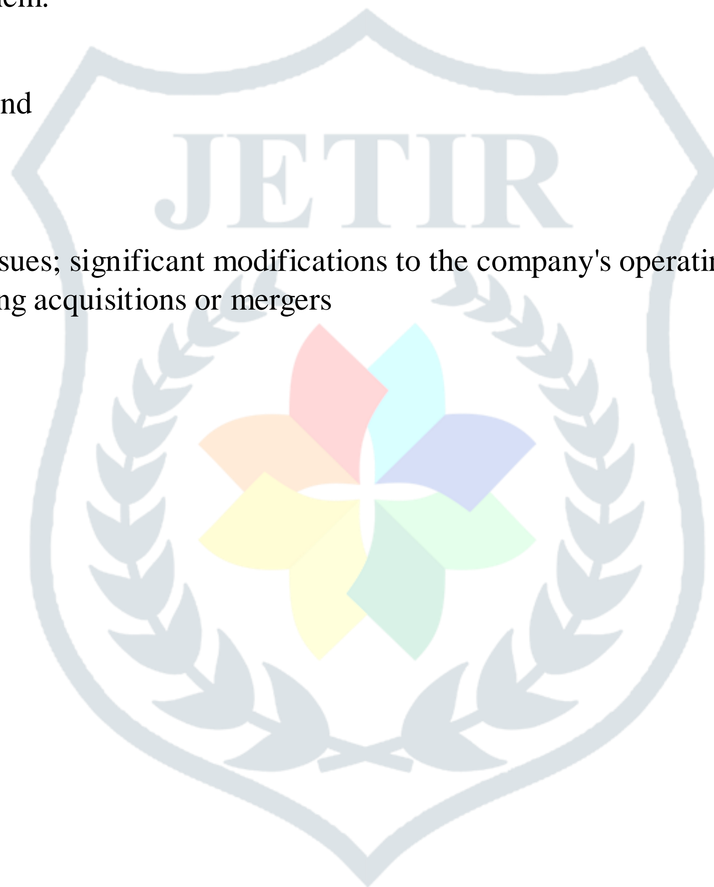
- Allow information to flow freely and avoid information symmetry

The data that follows is considered sensitive. If a trader has access to such knowledge, insider trading lawsuits could be brought against them.

- Declared intended dividend

- regular financial reports

- Buybacks or securities issues; significant modifications to the company's operating strategies or
- procedures; any impending acquisitions or mergers



Conclusion

Insider trading is a topic of much discussion in the legal and economics communities. Insider trading is one part of securities regulation. Insider trading is considered misleading for a number of reasons. Although there are many other ways to create market inefficiencies, insider trading is opposed primarily because it is inherently unfair. Insider trading's negative impact on market efficiency is arguably its most important side effect.

Insider trading is mysterious, which makes it difficult to identify and convict, and the large amounts involved make deterrent difficult. The fundamental tenet of the securities system is that all investors ought to have equal access to the advantages of engaging in securities transactions. Put another way, the risks associated with the market should be the same for all investors.

It is important to recognize that disparities resulting from different people's access to information are an unavoidable part of our society. That's why it's so important to create markets that are devoid of fraud of any kind, especially insider trading, which makes regular investors less confident in the way the markets operate and makes them feel like they're being invited to play a game of chance with rigged dice.