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A REVISED INSIDER TRADING POLICY COULD BE MORE PRACTICAL IN THE INDIAN STOCK MARKET

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i. ABSTRACT

Insider trading in India refers to the buying or selling of a company’s securities based on confidential information not available to the public. This practice undermines market integrity and investor confidence by giving an unfair advantage to those with access to sensitive information. Regulatory oversight in India has evolved significantly, with the Securities and Exchange Board of India (SEBI) playing a central role in monitoring and controlling insider trading activities. Following the landmark TISCO case in 1992, SEBI introduced the first set of insider trading regulations, which have since been updated with the SEBI (Prohibition of Insider Trading) Regulations, 2015, and further strengthened by amendments in 2019. Additionally, the SEBI Act outlines legal prohibitions and penalties associated with insider trading. These developments underscore India's commitment to maintaining a transparent and fair financial market by reducing the risk of unfair trading practices.

ii. INTRODUCTION

As a core issue is financial feasibility, what may work best in India is a modified policy as a base to which other transfer policies can be added as and when appropriate. “Insider Trading” in the financial market refers to trading in securities such as equity and bonds by company insiders who have access to exclusive information about the issuer of a particular security before such information is released to the general public. This allows insiders to benefit from buying or selling shares before they fluctuate in price.

Insider trading has been present throughout the history of the financial market and was particularly prevalent during periods of elementary years of Indian stock markets. Insider trading is common in developing countries like India, where the practice is in a wide range of market participants, corporate officers, and regulative authorities. Primary insiders gain access to information based on their position, employment or responsibility. They include controlling shareholders, corporate executives and officers as well as financial-market professionals who compile information on a firm's operation. Government officials with access to insider information also fall into this category. Secondary insiders are friends or relatives of primary insiders. Dynamic regulations not only help reduce the impact of such events but also help in restoring stability.

iii. THE HISTORY OF EVOLUTION OF INSIDER TRADING IN INDIA

In the late 1970s, insider trading was first officially recognized as a problematic practice in India. Following this identification, several committees were established to assess the situation and recommend stricter regulations, leading to the creation of a regulatory authority in 1992.

A. Sachar Committee (1979): Formed in June 1977, the High-powered Expert Committee, known as the Sachar Committee, aimed to review the Companies Act of 1956 and the Monopolies and Restrictive Trade Practices (MRTP) Act. In its 1979 report, the committee made two key recommendations: first, it called

for full disclosure of transactions involving price-sensitive information; second, it proposed prohibiting certain individuals from trading during specific periods, except under exceptional circumstances. The committee identified insiders, including company directors, statutory auditors, accountants, and legal advisors, as potential participants in insider trading. It mandated that all public companies maintain a register disclosing share dealings by these insiders, as well as their immediate family members and employees earning above a certain salary threshold.

B. Patel Committee (1987): In May 1984, the Government of India constituted the Patel Committee to conduct a thorough review of stock exchange operations. The committee's final report expressed deep concern over the lack of specific legislation to curb insider trading. It recommended stringent penalties for insider trading offenses, highlighting that such practices were prevalent in Indian stock exchanges and contributed to excessive speculation. It noted that individuals working in various capacities, including solicitors, auditors, and financial consultants, were often found to be engaging in insider trading.

C. Abid Hussein Committee (1989): The Working Group on the Development of the Capital Market, known as the Abid Hussein Committee, was established in 1989. This committee recommended classifying insider trading as a serious offense, subject to both civil and criminal penalties. It emphasized that effective regulatory measures could address the issues associated with insider trading and secret takeover bids. The committee suggested that the Securities and Exchange Board of India (SEBI) should be empowered to draft necessary legislation and enforce these provisions.

These committees laid the groundwork for the regulatory framework governing insider trading in India, ultimately leading to the establishment of SEBI and the formulation of laws aimed at maintaining market integrity.

iv. UNDRSTANDING INSIDER TRADING: CHALLENGES AND REGULATORY FRAMEWORKS

Insider trading essentially denotes dealing a company's securities on the basis of confidential information, relating to the company which , that is not published or not known to the public, also called as unpublished price sensitive information, used to make personal profits or avoid loss . It is fairly a breach of fiduciary duties if officers of a country. It arises when an individual with potential access to non–public information about a company buys or sells shares or stocks of that company. The practice of insider trading came into existence even since the very concept of trading of securities of joint stock companies became prevalent among investors worldwide and has now become a formidable challenge. The growing magnitude of the world's securities markets wherein trading in shares, derivatives and bonds take place at international levels has further raised the concerns of regulators all over the world. Insider trading caught the attention of the public and the government owing to them suspecting unusual profit of businesspeople as well as shareholder. The Companies Act in India has exhibited dearth of competency in resolving trading issues along with limiting unfair trading. The SEBI Act was enacted in the year 1992 to provide a regulatory framework to promote healthy trading and protect investors to ensure the growth of securities market. Under Section 11(1), 11(2), of SEBI Act and section 30, SEBI has a legal power to intervene and prevent insider trading while the said section also implements further regulations to limit illegal activities. The first case regarding violation of insider trading regulation was registered against HINDUSTAN LEVER LIMITED in India. Insider trading is an extremely complex issue and it is almost impossible to get rid it because it evolves from a very basic human instinct i.e., greed. One who has insider information and arrive at a decision pf future profit or reduction of loss by discounting such information, it is extremely

difficult for him to keep himself abstain from trading based on that information. The present effort is an endeavor to understand the magnitude of this problem and the regulatory practices that exist to combat it.

Insider trading is when some persons makes extra gains in stock market through use of some undisclosed information , like information on expected dividends ,expected decline or rise in profits, any information on acquisition , merger , potential threat etc. Or any other price sensitive information. In Indian context, the term insider is used for those who have direct or indirect connection to the organization or otherwise and have access to unpublished price sensitive information is a major aspect to be considering this regards is the accessibility to unpublished price sensitive information. In the Indian context, the term insider is used for those who have direct or indirect connection to the organization or otherwise and have access to unpublished price sensitive information. Insiders can be connected individual or relatives but fact to be considered in this regard is the accessibility to unpublished price sensitive information of company or group of companies is also liable to be marked as an insider. Accessibility and possession of unpublished price sensitive information is a major aspect to be considered as an insider in the Indian legal context.

The Indian legislation directs initial disclosure, continual disclosure, and disclosure by other individuals connected. The promoters, directors, and key managerial personnel are bound to disclose and report their shareholdings within 30 days of times while newly appointed promoters, directors, and key managerial personnel get seven days. The traded value when crosses the margin of ten lakhs, and in any calendar quarter the disclosure of the same by the promoter, director or employee shall be made within two days.

The regulation requires every insider to formulate a trading plan, in advance and present it to the Compliance Officer for approval & public discloser, pursuant to which trades may be carried out by him or on his behalf. The regulation requires every listed company in India to formulate and publish on its official website, a code of practice and procedure for fair disclosure of unpublished price sensitive information and also a code of conduct to regulate, monitor and report trading its employees and other connected persons, so as to comply with these.

The Chinese wall arrangement functions as a defense against the allegation of insider trading. The defenses that can be utilized in case of proving innocence or defending own position following the ground of – information parity.

The idea of insider trading and manipulation of the market keep surfacing from time to time. Market regulator, SEBI recently announces expansion of the definition of connected person insider trading regulations. Currently, connected persons are individuals who may have access to unpublished price – sensitive information due to their profession or employment, as well as their profession or employment, or such as immediate relatives like parents, sibling and children. The regulator announced that the board has expanded the definition of connected persons to include a firm or its partner an employee where a "connected person" is also a partner, as well as individuals sharing a household or residence with a 'connected person 'will apply to "relatives" rather than just "immediate relatives".

The regulator noted that these changes will not impact the existing provisions of the code of conduct applicable to designated persons and their immediate relatives, ensuring that no additional disclosures will arise from amendments.

The fact that most of the studies cited previously used insider trading data provided to the regulatory authority by the insiders themselves has led researchers to believe that insider trading regulation has been largely ineffective. Despite the regulatory measures in place, there remains a belief among some

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researchers that insider trading regulation may not be wholly effective. The notion of unrestricted insider trading raises concerns regarding equity and fairness in capital markets. Critics argue that allowing insider trading may undermine the principles of competition, as it creates a disparity between those with insider information and those without.

However, some argue that insider trading can have positive effects, such as enhancing managerial incentives and improving market efficiency. When insiders trade based on their information, it may lead to more accurate price reflections in the market. This dynamic suggests that while insider trading poses ethical and regulatory challenges, it may also contribute to a more informed and efficient market environment.

v. WHY INSIDER TREDING SHOULD BE CONTROLLED?

Insider trading significantly erodes investor trust in the fairness and integrity of capital markets. This practice can manipulate market dynamics, resulting in substantial losses for companies and their investors while providing undue profits for those with insider information. It deprives investors of the chance to earn returns on their investments. Therefore, it is crucial for company directors to safeguard both the interests and reputation of their firms. When a company is implicated in insider trading, it can lead to diminished investor confidence, prompting shareholders to sell their stocks and withdraw their investments.

Market regulators are expected to uphold confidence in stock exchange operations, as maintaining public trust in the financial system is essential. In India, low domestic investment rates highlight the need for a robust financial system. Ensuring market confidence is critical for fostering a healthy economy and attracting investment.

vi. REGULATIONS FOR INSIDER TRADING

In India, the Securities and Exchange Board of India (SEBI) is the primary regulatory body responsible for ensuring effective corporate governance, including monitoring irregular activities related to the purchase or sale of listed securities. The TISCO Case of 1992 highlighted the need for regulatory oversight, leading to the establishment of SEBI that same year.

In the TISCO case, the court found no evidence of insider trading due to a lack of regulations at the time, which made it difficult to hold any parties accountable. This gap prompted the creation of the *SEBI (Insider Trading) Regulations, 1992. These initial regulations laid the foundation for insider trading laws in India, but significant reforms followed. In 2015, the SEBI (Prohibition of Insider Trading) Regulations, 2015 were introduced to address limitations in the 1992 regulations, expanding the scope to better cover unlawful transactions. Another key amendment came in 2019, broadening the regulations to include both direct and indirect transactions.

The Companies Act, 2013 also initially included provisions for addressing insider trading. However, with the introduction of SEBI's regulations, Section 195 of the Companies Act was omitted by notice in 2017 to clarify jurisdiction, thereby giving SEBI the authority to prosecute insider trading cases. Today, India's primary insider trading regulations are the *SEBI (Prohibition of Insider Trading) Regulations, 2015, along with Sections 12A and 15G of the SEBI Act, which outline prohibitions and penalties related to insider trading.

vii. JUDGEMENTS ON INSIDER TRADING WHICH WE MAY LOOK FOR:

The United States was the pioneer in establishing regulations against insider trading, beginning with the Securities Act of 1933, enacted in response to the devastating stock market crash of 1929. This act was followed by the Securities Exchange Act of 1934, which laid

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the groundwork for all subsequent laws and regulations regarding insider trading and securities fraud. In 1961, the U.S. became the first country to enforce a law explicitly prohibiting insider trading.

A landmark case in this context was SEC v. Texas Gulf Sulphur Company (1966), which established that individuals possessing insider or non-public information must either disclose that information to all interested parties or refrain from trading. This ruling aimed to prevent any unfair advantage in the market.

In United States v. Newman, insider trading was declared unlawful for the first time, reinforcing the need for transparency in securities transactions.

In India, the case of Hindustan Lever Limited (HIL) vs. SEBI marked one of the earliest instances of SEBI taking action against insider trading. HIL acquired around 800,000 shares from the Unit Trust of India, shortly before a merger with a subsidiary was announced. SEBI conducted an investigation and determined that HIL had acted on insider information. HIL appealed the decision, but the appellate authority upheld SEBI's findings, rejecting HIL's claims of ignorance regarding the insider information. This case led SEBI to amend its regulations and provide a definition for "unpublished price-sensitive information" in India.

Another significant case was Reliance Industries Limited (RIL) vs. SEBI, where RIL increased its stake in Larsen & Toubro (L&T) from 5% to nearly 10%. Following this, RIL sold shares at a premium to Grasim Industries. An investigation ensued, and SEBI found RIL at fault for insider trading. However, the appellate tribunal later overturned SEBI's ruling, stating that the nominees from L&T had not communicated any insider information, and there was insufficient evidence to support the allegations against RIL.

In January 2020, SEBI investigated investor Rakesh Jhunjhunwala for alleged insider trading concerning trades made by him and his family in the IT education firm Aptech, where he held managerial control. This was not the first time Jhunjhunwala faced scrutiny; in 2018, he was also questioned about potential insider trading in Geometric shares. Ultimately, Jhunjhunwala resolved the matter through a consent order mechanism.

These cases highlight the evolving landscape of insider trading regulations and enforcement in both the U.S. and India, reflecting the ongoing efforts to maintain fair and transparent markets.

viii. SOME EXCEPTIONS TO INSIDER TRADING:

Understanding the distinction between legal trading and illegal insider trading is crucial. Insiders often possess confidential information about their company, which they are expected to keep secret as part of their professional responsibilities. Prohibiting insiders from trading in their company's securities could infringe upon their rights and would contradict the principles of freely tradable securities.

It would be illogical to prevent promoters and insiders from participating in trades involving their own securities. Therefore, the key concern lies in ensuring that insiders do not exploit price-sensitive information that is not available to other shareholders when making trading decisions. Insiders are free to trade in their company's securities as long as they do not possess any undisclosed price-sensitive information. In certain situations, insiders may even make educated guesses about how the market will react to forthcoming news or information without violating insider trading laws.

ix. CONCLUSION:

Insider trading is a highly contentious issue in securities regulation, often debated among law and economics scholars. At its core, insider trading is widely viewed as unjust because it creates an imbalance in market access, undermining the principle that all investors should have equal opportunities and access to

information. This lack of fairness can erode trust in the markets, discouraging participation from average investors who may feel they are entering a rigged system.

Despite regulations introduced to curb insider trading—such as the 2002 mandate requiring listed companies to establish internal policies to prevent it—enforcement remains challenging. The covert nature of insider trading makes it difficult to detect and prosecute, which has contributed to a perception that current regulations are insufficient. This regulatory challenge is not unique to India; it has become a global concern as countries strive to build investor confidence and appeal to international markets.

To improve enforcement and efficiency, the establishment of specialized courts for insider trading cases could streamline the legal process, making justice more accessible and timely. Ultimately, addressing insider trading is essential to fostering a transparent and fair market environment, strengthening investor confidence, and encouraging sustainable market growth.

x. SUGGESTIVE SOLUTIONS:

To effectively address insider trading in India, SEBI could focus on identifying the core issues and implementing targeted measures to reduce this malpractice. The following strategies are suggested to tackle insider trading:

1. **Education, Training, and Awareness –** Raising public awareness about insider trading and its detrimental effects is essential. SEBI could distribute educational materials, like an insider trading manual, and collaborate with NGOs, stock exchanges, companies, and other intermediaries to reach a wide audience. Regular programs, discussions, and seminars would help investors understand the risks and empower them to protect themselves. Additionally, companies and the government, along with directors and employees, should take responsibility for educating individuals about insider trading laws and encouraging compliance.

2. **Corporate Governance –** Strong corporate governance practices are vital to prevent insider trading. Companies should self-regulate by establishing robust internal policies and monitoring their directors and officers closely. Each organization should implement a strict insider trading code as part of its governance framework, enforced by compliance officers who monitor personal trading activities to prevent misuse of privileged information.

3. **Multi-Jurisdictional Regulation –** To protect domestic markets from insider trading with international elements, India should consider extending its regulations beyond national borders. The U.S. has achieved this through Section 27(b) of the Securities Exchange Act, 1934, which grants extraterritorial jurisdiction to its regulators. Providing SEBI with similar authority could deter cross-border insider trading, especially with increased cooperation between India and other jurisdictions through mutual legal assistance treaties (MLATs) and other agreements.

4. **Eliminating Consent Orders for Insider Trading Cases –** To ensure that penalties are an effective deterrent, it is advisable to limit the use of consent orders in insider trading cases. Consent orders can undermine the development of judicial guidance on insider trading and may reduce the deterrent effect, as insiders could perceive insider trading as a low-risk offense.

5. **Judicial Approach –** The U.S. has successfully handled insider trading cases due to a strong alignment between its legislative and judicial branches. India's judiciary could consider a stricter stance on insider trading, focusing on convicting violators based on circumstantial evidence when necessary and enforcing penalties that reflect the severity of the offense. This would strengthen the deterrent effect and reinforce the judiciary's role in regulating insider trading.

6. **Media Exposure –** Publicizing insider trading cases can be an effective deterrent. SEBI could increase visibility for successful prosecutions, using media coverage to highlight the consequences of insider trading and discourage others from engaging in it.

India's judiciary and regulatory authorities have made significant strides in addressing insider trading through legislative amendments and legal interpretations. Continued improvements, including timely adjudication by specialized bodies and strict penalties, can send a strong message to potential offenders and promote fairness in the market for all shareholders.

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