INDIAN JOURNAL OF LEGAL REVIEW [IJLR – IF SCORE – 7.58]

VOLUME 4 AND ISSUE 4 OF 2024

APIS – 3920 - 0001 *(and)* ISSN - 2583-2344

Published by

Institute of Legal Education

https://iledu.in

INSIDER TRADING UNDER THE INDIAN CORPORATE LAW REGIME - AN OVERVIEW

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BEST CITATION – VIJAY PRATAP SINGH & MR. AYUSH SARAN, INSIDER TRADING UNDER THE INDIAN CORPORATE LAW REGIME - AN OVERVIEW, INDIAN JOURNAL OF LEGAL REVIEW (IJLR), 4 (4) OF 2024, PG. 921-927, APIS – 3920 – 0001 & ISSN – 2583-2344.

Abstract

This abstract delves into the intricate dynamics of corporate governance, insider trading, and market regulations, particularly focusing on the Indian context. It explores the evolution of corporate governance frameworks, highlighting the influence of global movements such as the Cadbury Committee's recommendations. The narrative emphasizes the importance of transparency, accountability, and professionalism in corporate practices, showcasing the shift from traditional family-dominated businesses to modern institutionalized structures.

The abstract also touches upon the concept of insider trading, delineating its legal and illegal aspects and the regulatory efforts to curb unfair advantages in securities trading. It discusses the historical context of insider trading, referencing shifts in societal perceptions from viewing it as an advantage to recognizing it as a crime against shareholders and market integrity.

Furthermore, the abstract underscores the ongoing challenges in corporate governance, including the need for independent directors, robust disclosure norms, and the role of institutional investors in enhancing accountability. It reflects on the regulatory landscape in India, acknowledging progress while also highlighting persisting issues such as poor disclosure levels and opaque corporate structures.

Overall, this abstract provides a comprehensive overview of the complexities and evolving paradigms in corporate governance and market regulations, drawing insights from global trends and contextualizing them within the Indian business landscape.

INTRODUCTION

In the realm of finance and corporate governance, a complex interplay of human nature, market forces, and regulatory frameworks defines the landscape. The story begins with mankind's timeless pursuit of wealth, often marred by greed and moral ambiguities. Over the last two decades, the stock market has become both a symbol of opportunity and a battleground of ethical dilemmas, epitomized by the pervasive tactic of insider trading.

At the heart of stock market dynamics lies the fundamental principle of supply and demand, dictating the ebb and flow of share prices. Investors engage in buying and selling shares, seeking not just financial gain but also a stake in the companies they invest in, entitling them to a share of profits through dividends. This financial ecosystem has seen significant evolution, especially in India's corporate sector, propelled by economic reforms, technological advancements, and increased scrutiny from global investors.

Corporate governance emerges as a critical pillar in this narrative, transcending mere

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regulatory compliance to embody a broader ethos of transparency, accountability, and professionalism. The influence of global paradigms, such as the Cadbury-style approach to governance, has been palpable, catalyzing debates and reforms within India's business landscape. Key to this evolution is the recognition of the role played by institutional investors, independent directors, and regulatory bodies in shaping corporate behavior and market integrity.

However, amidst these strides in governance, challenges persist, notably in board effectiveness, disclosure norms, and the persistent specter of insider trading. The latter, once viewed with leniency, has now been unequivocally condemned as a betrayal of market trust and fairness. India's regulatory authorities, like the Securities and Exchange Board of India (SEBI), have taken proactive measures to combat insider trading, reflecting a broader global trend towards stricter market oversight.

As India's corporate story unfolds against this backdrop of ambition, innovation, and ethical reckonings, the quest for a robust, ethically sound business ecosystem continues. It is a journey marked by the tension between individual ambition and collective responsibility, where each stride towards financial prosperity is tempered by the imperative of ethical conduct and market integrity.

STATEMENT OF PROBLEM

The legislation on insider trading is new to the Indian Corporate Law regime. Therefore, it becomes very important to address its analysis from both legislative as well as from implicative perspectives. Therefore, the fundamental question on which the research has focused is the implicative nature of insider trading law. The research seeks to answer the questions on why and how insider trading is introduced in the Indian legislation

OBJECT OF THE STUDY

The Companies Act, 2013 and SEBI (Prohibition of Insider Trading) Regulations, 2015 have dealt with insider trading, therefore it becomes necessary to analyze the view of both the Parliament and SEBI in harmonious construction. The research aims to analyze the conceptual framework of Insider Trading under the Indian legislation. Following parameters have been taken into consideration for the purpose of research:

Defining concept of insider trading

Intention of the legislature behind the provision Implications of the provisions for Insider Trading Comparative analysis of Indian and Foreign legislations Critical Analysis of the legislation perse.

LITERATURE REVIEW

Insider trading law is relatively new in India. Unlike the developed economies of the world, Indian corporate law regime is nascent. It becomes pertinent to observe whether Indian laws are at par with the international practices or not. This is because, with the advancement in technology and sciences, gravity of crime has also increased and with the considerable amount of money involved, it becomes important to study about the present status of laws which regulate corporate practices. This study involves an introspective analysis of Insider trading and also attempts to answer that whether the Indian legislation on insider trading is at par with the legislations of developed countries or-not.

HYPOTHESIS

It is perfectly legal for insiders to buy and sell co mpany stock without breaking the law, as long a s they are trading on publicly available informat ion. Insider trading is illegal because it is a form of security fraud and fraud is considered a form of theft or theft. Felony is defined as an offense i n which the accused took something from anot her person with the intent to steal. If security pric es go wrong because one party trades using ins

ide information that is not available to other par ties, the broader market may suffer. So, it's impo rtant to see the judge's interpretation of the bill.

RESEARCH METHODOLOGY

The study is conducted with historical, critical and analytical method. The researcher has referred existing data on insider trading from books, reference journals, articles, reports, relevant international laws and practices, decisions of Supreme Court and High Courts. The researcher has attempted to analyze the ruling of Supreme Court, High Courts and Courts of foreign jurisdictions. The researcher has referred to the empirical market survey conducted by Securities and Exchange Commission of the United States of America, the Securities and Exchange Board of India and Reserve Bank of India.

RESEARCH DESIGN

The scope of present research is not restricted only to India. The researcher has undertaken the study of comparative legislation on insider trading in United States of India and European nations. This study is based on examining the nature of insider trading law and how the existing framework can stop the insider trading in India. The study draws examples from the judgements from both domestic as well as foreign-courts.

ANALYSIS OF THE INDIAN LEGISLATURE ON INSIDER TRADING

The Government of India had constituted a high-power committee in May 1984 headed by G. S. Patel to make a comprehensive review of the functioning of the stock exchanges. The Patel Committee had highlighted that insider trading was unethical as it involves misuse of confidential information and betrayal of fiduciary position of trust and confidence. The Patel Committee had suggested that a malpractice such as 'insider trading' should be made a cognizable offence. The report submitted by the Patel Committee defined 'insider trading' as "trading in the shares of the company by the persons who are in the management of the company or are close to them, on the basis of unpublished price sensitive information, regarding the working of company, which others do not have." This was the first time that the term "insider trading" was defined and proposed as an area that required legislation, to the Indian Government. Further, it was for the first time in India that a government committee had recommended a specific statutory prohibition of insider trading. Although the Sachar Committee had recommended that transactions by directors and key managerial persons of like nature should be prohibited, the activity by the name of 'insider trading' was sought to be prohibited for the first time by the Patel Committee. The Patel Committee had recommended that a codified legislation similar to the Australian law should be drafted in India also to counter the malpractice of 'insider trading.'

The committee had also submitted draft legislation for prohibiting insider trading. As regards the legal mechanism, the Patel Committee had recommended the introduction of provisions relating to insider trading as an amendment to the SCRA, on the lines of the Australian legislation. Additionally, the committee also recommended incorporating some of the important provisions of the U.K. Company Securities (Insider Dealing) Act, 1985. As illustrated above, the contributions by the Patel Committee to the laws on 'insider trading' are significant. This committee dealt with the offence of insider trading in a thorough and comprehensive manner.

For example, the committee had suggested that insider trading should be fined heavily for first offence, and imprisonment up to five years should be given for second and subsequent offences. The Patel Committee report also acknowledged that in the U.S., other than the specific legislation, the Supreme Court and the Court of Appeals of various states have issued guidelines on insider trading,to maintain proper 'fiduciary standards', ensure justice and

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equity in the securities market, and to protect the interests of the investing public. Further, the committee had also briefly discussed the insider trading laws in the U.S. and U.K. Although the committee appreciated that SEC in 1983 recommended civil penalties in addition to the criminal proceedings for insider trading cases, and that the U.K. has made insider trading a criminal offence in certain eventualities by amending its Companies Act in 1981, the Patel Committee recommended that insider trading be made a criminal offence in India. Also, the committee did not discuss about imposing civil penalties for insider trading under Indian law. The Patel Committee also discussed in its report regarding the U.K.'s model code with regard to restrictions on the transactions carried out by directors and their relatives and employees of listed companies. Therefore, although, the Patel Committee had reviewed and analyzed the insider trading legislations in U.S.A, U.K and Australia, and some of the recommendations of the committee reflected these legislations, the committee overlooked certain significant provisions in those jurisdictions relating to insider trading which, if introduced in India, would have significantly improved the Indian laws on insider trading.

The committee's report also suggested certain remedial measures for tackling the menace of insider trading. The Committee had identified that one of the reasons for excessive speculation in the stock exchanges during 1980s, was the lack of prompt disclosure of corporate news by the companies whose shares are listed with the stock exchanges. For instance, at the time of announcement of the annual results, rumors would start spreading in the market about the working results of the company, the quantum of the dividends or the possibilities of bonus or right or convertible bond issues by the companies. These rumors, in turn, lead to the speculative activity in the shares of the companies concerned. Therefore, as remedial measure, the Patel Committee had recommended that all the listed companies should publish their un-audited working results at least on a half -yearly basis, and on a quarterly basis if the paid-up capital of the company is more than Rs.10 crores.

The committee further recommended that the stock exchanges should be immediately informed about any significant financial or other news or developments affecting the price of the company's securities, as soon as such matters are placed on the agenda of the board meetings and circulated to other directors. The committee also proposed that if any company fails to comply with the provisions of the listing agreement (entered between the companies and the stock exchanges) relating to material disclosures by the company, the person in-charge of the management of the company should also be penalized for non-compliance.

The committee recommended that such statutory responsibility for non-compliance of disclosure obligations should be introduced under the Companies Act, 1956, and the SCRA. However, it was only after 20 years in 2002, that a provision imposing monetary penalty for non-compliance of listing agreement was inserted in SCRA as Section 23E.[16]

As discussed earlier, the Sections 306 and 307 of the Companies Act, relating to disclosures from directors and other insiders was the first step towards regulating 'insider trading' in India. The reasoning behind initial attempts keeping focus on the maximum possible disclosures to the public was that the mischief involved in cases of insider trading primarily resulted from disparity of information. The concept of listing was formally introduced in India under the Companies Act and the SCRA, i.e., a company was required to register itself with the recognized stock exchange prior to offering its securities to the public. Section 73 of the Companies Act mandates that a company offering its securities to the public through prospectus must get itself listed in one or more recognized stock exchanges. Further, Section 21 of the SCRA mandated compliance of the

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conditions prescribed under the listing agreement between the company and the stock exchange. Each stock exchange can formulate its own terms and conditions of the listing agreement.

The listing agreement mandates several disclosures by the companies in addition to the disclosures required under the Companies Act and the SEBI Takeover Code and Insider Regulations. Under clause 41 of the listing agreement, it is mandatory for every public company whose securities are listed on a recognized stock exchange to publish unaudited working results twice a year. In 1985, the Ministry of Finance proposed an amendment that clause 41 of the listing agreement should be substituted with a new clause 41 with regard to insider trading. These disclosure provisions were further strengthened in 1991 by providing disclosure of the financial performance of the listed companies to the investing public. Under the amended clause 41, a new comprehensive format for publication of the financial results was prescribed. Also, a more effective and faster mode of publication was provided for. In order to protect the interests of the shareholders who were not concerned with the takeover, and to regulate the secret takeover bids, the listing agreement was amended in April, 1984, to incorporate disclosure provisions in relation to the take-over bids.

In 1989, the Abid Hussain Committee was set up to examine the adequacy of the existing institutions, instruments and the structures in the Indian capital market and the rules governing its functioning. One of the first and foremost problems identified by the committee was insufficiency of the basic rules of the capital market. The basic rules were adjudged to be insufficient because of the fast-changing needs capital market especially in the area of investor protection and guidance. The committee also acknowledged that despite the continuing efforts on the part of various authorities, many aspects of trading practices still required improvement. Rules and standards emphasizing fairness in securities dealings were perceived to be insufficient and amenable to misuse by the traders. The committee also observed that the absence of effective checks and penalties was encouraging the speculators and not the genuine investors. In April 1988, the Government of India constituted the SEBI, with the primary mandate of investor protection. During the deliberations of the Abid Hussain Committee, the SEBI had initiated the process of incorporating the legal framework to regulate the conduct of all the major players in the market, i.e., the issuers, intermediaries and the exchanges.

Although the Abid Hussain Committee had admitted its difficulty in prescribing remedies to each one of the trading malpractices in the Indian stock market, it is observed that problems of insider trading and secret takeover bids could be tackled to a large extent by appropriate regulatory measures. The committee proposed that insider trading should be regarded as a major offence, punishable with civil as well as criminal penalties. The committee recommended that the SEBI should be asked to formulate the necessary legislation, empowering itself with the authority to enforce the provisions.

INSIDER TRADING UNDER THE COMPANIES ACT 2013

After many drafts, delays and parliamentary debates, a new company law, the Limited Liability Companies Act 2013 (the "2013 Act") was finally passed on 29 August 2013. The 2013 Act was praised by both companies and lawyers for to be business-friendly. corporate rules, improved disclosure standards, investor protection and better governance. The 1992 regulations restrict insider trading only in listed companies, but the Companies Act of 2013 extends the ban to private and public unlisted companies. Unlike the Companies Act of 1956, which did not deal with insider trading, the 2013 Act contains a general provision under section 195 which prohibits directors or key persons

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from engaging in insider trading in the securities of a "company", regardless of whether the company is audience or private, listed or unlisted.

The provision also prohibits the transmission of secret price-sensitive information, but exempts transmission required in the ordinary course of business, profession or employment. The law provides civil and criminal penalties for this violation.

The provision has generated considerable debate among researchers, academics and lawyers about its scope. Since the concept of insider trading has traditionally been considered a feature exclusively linked to listed companies, there is a fear of private and public sector companies not listed on the stock exchange falling into the field of insider trading. The matter is uncertain, partly because of its novelty and partly because of.

The 2013 Act takes a big step towards corporate disclosure and investor protection by adding Section 195, which deals with the prohibition of insider trading. The section essentially deals with the Securities and Exchange Commission of India (Prohibition of Insider Trading) Regulations, 1992, but extends its applicability to unlisted companies. According to the section, no manager or key person of the company shall engage in insider trading involving the listing or sale of securities or the communication of price-sensitive information to any person. In the context of insider trading under the Act of 2013, securities has the same meaning as in the Securities Contract Regulation Act of 1956, which applies only to marketable securities It is a well-established legal position that the securities of a private company are not marketable. In light of the definition, it can be argued that the section should not apply to private companies, although the limitation applies to trading securities of a "company". Clarification of this issue by the MCA would at least remove the ambiguity in the application of this provision to private companies.

CONCLUSION AND SUGGESTIONS

According to conventional wisdom, the hallmarks of business are clarity and certainty. Commercial law must primarily try to provide functional and comprehensible rules so that traders have the full opportunity to determine their behavior accordingly. The inclusion of insider trading provisions in the Companies Act 2013 has raised more concerns in parliament than it ever hoped to address. Section 195 of the Act is a complete mess and uncertainty, firstly regarding the scope of the application itself and secondly, if the provision will eventually also apply to private companies - regarding the enforcement mechanism of the restrictions arising from the Act. Under current law, a director of a private company who trades in the securities of one of his companies is potentially involved in insider trading, which could result in large fines or even prison terms. The core of securities regulation is the realization of the goal that all investors have equal opportunities to receive the benefits of participation in securities transactions. In other words, all members of the investing public should be exposed to similar market risks. Inequality based on unequal access to information should not be seen as an inevitable way of life. Therefore, it is critical that the market is free of any type of fraud, especially insider trading, which makes the average investor feel like they are being asked to play crap with the dice. Unfortunately, the idea of good corporate governance has been forgotten due to the massive frauds exposed in the war cry, although India is not alone in this. And as a result, when good governance became legislative duties, government became too micromanaged. We often forget the fact that fraud cannot be prevented by micromanagement. it can only be curbed by effective enforcement of laws that should prohibit flagrant criminal behavior. Let us not forget that what we want to catch is a crime, and we should avoid treating all insiders as prerequisites for unfair trade. Management and control systems should be left to company

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managers.

The regulatory body must present in the list of regulations a list of optional procedures 1 to limit the possibility of insider trading. Instead, the annual report should report compliance with the listed standards. As a result, shareholders punish companies that do not follow the guidelines of corporate governance systems. The author also recommended the introduction of corporate governance ratings similar to debt ratings, which would pressure management to comply with such measures. It could be the missing link to provide a simple number that the big players understand and understand, and that would show the processes the company has put in place for the benefit of its non-internal shareholders.

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A just legal system requires that no one be punished without reason. Justice, therefore, demands that the mens rea criterion of criminal punishment be revived and preserved in the Indian legal system. It is hoped that the precedent set by the SEC and US courts to criminalize insider trading under mens rea will continue to be a guiding factor for other emerging economies such as India in the current period of financial market instability. , enjoy the benefits of globalization.