VOLUME 3 | ISSUE 3

INTERNATIONAL JOURNAL OF ADVANCED LEGAL RESEARCH

PREVENTION MECHANISMS OF INSIDER TRADING AND IMPOSITION OF ACCOUNTABILITY

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Abstract

Insider trading is a practice that occurs when individuals who have access to confidential information about a company use that information to gain an unfair advantage in the financial markets. This can be done by either buying or selling securities based on the information before it becomes public knowledge. While insider trading is illegal in most countries, it remains a pervasive problem in many emerging markets, including India.In India, the Securities and Exchange Board of India (SEBI) is responsible for regulating the country's financial markets, and has been working to curb insider trading. Despite this, insider trading remains a serious issue in India, with many high-profile cases making headlines in recent years. These cases have highlighted the challenges of enforcing insider trading laws, particularly in a country where corruption and cronyism remain significant obstacles.The problem of insider trading in India has significant implications for investors, as well as for the integrity of the country's financial markets. Addressing this issue requires a combination of effective regulation, strong enforcement mechanisms, and a commitment to transparency and accountability from all market participants.

This paper revolves around the concept of insider trading, its effects and the position of insider trading in India. It further explores the various laws that have been formulated to govern insider trading laws and examine the whistle-blower mechanism to enable the imposition of accountability.

Keywords: Insider trading, Laws, Mechanisms, India

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Introduction

Insider trading is described as a practise whereby individuals who, due to their employment, have access to information that is otherwise not publicly available but may be essential for making investment decisions, trade the securities of a company.

The survivability and success of a corporate organisation depends on a few factors, including transparency, openness, disclosure and trust. It is the primary responsibility of an organisation to have a cordial relationship with its shareholders and investors. Good Governance ultimately contributes to a company's market and face value which drastically affect the projected capital gains of the company.

The Directors of a Company play a significant role in deciding the future of the company and such decisions are usually arrived upon at board meetings and general meetings. Such meetings involve the interaction of all top executive and managerial position holders who decide the fate of the company and its ventures. Consequently, such members of the company hold confidential information that can be utilized to gain unfair advantage over others in the stock market.

Such unfair trade is morally wrong and steps have been taken by different nations around the globe to prohibit and control the practise. Moreover, the problem of insider trading emerged with the introduction of the concept of trading in the global market. There have been many reforms and guidelines by the **SEBI** which are formulated to prevent such mis happenings.

This article shall focus on insider trading in the Indian scenario and explore the mechanisms that have been enforced to prevent insider trading. It will further focus on how accountability and liability is imposed its process. The article will focus on SEBI guidelines and other redressal mechanisms that have been predominant in the recent years.[2]

What is Insider trading

Insider trading is the practise of trading in a company's securities while using secret knowledge '(unpublished price-sensitive information)'. The unpublished price-sensitive information is related to decisions made by the company's board of directors but is not known

[2]Megha Dalakoti, *Insider trading in India : regulations and controlling authority*,iPleaders, *Available at "https://blog.ipleaders.in/insider-trading-in-india-regulations-and-controlling-authority/ (last visited March 15, 2023)*

to the general public because it is not released. Insider trading refers to the use of such knowledge to generate unjustified profit or loss. The information is referred to as "price-sensitive" because it has the potential to affect the market price of a company's assets.

Insider trading is defined as *"the act of purchasing, disposing of, or agreeing to purchase, directly or indirectly, securities of a company by key management personnel or the director of the company who is anticipated to have access to Unpublished Price Sensitive Information with respect to securities of the company."*

If information is related to company decisions, is not publicly available, and has the potential to influence market prices, it is said to be price sensitive. Financial statements, dividend announcements, public rights issues, merger or amalgamation information, stock buybacks, information on de-mergers, revised business policies, and changes to operational procedures can all be considered unpublished price-sensitive information.

When trading is done while adhering to all fair-trading regulations and rules, it is referred to as fair trading; however, when trading is done while breaking these regulations and rules for unfair benefit, it is referred to as unfair trading. The use of unreleased price-sensitive knowledge in unfair trading is referred to as insider trading in a similar manner. Sharing such knowledge in the market is unethically and morally wrong because it gives the person with the information an unfair advantage while placing the traders who do not have the information at a disadvantage.

In order to preserve transparency and limit the use of confidential information, members of a company in India are permitted to trade in the stocks of their company under the condition that transaction records be made public. For the purpose of instilling trust in investors and ensuring trading transparency, SEBI has drafted a number of regulations regarding insider disclosure. Insider trading has been made a criminal offence in the nation in order to guarantee fair market trade.[3]

Effects of Insider Trading

[3]Megha Dalakoti, *Insider trading in India : regulations and controlling authority*, *iPleaders, Available at "https://blog.ipleaders.in/insider-trading-in-india-regulations-and-controlling-authority/ (last visited March 15, 2023)*

Those who are unaware of the sensitive knowledge bear the consequences of insider trading. They don't trade in securities as a result. Insider trading is unethical and constitutes a breach of fiduciary duty because it violates the faith and confidence of others. Insider knowledge abuse is discouraged for a variety of reasons:

a) An insider unfairly exploits an individual without information;

b) It creates a conflict of interest because it serves insiders' interests rather than those of the business;

c) It damages the market's image and discourages investment.

The advantageous person's conditional purchasing or selling of securities only when in possession of confidential information has an impact on how much those securities are worth. Additionally, the beneficial person's ownership of the pertinent confidential information suggests that they are connected to the company that is providing the information to them in some way. He might work there as an employee, superintendent, or expert advisor. Additionally, the company suffers from this.

For instance, a board member of an automobile company has an undisclosed knowledge of a new product launch in the market which could result in the immediate rise in process of shares of the company. Upon such knowledge, the member, purchases some shares of the company before the public announcement of the new product and hence purchasing the shares in the pre bid price. Once the company launches the new product and the share prices rise, the member can then sell those pre-bids purchased shares at a profit. This practise is considered illegal and unfair, as the person with **the UPSI** has a leverage over other investors in the market.[4]

Insider Trading in India

The '**Thomas Committee'** was established in 1948 as the first actual effort to control insider trading. It aided in the **'Securities Exchange Act of 1934's Restriction of Insider Dealing'**. **Sections 307**[5] and **308**[6] were added to '**the Companies Act of 1956'**. Disclosures from directors and officers are now required as a result of this shift.

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[4]Mandeep Singh, *Insider trading and & its regulation in India,* Manupatra, *available at https://articles.manupatra.com/article-details/Insider-Trading-its-Regulation-in-India (last visited March 16, 2023)*

[5] The Companies Act, S.307

The '**Sachar Committee**' recognised in 1979 that 'the Companies Act of 1956' needed to be amended because employees could abuse business information and manipulate stock prices. The **Securities Contracts (Regulations) Act, 1956** should be changed, according to the '**Patel Committee's 1986'** recommendation, to make exchanges less conducive to insider trading.

The **Abid Hussain Committee** proposed in 1989 that insider trading activities be subject to both civil and criminal sanctions, and that SEBI create rules and regulations to guard against unethical business practises. The "**Security and Exchange Board of India (Insider Trading) Regulations Act, 1992**" also outlawed insider trading as an illegal activity in India.

Insider trading is considered illegal in India under the Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015 (PIT Regulations). The PIT Regulations were introduced to prevent insider trading and ensure transparency and fairness in the Indian securities market.

According to the PIT Regulations, insiders are defined as "*persons who are connected with the company and include its directors, officers, employees, intermediaries, and immediate relatives of such persons.*" Insider trading is prohibited under the PIT Regulations, and it is considered a violation of securities law.

The PIT Regulations also provide guidelines for companies to prevent insider trading. Companies are required to create a code of conduct that specifies the procedures for dealing with insider trading, including the disclosure of insider information and the creation of a designated compliance officer.

In India, the Securities and Exchange Board of India (SEBI) is responsible for enforcing the PIT Regulations. SEBI has the power to investigate and penalize individuals and companies involved in insider trading. Penalties for insider trading can include fines, imprisonment, and the disgorgement of profits gained through illegal trading.

Overall, the legal scenario of insider trading in India is strictly regulated, and individuals and companies who engage in insider trading can face severe penalties. Companies are required

[6] The Companies Act, S.308

to take measures to prevent insider trading, and individuals who have access to non-public information should refrain from trading until such information is made public.[7]

Insider Trading Laws in India

- **SEBI (Prohibition of Insider Trading) Regulations, 2015**

  The **SEBI Act of 1992** and the **Companies Act of 2013** forbid insider dealing in India. The 'SEBI (Prohibition of Insider Trading) Regulations, 2015', established by SEBI, set forth the guidelines for the limitation and outright ban of insider trading in India.

  'The SEBI (Prohibition of Insider Trading) (Amendments) Regulations, 2018', passed by the Securities Exchange Board of India, are primarily applicable to "dealing in securities," which involves *"buying, selling or agreeing to buy, sell or deal in any securities by any person either as principal or agent on the basis of any private confidential information."* The Exchange of Listed Securities is the only Transaction Subject to the Regulations.

Here are some of the key features-

Code of Conduct: Companies are required to establish a code of conduct for prevention of insider trading, which specifies the procedures for dealing with insider trading and the creation of a designated compliance officer. The code of conduct should also outline the roles and responsibilities of the board of directors, senior management, and employees in preventing insider trading.

Insider Trading Policy: Companies are required to develop an insider trading policy that defines the procedures for the handling of UPSI, the disclosure of such information to the stock exchange, and the creation of a pre-clearance procedure for trading by insiders.

Disclosure Requirements: Companies are required to disclose all UPSI to the stock exchange as soon as possible and not later than 24 hours from the time the information becomes available. Companies are also required to disclose the details of the designated compliance officer and the insider trading policy on their website.

[7] Nikunj Arora, *Insider trading regulations*, iPleaders, *available at https://blog-ipleaders-in.cdn.ampproject.org/v/s/blog.ipleaders.in/insider-trading-regulations/?*(last visited March 16,2023)

Insider Trading Monitoring: Companies are required to monitor and prevent insider trading by their employees and other insiders. The PIT Regulations require companies to maintain a database of all employees who have access to UPSI and to monitor their trading activities.

Penalties: The SEBI has the power to investigate and penalize individuals and companies involved in insider trading. Penalties for insider trading can include fines up to 25 Crores, imprisonment, and the disgorgement of profits gained through illegal trading.[8]

- ## Whistle Blower Mechanism

A scheme laid down under the '**SEBI (Prohibition of Insider Trading) Regulations, 2015'**, any informant who is ready to divulge information about insider trading will be eligible for financial rewards if they meet SEBI's prerequisites. The informant would be eligible to financial benefits if the total was at least 5 crores. The monetary reward will be 10% of the total amount gathered, but it will not be more than Rs. 1 crore. Additionally, an interim prize of no more than 10 lakhs is allowed. The Investor Protection and Education Fund (IPEF) will be used to pay out the ultimate reward after the money has been recovered. The ultimate reward will include an adjustment to the interim payment.

Voluntary Information Disclosure Form ("VIDF"): According to SEBI, filling out a VIDF is a requirement for informants. The trustworthy, exhaustive, and authentic information about insider trading, including information about UPSI, will be included in the VIDF, among other things. The tipster would have to admit who they were. However, the tipster has the choice to stay anonymous and secret.

Disclosure of Information Source: The informant is required to provide the initial information's source. He will have to certify that the knowledge was not obtained from a SEBI insider.

Office of Informant Protection ("OIP"): SEBI has also suggested that the Office of Informant Protection be established. The OIP would serve as a means for receiving and registering VIDF. Along with other connected issues, it will resolve the grant of a reward to the informant following the conclusion of enforcement action. According to SEBI's suggested

[8] Nikunj Arora, *Insider trading regulations*, iPleaders, *available at https://blog-ipleaders-in.cdn.ampproject.org/v/s/blog.ipleaders.in/insider-trading-regulations/?*(last visited March 16,2023)

action, the board and the informant/legal agent would communicate through the OIP. A hotline directing and urging people to report information must be kept active.

Confidentiality of Informant: The tipster will have the choice to remain anonymous and secret. However, the informant will be required to provide VIDF through an agent who ought to be a working attorney.[9]

Conclusion

In conclusion, insider trading is a serious offense in India, and the SEBI has put in place several regulations to prevent such practices. The Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015 (PIT Regulations) provide guidelines for companies to prevent insider trading and ensure transparency and fairness in the Indian securities market.

The prevention of insider trading is crucial to maintain the integrity of the securities market and protect the interests of investors. Companies are required to establish a code of conduct, develop an insider trading policy, and maintain a database of all employees who have access to UPSI to monitor their trading activities. The SEBI has the power to investigate and penalize individuals and companies involved in insider trading, and penalties can include fines, imprisonment, and the disgorgement of profits gained through illegal trading.

Investors and other stakeholders in the Indian securities market can have confidence in the integrity of the market due to the measures taken to prevent insider trading. However, it is essential that companies and insiders remain vigilant in their compliance with the regulations and take responsibility for maintaining ethical conduct to prevent insider trading. The SEBI also plays a crucial role in promoting awareness about insider trading and its prevention through investor education programs.

In conclusion, the mechanisms of prevention of insider trading in India are comprehensive and designed to ensure that insiders do not misuse their access to UPSI for personal gain. The continued implementation of these regulations and the promotion of ethical conduct among companies and insiders are critical for the sustained growth and integrity of the Indian securities market.

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[9] Mohit Kar, *Sebi's Whistleblower Mechanisms: Can Insider Trading be Impeded*, Ipleaders, Available at https://blog-ipleaders-in.cdn.ampproject.org/v/s/blog.ipleaders.in/sebis-whistleblower-mechanisms-can-insider-trading-impeded/?amp=1&amp, (Last Visited March 17, 2023)