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INSIDER TRADING: BITING THE HAND THAT FEEDS YOU- Aakash Prakash¹**ABSTRACT**

The concept of insider trading encompasses the utilization of confidential, unpublished information regarding a company, known as unpublished price sensitive information (UPSI), to gain personal profit or avoid loss through transactions in the company's securities. This practice constitutes a breach of fiduciary duties owed by company officers. Originating alongside the emergence of securities trading in joint stock companies, insider trading has become a pervasive challenge in the global investment landscape. Its complexity lies in its rootedness in human nature, particularly the instinct of greed, making it inherently difficult to eradicate. This paper delves into the intricate framework of insider trading laws in India, offering recommendations aimed at mitigating this issue and fostering robust corporate governance practices.

Keywords: *Insider Trading, Corporate Governance, UPSI, White Collar-Crime, Corporate Crime, Securities of Company.*

INTRODUCTION

Since the inception of monetary systems, supplanting the barter system, there has arisen an escalating demand for currency, fueled by the boundless desires of humanity. In response, individuals resorted to deceitful tactics to augment their earnings and gratify their desires. Among these stratagems emerged insider trading, subsequently categorized as a white-collar offense. Employees clandestinely disseminated proprietary data from their organizations for lucrative gains, a practice that permeated various facets of the market, compromising its integrity.

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Currency wields profound influence over our conduct, aspirations, and vocational pursuits. While the advent of currency or fiat money has facilitated the imperative of exchange and trade, it has also engendered certain constraints. Monetary pursuits have engendered a pervasive sense of acquisitiveness, perpetuating an insatiable quest for accumulation. Contemporary society finds itself ensnared in a relentless pursuit where those lagging behind risk obsolescence within the unforgiving confines of the capitalist milieu.

As the landscape of commerce evolved with the advent of modernization and digitization, the paradigm of currency transitioned from tangible forms like paper and coins to digital variants. Digital currency, a manifestation of soft currency transacted electronically via digital computing, encompasses cryptocurrencies and similar entities, comprising a wholly digital repository.²

The World Inequality Report 2022 highlights a stark reality in India, where the top decile commands a disproportionate 57% share of the national income, a glaring testament to the burgeoning disparities within the socioeconomic fabric. Fearing marginalization, some resort to unsavoury tactics to propel their ascent, exacerbating the cutthroat competition.³

Following the liberalization and industrialization movements of 1854, a wave of modernization swept through, heralding the ingress of myriad corporate entities, and intensifying the competitive milieu. In their quest for ascendancy, individuals embraced nefarious stratagems, including illicit trading, to expedite wealth accumulation. Success within this crucible hinges upon a litany of attributes, including transparency, operational efficacy, and cohesive interpersonal dynamics. The organizational hierarchy, with its intricate layers, embodies the backbone of corporate operations. Ownership delineates the framework, while the board of directors navigates policy formulation, wielding stewardship over sensitive information.

Competition and profit motive propel these entities into perennial rivalry, vying for ascendancy atop the echelons of success. Consequently, employees find themselves embroiled in this cutthroat race, albeit with the potential for constructive competition across

²*What Is Insider Trading? Common Causes and Solutions*, LHT LEARNING (March 8, 2024,00:24 AM), <https://www.lhtlearning.com/what-is-insider-trading/>.

³Lucas Chancel, *World Inequality Report 2022*, WORLD INEQUALITY LAB (March8, 2024, 01:36AM), https://wir2022.wid.world/www-site/uploads/2023/03/D_FINAL_WIL_RIM_RAPPORT_2303.pdf.

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corporate boundaries. Regrettably, breaches of integrity and fiduciary duty manifest as employees transgress organizational protocols, divulging confidential intelligence to rival entities for substantial remuneration. This phenomenon, known as insider trading, underscores the exploitation of regulatory loopholes to subvert the sanctity of corporate confidentiality.⁴

WHAT IS INSIDER TRADING AND HOW DID IT EMERGE?

"Insider trading pertains to the exchange of a corporation's shares or alternative securities by individuals possessing privileged access to undisclosed or confidential company information."⁵

The illicit exploitation of privileged information, including price-sensitive data ("PSI"), from one's own company for the benefit of other entities is commonly known as insider trading. PSI, as delineated in Section 195 of the Companies Act 2013⁶, pertains to unpublished information capable of impacting a company's stock price if disclosed to the public. Presently, its definition is codified under Reg.2(1)(n) of the Securities Exchange Board of India ("SEBI") (Prohibition of Insider Trading) Regulations, 2015⁷. This phenomenon has its roots in the practice of trading securities within the global capital market and is categorized as a form of white-collar crime encompassing various transgressions within the realm of corporate professionals.

For instance, the case of Harshad Mehta, an Indian stockbroker, illustrates the exploitation of price-sensitive information for personal gain. The customary procedure preceding the public release of any share price entails notification to SEBI, followed by dissemination to the general populace. Leveraging his position, Mehta opportunistically acquired shares of companies experiencing upward trends. Subsequently, upon public disclosure of this information, demand for the shares surged, driving prices higher. Mehta then capitalized on this surge by selling his shares at inflated prices, reaping substantial profits. This

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⁵Legal Information Institute, *Insider Trading*, CORNELL LAW SCHOOL (March 8, 2024, 2:01 AM), https://www.law.cornell.edu/wex/insider_trading#:~:text=Insider%20trading%20is%20the%20trading,of%20the%20individual's%20fiduciary%20duty.

⁶Companies Act 2013, S.195, Acts of Parliament, 2013 (India)

⁷SEBI (Prohibition of Insider Trading) Regulations, 2015, Reg.2(1)(n), Regulations by SEBI, 2015 (India)

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manipulation of unpublished price-sensitive information for personal benefit epitomizes the unethical practice of insider trading.⁸

WHO IS AN INSIDER?

In accordance with Regulation 2(1)(g) of the SEBI (Prohibition of Insider Trading) Regulations, 2015, an "insider" is defined as follows:

- i) A connected person; or
- ii) One who possesses or has access to unpublished price-sensitive information.

In essence, any individual who possesses knowledge of unpublished price-sensitive information or maintains a connection with entities from which such information may be obtained falls within the purview of an insider. Examples of insiders encompass a diverse range of roles, including auditors, consultants, legal entities, directors, partners, and shareholders, among others.

Insiders, within the corporate realm, wield their privileged access to confidential company information for personal gain through transactions with other entities. This category encompasses a diverse spectrum of individuals, including directors, partners, shareholders, employees, and managers.

For instance, consider a seemingly ordinary employee tasked with overseeing departmental accounts and transactions. Armed with unfettered access to sensitive financial data, this individual exploits their position for personal benefit, clandestinely disseminating this information to a competitor. By leveraging their insider status, they evade accountability while lucratively profiting from the illicit exchange.

In today's fiercely competitive corporate landscape, characterized by a relentless pursuit of financial gain, the spectre of insider trading looms ominously over companies, posing a significant threat to their integrity and stability.⁹

WHAT IS U.P.S.I.?

In accordance with Regulation 2 (1)(n) of the Securities Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015, Unpublished Price-Sensitive Information

⁸Harshad S. Mehta v. Central Bureau of Investigation, BomCR 783, 2 BOMLR 114, 1998

⁹SEBI (Prohibition of Insider Trading) Regulations, 2015, Reg.2(1)(g), Regulations by SEBI, 2015 (India)

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(UPSI) is delineated as information encompassing financial matters, corporate restructuring, dividend declarations, acquisitions, divestitures, mergers, and other significant business developments.

UPSI constitutes proprietary data held by a company that remains undisclosed and possesses the potential to influence the company's stock price once disseminated to the public domain.

Illustratively, consider a scenario where a director of XYZ company divulges confidential information regarding an impending business deal to an acquaintance employed at a competitor firm. Subsequently, the acquaintance utilizes this privileged information to purchase shares of XYZ company. In such circumstances, both the director and her associate would incur liability for contravening SEBI regulations.¹⁰

HOW IS INSIDER TRADING HARMFUL? IS IT ILLEGAL?

The dissemination of confidential and price-sensitive data pertaining to a company, including financial records, transactions, dividends, details of mergers and demergers, and policy adjustments, exerts a profound impact on the valuation of the organization's securities within the market. This not only diminishes the company's profitability but also deters potential investors from engaging with the company, thereby eroding its standing in the stock market and substantially reducing its turnover.

For instance, consider the scenario where Ms. P, serving as a Director of a company, becomes privy to information indicating a decline in the company's shares and overall business performance. Ms. P proceeds to share this sensitive information with a close associate who happens to be a stockbroker. Upon receiving this information, the stockbroker swiftly acquires a significant volume of the company's shares, reaping substantial profits in the process. Consequently, the company, led by Ms. P, incurs substantial losses, potentially impeding its recovery prospects. In such a scenario, both Ms. P and her stockbroker

¹⁰*Id.*, Reg. 2(1)(n)

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acquaintance may be held accountable for the offense of insider trading and could be compelled to indemnify the company for the damages incurred.¹¹

The United States of America stands as a pioneer in the denouncement of insider trading, notably evidenced by the pivotal report of the Thomas Committee in 1948. This landmark initiative served as a catalyst, inspiring policymakers in India to undertake analogous measures.¹²

In light of various factors, insider trading has been deemed a prohibited activity. This designation arises from its inherently immoral and unethical nature, constituting a violation of the fiduciary duty owed by individuals to their respective organizations. Below are enumerated several reasons underpinning the statutory discouragement of this practice:

1. Inequity Prevails: Insider trading epitomizes profound unfairness, as insiders exploit their privileged access to information for personal gain.
2. Conflict of Interest: It engenders a fundamental conflict between the self-serving motives of individuals trading on insider information and the fiduciary responsibility they owe to their company, representing a clash between personal greed and organizational well-being.
3. Detrimental Ramifications: Given the substantial ramifications, insider trading exacts significant losses upon companies, manifesting in tarnished market reputations and diminished investor confidence.¹³

INSIDER TRADING IN INDIA AND EFFORTS TAKEN TO CURB ILLEGAL TRADING

Observing the enactment of regulations targeting insider trading in other jurisdictions, such as the establishment of the Thomas Committee in the USA and the imposition of significant duties on company directors by the United Kingdom concerning the handling of sensitive information, India was prompted to develop its own regulatory framework.

¹¹ Akhilesh Ganti, *What Is Insider Trading and When Is It Legal?*, INVESTOPEDIA (March 8, 2024, 6:00 AM), <https://www.investopedia.com/terms/i/insidertrading.asp#:~:text=Essentially%2C%20insider%20trading%20involves%20trading,insider%20transaction%2C%20which%20is%20legal>.

¹² Thomas C. Newkirk, *Speech by SEC Staff: insider trading – A U.S. Perspective*, US SECURITY AND EXCHANGE COMMISSION (March 8, 2024, 6:08 AM), <https://www.sec.gov/news/speech/speecharchive/1998/spch221.html>.

¹³ *Supra* note 10.

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In response to the imperative of instituting regulations to combat insider trading, Sections 307 and 308 were integrated into the Companies Act of 1956. During the 1970s, insider trading was officially classified as an 'undesirable practice' for the first time. Subsequently, numerous committees, including the Sachar Committee (1979), the Patel Committee (1986), and the Abid Hussain Committee (1989), proposed a multitude of recommendations. Eventually, in the culmination of these efforts, the Securities and Exchange Board of India (SEBI) was established as a comprehensive regulatory authority.

A succinct timeline tracing the progression towards the legal proscription of insider trading in India unfolds as follows:

1. BHABHA COMMITTEE, 1952:

The Bhabha Committee of 1952 advocated for mandatory disclosure of share transactions by company managers in a dedicated register, emphasizing transparency in corporate dealings.¹⁴

2. COMPANIES ACT, 1956:

Under Section 307, the Companies Act of 1956 mandated the recording of directors' shareholdings within the organization, with Section 308 further emphasizing the duty of directors to disclose their shareholdings, promoting accountability.¹⁵

3. COMPANIES AMENDMENT ACT, 1960:

The Companies Amendment Act of 1960 extended the obligation of shareholding disclosure to both managers and directors, reinforcing transparency in financial transactions.¹⁶

4. SACHAR COMMITTEE, 1978:

Convened in June 1977, the Sachar Committee aimed to review the Companies Act of 1956 and the Monopolies and Restrictive Trade Practices Act (MRTP) of 1969. It recommended

¹⁴*Bhabha Committee Report on Company Law Committee*, MINISTRY OF CORPORATE AFFAIRS (March 09, 2024, 1:28 AM), <http://reports.mca.gov.in/Reports/22-Bhabha%20committee%20report%20on%20Company%20law%20committee,%201952.pdf>.

¹⁵Companies Act 1956, S.307&308, No. 1, Acts of Parliament, 1956 (India)

¹⁶Companies Amendment Act 1960, No. 31, Acts of Parliament, 1960 (India)

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stringent measures to curb unfair gains from the sale of price-sensitive information in the market.¹⁷

5. G.S. PATEL COMMITTEE, 1986:

The term "insider trading" was formally defined in a report by G.S. Patel, which proposed amendments to the Securities Contract (Regulation) Act (SCRA).

6. ABID HUSSAIN COMMITTEE, 1989:

Established in 1989, the Abid Hussain Committee recommended the criminalization of insider trading, advocating for both civil and criminal penalties.

7. SEBI ACT, 1992:

The Securities and Exchange Board of India (SEBI) was established under the SEBI Act of 1992 as a governmental body tasked with regulating the Indian capital market, safeguarding investor interests, and overseeing securities trading.¹⁸

8. THE SEBI (PROHIBITION OF INSIDER TRADING) REGULATIONS, 1992:

The SEBI Regulations of 1992 explicitly identify insider trading as a punishable offence and a breach of fiduciary duty by company employees.¹⁹

Following the recommendations put forth by the committees, SEBI promulgated the subsequent regulations aimed at combating insider trading:

- The "SEBI [Prohibition of Insider Trading] Regulation-1992"²⁰
- The "SEBI [Substantial Acquisition of Shares & Takeover] Regulations 1994"²¹
- The "SEBI [Prohibition of Fraudulent & Unfair Trade Practice relating to securities market] Regulations-2003"²²

¹⁷*Sacher Committee Report*, MINISTRY OF CORPORATE AFFAIRS (March 09, 2024, 3:22 AM), <http://reports.mca.gov.in/Reports/30-Rajindar%20Sacher%20committee%20report%20of%20the%20High-powered%20expert%20committee%20on%20Companies%20&%20MRTP%20Acts,%201978.pdf>.

¹⁸Securities and Exchange Board of India Act 1992, No. 15, Acts of Parliament, 1992 (India)

¹⁹Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 1992, Regulations, 1992 (India)

²⁰*Id.*

²¹Securities and Exchange Board of India (Substantial Acquisition of Shares & Takeover) Regulations, 1994, Regulations, 1994 (India)

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Under Section 15G of the Securities Exchange Board of India Act 1992, insider trading stands prohibited, with stipulated penalties ranging from a minimum of Rs. 10 lakh to a maximum of Rs. 25 crores, or three times the profits accrued from trading on privileged information.²³

SECURITIES AND EXCHANGE BOARD OF INDIA (SEBI)

In contemporary India, a multitude of regulatory bodies oversee the intricacies of the corporate landscape. Noteworthy among these entities are the Reserve Bank of India, the Company Law Board (CLB), and various national stock exchanges. Among these regulatory institutions, the Securities and Exchange Board of India (SEBI) was established as a pivotal authority through the enactment of the SEBI Act in 1992, entrusted with the oversight of the securities market within the nation. Tasked with vigilant market surveillance, SEBI remains vigilant in identifying and addressing instances of insider trading.

While it is acknowledged that the depth of the Indian market may not rival that of some global counterparts, it is imperative to recognize the resilience inherent in India's economic fabric. This resilience is underpinned by the nation's vast population, comprising a substantial array of companies, investors, employees, and, notably, consumers, which collectively sustain the dynamism of the Indian market. Furthermore, the continual implementation of numerous economic reforms by the government has contributed to the refinement and evolution of our markets, further bolstering their resilience and adaptability.²⁴

SEBI, in its enactment of the SEBI (Prohibition of Insider Trading) (Amendments) Regulations of 2018, delineates insider trading as the act of "engaging in the purchase, sale, or negotiation of securities, either directly or through representation, by individuals privy to confidential information, whether acting as principals or agents."

SEBI (Prohibition of Insider Trading) (Amendments) Regulations, 2018 provide that the sale and buying of insider information are prohibited. SEBI also has the power to punish and imprison any person who contravenes with its provisions. Moreover, it has the authority to

²²Securities and Exchange Board of India (Prohibition of Fraudulent & Unfair Trade Practice relating to securities market) Regulations, 2003, Regulations, 2003 (India)

²³*Supra* note 5, S.15G

²⁴SECURITIES AND EXCHANGE BOARD OF INDIA (March 10, 00:56 AM), <https://www.sebi.gov.in/powers-and-functions.html>.

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freely investigate matters relating to insider trading. It can investigate matters on the following grounds-

1. Complaints received from investors, shareholders, intermediaries, etc.
2. Any knowledge or data learned about cases of insider trading in the market²⁵

SUGGESTIONS AND CONCLUSION

In order to efficaciously combat the menace of insider trading, several strategic measures are proposed. Primarily, raising public awareness regarding the pernicious consequences of insider trading through educational initiatives and training programs is imperative. Moreover, fostering robust corporate governance frameworks within organizations, including the enforcement of rigorous insider trading protocols, is pivotal in mitigating such malfeasance. Expanding the purview of insider trading regulations to encompass transnational dimensions is advocated to effectively address cross-border infringements. Additionally, eliminating the utilization of consent mechanisms in insider trading cases can bolster the deterrent effect. Drawing inspiration from the symbiotic relationship between the legislative and judicial branches in the United States, the Indian judiciary should prescribe stringent penalties for perpetrators of insider trading, thereby instilling a culture of accountability. Harnessing the power of media coverage to spotlight successful prosecutions can serve as a potent deterrent against potential offenders. While commendable strides have been taken by Indian authorities and the judiciary, expeditious adjudication and the imposition of severe penalties remain indispensable in deterring future transgressions effectively.

In simplistic terms, insider trading can be elucidated as the unauthorized disclosure of price-sensitive information pertaining to a company to external entities for personal gain. Despite its flagrant disregard for ethical and moral standards, this malpractice persists within contemporary capital markets. Not only does it result in substantial losses for companies, but it also contravenes the fiduciary duty of confidentiality owed by individuals to their organizations. This fiduciary obligation encompasses the imperative to maintain information confidentiality and refrain from exploiting it for personal enrichment. Moreover, it

²⁵Securities and Exchange Board of India (Prohibition of Insider Trading) (Amendments) Regulations, 2018, Regulations, 2018 (India)

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necessitates compliance with insider trading laws, mandating abstention from trading until such information is publicly disclosed.

The investigation and regulation of insider trading instances pose formidable challenges for the Indian Government. Despite the establishment of numerous legislations and regulatory bodies, the prevalence of such malpractices persists, primarily among white-collar elites. The Annual Report of the Securities and Exchange Board of India (SEBI) for the fiscal year 2016-17 revealed that insider trading accounted for 14% of the total white-collar crimes investigated, with a worrisome upward trend in occurrences. Compounding the issue, a significant proportion of these cases remain unresolved, prolonging the quest for justice.

Insider trading investigations are inherently intricate, often relying on circumstantial evidence rather than concrete proof, rendering detection and prosecution arduous tasks. The efficacy of regulatory bodies such as SEBI is hindered by technological deficiencies and manpower shortages, hampering surveillance and enforcement efforts. Addressing these challenges necessitates empowering regulatory authorities with greater autonomy to formulate and enforce regulations, bolstering surveillance mechanisms, and imposing stringent penalties for non-compliance.

Moreover, the Indian market landscape harbors numerous loopholes, exploited by unscrupulous individuals for personal gain. These loopholes, including the absence of regulations governing foreign insider trading activities and technological inadequacies within SEBI, exacerbate the prevalence of insider trading. To mitigate these issues and fortify the integrity of the Indian market, the government must prioritize the enhancement of regulatory capabilities, augment manpower and technological infrastructure. Additionally, imposing stricter fiduciary duties on company directors and employees, coupled with robust enforcement mechanisms, can serve as deterrents against illicit trading practices.

In conclusion, addressing the scourge of insider trading demands a multifaceted approach encompassing legislative reforms, regulatory enhancements, and ethical imperatives. By fortifying regulatory frameworks, fostering technological advancements, and instilling a culture of transparency and accountability, the Indian Government can mitigate the menace of insider trading and safeguard the integrity of the nation's financial markets.

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