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**ISSUES IN ENFORCING INSIDER TRADING AS A WHITE  
COLLAR CRIME**- Rupam<sup>1</sup>**• INTRODUCTION**

The prevention and the enforcement of white collar crime has been a challenge for the regulators world wide. As a substantial amount of insider trading cases happen to be white collar crimes, a specific approach to its enforcement as a white collar crime will contribute significant value.

There is no statutory definition for the term “white collar crime.” The term “white collar crime” was first used in 1939 by a noted criminologist, Edwin Sutherland, in a presidential address to the American Sociological Association and explained it as "a crime committed by a person of respectability and high social status in the course of his occupation"<sup>2</sup>. In 1989, the FBI explained white collar crime as “those illegal acts which are characterized by deceit, concealment, or violation of trust and which are not dependent upon the application or threat of physical force or violence. Individuals and organizations commit these acts to obtain money, property, or services; to avoid the payment or loss of money or services; or to secure personal or business advantage.” A significant formulation of what constitutes ‘white collar crimes’ has been offered by the U.S. Department of Justice, Bureau of Justice Statistics, which defines white collar crime as:

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<sup>2</sup>The term was first used by noted Criminologist Edwin Sutherland, , in a presidential address to the American Sociological Association, Stuart P Green, The Concept of White Collar Crime in Law and Legal Theory, 8:1 Buff L.R.1(2005)

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*[n]on-violent crime for financial gain committed by means of deception by persons whose occupational status is entrepreneurial, professional or semi- professional and utilizing their special occupational skills and opportunities; also, non-violent crimes for financial gain utilizing deception and committed by anyone having special technical and professional knowledge of business and government, irrespective of the person's occupation.*

Sutherland has distinguished the perpetrators of white collar crimes and blue-collar crimes i.e., crimes such as robbery, burglary, and murder. He says that those who indulge in blue-collar crimes are typically street criminals. The acts of commission or omission in such crimes have no connection to their occupation. Contrary to the ordinary crimes, individuals of higher economic and social status committed the white-collar crimes and such crimes were linked to their socially respected professions. White collar crimes involve sophistication and the criminals who perpetrate them have specialized knowledge that allows them to commit complex transactions that are often difficult to identify.

Although the white collar criminals inflict more harm on the society, the fact is that very few amongst the white collar criminals have been convicted. The law enforcement authorities are unable to easily prevent or catch the white-collar criminals. The criminal justice system existing in various countries appear to treat the white-collar offenders with more lenience and with less consistency than the street criminals.

The term “white collar crime” appears in very few obscure criminal statutes and the question whether an offense should be considered as a white collar crime is one that has arisen in fewer cases. The term has appeared in the recently enacted U.S. legislation on corporate governance, the SOX, one of the most important pieces of federal criminal law relating to the companies.

- **WHITE COLLAR CRIMES IN INDIA**

India also does not have a specific statutory definition or provisions referring to white collar crimes. The 47<sup>th</sup> (forty-seventh) report of the Law Commission on ‘The Trial and

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Punishment of Social and Economic Offences<sup>3</sup> defines ‘white collar crime’ for the purpose of the report as “a crime committed in the course of one’s occupation by a member of the upper class of the society.” The Supreme Court of India, in *Ram Narain Poply v. CBI*<sup>4</sup>, has observed that the white-collar crimes are nothing but cases of private gain at the cost of the public, and lead to economic disaster. Socio- economic crimes and white collar crimes are reportedly the intersecting circles.

Some of the common categories of white collar crimes in India include the violation of the foreign exchange laws, import and export related laws, banking and accounting frauds, offences under the Prevention of Corruption Act, 1988, tax-evasion, adulteration of food, edibles and drugs, etc.

Unlike the regular crimes such as a murder, which is the outcome of the heat of moment, the economic offences involve pre-determination and planning under a scheme. *“The offense is committed with cool calculation and deliberate design with an eye on personal profit regardless of the consequence to the community. A disregard for the interest of the community can be manifested only at the cost of forfeiting the trust and faith of the community in the system to administer justice in an even handed manner without fear of criticism from the quarters which view white collar crimes with a permissive eye, unmindful of the damage; done to the national economy and national interest.”*<sup>5</sup>

- **ENFORCEMENT IN THE U.S. AND THE U.K.**

As opposed to the traditional crimes, the white collar crimes are regulatory offences requiring *malum prohibitum*, i.e., an act that is wrong solely because it is prohibited by the law. The jurisdictions such as the U.S. and the U.K. have treated insider trading as a white collar crime.

During the late 1990s, a number of corporations had manipulated financial information and made improper financial transactions, hand in glove with the accounting firms, which undermined the investor confidence in the stock market and corporate governance in general. For instance, the

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<sup>3</sup>The Law Commission was set up by the Government of India in 1972.

<sup>4</sup>*Ram Narain Poply v. CBI*, 2003 Indlaw SC 51

<sup>5</sup>*State of Gujarat v. Mohanlal Jitmalji Porwal and Anr* (AIR 1987 SC 1321)

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Enron and WorldCom episodes of corporate scandals that emerged in 2001 involved the accounting firm of Arthur Andersen.

As a consequence of the Enron scam and many other financial scams that surfaced in the U.S., the U.S. Congress had realized the need to strengthen its legislative framework as well as the enforcement of the existing legislations. Consequently, the U.S. Congress in 2002 enacted the Public Company Accounting Reform and Investor Protection Act popularly referred to as the Sarbanes-Oxley Act. SOX includes a variety of new offenses, stiffer penalties for existing offenses, requirement for the companies to have audit committees, mandate to create a board to regulate auditors, new duties on CEOs and CFOs, simpler process to file class actions against corporations and directors, new regulatory compliance requirements, and the extended authority of the SEC over the corporate governance matters. Title IX of SOX has five

(5) substantive sections, which has the title “White-Collar Crime Penalty Enhancement Act of 2002.” This title relates to the rules and penalties regarding white-collar crimes. This Title IX increases penalties for various forms of fraud and also issues a mandate for a general review of the sentencing guidelines regarding white collar offenses and also requires corporate officers to certify financial reports. The SOX had increased the penalties for the white-collar crimes of mail fraud and wire fraud from a maximum of five (5) years to twenty (20) years in prison. Additionally, falsifying the financial reports by the corporate officers was also regarded as a crime punishable with fine up to US \$5 million and imprisonment up to ten (10) years. Most importantly, the SOX had categorised a new crime of securities fraud. A person convicted of this crime could be sentenced to twenty-five (25) years in prison. The SOX had also directed the U.S.’ Sentencing Commission<sup>6</sup> to review and amend its sentencing guideline s regarding white-collar crimes.

As regards the enforcement, although the SEC has not always succeeded in policing the white-collar crimes, compared to the other jurisdictions, the SEC has been more effective in prosecuting the white collar criminals. Numerous brokers and dealmakers have been prosecuted over the

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<sup>6</sup>The United States Sentencing Commission is an independent agency in the judicial branch of government. Its principal purposes are: (1) to establish sentencing policies and practices for the federal courts, including guidelines to be consulted regarding the appropriate form and severity of punishment for offenders convicted of federal crimes; (2) to advise and assist Congress and the executive branch in the development of effective and efficient crime policy; and (3) to collect, analyze, research, and distribute a broad array of information on federal crime and sentencing issues, serving as an information resource for Congress, the executive branch, the courts, criminal justice practitioners, the academic community, and the public. ([http://www.ussc.gov/About\\_the\\_Commission/index.cfm](http://www.ussc.gov/About_the_Commission/index.cfm), last visited November 2023)

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years<sup>7</sup>. Recently, in the *Galleon Cases*<sup>8</sup>, the SEC had charged the billionaire Raja Rajaratnam and his New York based hedge fund advisory firm, Galleon Management, for indulging in a massive insider trading scheme that generated more than US\$52 million in illegal profits or losses avoided. The SEC's complaint alleged that Rajaratnam had paid bribes in exchange of inside information regarding the corporate earnings or takeover activity and then used the non-public information to illegally trade on behalf of Galleon. In related Galleon actions, the SEC had charged nineteen (19) other high ranking corporate executives and insiders involved in the insider trading scheme. The SEC has settled the dispute with two (2) individual tippers and one of the entities involved. The SEC is seeking permanent injunctions, disgorgement and penalties in the remaining actions against Rajaratnam and others. The SEC's investigation is continuing. This clearly reflects the U.S.' Congress' efforts and activism in dealing with and curbing the corporate frauds and prosecuting the offenders involved, notwithstanding their social standing.

#### ● **ENFORCEMENT IN INDIA**

India also recognizes securities frauds as white collar crimes, considering the nature of the crime, class of the offenders involved and the social and economic impact of the crime. However, until date, India has not been able to establish precedents of successful enforcement of insider trading cases that can act as a deterrent against potential violators.

India had framed the Insider Regulations way back in 1992. Further, the legislative framework was primarily adopted from the U.K. and U.S. securities law. Despite this, there have been multiple cases in the U.S. and a few in U.K. where the companies and the insiders have been booked for insider trading and other securities frauds. However, in India, there has not been a single case of conclusive conviction of an insider for the violation of the Insider Regulations by the SEBI.

The first Indian landmark case on securities fraud was the Harshad Mehta's Case. Although India can boast of successful prosecution in the Harshad Mehta Case, the case of Harshad Mehta reached prosecution stage and conviction, mainly because of many other factors including the case being profiled as a major bank fraud and also involvement of political issues. The recent case of prosecution of Ramalinga Raju in the Satyam Case is also pursued forcefully where the corporate governance principles in India faced a major threat.

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<sup>7</sup>Kathleen F. Brickey, *Corporate and White Collar Crime* (4<sup>th</sup> Edn. Aspen Publishers (2006))

<sup>8</sup>SEC Annual Report 2010

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Notwithstanding, the prosecution of Harshad Mehta reflected the government's and the court's positive approach towards the enforcement of the securities law and to some extent restored the investors' trust in the securities market. However, after the Harshad Mehta Case, there were no cases of securities fraud for a long time. There could be multiple reasons for the laxity in the enforcement of the securities fraud cases. One of the reasons could be that India had not yet realized the need to regulate such offences because such offences were not regarded as serious crime. This is so because in the securities fraud, there are no clearly identifiable victims and the impact of the offence is not so severe to motivate an individual to pursue the prosecution or authorities in this regard. However, these reasons are unjustifiable because there are victims to the securities fraud who suffer significant monetary losses. But these victims are rarely identified because the victims do not have the right to take private actions against the offenders. The securities law as well as the Insider Regulations does not provide private actions against the offender. In India, the law requires that any action against the offender in a securities fraud must be initiated by the SEBI itself. Although the victim may file a complaint with the SEBI based on which the SEBI can take action against the offender, such complaints appear to be rare. The reason could be the lack of awareness on the victim's behalf or the lack of initiative by the SEBI after receiving the complaint.

As regards the impact of the securities fraud, the nature of the crime is such that there are far reaching effects of the securities fraud. Each instance of securities fraud undermines the investors' confidence in the securities market. Consequently, the primary objective of the securities law which is to protect the investor's interest in securities and to promote the development of, and to regulate the securities market is not fulfilled. Hence, considerable injury is caused to the investors and the securities market because of the securities fraud cases.

Insider trading in India does not appear to be prosecuted as a crime by the SEBI, although under the SEBI Act, Section 24 empowers SEBI to initiate prosecution for violations of the provisions of the SEBI Act, Rules and the Regulations framed under it.

The procedure to establish the trader as an insider and the offence of insider trading is complicated and cumbersome. For example, the SEBI has very high burden of proof to establish beyond doubt that the person who has traded is an insider, the insider has traded while in possession of the UPSI, the information involved is UPSI and such other factors, to conclusively prove the violation of the Insider Regulations. However, civil remedies are available to SEBI, where there is no requirement to prove the *mens rea* and the standards of proof are also easier. For general queries or to submit your research for publication, kindly email us at [editorial@ijalr.in](mailto:editorial@ijalr.in)

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The SEBI has the power to debar a trader temporarily or permanently from dealing in the securities market under Sections 11B and 11 (4) of the SEBI Act, to pass cease and desist orders against the market participants under Section 11D, to impose penalty of Rs.25 crores or three (3) times the profits, whichever is higher, under Section 15G of the SEBI Act. Further, the Insider Regulations, *inter alia*, provides under Regulation 11 that the SEBI can direct a violator to transfer or return the proceeds equivalent to the cost price or the market price of the securities, which is similar to the order of disgorgement of profits under the U.S. law.

These are certain provisions under the SEBI Act and the Insider Regulations which provide a strong enforcement scheme. A robust framework should have enhanced the efficacy of the enforcement of the insider trading prohibition.

A further reason which may be given for the ineffective enforcement against the securities fraud is the attitude of the Indian courts and the Indian justice system. This becomes all the more relevant in view of the fact that no case of insider trading has reached the high courts or the Supreme Courts of India. However, this reason is untenable. Although there are delays in the legal system due to the procedural laws, Indian courts have convicted offenders in both civil and criminal cases including the grave crimes of theft, rape and murder. Therefore, the enforcement machinery cannot be blamed completely for the non-enforcement of the Insider Regulations.

A few reasons common to all jurisdictions including India for non-effective prosecution of the white collar crimes are discussed below:

- **Social status:**

One of the foremost reasons for the ineffective enforcement against white collar crimes is the class of persons involved in the crime. The white collar crimes are usually committed by people with high social status. These offenders have the social, political and economic power to influence such charges against them.

- **Complexity:**

The perpetrators of the white collar crimes learn the techniques of defrauding and embezzling funds and are aware of the methods to cover up their illegal actions, and therefore, it is very

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difficult to obtain cogent evidences to prosecute them in court of law. Insider trading is a typical example where collating the evidence against the violator is extremely cumbersome.

- **Corruption:**

Rampant corruption in the society which makes it possible for the offenders to bribe their way out even when a tribunal or a court finds an individual guilty of white collar crime also is a negating factor for effective enforcement against white collar crimes.

- **Chain Linking:**

The offence of insider trading involves strong ties among the individuals who commit crimes. The offence is committed by the professionals as a group and are mostly of high social status who have knowledge, techniques and tactics to undertake such crimes, besides that they employ strategic means of acquiring funds and opportunity, which makes it difficult to trace the suspect and prosecute.

### **CONCLUSION**

In this backdrop, to assess the robustness of India's insider trading enforcement regime, one should analyse the adequacy of India's insider trading laws, the history of enforcement, the regulator's approach and the deterrent or remedial impact created in the market. Further, an analysis of the key enforcement mechanisms in other jurisdictions would assist in understanding whether India should incorporate any of those principles or experiences into the Indian enforcement mechanism.

In India, the insider trading regulatory mechanism consists of the following:

The SEBI Act read with the Insider Regulations prohibits an insider from dealing in securities while in possession of the unpublished price-sensitive information (Section 12A of the SEBI Act and Regulations 3 and 4 of the Insider Regulations). The Insider Regulations provides an exhaustive definition of the terms 'insider', and 'unpublished price sensitive information'.

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