

AARUSHI SHINDE - 411

KSHITIJ SRIVASTAVA - 431

Insider Trading : The Rabbit Hole in India's Capital Market

2022

TABLE OF CONTENTS

1	ABSTRACT	02
2	INTRODUCTION	03
3	LITERATURE REVIEW	05
4	METHODOLOGY	06
5	BODY	07
6	CONCLUSION	16
7	BIBLIOGRAPHY	17

ABSTRACT

Insider trading involves more than just stealing confidential knowledge. Insider trading is when someone with non-public, substantial knowledge about a publicly listed firm buys or sells its stock. The goal of this study is to evaluate insider trading behaviour in the Indian stock market and assess the profitability and informational content of insider trading. The empirical analysis is based on disclosures issued in accordance with the SEBI (Prohibition of Insider Trading) Regulations, 1992. The research paper covers the definition of Insider Trading in India, the regulations regarding it, and prominent instances of Insider Trading. Reviewing through the regulations we could see that there are few loopholes which led us to the mismanagement of SEBI.

INTRODUCTION

Insider trading is one of India's most prominent embezzlements, spanning back to the early 1920s. It can be defined as an illegal practice in which stocks of a firm are traded by individuals who, by virtue of their job, have access to otherwise non-public information that might be critical in making investment decisions. It is an ethical violation in which other stockholders are significantly disadvantaged owing to a lack of critical insider non-public knowledge.

However, if the information has been made public in such a way that all interested investors have access to it, it will not be considered illegal insider trading. It is a profoundly complicated issue that is nearly hard to eradicate since it originates from a very basic human emotion, i.e. greed.

It is exceedingly difficult for someone who has insider knowledge to refrain from trading based on such information in order to make a judgement of future profit or loss by discounting such information.

Consider a hypothetical example for better explanation – The CEO of a company divulges important information about the acquisition of his company to a friend who owns a substantial shareholding in the company. The friend acts upon the information and sells all his shares before the information is made public. This is a classic example of insider trading. The rest of the investors in the market are unaware of this insider information, and are therefore unable to take advantage of it. Insider trading is a crime since it makes the market unfair and favors certain individuals.

The expanding size of the world's securities markets, where trading in stocks, derivatives, and bonds takes place on a worldwide scale, has increased the concerns of regulators throughout the world.

INTRODUCTION

Insider trading drew the attention of the public and the government because they suspected anomalous profit/gain of businesspeople and shareholders. The Companies Act of India has demonstrated a lack of skill in resolving trade concerns and restricting unfair business.

Let's get technical

In 1986, the Patel Committee defined insider trading as the trading of the shares of a company

- by a person in the management of the company or by someone who is close to them, and
- the trading is done on the basis of undisclosed “price sensitive information” regarding the working of the company, and
- this information is not available to others.

Who is an insider?

According to the Securities and Exchange Board of India (Prohibition of Insider Trading) (Amendment) Regulations, 2008, a person qualifies as an insider if three requirements are fulfilled -

- Any person who is or was connected or deemed to be connected with the company and,
- Is expected to have access to price sensitive information with regard to securities of the company. OR,
- Any person who has or had access to unpublished price sensitive information.

There can be three types of insiders -

- Insiders who are connected with the company
- Insiders who were connected with the company
- Insiders who are deemed to be connected with the company.

LITERATURE REVIEW

A few research papers published on “Insider Trading” are as follows -

Merger Announcements and Insider Trading Activity in India: An Empirical Investigation by Manish Agarwal, Harminder Singh

(Agarwal & Singh, 2006) empirically investigates the possibilities of insider trading prior to merger announcements in India. It focuses on daily volume and stock price movements of target companies 15-150 days before the first public announcement of their proposed mergers. It also examines the potential implications of the desire for fairness and information symmetry in the capital markets. The analysis examines possible abnormalities in average returns and trading volume prior to merger announcements. The report has found six companies where the investigation infers insider trading.

Insider Trading: Comparative Analysis of India and USA by Arun Singh, Anil Kumar

(Singh & Kumar, 2014) examines the legal mechanism of Insider Trading in India and assesses the extent to which it has been implemented by interpreting cases of Insider Trading. It draws a comparison between Insider Trading Laws in India and USA. It finds that Indian laws are ill-equipped to combat insider trading and needs to evolve significantly.

Insider Trading: An Overview by Stephen M. Bainbridge

(Bainbridge, 2000) examines the two schools of thought regarding Insider Trading - whether to regularize it or let companies make their own insider trading norms. The research takes a worldwide perspective.

In our research, we have taken a broad overview of insider trading, but restricted the geographical domain to India. Through our research, we have dug deep into the rabbit hole of insider trading which plagues the Indian capital markets. The aim is to cover what constitutes Insider Trading in India, the laws regarding it, some of the landmark cases, and conclude with what needs to be improved to promote fairness in the capital markets.

METHODOLOGY

The paper has been written on a step-by-step basis. We begin by introducing the topic of Insider Trading and the developments around it. The context is then narrowed down to an Indian perspective by defining how Indian laws define Insider Trading and providing a timeline of the major events concerning it. After a look at the Rules and Regulations of Insider Trading in India, we go through some of the landmark cases in India and conclude with some suggestions regarding how the situation can be improved in India.

A TIMELINE OF INSIDER TRADING IN INDIA

Instances of Insider Trading have been observed in India since the 1940s.

1948

The Thomas Committee published a report under the chairmanship of P. J. Thomas, citing instances of agents, directors, auditors and officers having information about the economic conditions of the company, dividends to be declared, issue of bonus shares and favorable contracts before it was publicly disclosed. It declared that all directors, agents, executives, and auditors should make correct disclosures.

1956

In response to the findings of the Thomas Committee, The Companies Act was passed in 1956, which included Sections 307 and 308 to combat insider trading.

- Section 307 - required the companies to maintain a register which recorded the director's shareholdings in the company
- Section 308 - required the directors and the persons deemed to be the directors to disclose their shareholding in the company.

1960

The Companies Amendment Act extended the requirement of disclosure of shareholding to the Company's managers as well. However, these safeguards were insufficient to prevent insider trading offences.

1979

The Sachar Committee reported that the directors, auditors, company secretaries, and other related people may possess price sensitive information which could be used to manipulate stock price. The Committee concluded that Sections 307 and 308 of the Companies Act were not enough to control insider trading.

A TIMELINE OF INSIDER TRADING IN INDIA

1986

The Patel Committee gave a formal definition of Insider Trading, which has been mentioned in the above section. It recommended that the Securities Control (Regulation) Act (SCRA), 1956 be amended to make stock exchanges curb unfair insider trading and unfair stock deals.

(Section 21 of the SCRA made it mandatory for companies to comply with the conditions of the Stock Exchange, which the Exchange could formulate on its own)

1989

The Abid Hussain Committee recommended SEBI to formulate the regulation and governing codes for the prevention of unfair deals. It further recommended that insider trading be convicted under civil and criminal laws.

1992

The Securities and Exchange Board of India (Insider Trading) Regulations Act, 1992, was passed. The Act incorporated the recommendations of the various Committees focused on Insider Trading.

REGULATIONS IN INDIA REGARDING INSIDER TRADING

The Securities and Exchange Board of India (SEBI) is the regulatory organization in India that guarantees effective corporate governance. This organization keeps a watch for any irregular transactions involving the purchase or sale of listed securities.

In 1992, the TISCO (Tata Iron and Steel Company, now Tata Steel) Case paved the path for the establishment of the Securities and Exchange Board of India. The company's earnings had dropped drastically, and it was observed that shares were sold in tiny numbers before the announcement of the half-year results. However, regulations regarding insider trading were not properly developed at that time, and the Court ruled that there was no insider trading due to a lack of evidence.

This eventually resulted in the Securities Exchange Board of India (Insider Trading) Regulations, 1992. By powers vested on it through Section 30 of the Securities and Exchange Board of India Act, 1992, SEBI came up with these regulations.

The provision states that no insider shall -

- Deal in securities of any listed company on any stock exchange either on their behalf or any other person while in possession of unpublished price sensitive information.
- Share unpublished price sensitive information with any person.

The above provisions are not applicable to ordinary business communication.

After the 1992 Regulation, a major adjustment was made to Insider Trading regulations in 2015. As a result, the "SEBI (Prohibition of Insider Trading) Rule, 2015" was created to address inadequacies in the previous policy, as illegal transactions were not covered by the narrow scope of the regulation.

REGULATIONS IN INDIA REGARDING INSIDER TRADING

Another substantial adjustment was introduced in the year 2019, with attempts made to include direct and indirect transactions. Insider trading was also outlawed under the Companies Act of 2013. Section 195 of the Act restricted key management personnel from communicating sensitive information.

Later, this section was omitted because section 458 of the Companies Act delegated the power to SEBI to conduct trials against the accused persons, creating confusion about whether the accused should be held under the Companies Act or the SEBI regulations, and thus the section 195 was omitted by a notification in 2017.

As a result, the current rules in India for Insider Trading are the SEBI (Prohibition of Insider Trading) Regulations, 2015, as well as Sections 12A (Prohibition of Insider Trading) and 15G (Penalty for Insider Trading) of the SEBI Act. The SEBI (Prohibition of Insider Trading) Regulations, 2015 were enacted by SEBI to provide the guidelines for the prohibition and limitation of insider trading in India.

The Regulations provide that an insider is not permitted to communicate or distribute any confidential information. The information shared or distributed must be lawfully communicated or circulated. Any violation of any provision of the SEBI Regulations is an offence under the SEBI(Prohibition of Insider Trading) Regulations and is punishable by imprisonment for up to ten years or a fine of up to twenty-five crores, whichever is higher.

Besides the violation committed under Section 24 of the Act, the adjudicating officer may impose a penalty under the SEBI Rules on any person who violates the requirements of the regulations..

REGULATIONS IN INDIA REGARDING INSIDER TRADING

The powers of Investigation may be exercised by SEBI for two main reasons:

- to investigate complaints received from investors, intermediaries, or any other individual concerning any subject related to claims of insider trading.
- to investigate the case based on its own knowledge or information in its control in order to protect the interests of investors in securities against violations of these rules.

There are some loopholes in the regulation of the practice of Insider Trading, as it has been quite a task for SEBI.

- The lack of a current, modern, and technologically sophisticated monitoring and surveillance system, without which it is difficult to apprehend the criminal, has been an issue in Indian insider trading trials. SEBI lacks technical knowledge in this area, and this disadvantage significantly reduces the efficiency of the investigation.
- Proving cases of insider trading is difficult since the allegations are nearly exclusively dependent on circumstantial evidence. In most situations, phone records and transcripts are the only evidence available to establish a link between people engaged in such criminal activities. SEBI does not have the authority to tap phones. Only in suspicious circumstances may it seek call data records. Only a few economic organisations in India, like the Central Board of Direct Taxes, have the authority to wiretap phones.

REGULATIONS IN INDIA REGARDING INSIDER TRADING

"According to SEBI's Annual Report for 2016-2017, insider trading cases accounted for 14 percent of all investigations conducted by SEBI (34 in all) in 2016-2017, up from 12 instances in 2015-2016. Insider trading is becoming a more serious offence with each passing year, as is the call for stronger rules.

The number of cases still pending is also a serious problem, with just 15 of the 34 investigated cases resolved. The charges of insider trading are based on circumstantial evidence, and the lack of specific proof makes it difficult to identify and establish the crime.

Despite the fact that the regulatory system is relatively strong, the number of successful cases is quite low. This is because SEBI lacks the necessary technological skills to conduct efficient investigations. One cause for SEBI's failure is a severe lack of resources and staff.

Moreover, Indian law does not apply in circumstances when an insider trading offence is committed by a foreign citizen. In such instances, there is no provision for a penalty or an investigation. The Acts do not address the international legal application of rules.

LEGAL CASES OF INSIDER TRADING

Rakesh Agarwal vs. SEBI (1996)

In 1996, the Managing Director of ABS Industries Ltd., Rakesh Agarwal, had been involved in negotiations with a German company, Bayer A.G, to acquire 51% of the shares of ABS Industries Ltd. He had access to unpublished price sensitive information regarding the takeover intentions of Bayer. Before the acquisition was publicly announced, Rakesh Agarwal bought a significant portion of his ABS Industries shares from the market and sold it to Bayer, through his brother-in-law Mr. I.P. Kedia.

SEBI considered Mr. I.P. Kedia to be a well-connected individual, and held that Mr. Agarwal was guilty of insider trading. He was directed to deposit ₹34 Lakhs in the Investor Protection Funds of both the Stock Exchanges, BSE and NSE (₹17 lakhs each) to compensate any affected investors.

Mr. Agarwal argued that his actions were in the interest of the company. For the deal to go through, Bayer needed 51% of the shareholding of the company. Therefore, he arranged for the shares through his brother-in-law.

When the case was appealed to the Securities Appellate Tribunal (SAT), it was concluded that Rakesh Agarwal was not guilty as his actions were in the interest of the company and he did not intend to make a profit.

LEGAL CASES OF INSIDER TRADING

Hindustan Lever Ltd vs. SEBI

Hindustan Lever Ltd. (HLL) purchased 8 lakh shares of Brooke Bond Lipton India Limited (BBLIL) on March 25, 1996. The issue was that this was done barely two weeks before it was publicly announced that HLL and BBLIL would be merging. Suspecting insider trading, SEBI issued a show cause notice to the Board of Directors and Company Secretary of HLL.

HLL and BBLIL were both subsidiaries of London-based Unilever, and were being operated under the same management. SEBI classified HLL and its directors as insiders since they had prior knowledge of the merger and held that they possessed unpublished price sensitive information related to the merger.

HLL appealed SEBI's decision before the Securities Appellate Tribunal (SAT). The SAT concurred with the SEBI on the fact that HLL was an insider in the case and that it had access to price sensitive information. However, it concluded that since the news of the merger was widely published in various news articles, it could not be classified as “unpublished”.

LEGAL CASES OF INSIDER TRADING

Kishore Biyani vs SEBI

Future Retail announced in April 2017 that it will be consolidating its home retail business (HomeTown offline stores) and its e-commerce home retail business (Fabfurnish.com) into a single entity. This was done in order to enable better business synergies and bring greater visibility to both the businesses.

A SEBI investigation into the matter found out that Kishore Biyani, Founder and CEO of the Future Group, had been buying shares of the Future Retail Group (FRL) from March 2017 onwards, while news of the consolidation was publicly announced only on 20th April 2017.

It was revealed that orders for purchase of FRL securities during this period were placed through written instructions of Anil Biyani, brother of Kishore Biyani. The FRL shares were purchased through funds transferred from Future Corporate Resources Limited (controlled by the Biyani Family), under the authorisation of Kishore and Anil Biyani.

In February 2021, SEBI barred Kishore and Anil Biyani and several other individuals involved in the matter from the capital markets for a period of one year. Since the purchase of shares was an illegal trade, the capital markets regulator sought a clawback from Future Corporate Resources Limited of benefits worth ₹17.78 crore, along with interest at the rate of 12% per annum from 20 April 2017. Additionally, Ashok Biyani was banned from transacting in shares of FRL for a period of two years.

CONCLUSION

The impact, degree, and repercussions of insider trading varies by nation, but any quantity of insider trading has a significant influence on the country's image. Every shareholder puts their money in the market with the expectation of market transparency and efficiency.

Through this study, we have been greatly exposed to the problem of Insider Trading in India. In order to solve this problem, we would suggest the following -

- **Raising Awareness** - SEBI can spread awareness about insider trading and its harmful effects among the uninformed and the general public. This will help in reducing instances of Insider Trading. This can be achieved by distributing pamphlets and newsletters through newspapers and stock exchanges.
- **Corporate Governance** - SEBI needs to work with companies at the grassroot level to set company standards regarding insider trading. Management and directors need to be informed about what constitutes insider trading. Companies should set internal standards for insider trading so that none of the employees, directors, and shareholders engage in it
- **Bounties** - SEBI should encourage people to tip them in case they notice insider trading activities. A similar practice is followed by the Securities Exchange Commission (SEC) in the USA.
- **Publicity** - Successful Insider Trading prosecutions should be hyped up by the media so that people are deterred from engaging in it.
- **Anticipatory Action** - The current approach of prosecuting Insider Trading focusses on punishing Insider Trading only after it has occurred. Alternatively, a preventive approach can be used where a surveillance system will monitor share price movements and alert SEBI in case of any abnormalities. Additionally, stock price movements should be monitored before and after public announcements and corporate actions.

BIBLIOGRAPHY

- Insider Trading in India [Online]. Available at: <https://www.legalserviceindia.com/article/l199-Insider-Trading.html> (Accessed: 10 February 2022)
- Das, Somakshi & Sahu, Sanjana (2015) The Know-All of Insider Trading – Decades of Corruptive Prevention [Online]. Available at: <https://www.lawctopus.com/academike/know-insider-trading-decades-corruptive-prevention/> (Accessed: 10 February 2022)
- Saxena, Jayant (2021) Five Landmark Cases of Insider Trading [Online]. Available at: <https://blog.ipleaders.in/five-landmark-cases-insider-trading/> (Accessed: 10 February 2022)
- SEBI (Prohibition of Insider Trading) Regulations 1992 [Online]. Available at: <https://taxguru.in/sebi/securities-exchange-board-india-1-prohibition-insider-trading-regulations-1992.html> (Accessed: 10 February 2022)
- Insider Trading in India : Regulations and Controlling Authority [Online]. Available at: <https://blog.ipleaders.in/insider-trading-in-india-regulations-and-controlling-authority/#:~:text=Insider%20trading%20in%20India%20is,of%20Insider%20Trading%20in%20India.> (Accessed: 10 February 2022)
- Sachar, Roopanshi & Dr. Wani, M. Afzal, Regulation of Insider Trading in India : Dissecting the Difficulties and Solutions Ahead [Online]. Available at: <https://jcil.lsyndicate.com/wp-content/uploads/2017/01/Roopanshi-Dr.-Afzal.pdf> (Accessed: 10 February 2022)

THANK
YOU