

INSIDER TRADING, REGULATORY ADVANCEMENT AND REGULATOR ACTIVISM IN INDIA

NEGOCIAÇÃO PRIVILEGIADA, AVANÇO REGULATÓRIO E ATIVISMO REGULATÓRIO NA ÍNDIA

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Abstract: In the era of globalization and the world economy, corporations and governments are focusing more on the concept of sustainability and far-going security to the stakeholders and investors. Insider trading is a deep-rooted evil opportunity in the stock market. The transfer of unpublished price-sensitive information to an outsider or the use of it for unfair gains by the insider is a governance issue per se. The current Indian regulation i.e. SEBI (Insider Trading) Regulation 2015 has traveled a long journey to curb the root cause but still must move on the international parameters. It has a major objective to prevent the unauthorized use of price-sensitive information. The review paper will critically analyze the historical development in the Indian Capital market with reference to the incidents of insider trading and preventive steps by the Indian market regulations and regulator activism. It will also review the regulatory advancement of the insider trading norms after the Harshad Mehta scandal in the year 1992 to the happening of ICICI-Videocon loan scam and thereafter. The objective of the review paper is a structural analysis of the historical development in the regulatory framework of insider trading in India. Also, to demonstrate the legal transformation of Indian Stock Exchanges in response to insider trading issues.

Keywords: SEBI. Price Sensitive Information. Insider trading. NSE. BSE.

Resumo: Na era da globalização e da economia mundial, as empresas e os governos estão a concentrar-se mais no conceito de sustentabilidade e segurança abrangente para as partes interessadas e investidores. O uso de informações privilegiadas é uma oportunidade maligna profundamente enraizada no mercado de ações. A transferência de informações não publicadas sensíveis ao preço para alguém de fora ou a sua utilização para ganhos injustos por parte de quem está dentro é uma questão de governação em si. A atual regulamentação indiana, ou seja, o Regulamento SEBI (Insider Trading) de 2015, percorreu um longo caminho para conter a causa raiz, mas ainda deve avançar nos parâmetros internacionais. Tem como objetivo principal impedir a utilização não autorizada de informações sensíveis em matéria de preços. O artigo de revisão analisará criticamente o desenvolvimento histórico no mercado de capitais indiano com referência aos incidentes de abuso de informação privilegiada e às medidas preventivas tomadas pelas regulamentações do mercado indiano e pelo ativismo regulador. Ele também revisará o avanço regulatório das normas de uso de informações privilegiadas após o escândalo Harshad Mehta no ano de 1992 até o acontecimento do golpe de empréstimo ICICI-Videocon e depois disso. O objetivo do artigo de revisão é

uma análise estrutural do desenvolvimento histórico no quadro regulamentar do abuso de informação privilegiada na Índia. Além disso, para demonstrar a transformação legal das bolsas de valores indianas em resposta a questões de abuso de informação privilegiada.

Palavras-chave: SEBI. Informações Sensíveis a Preços. Negociação de Informações Privilegiadas. NSE. BSE.

1. Introduction

In the meta world, the boundaries of all nations have been changed with the change of the technological gaps and globalization. Economic development and divergence have brought disparity in economic activities. The popular attributes involving the attraction of the investor to the company lie in the governance practices of the company. Good governance lies in the harmonious relationship between the management and the investors, which is built on policy-related transparency and fair disclosures. The board room talks are confidential for the protection of the money of genuine stakeholders. Now, economic enablers are working across borders in the territory. It gives rise to the regulatory mix of different jurisdictions, which creates confusion among traders. The concept of insider trading lies in the principle of on the foundation of the important belief of impartiality and objectivity. The fair internal policies and governance is the key attraction of any investor.

2. Insider Trading and Indian Jurisprudence

The declared connotation of “insider trading” for the common people is revised and easiest to understand after the Indian regulatory clarifications. It means the passing of price-sensitive information from nonpublic sources to stock-traders or others having an interest in the share prices for financial gains. It may occur due to the fraudulent behavior of the informant and prominent position in the corporation. The passing of price sensitive information by the informant holding position in the management for the gains or manipulation of price is insider trading. The explanation of price-sensitive information includes financial outcomes of the companies, information related to the dividend announcements, companies planning of buyback of shares, internal policy matters, acquisition plans of the company, etc. The meaning of “insider trading” illustrated as per the Black’s Law thesaurus as “The use of material nonpublic information in trading the shares of the company by a corporate insider or any other person who owes a fiduciary duty to the company”.

The periphery of insider trading not only includes which are the part of the company but also includes bodies having information of the insider corporate activities and makes profit out of it by taking market positions out of the information. The passing of the information and reaction of the price due to insider is the matter of examination. The use of insider information must be in the violation of the fiduciary relationship with company. The measure of the gain means the purchases and not selling of the stocks to circumvent the loss in the insider trading strategy.

The jurisprudential journey of market wisdom started from the report of the Thomas committee constituted in the year 1948. Indian government has started working on the recommendation of the committee and the market reforms. The result was reflected in the incorporation of a few sections dealing with insider trading. i.e. 307 and 308 of the Indian Companies Act 1956. The very first time in the history of the Indian corporate reforms, insider trading was recognized in the year 1970. To establish and answer the problem of insider trading, various committees were formed, which finally resulted in the enactment of the SEBI Act, 1992. The paper has also highlighted a few important glimpses of different committees as follows:

The Sachar committee was constituted (1979) to take a view and recommendation on the role of “Insider” under Companies Act, 1956 as well as MRTP Act, 1969. It has recommended the limitation of insider in terms of trade and disclosures. The committee has put restrictions on the sale and purchase of shares by the insiders up to the end of the accounting year. It will apply for two months and also covers the right issue holders. The company has to maintain the records of sale and purchase by the insider. It has provision for the compensation in case of any wrong. The committee was headed by Justice Rajinder Sachar and high-profile dignitaries. In the year 1984 next prominent committee was formed for the betterment of the Indian Stock exchanges and its functioning. The committee has identified insider trading as a major problem in the growth of the stock market and recommended to form legislation for the same. The Abid Hussain Committee was constituted in the year 1989 and headed by Mr. Abid Hussain, former chairman of planning commission of India. Committee has made significant recommendation to SEBI to make appropriate code of practice to curtail the malpractice of insider trading. It is the body recommended the insider trading as an offence.

3. Indian Regulatory Setup-SEBI

It was observed that the Indian Government reforms package of 1991 has invoked money in the market and generated the shadow of malpractices in the stock market. Due to the infusion

of money in the market, substantial volumes has been witnessed in both the segments of the markets. The capital market of India has witnessed the issues of insider trading faced by the both the sides of the trade participants. The fraudulent trade structure of the Enron case has highlighted globally the requirement of regulatory setup to address the malpractice of insider trading. It is interesting to consider that the few are only proven in the global markets. Indian stock market has two major stock exchanges, i.e., the National Stock Exchange and the Bombay Stock Exchange. It has ranking of seventh in the world stock market capitalization. To control the bazaar and its trading activities, SEBI was formed under SEBI Act, 1992 for the smooth functioning of the market activity. Later, with the consultation with the SEBI, insider trading laws were constituted. The regulatory body has its powers to shield the monetary concern of the stakeholders in the market through the ordinance issued on 30th January 1992. It has a very wide range of powers to regulate and monitor the insider trading and market governance. The actual birth of the well-known regulatory i.e. SEBI was on 12th April, 1988 but with very less powers and jurisdiction. Later, it substituted the Controller of Capital Issues Department of the Government. In the year 1992, SEBI has emerged as a major regulator equipped with extended power and jurisdiction.

The SEBI has given a wide range of powers to investigate and take appropriate measures against the market participants like stockbrokers, depositories, credit rating agencies and international investors. The powers of the SEBI have been increased by the 1995 amendment under the Securities Laws Act 1995. It has also power to regulate and monitor the registration of all the market participants and adopted compliance procedure by the market participants. The transfer of securities from one to another and the whole process via depositories is under the surveillance of the regulatory body. The regulating body has authority to file case against the wrongdoer without the permission of the Central government. SEBI acts as a quasi-judicial body to adjudicate matters and impose penalties after due investigation. To prevent the malpractices in the market by the stakeholders like insider trading, unsolicited stock advices etc. are regulated by the SEBI Act and depositories Act. They issue guidelines and regulations which must be complied by the market stakeholders. Various departments also help and govern the Indian stock market operations, like the Department of Company Affairs, the Department of Economics Affairs, and the Reserve Bank of India.

In the initial stage of the development of the regulatory authority and environment of the Indian stock market, insider trading was not fully scrutinized and penalized for the wrong doing. But after many years, now it has been witnessed that SEBI has widened the definition of the term "Insider". Initially, in the case of insider trading cases, no major penalty was awarded to the culprits.

In the reformatory process of insider trading, the nature of insider trading is compounding in nature. It means the wrongdoer has to pay penalty and fees to avoid the criminal proceedings.

4. Shadow of Financial Scams in India

The reasonable infusion of money in the economy after liberalization and economic packages has given the stock market leverage to raise the volume of trade and investors' profit. In the meantime, it also gives space to insider traders and manipulators to make profits due to a lack of nurtured regulatory infrastructure. The stock market has faced major blows of serious scams in the last two decades and huge wealth loss of genuine investors and traders. The famous stock market scams include a few unforgettable names like Harshad Mehta, Ketan Parekh, Telgi, Satyam, Sahara India, etc. The dark story of Indian scams started in the year 1992 with the famous Harshad Mehta scam. Harshad Mehta Scam is the biggest lesson for a stock brokers and market regulators. He triggered the price of shares by manipulative activities up to 9000/- from 200/- with the misappropriation of the funds provided by the banks and received by fraudulent activity.

Due to the sudden rise in the price of the shares, general investors bought the shares and were stuck in the crash which resulted in big losses. After the scam, the regulator strengthened the disclosure norms by the companies and introduced the listing norms for all listed companies. The disclosure included the material facts and other crucial accounts and risk-related information to the regulator in the filing process. National Stock Exchange (NSE) has completely changed the process of trading with the adoption of screen-based electronic trading on the national level. Later, Bombay Stock Exchange (BSE) also adopted online trading for the protection of investors and to answer governance issues. In a major reform, the "Badla" system has been replaced by the market. Majorly, Harshad Mehta's scam reforms were focused on the advance disclosure by the companies before collecting money for any purposes. The positive side of the scam is that it gives more advancement to the regulatory reforms.

Likewise, in the Ketan scam, K-10 companies' prices were rigged to the highest in the market and then the price crash occurred. He was cited for the price rigging of the stocks and circular trading in the Indian stock market. After the scam, SEBI changed the margin norms for stock trading to regulate the volatility in the stock prices, and a rolling settlement was made essential for all the market participants.

5. Indian Regulatory Journey from 1992 to AI adoptions

The Indian regulatory history and development of insider trading are connected with USA insider trading norms. The Securities Exchange Act, 1934 USA attracted the Thomas committee (1948) constituted in India for the market reforms, and as result sections were integrated into the Companies Act, of 1956. Section 307 and 308 were inserted in the Companies Act to address insider trading, which requires the full disclosure of their holdings by the key officials i.e., directors and managers of the company. After the formation of the Sachar Committee for the reforms in the Companies Act, of 1956, 'insider trading' was also the agenda of the committee. The committee has restricted insider activity in its recommendation report. It prohibits the dealing of insiders, including the employees of the company. The Patel committee has recommended that the Securities Contract (Regulation) Act, 1956 should be amended for curbing the problem of insider trading and unfair trade practices. The formation of the SEBI was also based on the Abid Hussain Committee (1989) recommended the creation of the SEBI (insider trading) regulation, in 1992. This regulation has been amended with the change in time. Later, the nomenclature of the act has been changed to SEBI (Prohibition of Insider Trading) Regulations 1992 Act. In the year 2002, sections were added to prohibit manipulative and deceptive devices. A few judicial judgments also marked the problem of Insider trading in India i.e. Hindustan Lever Ltd. v. SEBI and Rakesh Agarwal v. SEBI. The list of Indian insider trading governing laws and amendments is as:

- Securities & Exchange Board of India Act, 1992
- SEBI (Insider Trading) Regulations, 1992
- SEBI (Prohibition of Insider Trading) (Amendment) Regulations, 2002
- SEBI (Prohibition of Insider Trading) (Amendment) Regulations, 2003
- SEBI (Prohibition of Insider Trading) (Amendment) Regulations, 2008
- SEBI (Prohibition of Insider Trading) (Amendment) Regulations, 2011
- SEBI (Prohibition of Insider Trading) Regulations, 2015
- SEBI (Prohibition of Insider Trading) (Amendments) Regulations, 2018.
- SEBI (Substantial Acquisition of Shares & Takeover) Regulations, 1994.
- SEBI (Prohibition of Fraudulent & Unfair Trade Practice relating to securities market) Regulations, 1995.
- Reserve Bank of India Act, 1934

In the year 2001, a joint committee on the Indian stock scam was established under the leadership and chairmanship of Shi. Prakash Mani Tripathi, along with a total of thirty members from the Indian Parliament. The committee has suggested legislative reforms for

strengthening the solution of manipulative trading. In line with reforms and the Satyam scam, Clause-49 of listing agreements was issued by the SEBI in the year 2005. These were majorly interrelated to the corporate governance of the company.

6. Discussion and Conclusion

The intent of insider trading is dependent on the behavior of the trader with respect to the fiduciary relationship between him and the target company. The conclusion is clear from the term itself that if it violates the relationship, then it will become illegal trade. Indian Companies Act, 2013 and SEBI have defined the term “insider” in a very detailed way with the preventive measures of the trading evil.

The paper has observed the promptness of the Indian regulatory body (SEBI) to answer every newly adopted trading system-based loophole mechanism of the scams. From the Harshad Mehta to the Videocon scam, the regulator has widely strengthened the Indian regulatory environment against the market malpractices. The insider trading regulation was first adopted in 1992, and with amendments in 2015, the regulation came into force. The activism of the Indian market regulator has shown the vibrant approach for investor protection and good governance by radical changes in the market practices.

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Legal Acts

Section 2(n) of SEBI (Insider Trading) Regulation, 2015

Securities and Exchange Board of India Act, 1992

Section 2 (H) of SEBI (Prohibition of Insider Trading) Regulations, 2015