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Insider Trading and India

SHIVANI SOLANKI[1]

Insider Trading is essentially the trading of stocks and securities of a public company by an employee of such company or a member of such organization having access to private information about the company. Such private information could prove to be so vital potentially because it has an impact on the investment decisions of the company. Insider Trading is an act of reaping increased profits because of access to a certain piece of information that is not in the public domain and therefore not known to other investors by virtue of work affiliation of such person trading company's securities in the stock market.Insider trading creates an unlevel playing field where those key executives having access to strategic information about the company and acting on such information would win the battle of the stock exchange at the expense of the general public and other investors. Commonly discouraged throughout the world, the practice of Insider Trading is prohibited by SEBI (Security Exchange Board of India) to promote the benefit of the general investor, creation of a level playing field, and promoting fair trading practices in the stock exchange market.

I. INTRODUCTION

The term 'insider trading' denotes buying or purchasing of shares of a specific company based on some confidential information that has not been made to the general public yet. Unpublished price-sensitive information is the title given to such information. Such activities are a breach of the fiduciary duty that an officer of any company has towards its investors. Insider trading occurs when some information that is not meant to be given to the general public is used by someone to earn profit or loss via buying or selling the shakes/stocks of the company. This practice of Insider Trading has been happening for a long time now. Their perpetrators have evolved with time and so have the laws prohibiting insider trading have. But in the modern time when the whole world is investing in shares and stocks, the risk of people getting affected by Insider trading has increased multifold. It is not like the 1990s when only a few of the wealthy families in India were involved in the stock market. The digitalization of the stock market has given everyone a chance to trade and this has increased the risk factor in the market. It has become relatively easier to use any technical loophole to

[1] Author is a student at Symbiosis Law School, Pune, India

change the complete structure of the market. Companies leading markets could suffer numerous losses or a new company may become the market leader with the help of insider trading. The whole concept of insider trading is quite difficult to understand. And it is more difficult to be removed completely. It so because, the main motive behind the concept of insider trading is greed and this is quite intrinsic to human nature.

II. HISTORICAL BACKGROUND OF INSIDER TRADING IN INDIA

India faced insider trading for the first time in the early 1940s. This led to the formation of the Thomas Committee[2]. This was formed in 1948 under P.J. Thomas's chairmanship. In the report published by the committee instances of insider trading were cited. These examples varied from directors, agents, officers, auditors, or any other person who had access to strategic information relating to economic conditions used it to gain further benefits from such news. The next such report was published in 1952. This time it was the Bhabha committee. This committee tried to give solutions to avoid instances that were cited in the Thomas report. They asked the government to put obligations on the directors to disclose sales or purchases of shares made by them in a different register. This was said with the aim to keep an eye on the transactions done by the directors of the firm. Some of the recommendations of the committee were included in the company law,1956 in the form of sections 307 and 308. The next committee which was formed to deal with this topic was the Sacher Committee. This committee was formed in 1978. This committee also pointed out the need for stringent laws for gaining information regarding the transactions where one party (which gained the information) used the undue advantage of the transaction due to possession of price-sensitive information. Eight years later in 1986, a new committee was formed. This committee was headed by G.S. Patel. Patel committee gave a new definition of insider trading. It also gave recommendations for amending the Securities contract (Regulation) Act (SCRA),1956.

The last committee which was formed in India, which dealt with the topic of insider trading is Abid Hussain Committee. This was formed in the year 1989. This committee recommended covering the offense of insider trading under civil and criminal laws. Committee also recommended SEBI apply stricter rules.

The establishment of SEBI in 1988 led to the formulation of SEBI (Insider Trading) Regulations, 1992 in an attempt to regulate the market in which 1970s and 1980s were a

[2] Thomas, P.J. (1948). Report on the Regulation of the Stock Exchanges in India. Securities and Exchange Board of India.

period where such malicious practices increased exponentially and cover the loopholes which were being taken advantage of.

III. LAWS AGAINST INSIDER TRADING

Checks on insider trading are majorly done by SEBI. By way of certain legislations, it keeps an eye on the market to stop and prosecute incidents of insider trading.

Major amendments were made in SEBI regulations in February 2002. It mandated the policy on disclosures and internal procedures of the company. This was done to reduce the chances of insider trading. Now, it was compulsory for every person who had more than 5% of the shares or voting rights in any company to disclose their holdings. It also made continual disclosures a compulsory activity for directors /officers. This was to be done only in the case when there had been any change in their holdings exceeding INR 5 lakh in value or 5,000 shares or 2 percent of the total shareholding or voting rights, whichever is lesser[3].

Subsequent amendments were done in 2003 and 2007. SEBI had introduced a new section 11A. This section deals with the manner of the service of summons and notices in the case of insider trading. In December of 2013, a new committee was formed by the government. The chairman of this committee was N.K. Sodhi. The recommendations of this committee laid the cornerstone for the development of the SEBI regulation 2015/

In 2015 came a major amendment, where SEBI introduced SEBI (Prohibition of Insider Trading) Regulations, 2015 which repealed the SEBI (Insider Trading) Regulations, 1992. SEBI constituted a committee that was led by T.K. Viswanathan. He had worked as Ex-Secretary General, Lok Sabha, and Ex- Law Secretary. This committee was formed in 2017. The main objective for making this committee was to ensure that the conduct of the market in the securities market was fair. This was done by reviewing the present legal framework and by avoiding abuse of power within the marker. The committee consisted of law firms, brokers, mutual funds, chamber of commerce and stock exchanges, etc. The committee made certain recommendations to improve the existing legal fra\mework governing the securities market in an attempt to regulate the market in a better manner.

Regulation- 3(1) of SEBI (Prohibition of Insider Trading) Regulations, 2015 provides that any unpublished price-sensitive information should not be handed over to any person. The term “any person” also includes other insiders of the company.

Regulation- 3(2) of SEBI (Prohibition of Insider Trading) Regulations, 2015 prohibits any

[3] Anil Kumar Manchikatla and Rajesh H. Acharya , “Insider trading in India- regulatory enforcement”

person whether insider or outsider to procure any unpublished price-sensitive information about the company. An exception of 'legitimate expectation' has been provided under this sub-regulation.

Regulation- 4 of SEBI (Prohibition of Insider Trading) Regulations, 2015 lays down prohibitions on trading in the stock market by any person who has access to unpublished price-sensitive information. Such information should have been from a listed company only. Otherwise, the prohibition does not work. There are however certain exceptions to the prohibition provided under this regulation like:

off-market inter-se transactions which is a transaction entered into by 2 persons both of whom are insiders of a company and remain in possession of the particular unpublished price sensitive information and take a conscious decision to trade, since both the persons possess the material facts, hence no single party can obtain unlawful advantage or gain out of the other party.

Section-15(G) of SEBI Act, 1992 Amended by Securities Laws (Amendment) Act, 2014 provides a penalty for committing the offense of Insider Trading by an 'insider'.

The offender is liable to a penalty of not less than Rs. 10 Lakhs extendable up to Rs. 25 Crores or 3 times the profit made out of insider trading, whichever is higher.

The Company Act 2013 also deals with insider trading. Section 195 of the said act prohibits any communication of sensitive information by key managerial positions. But this section was later removed and section 458 now came into use. This section gave delegated powers to SEBI to conduct trials against the person who has been accused of insider trading.

The punishment for doing insider trading has been given in the SEBI regulations, 1992:

1. Impose a penalty of either Rs. 25 crores or three times the profit (whichever is higher) that the person has earned.
2. They can initiate criminal prosecution

IV. MAJOR CASES

One of the most important cases in the Indian scenario regarding insider trading. This was the case of Hindustan Lever Limited (HIL) Vs SEBI[4]. Hindustan Lever Ltd (HLL) and Brook Bond Lipton India Ltd. (BBIL) controlled by Unilever, Inc. UK were both under the same management.

[4] Hindustan Lever limited (HIL) Vs SEBI, (1998) 18 SCL 311 MOF

HLL purchased 0.8 million shares of BBIL from UTI in 1996 and the shares were bought 2 weeks before the public announcement of a merger of HLL and BBIL.

As a result of the merger, the prices of shares of BBIL shot up and UTI suffered losses in the process. SEBI held HLL liable for Insider Trading as it misused UPSI (unpublished price sensitive information) to gain profits whilst having complete knowledge of the impending merger.

The Securities Appellate Tribunal reversed the given order. This was done so because the information which was in question was not considered to be price-sensitive information. It was so because the news had already published this and hence it was within the ambit of public knowledge.

The Securities Appellate Tribunal reversed the order on the ground that the information was not priced sensitive as it was published in the media and therefore treated as within the ambit of public knowledge.

Accordingly, SEBI amended the provisions to exclude the publication of media reports which may be speculative in nature as a part of public knowledge of price-sensitive information.

Another important case is Reliance Industries Limited (RIL) V. SEBI[5]. In the present case, RIL had in possession over 5 percent of in the L & T company. There were only two nominees created by RIL. RIL kept on buying the shares and took over a total of 10%of the L&T company. These shares were then sold by RIL above market price to Grasim industries. SEBI launched an investigation in the alleged case and a case was filed against RIL. SEBI after investigation held that the company was guilty. But the judgment got reserved in the appellate tribunal.

SEBI has been doing investigations in complaints regarding insider trading. The first case that SEBI took over for such investigation was in 1991. Froom 1996 to 2014, a total of 200+ investigations had been done.[6]

V. CONCLUSION

There have been many debates regarding the pros or cons of this practice of insider trading in the stock market. Developed countries have surely been more active in prosecuting offenders as compared to developing nations. One of the main objectives of bringing SEBI was to give India the counterpart of the USA's SEC. It would not be wrong to say that SEBI has not been

[5] Reliance Industries limited (RIL) Vs SEBI, 2004 55 SCL 81 SAT
[6] Supra Note 3

as successful as its American counterpart had been. But SEBI has shown that the government is not taking the topic of insider trading a lot. It is only for the benefit of the government to keep a check on insider trading. Removal of insider trading from the market ensures that the number of Indians working in the stock market does not reduce. The government's SEBI is one of the most evolving bodies. They keep themselves updated with all the new ways of insider trading that are happening all over the nation. But sadly, our laws are not as strong as we needed to be. And hence, we need new and stronger laws to protect the interest of the investors. SEBI should also improve the speed by which it gets conviction in a particular case. For that, fast track courts should be made for the same.

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