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Understanding & Conceptualizing Insider Trading Laws of India & US

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Abstract

Insider trading revolves around acts of trading securities, including stocks, bonds, and stock options on the basis of the information that is not available for the public yet. Examples of insider trading include purchasing a large amount of shares in the same company by a senior executive after getting the news of stock price up before the information goes public. Primarily, it is a malpractice and criminal offense as this act is considered as unfair to the investors without having the inside information of a company. However, it is quite different from any general investment fraud as it does not make any individual investors its prey. It is all about exploiting the available information to gain unfair advantages in the case of investments. Hence, regulations and federal statutes are active in countries to prosecute and investigate such offenses regarding securities fraud. In this case, the research paper dwells on the insider trading laws and regulations in India and the US in a comparative tone.

Keywords— Insider trading, India, SEBI, Companies Act, Market, Securities, Securities Exchange Commission, US, Securities Exchange Act

I. INTRODUCTION

Companies Act 2013 defines insider trading as a procedure of purchasing, selling, subscribing or dealing any inside bond and security of a company that holds any information sensitive to non-public price by the director of the company or any person of managerial rank, or other officers. Price sensitive information is a secret and top prioritized element of a company as its exposure to the public can cause the drastic downfall of value of company securities. It is prohibited by law that such personnel holding company's hierarchy should not publish any such documents and evidence of company security to external ground for personal gain as it may be hazardous for company business. ***Companies Act 2013***, under Section 195 also restricts insider trading within a firm to prevent the principle of good governance.

Notably, **Securities and Exchange Board of India** introduced the Prohibition of Insider Trading Regulation, 2015 that extends the chances of insider trading. Regulation 2 (d) (i) state that any officer staying in the company for minimum 6 months has the access to secret price sensitive information directly or indirectly can monitor an insider trading within a company. Actually Regulation 2(g) (i) recognizes every linked person as insiders of a company. This review focuses on the research paper devoted to discussing insider trading and its side effects, SEBI laws and controversies.

II. BROAD DISCUSSION OF VARIOUS PARTS

Insider trading is a crime that has no victim[1]. It can be assumed that the seller might be victimized by selling company stock to a person associated with the same company but it is crucial to note that stocks are meant to sell, no matter who the buyer is[2]. So an insider

[1]Goergen, M., Renneboog, L. and Zhao, Y., 2019.Insider trading and networked directors.Journal of Corporate Finance, 56, pp.152-175.
[2]Widyastuti, M., 2019. Analysis of liquidity, activity, leverage, financial performance and company value in food and beverage companies listed on the Indonesia

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purchasing the stock from the seller has no effect on the proceeds received by the insider. It can be said that insider trading is never hazardous for any individuals or group as the seller gains a better profit by selling stocks to an insider. Nevertheless, insider trading is considered a means of interaction within the company that helps to predict the market reaction as transactions of large quantities of stock can encourage a chain reaction and helps the investors and stakeholders to determine the price of commodities[3].

However, it is at the hands of staff of a company whether they would misuse this technique by revealing the company's inside data[4]. A trader having the purchasing power of a company's share can hike the share prices by buying multiple shares of that company. Market can be influenced assuming that the trader holds some crucial information about the financial state of the associated company. Experts opine that shareholders of a company can be benefited by insider trading instead of losing if the information regarding a company's inside is in the favor of the company, the prices of shares increase[5]. If prohibitions and restrictions are imposed on insider trading, the insider will keep a low profile about their transaction to prevent other external traders from gaining higher benefit from the same.

Moreover, the prior arguments assume that the information will be wholly public because a trader aware of the inside information regarding the company can fast trade his stock before the publication of quarterly and yearly results to avoid drastic fall of share prices and can prevent his loss. It can cause aftereffect as the other traders will have the propensity to sell shares at high discount rate that leads to incur heavy loss. So it is proved that the first person receiving insider information always gets a head start over the others in terms of gaining profit. The sellers trading with an insider may demand a risk covering safeguard for them for the stake they are on otherwise they will not invest. Same traders will not invest in the capital market as the risk is high and investors' are not much confident as insider trading is prominent[6].

Insider business shortens the scope of market liquidity, value of capital increases and ownerships get concentrated. This opinion is strengthened by the support of empirical evidence that shows country markets are less liquid and equity cost is higher where insider trading laws are not in force compared to those markets having insider trading laws enacted. Performing insider trading enables the managers to gain from price fluctuation by making short term decisions. These decisions may come with conflict of interest with the company as insiders can gain significantly no matter if the stock value increases or decreases. The decision taken not in favor of the company can make the shareholders incur loss.

Section 11 of SEBI act 1992, entrusts SEBI with the responsibility to safeguard the investors' interest in securities by suitable regulation of the market[7]. If it is found that any company or company personnel has violated Section 12-A that restricts insider trading, a penalty of 23 cr INR three times the amount of profit will be levied on that company. Section 24 of SEBI act orders the accused would be punished with ten years of debarment or fine. Though these laws are present to prohibit insider trading, SEBI still

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is unable to stop it except few initiative investigations after those came into light by media. Past couple of decades did not witness any conviction for this crime. Accused person frees himself with a minimum suspension and penalty even after he is charged with the offense of insider trading. Imprisonment never happens in most cases and the accused is given a penalty only. Such negligence of law mitigates the fear of punishment and the laws are useless practically. Such penalties and donations obstruct the insider trading law to be enforced.

Two cases proving the uselessness of SEBI in prevention of insider trading have been discussed here. Rakesh Agarwal, the managing director of ABS Industries Ltd, engaged in insider trading with Bayer A. G. Rakesh was ready to hand over 51% stake to Bayer. Rakesh bought ABS shares from his brother-in-law before the settlement was made public. SEBI made a probe into this case and found out that Rakesh holds price sensitive information in time of buying ABS shares and he intends to gain a substantial profit from the open market[8]. SEBI ordered Rakesh to deposit 340000 INR with **Investor Education & Protection Funds of Stock Exchange Mumbai and NSE** to compensate any investor that can make any claim of loss caused by Rakesh. He challenged this verdict of SEBI in **Securities Appellate Tribunal** stating that he acquired these shares from open market and the interest of the company is not in conflict with his own interest[9]. He also stated that his target was to make this takeover fruitful for the company and he attempted to source the required shares and those were intended to be sold to Bayer through his brother-in-law.

Dealing insider securities by a person with possession of price sensitive information is prohibited by SEBI but SAT tribunal opined that the investigation against the accused must gather the knowledge of the motive of the culprit regardless of the fact that regulations do not support the presence of *Mens Rea* as an element for insider trading[10]. The court dismissed the verdict given by SEBI saying Rakesh would not have to pay the fine as he was working according to the interest of the company[11].

Other cases of Samir C. Arora can be reviewed in this context. SEBI restricted Samir to trade any insider securities directly or indirectly for five years. SEBI found that Samir has the hold of price sensitive information of the company regarding a demerger and he skipped a loss of 23.57 crore as he was prior informed about the publication of company data. He also challenged SEBI's decision and won as SAT did not find any proof of insider trading.

So it is noted that though insider trading is banned on account of business ethics and justice, few rule breaking incidents are occurring and the punishment is being skipped by culprits because of the lack of proper investigation and solid evidence.

III.CRITICAL REVIEW

A critical review based on research finds out the incompetency of SEBI in formulating strong law against insider trading. SEBI has the responsibility to watch over the happenings of any insider trading but it has failed to execute a single conviction over the decades. Investigations result in a mere fine by the accused; there remains a clear direction of imprisonment in the SEBI laws and regulations. SEBI's propensity to settle down cases of insider trading by consent orders results in an assumption that act of insider business is not actually a penal offense and chances of apprehension and imprisonment of the accused is almost zero. This actually encourages traders to engage themselves in insider trading. Once the offender has signed the consent from, he has

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been provided with a safeguard to admit or deny his conviction. This practice is well utilized by rich and powerful people to save them even after committing a severe crime that can cause wastage of lives and wealth of numerous people. Besides, SEBI's inappropriate measures are pushing investors to lose their interest to invest in market,

SEBI act only makes the authoritative body powerful once they apprehend any person or medium violating act and regulations. Therefore, in the case of foreseeing an act of insider trading by any informer, SEBI is unable to take prior action as Indian law has no article or verdict to take anticipatory action against insider trading. Section 26 of SEBI Act, 1992 prevents courts from interfering in any punishable offense unless SEBI files a complaint. This act makes investors vulnerable as they are unable to protect their interests through **civil action suits**[12]. This act is self-contradictory as it leaves investors vulnerable instead of safeguarding them by declaring investors are not the primary victims of insider trading. Imperatively it can be noted that encouraging investors and private individuals to complain **civil action suits** can discourage the practice of insider trading.

Several SEBI regulations sabotaged its motive of banishing insider trading, this review witnesses that successful case study of insider trading is challenging because prosecution depends on circumstantial evidence. SEBI refused to have authority to tap phone calls of the suspect by the Central government. This authority to spy over suspects is crucial to eradicate insider trading cases. Evidence would be useful for conviction of the accused. It is found that the US government has successfully convicted Mr Rajat Gupta guilty for insider trading by tapping his phone calls.

SEBI's failure to utilize evidence and overdependence on circumstantial evidence is one the main reasons behind the drastic increase of insider trading all over India. Efficient traders are well known of the rules and regulations and they can strategically skip investigations even after having price sensitive information. In almost every case of insider trading investigation is attracted if only price variation crosses specific barriers during trading. It ensures the inside trader to estimate the future threshold of price as he has the price sensitive information and can foresee if the investigation can be conducted or not. Thus insiders can strategize before stock prices reach the threshold and gain profits. Liquidity of the Indian market follows a steady rise over a few years. Increase in market liquidity enables insider traders to conduct business more secretly. The more the number of daily business, the more chances insider traders have to conceal their trades. Such circumstances put regulating authority in a position that makes it unable to detect fair trade and doubtful trade.

Market liquidity shortens the utility of circumstantial evidence regarding insider trading. One argument against insider trading is that if the traders are engaged in insider trading of non-public information, it may cause the public and investors to be uninterested in this distorted market. Public investing lower amounts in the market, companies find difficulties to fundraising. Companies eliminated due to financial crises can cause hazardous effects on economics within nations, inflation and business monopoly. Insider trading is against business ethics and harms the interests of the overall economy.

The first and foremost country towards handling insider trading suitably however can be recognized as the United States. In addition, in the USA, this "Securities and Exchange Commision " has empowered underneath the "Insider Trading Act" in 1984 towards imposing civil penalties in association to criminal proceedings[13]. The basic source regarding the regulation of this insider trading in the US can be recognized as federal law. This law has been enforced through an agency of federal regulation, the "Securities Exchange Commission", through federal prosecutors including through federal

[12]Fletcher, M.L., 2020. Politics, Indian law, and the Constitution.*Calif. L. Rev.*, *108*, p.495.

[13] SINGH, A., KUMARI, K., Srivastava, H. and KUMAR, M., 2019. Corporate Governance and Insider Trading Regulations: A Comparative Study of India and the United States. *JIM QUEST*, *16*(1), p.28.

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private actions regarding civil rights both implied and expressed. Some regulations related to insider trading in US have been mentioned below:

- **Rule 10b-5**

"Rule 10b-5" is mainly the "catch all" focused anti-fraud regulation that the SEC has promulgated in the year of 1943 pursuant towards its authority underneath section 10(b) regarding the ***"Securities Exchange Act of 1934"*** towards prohibiting some type of manipulative or else deceptive contrivance or else device[14]. While most of the cases that have been brought underneath the Rule 10b-5 include misrepresentation, this rule has effectively been stretched towards covering conduct known as insider trading in that the complaint is mainly not who has lied, though that person had not said nothing as well. It is necessary to highlight that in the US there are some laws and regulations regarding insider trading such as rule 10b-5 Prohibition on Insider Trading. On this note, ***"SEC Rule 10b-5"*** helps in prohibiting corporate officers including directors or else some other insider employees through utilizing confidential corporate focused information towards reap any profit or else neglecting loss through trading in this stock of the business firm. ***"SEC Rule 10b-5"*** has clarified that this prohibition against insider trading does not just require some proof mainly that any insider utilized materialized data during executing a trade. This rule has also prohibited some "tipping" of this confidential corporate focused data towards third parties.

- **Rule 14e-3**

Section 14(e) of this Williams Act has been outlawed fraudulent, manipulative or else deceptive acts or else some practices in association including a tender offer. In addition, in the year of 1980, after this Chiarella, it can be stated that SEC has promulgated this ***"Rule 14e-3"***. This rule has also created it unlawful regarding the bidder, the main target, their tippers or else their insiders towards providing non-public data regarding a tender focused offer towards any person who has liked to trade.

It is also necessary to highlight that, in the US there are two patterns of penalties that are there for insider trading related acts. In case anyone has been caught in this insider trading act, then that person might be either sent towards prison or else charged for fine and in some cases both can happen. As per the SEC in this US, any conviction regarding insider trading might lead towards a maximum fine of nearly ***$5 million*** including that imprisonment for nearly 20 years[15]. It is also important to highlight that, ***"the Insider Trading Sanction Act of 1984"*** including ***"the Insider Trading along with Securities Exchange Act of 1988"*** both has provided for this insider trading focused penalties in terms of surpassing three times of profits gained from this trading[16]. Therefore, through the above illustration some regulations and laws regarding insider trading in US and India have been effectively highlighted.

IV. CONCLUSION

Insider trading is all about a malpractice that intrigues inequality among investors along with de-motivation among the public regarding investing in any stock. The impact, extent and effects of insider trading might vary in each country but any amount of insider trading has a massive effect on the reputation of the country. Every shareholder invests his money in the market with the prior faith of transparency and efficiency in the market. Any investor while making his decision about investment (to sell, buy or hold stock) relies upon the available price sensitive information provided by the listed company in the stock exchange. The investment into the securities market has increased many folds in recent times. Globalization has created many ways to invest money and investment is being made all over the world by citizens of

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different nations. When an investor relies upon the available price sensitive information, he has the prior thought of trust about the correctness of the value of the security he is trading. Efforts of law enforcement agencies should be to strictly deal with this menace and swiftly punish the offenders so that trust can be established in the minds of investors and the market can remain a fairground for everyone.

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