INSIDER TRADING:
GAMBIT OF AN INSIDER AND OUTSIDER OF A COMPANY

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INTRODUCTION

Since the establishment of the money system which, replaced the barter system, there has been a growing need for money as human desires have no end. People started using fraudulent methods, so as to obtain higher income and fulfill their wants. One such method used was insider trading, which was later classified as white collar crime. Employees started selling the confidential data of their organizations for a high amount, which buyers used for many purposes such as the purchase of stock, which had started affecting the market integrity.

Gradually as modernization and digitalization came into view, the form of money started shifting from paper and coins to digital currency. Digital currency is the form of soft currency that is stored or transacted using digital computers electronically, these include- cryptocurrencies, etc. These have a complete digital database that purely exists digitally.

Money acts as a key factor in shaping our actions, aspirations, careers, etc. The use of currency or paper money has greatly benefitted the necessity of exchange and trade but with these benefits, some limitations follow. Money has made most people selfish, greedy and wanting more. Humans today are never satisfied with what they have and keep wanting more.

We are currently in a rat race in which people who lag behind are crushed by the weight of today's capitalist market. According to World Inequality Report 2022, in India, the "top 10% of people holds 57% of total national income of the country". [1]Under the fear of getting left behind, some people try and push other people behind using unfair means to proceed forward faster.

After liberalization and industrialization in 1854, a high level of modernization could be observed where many new corporates entered the market which lead to an increase in

[1] WORLD INEQUALITY REPORT (July 23, 2022, 14:02 PM), https://wir2022.wid.world/.

competition among them. To stay above the race, people started adopting many false methods to earn faster, one such technique was illegal trading. An organization in such a competitive market proves successful only if it has some attributes like- transparency, pellucidness, smooth running, effective delegation of work and a positive relationship with and between employees. A corporate company has different building blocks and the absence of even one of them can make a company collapse. Each level of the corporation is equally important. The owners of the company establish the frame or structure of the organization. The board of directors formulates policies that govern the daily tasks of all employees, directly or indirectly. The directors play a very crucial role in guarding sensitive information because of their ability to access this data.

Competition and profit are the drives that keep these organizations in a continuous head-to-head trying to get at the top of the charts. It is therefore obvious that the employees of these corporations are in this competition as well. This competition would've been healthy for both, the companies and the market if the employees competed with the employees of other companies. But in many cases, this doesn't happen. Sometimes, employees bypass the integrity and confidentiality policies of their company, as well as, their fiduciary duty (the duty of a person to act in favor of their organization) by sharing confidential and crucial information about their organization with others. They become enemies of their own company and share top-secret information with other rival companies and for this information, the rival companies pay massively to these people. This is called insider trading and it started with the discovery of this loophole.

WHAT IS INSIDER TRADING AND HOW DID IT EMERGE?

"Insider trading is the trading of a company's stocks or other securities by individuals with access to confidential or non-public information about the company."[2]

The illegal and immoral use of confidential information including price-sensitive information ("PSI") of one's company to other companies is called insider trading. According to an omitted section 195 of the Companies Act 2013[3], PSI can be defined as the information which is unpublished and can affect the price of the company if released in the public domain. Now it

[2] Legal Information Institute, *Insider Trading*, CORNELL LAW SCHOOL (July 15, 2022, 12:09 PM), https://www.law.cornell.edu/wex/insider_trading#:~:text=Insider%20trading%20is%20the%20trading,of%20the%20individual's%20fiduciary%20duty.

[3] Companies Act 2013, S.195, Acts of Parliament, 2013 (India)

is defined under Reg.2(1)(n) of Securities Exchange Board of India ("SEBI") (Prohibition of Insider Trading) Regulations, 2015[4].) It emerged with the practice of selling securities in the global capital market. It is a type of white-collar crime which refers to a plethora of crimes associated with business professionals.

For example, in the case of Harshad Mehta, an Indian stockbroker, who used to take undue advantage of price-sensitive information. The procedure followed in determining any share price, before it is released in public is that first SEBI is informed then the general public gets to know about it. Harshad Mehta used his position and whenever he saw an upward trend in any company, he purchased its shares. When the notice reached SEBI and then the information was released to the public, the public started purchasing its shares which naturally increased the share price. Now later Harshad Mehta sold his shares at a high price, and he gained a lot of profit from it. So he used UPSI in his favor and this illegal use of UPSI can be considered as insider trading.[5]

WHO IS AN INSIDER?

As per regulation 2(1)(g) of SEBI Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015 "insider" means any person who is:
i) a connected person; or
ii) in possession of or having access to unpublished price-sensitive information;

Basically, any person, who knows unpublished price-sensitive information, or is connected to someone, or a company- which puts him in the position of obtaining price-sensitive information becomes an insider. [6]Common examples of insiders include- auditors, consultants, law firms, directors, partners, shareholders, etc.

Insiders are those people who take advantage of their position and ability to access confidential information of a company by trading this information to other companies. These individuals refer to a wide arena of people- directors, partners, shareholders, employees, managers, etc.

For example, a simple employee who handles the accounts and transactions of a department of a company has complete access to the transactional information of the company. She uses this

[4] SEBI (Prohibition of Insider Trading) Regulations, 2015, Reg.2(1)(n), Regulations by SEBI, 2015 (India)
[5] Harshad S. Mehta v. Central Bureau of Investigation, BomCR 783, 2 BOMLR 114, 1998
[6] SEBI (Prohibition of Insider Trading) Regulations, 2015, Reg.2(1)(g), Regulations by SEBI, 2015 (India)

position to her unfair advantage and sells this information to a rival company. Through this, no blame comes on her and she gets paid high amounts of money by the rival company.

In this increasingly competitive corporate world where people have a thirst for money and can do anything, insider trading has emerged as a nightmare for companies.

WHAT IS U.P.S.I.?

According to regulations 2 (1)(n) of the Securities Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015, UPSI or Unpublished Price-Sensitive Information can be defined as information as to finances, mergers, change in capital structure, dividends, acquisitions, de-mergers, expansion and disposals of a business, etc.

It can also be referred to as the exclusive data of a company that is unpublished and is likely to affect the price of the company if the information is available in the public domain.[7]

For example, a director of XYZ company casually tells her friend about an upcoming deal for her company. This friend is an employee of a rival company and uses this information and buys the stocks of the company. In such a case, the director and her friend will be held liable for violating SEBI regulations.

HOW IS INSIDER TRADING HARMFUL? IS IT ILLEGAL?

The release of confidential and price-sensitive information of a company like the accounts, transactions, dividends, information of mergers and de-mergers, policy revisions, etc. affects the price of the organization's securities in the market. This not only takes down the profits of the company but also discourages investors from investing in the company. It brings down the position of the corporation in the stock market, lessening the turnover of the company exponentially.

For example, if Ms. P, the Director of a company learns about the fact that the company is losing shares and its business is declining shares this information with her friend who is a stockbroker. After learning about this, the stockbroker buys all the shares of the company and earns a mammoth profit. Due to this, the company of Ms. P goes through a massive loss. Such a loss would be grave as it might make the recovery of the company difficult. In this case, Ms.

[7] *Id.,Reg. 2(1)(n)*

P and her friend, the stockbroker is liable for the offense of insider trading and can be made to compensate the damages to the company.

The United States of America was the first country to declare insider trading as an illegal practice through the Thomas Committee of 1948 which ultimately inspired the policy makers of India to make a similar step.[8]

There are various reasons that led to the announcement of insider trading as an illegal practice. It is highly immoral and unethical and leads to a breach of the fiduciary duty a person owes to their organization. Following are some reasons why this practice is discouraged by statutes:

1. It is profoundly unfair because the Insider takes advantage of their ability.
2. It counts as a disruption of interest between the person who trades Insider information and their company. It is basically, a conflict between the greed of an individual and the best interest of their organization.
3. Considering the grave consequences, it leads to magnanimous losses to the company in terms of its market reputation and lowering of investors' interest in the company.

INSIDER TRADING IN INDIA AND EFFORTS TAKEN TO CURB ILLEGAL TRADING

After noticing other countries making rules against insider trading like the formation of the Thomas Committee in the USA and United Kingdom placing many obligations on the directors of a company towards their control over transferring important data, India got inspired to form regulations of her own.

In congruence with this requirement of forming regulations against insider trading, Sections 307 and 308 were incorporated in the Companies Act, 1956[9]. In the 1970s, insider trading was labeled as an 'undesirable practice' for the first time. Further, many recommendations were put forward by numerous committees like Sachar Committee (1979), the Patel Committee (1986), and the Abid Hussain Committee (1989). Finally, a whole regulatory authority was formed, i.e., the Securities and Exchange Board of India (SEBI).

[8] Thomas C. Newkirk, *Speech by SEC Staff: insider trading – A U.S. Perspective*, US SECURITY AND EXCHANGE COMMISSION (June 22, 2022, 10:24 PM), https://www.sec.gov/news/speech/speecharchive/1998/spch221.html.
[9] Companies Act 1956, S.307&308, No. 1, Acts of Parliament, 1956 (India)

Following is a brief timeline leading to the criminalizing of insider trading in India:

1. *BHABHA COMMITTEE, 1952* - this committee recommended that the disclosure of information relating to the sale and purchase of shares of the company in a separate register by the managers of the company should be made mandatory.[10]
2. *COMPANIES ACT, 1956* - Section 307 makes it obligatory for the company to record the shareholdings of the directors in the organization.

   Section 308 discloses the information of shareholdings contributed as a duty of the directors of the company.[11]
3. *COMPANIES AMENDMENT ACT, 1960*- It was made mandatory for the managers, as well as, the directors to disclose information about their shareholdings.[12]
4. *SACHAR COMMITTEE, 1978*- This authority was established in June 1977 with the objective of reviewing the Companies Act, 1956 and the Monopolies and Restrictive Trade Practices Act (MRTP), 1969. It was recommended that the government should make strict provisions for checking any unfair gains by selling price-sensitive data taking place in the market.[13]
5. *G.S. PATEL COMMITTEE, 1986*- The term, 'insider trading' was defined by G.S. Patel in a report targeted at suggesting amendments to the Securities Contract (Regulation) Act (SCRA).
6. *ABID HUSSAIN COMMITTEE, 1989*- this committee was created in 1989. The criminalizing of insider trading under both civil and criminal offenses was recommended.
7. *SEBI ACT, 1992*- In India, the Securities and Exchange Board of India (SEBI) forms the rules for the market and regulates it. It was established under the SEBI Act in 1992 as a government organization to supervise the transactions taking place in the Indian capital market, protecting the investors from getting exploited and regulating the trading of securities.[14]

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[10] *Bhabha Committee Report on Company Law Committee*, MINISTRY OF CORPORATE AFFAIRS (June 24, 2022, 4:09 PM), http://reports.mca.gov.in/Reports/22-Bhabha%20committee%20report%20on%20Company%20law%20committee,%201952.pdf.

[11] Companies Act 1956, S.307&308, No. 1, Acts of Parliament, 1956 (India)

[12] Companies Amendment Act 1960, No. 31, Acts of Parliament, 1960 (India)

[13] *Sacher Committee Report*, MINISTRY OF CORPORATE AFFAIRS (June 23, 2022, 4:11 PM), http://reports.mca.gov.in/Reports/30-Rajindar%20Sacher%20committee%20report%20of%20the%20High-powered%20expert%20committee%20on%20Companies%20&%20MRTP%20Acts,%201978.pdf.

[14] Securities and Exchange Board of India Act 1992, No. 15, Acts of Parliament, 1992 (India)

8. *THE SEBI REGULATIONS, 1992*- exclusively mentions the act of insider trading as a punishable offense and also as a breach of fiduciary duty of the employees of a company.

After the recommendation of these committees, SEBI enacted the following regulations against insider trading –

- 'SEBI [insider trading] Regulation-1992'
- SEBI [Substantial Acquisition of Shares & Takeover] Regulations 1994.'
- 'SEBI [Prohibition of Fraudulent & Unfair Trade Practice relating to securities market] Regulations-1995.'

So, according to Section 15 G of the Securities Exchange Board of India Act 1992[15], insider trading is illegal and it prescribes the penalty for it as not less than Rs. 10 lakh and may extend to Rs. 25 crores or even thrice the number of profits made out of trading the information.

SECURITIES AND EXCHANGE BOARD OF INDIA (SEBI)

There are many authorities today which regulate the corporate world in India. For example- the Reserve Bank of India, Company Law Board (CLB), and several national stock markets. SEBI was included under this umbrella of Government Authorities by the SEBI Act, 1992 as a regulatory authority of the securities market in India. It supervises the market and tries to catch instances of insider trading.[16]

Even though, as compared to other countries, the Indian market is lacking depth, it is however important to note that with the huge population in India, there is a massive number of companies, investors, employees and most of all, customers which keep the Indian market ever-running. The numerous economic reforms introduced by the government has improvised our markets.

SEBI has formed the SEBI (Prohibition of insider trading) (Amendments) Regulations, 2018 which define insider trading as the "buying, selling or agreeing to buy, sell or deal in any

[15] Securities and Exchange Board of India Act 1992, No. 15, Acts of Parliament, 1992 (India)
[16] *Id.*

securities by any person either as principal or agent, by insiders on the basis of any private confidential information."

SEBI (Prohibition of insider trading) (Amendments) Regulations, 2018 provide that the sale and buying of insider information are prohibited. SEBI also has the power to punish and imprison any person who contravenes with its provisions. Moreover, it has the authority to freely investigate matters relating to insider trading. It can investigate matters on the following grounds-

1. Complaints received from investors, shareholders, intermediaries, etc.
2. Any knowledge or data learned about cases of insider trading in the market

CONCLUSION

In layman's words, Insider trading can be defined as the leaking of information that is price-sensitive to a company to outside sources for personal gain. This is a highly unethical and immoral practice, yet taken up by people in today's capital market. It not only leads to huge losses to companies but also translates to the defying of an established fiduciary duty of confidentiality one owes to their organization (Fiduciary duties include keeping the information confidential, it must not be misappropriated for personal gains. Family and friends of the insider should comply with the insider laws- the insider should ensure that the law complies with it. No trade should be made by an insider or connected, till the information is published.).

The investigation and regulation of instances of insider trading has been a very difficult task for the Indian Government. Many legislations and authorities have been established by the government and high penalties are prescribed for the defiance of these regulations. However, this has proved to be insufficient as even today, countless of these cases take place under the privilege of white-collar personalities.

The Annual Report of Securities and Exchange Board of India (SEBI) in the year of 2016-17 discovered through its investigations that of the total white-collar crimes investigated, 14% of the cases were of insider trading. With each year, the number of instances is growing and number and the statistics are frightening to the Government and Companies. Moreover, the majority of these cases are pending, delaying justice each day.

Insider trading cases are difficult to investigate because mostly, these are not based on concrete evidence but on mere information heard. This is why these cases are very hard to prove and detect. The non-delivery of justice in these instances can also be blamed on the poor technological advancements that SEBI has incorporated in its investigations. The low manpower and shortage of equipment make these cases go unnoticed and if detected, do not stand trial because of lack of evidence. For example, SEBI officials are barred from tapping phone calls under the Indian Telegraph Act, 1885. So, numerous limitations and restrictions on these regulatory authorities have made the job of investigating and penalizing these crimes an extremely difficult task. Few ethical improvements that can be made, to help SEBI be more effective include- giving them the freedom to make regulation of malpractices, check up on the tradings of a company more freely, give SEBI more power to insist companies to provide their trading information on a more regular basis and penalize companies if the rules are not complied.

Furthermore, people in the Indian markets and stock markets have discovered many loopholes (such as foreign insider trading misappropriation, made in India, is not covered under Indian law, and people use this for their benefit. Also, SEBI is not advanced in terms of technology so many cases of insider trading are missed). People have taken advantage of these to their benefit. Many crimes are included under this broad category. This category has been termed as 'white-collar crimes' which refer to a whole plethora of crimes committed in the corporate world, these are crimes that are committed for financial gains and exploitation is committed in non-violent methods, it is generally done by corporate personalities such as businessmen, professionals, etc. it includes Ponzi scheme, embezzlement, illegal trading, etc. insider trading is the most common white-collar crime.

To improve the conditions of the entire Indian Market, the Indian Government should work on endowing the already appointed authorities with better manpower and technology. This should be facilitated by a quick justice-delivery and redressal system as many cases still remain unsolved and it is part of a loophole also. Resolving this issue may reduce the problem of illegal trading. This can be done by introducing a completely new authority or branch that will specifically look after and resolve the cases of illegal trading. Companies should establish more stringent fiduciary duties on the directors and employees, this can be done by imposing a stricter penalty, or harsh punishments, in case any employee violates their employment contract

or the pre-signed NDA. The loophole in the present legislation should be identified and rectified to discourage people effectively from going on a path of illegal trading.