

# An Analysis of the Security Laws Relating to Insider Trading in India and Its Trends Internationally

Gayathri Narayanan N

3rd Year B.A., LLB (Hons.), SASTRA Deemed To be University, Thanjavur, Tamil Nadu

## ABSTRACT

This paper tries to provide an analysis of the evolution of security laws relating to insider trading in India and how the laws are functioning internationally for the same. The ultimate object of this paper is to understand the progress of law, to regulate one of the intricate offences that happen in the security market, i.e., insider trading. It also analyses the powers of the investigating and law enforcement agency of insider trading, SEBI and the recommendations put forward by its committee for the effective implementation of the law and tries to provide observation by comparing it with the foreign laws.

**KEY WORDS:** Insider trading, SEBI, SEBI (Prohibition of Insider Trading) Regulations, 2015.

## INTRODUCTION

The value of a company is reflected in the efficacy of the corporate governance of that company. There are certain attributes and fundamental principles that are needed to be adhered to function as a reputed and a stable organisation, which includes following security laws and abstain from involving any security offences that may lead to creation of any distrust among shareholders of the company or public at large for that matter. One of the most elusive security offences is Insider trading. It refers to the act of trading confidential and sensitive information relating to the price of the stocks or securities of a company by a person who possesses such information, for his or her own personal gains. The controversy regarding the legality and illegality of insider trading is also on rise since there are circumstances where the statutes governing the same interpret the ambit of insider trading and list out circumstances where it attains a legitimate state. The debate concerning the legality and morality of insider trading can be traced back to the work of Professor Henry Manne, "Insider Trading and the Stock Market" in 1966 in which he would have argued that insider trading is desirable because it is economically efficient.<sup>1</sup> This resulted in the abrupt shift of questioning the government regulation over insider trading as it was also argued to be economically efficient than inefficient. However, at present, most of the countries have prohibited and penalised the act as it is considered to be detrimental not only to the shareholders or other investors who do not possess any material information to trade in but also the entire dynamics of the market. The United States is the first country to prohibit trading by corporate insiders on inside information.<sup>2</sup> France became the second country which enacted a law in 1967 to prohibit insider trading. The expansion of stock markets

<sup>1</sup> Henry G. Manne, Insider Trading And The Stock Market 99-104 (1966).

<sup>2</sup> Franklin A. Gevurtz, Pacific McGeorge School of Law, The Globalization of Insider Trading Prohibitions,

in the year 1990s paved the way for acceleration in the adoption of laws to regulate insider trading by the world countries.<sup>3</sup> India enacted a separate legislation called Securities and Exchange Board of India ([Prohibition of] Insider Trading) Regulations Act in the year 1992. The first part of this paper attempts to explain insider trading. Then, the paper will analyse the security laws relating to insider trading, the trends present globally, amendments and changes incorporated with the rising needs and finally attempts to conclude with analysing the legal vacuum in Indian law governing insider trading with that of the US law.

## INSIDER TRADING IN INDIA

This part of the article focuses on the evolution of insider trading laws in India and the legal developments, powers of the Security Exchange Board of India (SEBI) to investigate into the matters of insider trading and the developments that are required to be inducted for the effective implementations of the laws.

### a) Evolution of Insider Trading Laws in india.

It was the **Thomas Committee** under the chairmanship of P.J Thomas who was an adviser to the Finance Ministry, which advised to establish an independent quasi-judicial body to regulate security offences. The committee in its report, titled “Report on the regulations of Stock Market in India 1948 pointed out the absence of a legislation to deal with “unfair use of insider information”<sup>4</sup>. In 1979, the **Sachar committee** was formed to review and recommend amendments to Sec. 307 and 308 of the Companies Act, 1956 and suggest penalties to prevent trade using inside information by insiders and their relatives as well.<sup>5</sup>

But, it was the **G.S Patel committee** report in 1986, which described the term “insider trading” and also recommended amendments to the Securities Contract (Regulation) Act (“SCRA”), 1956 to prohibit the trade using inside information. The **Abid Hussain committee** in 1989 recommended including the act of insider trading as a punishable offence under the provisions of civil and criminal laws. It also submitted its recommendations to SEBI to make stringent laws to govern the trade using inside information. Consequently, SEBI (Insider Trading) Regulations, 1992 was enacted to regulate the security market offences following the establishment of SEBI in 1992. However, the SEBI (Insider Trading) Regulations, 1992, was insufficient to address the issue with only a very limited number of (12) regulations.

The inadequacies in the SEBI Insider Trading regulations were learned through the landmark case of **Hindustan Lever Ltd v. SEBI**<sup>6</sup>. In this case, the interpretation of the term “Unpublished Price Sensitive Information” (UPSI) was done which led to the new provision of Sec. 2 (ha) that defined “price sensitive information” in the Act.

In the case of **Rakesh Agrawal v. Securities Exchange Board of India**,<sup>7</sup> The SAT held that Mr Rakesh Agarwal, gained unfair profit by selling shares at higher prices during the public offer, but not guilty since he had no intention to deceive. The case was settled through consent order.

<sup>3</sup> Ibid

<sup>4</sup> ICSI report - Role Played By Sebi In Restricting Insider Trading <https://www.icsi.edu/Portals/72/Year%202018/Presentation/ROLE%20PLAYED%20BY%20SEBI%20IN%20RESTRICTING%20INSIDER%20TRADING.pdf>

<sup>5</sup> Insider Trading And Market regulations In India - Varsha - <https://bnblegal.com/article/insider-trading-and-market-regulations-in-india/>

<sup>6</sup> Hindustan Lever Ltd v. SEBI (1998) 18 SCL 311 MOF

<sup>7</sup> Rakesh Agrawal v. Securities Exchange Board of India 2003 SCC OnLine SAT 38

And after several amendments to the SEBI (Insider Trading) Regulations, 1992, the law that is currently in existence to regulate insider trading is SEBI (Prohibition of Insider Trading) Regulations, 2015

**b) Relevant Statutory provisions dealing with insider trading.**

The Companies Act, SEBI Act and the special legislation SEBI (Prohibition of Insider Trading) Regulations are the major statutes that deal with the provisions to regulate insider trading.

- **Sec. 195** of the Companies Act, 2013 deals with ‘Prohibition on insider trading of securities’
  1. no person including director or key managerial personnel of a company shall enter into insider trading
  2. “Punishable with imprisonment for a term which may extend to five years or with fine which shall not be less than five lakh rupees but which may extend to twenty-five crore rupees or three times the amount of profits made out of insider trading, whichever is higher, or with both.”<sup>8</sup>
- **Sec. 458-** ‘Delegation by Central Government of its powers and functions’

The proviso of this provision says that “powers to enforce the provisions contained in section 194 and section 195 relating to forward dealing and insider trading shall be delegated to Securities and Exchange Board for listed companies or the companies which intend to get their securities listed and in such case, any officer authorised by the Securities and Exchange Board shall have the power to file a complaint in the court of competent jurisdiction.”<sup>9</sup>
- SEBI defines ‘Insider’ as “any person connected on the basis of being in any contractual, fiduciary or employment relationship that allows such people access to unpublished price sensitive information (UPSI).”<sup>10</sup>
- **Sec. 11** of the Security Exchange Board of India, Act enlist the Functions of the Board. **Sec. 11 (2)** (g) of the SEBI Act, defines ‘prohibiting insider trading in securities’ as an important function.
- **Sec. 12A** prohibits any person from engaging in insider trading
- **Sec. 15G** defines penalty for insider trading and says the involved person defined under this section “shall be liable to a penalty which shall not be less than ten lakh rupees but which may extend to twenty-five crore rupees or three times the amount of profits made out of insider trading, whichever is higher”<sup>11</sup>
- **Sec 24** goes to the extent of imprisonment up to 10 years or fine up to 25 Crore, or both, for any offences pertaining to contravention of the provisions of the Act.
- **Sec. 24A** empowers the Security Appellate Tribunal constituted under the SEBI Act to compound any offence not amounting to imprisonment alone or imprisonment or fine after the initiation of the proceedings.

**c) SEBI (Prohibition of Insider Trading) Regulations, 2015**

- **Regulation 2 (g)** defines an insider as a person in possession of or has access to price-sensitive information or Connected Person.
- **Regulation 2(i)** Trading means and includes:

<sup>8</sup> Sec. 195 of the Companies Act, 2013 - ‘Prohibition on insider trading of securities’

<sup>9</sup> Sec. 458 of the Companies Act, 2013 - ‘Delegation by Central Government of its powers and functions’

<sup>10</sup> ICSI report - Role Played By Sebi In Restricting Insider Trading <https://www.icsi.edu/Portals/72/Year%202018/Presentation/ROLE%20PLAYED%20BY%20SEBI%20IN%20RESTRICTING%20INSIDER%20TRADING.pdf>

<sup>11</sup> Section 15G - Penalty for insider trading.

- Subscribing
- Buying
- Selling
- Dealing
- Agreeing to buy sell, subscribe, deal in any securities
- **Regulation 2 (d)** defines connected person as, “Any person who is or has been associated with company, in any manner, during the six months prior to the concerned act, an immediate relative to the connected person, a banker of the company, an official of stock Exchange or of clearing corporation, a holding/associate/subsidiary company,”<sup>12</sup>
- **Regulation 2 (e)** defines generally available information as, an information that is accessible to the public on a non-discriminatory basis (Information published on the website of a stock exchange, would ordinarily be considered generally available.)<sup>13</sup>
- **Regulation 2(f)** defines immediate relative as, spouse of a person, and includes parent, sibling, and child on such person or of spouse, any of whom is either dependent financially on such person, or consults such person in taking decisions relating to trading in securities.<sup>14</sup>
- **Regulation 2(n)** defines Unpublished Price Sensitive Information as an Information, relating to a company or its securities, directly or indirectly, that is not generally available which upon becoming generally available, is likely to materially affect the price of the securities and shall, ordinarily but not restricted to, information relating to the following:
  1. Financial results
  2. Dividends
  3. Change in capital structure
  4. Mergers, de-mergers, acquisitions, delisting, disposals and expansion of business and such other transactions
  5. Changes in key managerial personnel and
  6. Material events in accordance with the listing agreement.<sup>15</sup>

An important case with respect to interpretation of unpublished price sensitive information was delivered in the case of **Samir C. Arora v. Securities and Exchange Board of India**.<sup>16</sup> In this case, Samir Arora, who was a fund manager in the Alliance Capital Mutual Fund, was found guilty of insider trading for selling the shares with UPSI which he had based on the merger ratio of DGL with HPI by the SEBI. However, in appeal, the SAT held that Samir Arora not guilty since the UPSI he used to trade itself was proven to be false and uncertain. Hence it was held that only accurate or confirmed information regarding the price and its subsequent trading amounts to insider trading.

In another landmark case, **B. Ramalinga Raju v. Securities and Exchange Board of India**, 2017<sup>17</sup>, commonly known as Satyam Computers case, where it led to thousands of suicides as a result of the loss that arose out of the market manipulation by inflating the accounts of the Satyam computers, “Rama Raju as MD of Satyam, while in possession of the unpublished price sensitive information relating to the books

<sup>12</sup> Regulation 2 (d) of SEBI (Prohibition of Insider Trading) Regulations, 2015

<sup>13</sup> Regulation 2 (e) of SEBI (Prohibition of Insider Trading) Regulations, 2015

<sup>14</sup> Regulation 2 (f) of SEBI (Prohibition of Insider Trading) Regulations, 2015

<sup>15</sup> Regulation 2 (n) of SEBI (Prohibition of Insider Trading) Regulations, 2015

<sup>16</sup> Samir C. Arora v. Securities and Exchange Board of India, 2004 SCC OnLine SAT 90

<sup>17</sup> B. Ramalinga Raju v. Securities and Exchange Board of India, 2017 SCC OnLine SAT 183

of Satyam being inflated for several years and had sold shares of Satyam and made illegal gains which is prohibited under the PIT Regulations”<sup>18</sup> was held guilty.

In a recent case, **Dr. Prannoy Roy v. Securities and Exchange Board of India and Others**<sup>19</sup> also an interpretation to UPSI was made. “In the present case, the board had not even contemplated any specific plans, but merely thought to explore the possibility of re-organisation of the company. The same, therefore, cannot be called as PSI within the definition of the same as found in the Regulations ( Regulation 2 (n)).”<sup>20</sup>

### **NEED FOR THE ENHANCEMENT OF POWERS OF THE SEBI.**

The SEBI PIT Regulations of 2015 and the consequential enhancement of powers of SEBI to deal with the insider trading offences was indeed a result of one of the biggest scams of that decade, 100,000 crore Saradha scam. Many new powers were conferred. As per the annual report of SEBI for the year ending 31.03.2018, SEBI has taken up around 85 cases for investigation in that particular year and could complete only 25 by the year end however with the conviction rate it failed substantively due to lack of link for the communication of the UPSI and linking them with any alleged trades. On an average over the last decade the average number of cases SEBI has completed in any particular year is 15.<sup>21</sup> As of 31st March 2020, 376 cases were pending before the SEBI for action which shows the high rate of pendency under SEBI which only deals with cases pertaining to securities<sup>22</sup>.

The SEBI PIT Regulations of 2015, gave rise to new and necessary regulations like Regulation 6 which mandates disclosure of trading plan, Code of Fair Disclosure and conduct under Regulation 8, Code of conduct under Regulation 9, and Institutional Mechanism for Prevention of Insider trading under Regulation 9A through 2019 amendments. Nevertheless, detection and prosecution of insider trading remains a challenge, since direct evidence of UPSI communication is seldom available across various jurisdictions.<sup>23</sup>

There are various suggestions put forward like incentives to informants and so on. But one longstanding recommendation as well as a suggestion that requires consideration is the power of SEBI to wire tap phone calls for investigating the offences of insider trading. It was after the Sharda scam, the government made amendments to Telegraph Act 1885, to enable SEBI with the authority to call off phone records itself in 2014. Despite regular requests from SEBI and recommendation from the **Viswanathan Panel**<sup>24</sup> The 2019 amendments were silent about this. Viswanathan Panel recommended that to ensure successful conviction, SEBI must be given the power with proper checks and balance, but, however the central government has time and again denied the same stating such move would lead to violation of right to

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<sup>18</sup> Ibid

<sup>19</sup> Dr. Prannoy Roy v. Securities and Exchange Board of India and Others 2023 SCC OnLine SAT 855

<sup>20</sup> Ibid

<sup>21</sup> Insider Trading in India – Deficiency from Prosecution to Conviction <https://taxguru.in/sebi/insider-trading-india-deficiency-prosecution-conviction.html>

<sup>22</sup> Ibid

<sup>23</sup> Discussion Paper on amendment to the SEBI (Prohibition of Insider Trading) Regulations, 2015 to provision for an informant mechanism [https://www.sebi.gov.in/reports/reports/jun-2019/discussion-paper-on-amendment-to-the-sebi-prohibition-of-insider-trading-regulations-2015-to-provision-for-an-informant-mechanism\\_43237.html#](https://www.sebi.gov.in/reports/reports/jun-2019/discussion-paper-on-amendment-to-the-sebi-prohibition-of-insider-trading-regulations-2015-to-provision-for-an-informant-mechanism_43237.html#)

<sup>24</sup> Report of Committee on Fair Market Conduct for public comments [https://www.sebi.gov.in/reports/reports/jun-2019/discussion-paper-on-amendment-to-the-sebi-prohibition-of-insider-trading-regulations-2015-to-provision-for-an-informant-mechanism\\_43237.html#](https://www.sebi.gov.in/reports/reports/jun-2019/discussion-paper-on-amendment-to-the-sebi-prohibition-of-insider-trading-regulations-2015-to-provision-for-an-informant-mechanism_43237.html#)

privacy guaranteed under article 21 of the Indian constitution. Even in the case of **Dilip Pendese v SEBI**,<sup>25</sup> SEBI had put forward the point for access of phone call records as due to the lack of the same all the accused could not be successfully convicted, but in vain.<sup>26</sup>

## INTERNATIONAL JURISPRUDENCE AND INDIAN JURISPRUDENCE

The first wiretapping case of insider trading for investigation was **Securities Exchange Commission v Rajat Gupta**<sup>27</sup> where the conviction of the offenders were made possible through evidence from intercepting calls. Though the legality of the same was questioned in the case of **SEC v. Galleon Management**<sup>28</sup>, it is an undeniable fact that the primary accused Rajarathinam was held guilty for receiving \$1.75 million “in exchange for tips on McKinsey clients from the by former McKinsey & Co management consultants director Anil Kumar”<sup>29</sup> and this was definitely made possible through interception of phone calls.

In a French case during 2021, The Court of Justice of the European Union reiterated that wiretapped conversations, although obtained illegally, help the State protect its economic interests and that of its people.<sup>30</sup>

In India, as discussed in the article before, SEBI has no power to wiretap and collect any evidence for investigation. Though Sec. 69 of the Information Technology Act allows interception of calls for the purpose of investigation of an offence, it is restricted only to 18 agencies in our country. The Centre is of the view that details of phone calls should be accessed only in case of threats to national security, terror financing, and money laundering, according to a report by Business Standard.<sup>31</sup> Now, the question that arises and requires serious consideration is, whether insider trading is a form of money laundering or not? Insider trading and money laundering are both financial crimes that undermine the integrity of financial markets. While insider trading involves the illegal use of non-public information for personal gain in securities trading, money laundering is the process of disguising the origins of illicitly obtained funds to make them appear legitimate. In some cases, individuals involved in insider trading may engage in money laundering activities to conceal the proceeds of their illegal trades.<sup>32</sup>

<sup>25</sup> Dilip Pandese vs SEBI SAT APPEAL NO 80 OF 2009

<sup>26</sup> Insider Trading in India – Deficiency from Prosecution to Conviction <https://taxguru.in/sebi/insider-trading-india-deficiency-prosecution-conviction.html>

<sup>27</sup> Securities Exchange Commission v Rajat Gupta, Civil Action No. 11-CV-7566 (SDNY) (JSR)

<sup>28</sup> SEC v. Galleon Management, LP, et al., Civil Action No. 09-CV-8811 (SDNY) (JSR)

<sup>29</sup> SEC and Galleon defendants tussle over wiretaps <https://www.reuters.com/article/galleon-rajaratnam-sec-idUSLNE60P01L20100126/>

<sup>30</sup> French Insider-Trading Case Near Collapse on Privacy Ruling [https://www.bqprime.com.cdn.ampproject.org/v/s/www.bqprime.com/amp/onweb/french-insider-trading-probe-near-collapse-after-privacy-ruling?amp\\_js\\_v=a6&amp\\_gsa=1&usqp=mq331AQKKAFQArABIACAw==#aoh=16246025825534&referrer=https%3A%2F%2Fwww.google.com&amp\\_tf=From%20%251%24s&ampshare=https%3A%2F%2Fwww.bqprime.com%2Fonweb%2Ffrench-insider-trading-probe-near-collapse-after-privacy-ruling](https://www.bqprime.com.cdn.ampproject.org/v/s/www.bqprime.com/amp/onweb/french-insider-trading-probe-near-collapse-after-privacy-ruling?amp_js_v=a6&amp_gsa=1&usqp=mq331AQKKAFQArABIACAw==#aoh=16246025825534&referrer=https%3A%2F%2Fwww.google.com&amp_tf=From%20%251%24s&ampshare=https%3A%2F%2Fwww.bqprime.com%2Fonweb%2Ffrench-insider-trading-probe-near-collapse-after-privacy-ruling)

<sup>31</sup> Centre declines SEBI's request to tap phones in insider trading cases: Report <https://www.moneycontrol.com/news/business/markets/centre-declines-sebis-request-to-tap-phones-in-insider-trading-cases-report-5737031.html>

<sup>32</sup> Exploring Bribery - Definitions, Dynamics, Types, and Prevention Measures <https://www.tookitaki.com/glossary/insider-trading#:~:text=In%20some%20cases%2C%20individuals%20involved,proceeds%20of%20their%20illegal%20tra des.>

## CONCLUSION

In this rapidly evolving technical world, when the offenders are using technological tools to carry out an offence and get away with the conviction, the government is often very cautious about reserving any power of investigation that may result in the infringement of the rights of the citizens. However, in cases like insider trading which has the potential of destroying the national economy itself, it is high time that SEBI should also be conferred with the power to intercept calls for the purpose of investigation of offences. A clear cut mechanism to prevent any misuse and ensure the fair and just convictions of offenders is what is necessary. The sole purpose of the PIT Regulations 2015, itself is to ensure a fair and transparent security market, to enable a level playing field for all the participants in the market and protect the interest of the nation by preventing any scam or scandal that would disrupt the economy of the country. But for the effective implementation of this law, the enforcing agency of security offences, SEBI should be conferred certain necessary powers so that the security market is also made just and fair.