# Insider trading-A Threat to an Efficient Securities Market

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Securities markets are expected to provide a level-playing field to all market participants, including investors who also need to be provided with uniform information. The flow of information should be such that the information is assimilated concurrently by all market participants in the securities market. Insider trading distorts the concept of level-playing field, and has an adverse effect on market efficiency by creating information asymmetry.

The entire premise of insider trading being an undesirable practice is based on 'undue advantage', which results in few individuals or entities enjoying an unjustified benefit over other individuals or entities.

**Evolution of insider trading regulations across the globe**

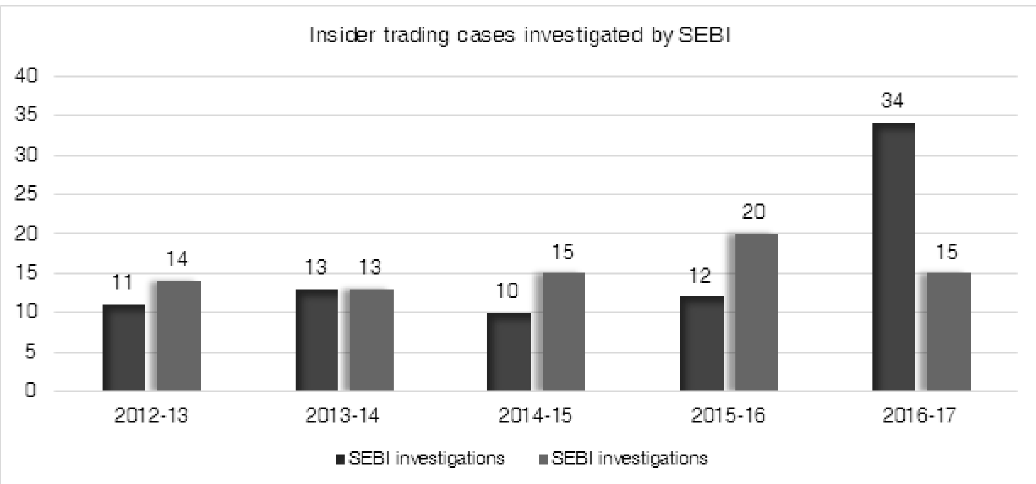
Insider trading regulations have evolved over a period of time to widen in scope and coverage.

- In the United States, prohibition of insider trading dates back to 1909, when the Supreme Court of the United States ruled against trading on insider information without disclosing it
- In the United Kingdom, in 1980, insider trading was not statutorily prohibited, though market manipulation and other market abuse were prohibited by statute since the early 1860s[1]. It was the Companies Act 1980 that enacted a legislation against insider trading
- In India, the history of formulating insider trading regulation dates back to 1948. To assess the possibility of imposing restrictions on short swing profits, a committee was formed under the chairmanship of P.J. Thomas.

In 1992, one of the first legislations formulated by Securities and Exchange Board of India (SEBI) was the 'SEBI (Insider Trading) Regulations, 1992'. There were significant amendments to these regulations until enactment of Indian Companies Act, 2013, which included legislation for prohibition of insider trading. Based on the recommendations of a high level committee under the Chairmanship of Justice N.K. Sodhi, SEBI issued the SEBI (Prohibition of Insider Trading) Regulations, 2015, which were enacted in January 2015, and came into effect from May 2015. These regulations intend to bring Indian insider trading regulations at par with international regulations.

**The imminent threat of insider trading and information leakage**

The instances of insider trading have been on the rise in the past few years, evident from the number of cases investigated by SEBI[2].



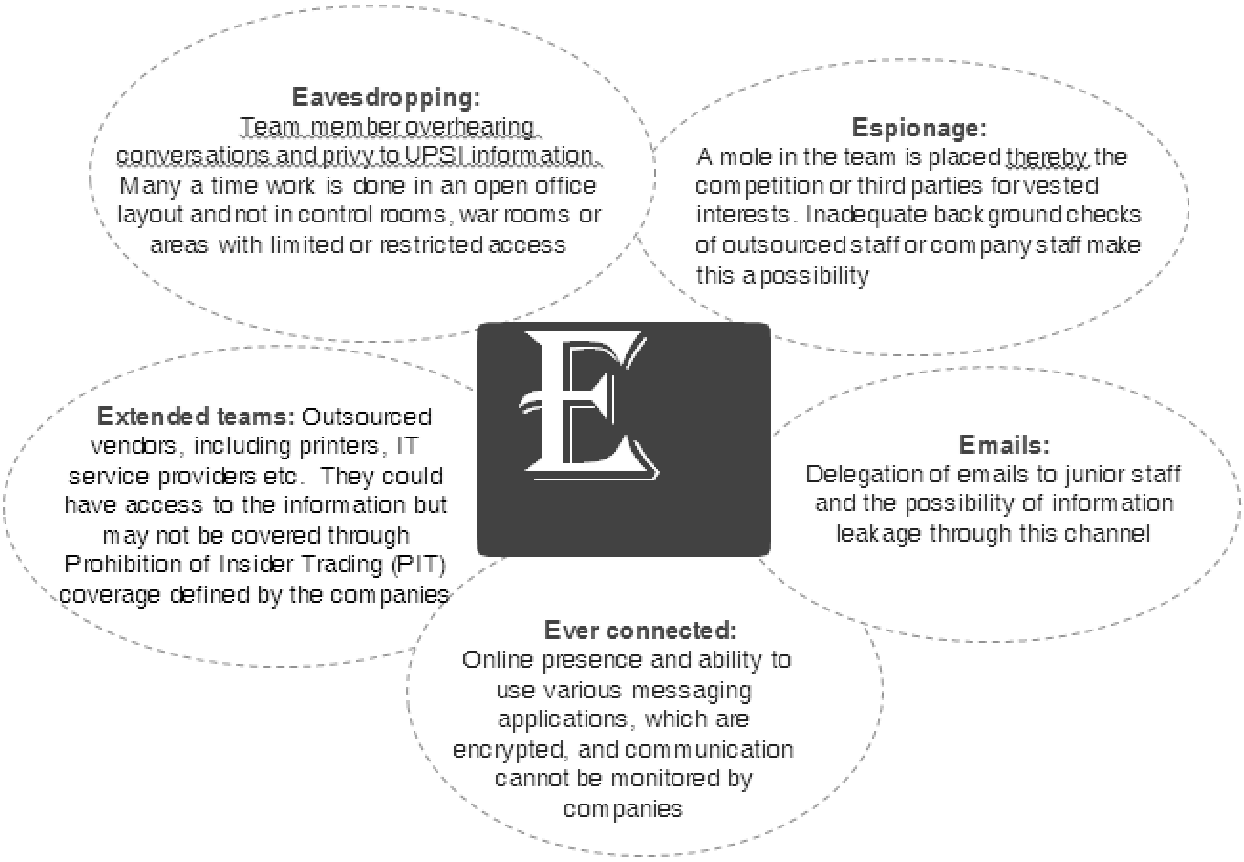
However, the actual number of insider trading cases may be much higher than what reflects in the SEBI statistics depicted in the above graph. Whether this rising number has a correlation to the advent of instant messaging applications, chat rooms/forums and social media is a subject of research.

The topic of insider trading and leakage of Unpublished Sensitive Information (UPSI) has regained interest due to some media reports on earnings leakage of listed companies through instant messaging applications/social media platforms.

In November 2017, a premier news agency had reported findings of an investigation that revealed potential leakage of financial results of various blue chip listed companies on instant messaging groups/social media platforms before their announcement to the public. The financial figures shared in these groups were matching or close to the actual announcement figures, suspecting insider trading activities. In this regard, SEBI has issued orders against companies to probe the leak of UPSI.

**Exposure to insider threats (Five Es)**

While evaluating the factors that can play a role in the leakage of information, we noted the following five factors being important for an organisation that needs to assess its preparedness to handle leaks through any of the modes.




The primary responsibility of reduction in incidents of UPSI leakage and insider trading lies with the stock exchanges, regulators and listed companies

Exchanges need to have effective pattern recognition models and surveillance mechanisms to detect such cases. Regulators can strengthen regulation and surveillance related to insider trading, and enforce strict action in instances of violation of PIT regulations.

Recent actions of the regulators clearly show that they are monitoring the UPSI leakage, and taking actions such as:

— Strengthen the key pillars of people, process and technology to avoid leakage of UPSI
— Identify present system and controls on UPSI, responsibility of who manages such controls and periodicity of such a review
— If required, conduct an appropriate enquiry or investigations.

However, listed companies have their tasks carved out, in view of the lack of adequate controls over UPSI and insider trading. Securing UPSI and ensuring that the data doesn't fall in wrong hands is critical for a company to ensure continued investor confidence, preserving its own reputation and goodwill in the market. Both these factors go a long way in ensuring smooth sailing for the company in these days of volatile markets and increased regulations and scrutiny.

It is imperative for companies to document the policy and process used to manage UPSI and ensure a comprehensive audit of the same from time to time. Red flags, if identified, from the audits should be documented and steps should be taken to mitigate the risks.

Additionally, companies may look at implementing a few good practices, as indicated below:

- **Invest in the right technology, e.g.**
  - To avoid data leakage IP based controls, blocking of emails containing key words, recording calls and restricted usage of mobile s phones
  - Avoid storing sensitive data over Internet or Public Online Storage Space
  - Encryption and password protect the sensitive files
  - Ensure physical security and encryption of data stored on computers
  - Strengthen the procedures of data and data holding asset in storage and physical transit through use of offline and online encryption methods

- **Invest in the right processes, e.g.**
  - Prepare an indicative list what can be UPSI and circulate it to all the employees, with guidance on how to handle it - should include the 'material events' as described in the materiality policy of the company, prepared as per the requirement under the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015
  - Use only official emails/channels for sharing information and avoid public emails
  - Try to create a separate work space with secured access for teams working on preparing financials during the 'non trading window'

- **Invest in people controls, e.g.**
  - Identify persons involved in major deals/activities and instruct them to not share any sensitive information beyond that set of people. Ensure information is percolated down to juniors or external teams only on a 'need to know' basis
  - Ensure proper background checks are in place for staff on boarded and dealing with UPSI data
  - Inculcate the culture to report on any attempt of breach and conduct refresher trainings around the sensitivity of the role played
  - Monitor for any significant price changes just before declaration of financial earnings for any significant fluctuations proactively

At the end, investigate as appropriate to ensure there is no exposure. An innocuous failed login attempt locking a user account or a social taping to fetch sensitive information could be your next breach!

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Sources include SEBI annual report and.

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- SEBI Annual reports for 2012-13, 2013-14, 2014-15, 2015-16 and 2016-17
- ASSOCHAM and KPMG's publication "The 'insider' threat – Safeguarding UPSI"
- www.mcser.org - A Historical Overview of Market Abuse Prohibition in the United Kingdom - Howard Chitimira (September 2014)
- Timeline: A History of Insider Trading - https://www.nytimes.com/interactive/2016/12/06/business/dealbook/insider-trading-timeline.html


[1] A Historical Overview of Market Abuse Prohibition in the United Kingdom - Howard Chitimira (September 2014)

[2] Source – SEBI Annual reports for 2012-13, 2013-14, 2014-15, 2015-16 and 2016-17