

Insider Trading



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Harry Truman once said, “It is selfishness and greed, individual or national, that causes most of our troubles.” Taking a leaf out of this, when greed takes over, at times, it can force us to take decisions that may not be good for us. Insider trading is one of such acts which is done to benefit few persons (insiders) at the cost of others. It is the act of purchasing or selling securities of entities which have listed their securities, by someone, directly or indirectly, based on materially price

insider trading. It says trading means and includes subscribing, buying, selling, dealing, or agreeing to subscribe, buy, sell, deal in any securities. The term trading is widely defined to include dealing in securities and intended to curb the activities based on unpublished price sensitive information (UPSI) which is strictly not buying, selling or subscribing but also includes pledging etc. Hence trading includes creation/invocation/revocation of pledge of securities as well. Further securities shall have the same meaning assigned to it under the Securities Contracts (Regulation) Act, 1956, which inter-alia covers shares, scrips, stocks, bonds, debentures, derivative, etc.

Is insider trading a threat to the Securities Market?

With the stock index touching new highs, the number of retail investors in the Indian Stock market is also increasing. Insider trading is certainly a threat to an efficient securities market since it causes losses to the general public at the cost of a few privileged persons which goes against the basic concept of fair trade practices. It can have detrimental effects on the securities markets, which inter-alia, may include:-

- **Market Integrity:** Insider trading undermines the fairness and integrity of securities markets. It erodes investor confidence as public investors are disadvantaged vis-à-vis trading by insiders with a material non-public information.
- **Market Efficiency:** It can distort the efficient pricing of securities on the basis of privileged / false information into the market.
- **Erosion of Investor Trust:** Insider trading can erode trust in the securities market.

sensitive information that is not in the public realm. Such insiders are typically persons / entities associated with such entities, either as employees or by way of frequent communication with them.

The act of Insider trading may lead to the insider either making profits or reducing losses. Some of the examples of material price sensitive information could be financial results, proposals for mergers and acquisitions, changes in capital structure, changes in key managerial personnel or any other information which, if disclosed, may significantly impact the company’s share price

Like other laws that attempt to maintain a spirit of equity, insider trading is a legal distinction that rests on a moral misgiving. It identifies a way of gaining information for a financial transaction that seems unfair. Hence it is a crime, a white-collar crime, and is not limited to company management, directors, and employees. Even outside investors, investment bankers, brokers, fund managers and others connected with the Company can also violate insider trading laws if they gain access to non-public, materially significant information.

Insider-trading cases include:-

- Corporate insiders trading in the company’s securities after learning of significant, confidential developments.
- Insiders’ friends and family, as well as other recipients of information, who trade in securities after receiving such information (irrespective of whether such information is used or not for trading).
- Employees of intermediaries / fiduciaries who come across material non-public information of companies they are working with as clients / otherwise and trade in such company’s securities.
- Others who obtain inside information because of their association with the Company.

The basic intention of having insider trading regulations across the globe is to have a level playing field between the insiders and the outsiders. With the advancement of technology, access to any information is just almost instantaneous. However, the Regulators across the world are also working to remain ahead of the curve to curb such instances.

In India, to prevent insider trading, some of the progressive steps taken by the Regulator alongwith the help of other market intermediaries include:-

- Enactment of SEBI (Prohibition of Insider Trading) Regulation, 2015, which serves as the primary legislative instrument governing insider trading activities in India as of today.
- Introduction of System Driven Disclosures for trades done by insiders.
- Introduction of system to restrict the trading activities by Designated Persons by freezing their Permanent Account Number (PAN) at the security level during the blackout period.
- Maintenance of data of Insiders with their relatives and with whom they share material financial relationship.
- Making it obligatory for the listed companies as well as Intermediaries / Fiduciaries to maintain a Structured Digital Database (SDD) for sharing material price sensitive information. This is also applicable to the companies which are proposed to be listed¹

Situation in India

In Indian context, SEBI (Prohibition of Insider Trading) Regulations, 2015, is the primary law which regulates

- Policy of ‘no trade’ in restricted list companies which is mainly applicable for all intermediaries / fiduciaries.
- Overall focus on digitization and automation.
- Recently amendment to provisions relating to Trading Plans like specifying an upper price limit for buy trades and a lower price limit for sell trades, allowing exemptions from following the plan in exceptional cases, splitting large trades etc. which might make implementation of such Plans more practical.
- Regulating the trades by employees of AMCs / trustees in units of own mutual fund as well as prescribing similar requirements for the persons with whom the information relating to mutual fund schemes is shared for legitimate purpose.
- Introduction of the ‘informant mechanism’ to encourage individuals to report insider trading violations by providing near-anonymity and financial incentives.

Few other additional measures / progressive steps include:-

- Regular amendments in Regulations to keep pace with the latest developments for example Rumour verification measures as part of amendments in LODR.
- Use of modern techniques in investigations like trading pattern analysis, bank statement analysis and funds arranged for trading, Call Data Records analysis and establishing whereabouts / proximity of persons communicating with each other from their mobiles based on their cell tower locations.
- Provide informal guidance when clarity is needed in interpretation of the Regulations.
- Investigations leading to issuance of orders in matters relating to insider trading which serve as deterrent.
- In genuine cases, providing certain exemptions to insiders to trade while in possession of UPSI as well as during blackout periods.

Action taken / which can be taken by corporates

As far as the corporates are concerned, the following measures will help curb insider trading:-

- Automation of insider trading work can take care of:-
 - Maintaining centralized data of insiders,
 - Automated requests for approval/rejection of trade(s),
 - Setting up UPSI, blackout period/no-trading windows,
 - Maintaining an automated restricted securities list (for intermediaries / fiduciaries),
 - Automated reminder emails, notification alerts & audit trails.
- Regular sensitization about the requirements / Do’s and Don’ts to the insiders.

Emerging Regulatory Challenges

In spite of all the steps taken by the Regulators / corporates, there are still challenges like:-

- Proving insider trading especially when the communication is made in private talks / closed door meetings.
- Difficulty in proving trades done through accomplices say by friends / relatives of insiders having access to UPSI.
- Use of high-end technology by insiders making it difficult to prove the offence.
- Difficulties faced by the Regulatory Authorities to detect and prosecute offenders because of the sophisticated methods of concealing illicit transactions.
- Monitoring and regulating insider trading internationally as the securities market is becoming more interconnected as more and more companies are going global.

Areas for Improvement

- Need for greater collaboration and information-sharing among regulatory authorities, exchanges, and market intermediaries to improve surveillance and detection capabilities.
- Use of artificial intelligence and advanced technology that can enhance the ability to identify suspicious trading patterns and unusual market activities.
- Strengthening enforcement mechanisms and increasing the severity of penalties for insider trading violations.
- Creation of awareness amongst investors / corporates, inter-alia, while trading through Portfolio Management Service Providers.
- Continuous *market surveillance activities by using* sophisticated tools to detect illegal insider trading, especially around the time of important events such as earnings reports and key corporate developments.

Conclusion

Since introduction of the PIT regulations in 2015, we have travelled a long way in increasing the awareness about the menace of insider trading and bringing in discipline among all market participants about prevention of insider trading which has resulted in us having a better regulated market. We must continue to remain steadfast in modifying the regulations and implementing all regulations in letter and in spirit to uphold the transparency and vibrancy which will certainly enhance confidence and would lead to expansion of market.

¹ As per SEBI (Prohibition of Insider Trading) Regulations, 2015 – “Proposed to be listed” shall include securities of an unlisted company:-
 (i) if such unlisted company has filed offer documents or other documents, as the case may be, with SEBI, stock exchange(s) or registrar of companies in connection with the listing; or
 (ii) if such unlisted company is getting listed pursuant to any merger or amalgamation and has filed a copy of such scheme of merger or amalgamation under the Companies Act, 2013.