The Indian Journal for Research in Law and Management

Open Access Law Journal – Copyright © 2024

Editor-in-Chief – Prof. (Dr.) Muktai Deb Chavan; Publisher – Alden Vas; ISSN: 2583-9896

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Meaning of Insider Trading

Insider trading is an unlawful practice that involves the purchase or sale of securities in violation of a fiduciary duty or trusted relationship, utilizing confidential and non-public information about those securities.

Those involved in insider trading exploit privileged non-public information for their financial gain or to avoid losses. The fundamental idea behind this term encompasses anyone who acquires undisclosed information that could significantly impact the prices of a company's securities.

Insider trading encompasses a range of activities, including buying, selling, subscribing, or agreeing to subscribe to a company's securities, whether directly or indirectly. This includes key personnel in management or company directors who are expected to possess unpublished price-sensitive information related to the company's securities. Such activities are categorized as insider trading.

Meaning of "Insider"

The term "insider" typically refers to individuals who have access to confidential company information and utilize it for trading securities. Insiders commonly consist of officers, directors, employees, major shareholders, and others associated with the company.

As per the SEBI (Prohibition of Insider Trading) Regulations, 2015, an individual qualifies as an "insider" under Regulation 2(1)(g) if they are either a connected person or possess or have access to unpublished price-sensitive information.

Regulation 2(1)(d) further elaborates that a connected person is someone who has been associated with the company within six months before the relevant act. This category encompasses immediate relatives, associated companies, officials of stock exchanges or clearing corporations, bankers of the concerned company, and other entities in which these

individuals hold an interest or have a stake of more than 10%. Additionally, legal consultants, auditors, and those with a direct or indirect interest in the company are also considered connected persons.

The SEBI (Prohibition of Insider Trading) Regulations, 2015 defines "Unpublished Price Sensitive Information" under Regulation 2(1)(n). This term encompasses any information, whether directly or indirectly related to a company or its securities, that is not generally available to the public. Such information, once made public, is expected to have a significant impact on the prices of securities. Typically, this includes details about financial results, dividends, changes in capital structure, capital restructuring, and modifications in key managerial personnel.

SEBI Regulations on Insider Trading

The issue of insider trading, which has been a persistent concern in the stock market and has been associated with various financial scandals, has led to regulatory action by SEBI. The Securities and Exchange Board of India (SEBI) has taken steps to promote transparency, fairness, and equitable returns for shareholders. To address this issue, the SEBI Prohibition of Insider Trading Regulations, 2015 (PIT Regulations) have been implemented. These regulations not only aim to improve the overall functioning of the stock market but also seek to maintain public confidence and trust, thereby encouraging investor participation. The absence of provisions related to insider trading in the Companies Act of 1956 necessitated the establishment of SEBI in 1988. Under Section 12-A of the SEBI Act, 1992, SEBI was granted authority to regulate matters about insider trading. The introduction of the PIT Regulations in 2015 marked a significant milestone in this regulatory journey.

Initially introduced in 1992, the regulations were found to be inadequate due to inherent loopholes. As a result, the PIT Regulations underwent amendments in 2015 and further revisions in 2018 to establish a more comprehensive framework for identifying and preventing instances of insider trading. These updates aim to address existing gaps and ensure a robust system for regulating insider trading activities.

The PIT Regulations encompass several significant characteristics. Initially, they incorporate comprehensive definitions of essential terms such as "connected persons," "designated persons," "Unpublished Price Sensitive Information (UPSI)," and "trading," thereby ensuring a wide-ranging scope that encompasses various individuals and activities.

Furthermore, the regulations incorporate protective measures to prevent potential abuses. Exceptions for trading plans and disclosures made in a fiduciary capacity, with the best interests of the company in mind, acknowledge that certain circumstances may necessitate deviation from the general rule. This flexibility allows for adaptability while still maintaining the integrity of the regulatory framework.

Additionally, the regulations include special provisions that offer insights into the legislative intent. These provisions grant discretionary authority to the Board, enabling them to define and implement measures by this intent. This empowerment allows the Board to uphold the overarching purpose of the Regulations, ensuring that interpretation and application align with the original legislative intent.

Expanded Scope:

The Regulations have expanded their coverage by including not only "listed securities" but also "proposed to be listed securities". This expansion aims to prevent individuals who possess insider knowledge about securities in the proposal stage from engaging in trading activities. Such trading activities have the potential to influence the prices of these securities, thereby impacting the market decisions made by shareholders. Moreover, it provides an unfair advantage to insiders, allowing them to maximize their profits and returns. In the context of insider trading, mutual fund units are treated similarly to securities, and any instances of insider trading involving mutual funds with Unpublished Price Sensitive Information (UPSI) are considered violations of these Regulations.

Nature of UPSI

The case of *Samir C. Arora v. SEBI* established that for an insider to be held accountable for insider trading, the Unpublished Price Sensitive Information (UPSI) must be accurate. If the disclosure of UPSI is later proven to be false, it falls outside the scope of the PIT Regulations as it does not meet the criteria of information capable of influencing security prices.

Penalty

As per Section 15-G of the Securities and Exchange Board of India Act, 1992, individuals who violate these regulations are subject to penalties ranging from a minimum of 10 lakhs to a maximum of 25 crore rupees or three times the profit derived from the insider trading transaction, whichever amount is higher.

Discretionary Powers of the Board

The Board of Directors and the compliance officer are granted significant discretionary power by the Regulations about insider trading matters. As stated in Regulation 3(3), the communication or procurement of UPSI will not be deemed a violation if it involves an obligation to make an open offer under the Takeover Regulations. However, this exemption is contingent upon the Board of Directors being convinced that it is in the "best interests of the company." The term "best interests of the company" is not defined in the Regulations and lacks clarification in legislative notes, thereby leaving the determination to the discretion of the Board.

Structure Digital Database

Regulation 3(5) requires the establishment of a Structured Digital Database (SDD) to ensure proper disclosure procedures. The primary purpose of this database is to record individuals who possess Unpublished Price Sensitive Information (UPSI) about the company. By doing so, it aims to prevent insiders from engaging in securities trading based on UPSI for personal gain, thereby safeguarding the interests of the company and its shareholders. Moreover, the SDD plays a crucial role as evidence in court during cases involving violations of these regulations. To maintain the integrity of the SDD, it must remain unalterable. The responsibility for maintaining the SDD lies with the compliance officer of the company or any individual authorized by the Board. The retention period for the SDD is a minimum of 8 years after the completion of the relevant transaction.

Conclusion

To summarize, insider trading has been a significant concern in the overall market, prompting SEBI's proactive regulatory intervention since 1992. SEBI has consistently strived to improve the regulations by making regular amendments and issuing circulars, aiming to rectify any possible deficiencies in the regulatory framework. The implementation of the Prohibition of Insider Trading (PIT) Regulations in 2015 introduced practical provisions that expanded the reach and effectiveness of the Regulations, leading to some progress in detecting cases of insider trading. However, there are still notable gaps that pose obstacles to the smooth functioning of regulatory mechanisms.