

INSIDER TRADING AND INDIAN STOCK MARKET

ABSTRACT

‘Insider trading’ in financial markets refers to trading in securities such as equity and bonds by company insiders who have access to exclusive information about the issuer of a particular security before such information is released to the general public. This allows insiders to benefit from buying or selling shares before they fluctuate in price.

Insider trading has been present throughout the history of financial markets, and was particularly prevalent during periods of elementary years of Indian stock markets. Insider trading is common in developing countries like India, where it is practiced by a wide range of market participants, corporate officers and regulative authorities. Primary insiders gain access to information by virtue of their position, employment or responsibility. They include controlling shareholders, corporate executives and officers, as well as financial-market professionals who compile information on a firm’s operation. Government officials with access to insider information also fall into this category. Secondary insiders are friends or relatives of primary insiders. Dynamic regulations not only help reduce the impact of such events but also help in restoring stability.

This study reviews the Insider Trading provisions in the Securities Market of India and the emerging trends and issues.

INSIDER TRADING – An Introduction

Insider Trading essentially denotes dealing in a company's securities on the basis of confidential information, relating to the company, which is not published or not known to the public, also called as unpublished price sensitive information, used to make personal profits or avoid loss. It is fairly a breach of fiduciary duties of officers of a company. It arises when an individual with potential access to non-public information about a company buys or sells shares or stocks of that company. The practice of Insider Trading came into existence ever since the very concept of trading of securities of joint stock companies became prevalent among the investors worldwide and has now become a formidable challenge.

The growing magnitude of the worlds' securities markets wherein trading in shares, derivatives and bonds takes place at international levels has further raised the concerns of the regulators all over the world. Insider trading caught attention of the public and the government owing to them suspecting unusual profit/gain of businessperson as well as shareholders. The Companies Act in India has exhibited dearth of competency to resolve trading issues along with limiting unfair trading.

The SEBI Act was enacted in the year 1992 to provide a regulatory framework to promote healthy trading and protect investors' interest to ensure growth of securities market. Under Section 11(1), 11(2) of SEBI Act and Section 30, SEBI has the legal power to intervene and prevent insider trading while the said sections also implement further regulations to limit illegal activities. The first case regarding violation of insider trading regulation was registered against *Hindustan Lever Limited* in India.

Insider trading is an extremely complex issue and it is almost impossible to get rid of it because it evolves from a very basic human instinct i.e., greed. One who is having insider information and arrive at a decision of future profit or reduction of loss by discounting such information, it is extremely difficult for him to keep himself abstained from trading based on that information. Present effort is an endeavor to understand the magnitude of this problem and regulatory practices that exist to combat it.

LITERATURE REVIEW

Rishikesh Desai and Yosham Desai (2010) in their article states that one of the fundamental and most general principles of law is that when any individual acquires any kind of special knowledge or price sensitive information by virtue of his or her confidential or fiduciary relationship with another individual, he cannot use such knowledge or information to his own advantage or for his own personal benefit and must account for any such profit so derived.

C. Koch Von (2014) says that the insiders regulate the price and status of stock market being aware of the firm's condition. UPSI is the key factor in insider trading while lack of monitoring, supervision and regulatory framework implicated in economic collapse of firms as well as nations.

Yesha Yadav (2016) in her research paper "Insider Trading and Market Structure" argues that the emergence of algorithmic trading raises a significant challenge for the law and policy of insider trading. It shows that the securities market are dominated by a cohort of "structural insiders" namely a set of traders able to utilize close physical and informational access to trade at speeds measured in milliseconds and microseconds, a practice loosely termed as high frequency trading (HFT).

Anil K. Manchikatla and Rajesh H. Acharya (2017) state the term insider trading is subject to many definitions and connotations and it encompasses both legal and prohibited activity. When a corporate insider trades by adhering to all regulations, it is called legal insider trading, and any violation of that amounts to prohibited insider trading. The past several decades have witnessed an increase in insider trading.

As per **Vinita Sharma (2016)** as the world continues to shrink, global financial markets are expanding and trading of shares, bonds, derivatives and other instruments continues to increase. These markets are the lifeline of capitalist economies, bringing in the much needed investment to fuel economic growth. A natural corollary to this function is the need for dynamic regulation that keeps pace with new developments – domestic as well as global to ensure global financial stability. Growing investments of middle classes of their savings in equity investment across the global markets makes it imperative that market fraud be taken seriously.

OBJECTIVE OF THE STUDY

This study focuses on the idea that the protection given against insider trading in the existing legal frame work is deemed to be inadequate in the present globalized era of financial market.

HYPOTHESIS OF THE STUDY

There is no relationship between the variables like annual income, age, gender, financial literacy, etc. and investment in the stock market.

RESEARCH METHODOLOGY

The present study is exploratory cum descriptive in nature as the researcher has to study the investment pattern in the securities market in India and impact of insider trading on the same.

RESEARCH FINDING

Insider trading is when some persons make extra gains in stock market through use of some undisclosed information, like information on expected dividends, expected decline or rise in profits, any information on acquisition, merger, potential threats etc. or any other price-sensitive information.

In the Indian context, the term insider is used for those who have direct or indirect connection to the organization or otherwise and have access to unpublished price sensitive information. Insiders can be connected individual or relatives but fact to be considered in this regard is the accessibility to unpublished price sensitive information. The individual who have any scope to get access or obtain unpublished price sensitive information of one company or group of companies is also liable to be marked as an insider. Accessibility and possession of unpublished price sensitive information is a major aspect to be considered as insider in Indian legal context.

The Indian legislation directs initial disclosure, continual disclosure and disclosure by other individuals connected. The promoters, directors and key managerial personnel are bound to disclose and report their shareholdings within 30 days of time while newly appointed promoters, directors and key managerial personnel get a period of seven days. The traded value when crosses the margin of ten lakh, in any calendar quarter the disclosure of the same by the promoter, director or employee shall be made within two days.

The regulations requires every insider to formulate a trading plan, in advance and present it to the Compliance Officer for approval & public disclosure, pursuant to which trades may be carried out by him or on his behalf.

The regulations requires every listed company in India to formulate and publish on its official website, a code of practice and procedure for fair disclosure³⁴ of unpublished price sensitive information and also a code of conduct³⁵ to regulate, monitor & report trading by its employees & other connected persons, so as to comply with these.

The Chinese wall arrangement functions as a defense against the allegation of insider trading. The defenses that can be utilized in case of proving innocence or defending own position following the ground of – information parity.

Securities and Exchange Board of India

SEBI is the supervisory body of all the stock exchanges in India. It is duty-bound to protect the interest of the investors in the securities market and to regulate the stock market through such regulations as it deems fit. The SEBI acts as the regulator in the share market by taking all preventive measures in order to build the confidence of the investors who are investing in the market.

SEBI is responsible for carrying out the investigation on complaints received from the shareholders about any malpractice in share market. SEBI is also duty bound to prohibit fraudulent and unfair trade practice relating to securities markets. SEBI as an independent

body carries its functions as defined by the Securities and Exchange Board of India Act, 1992. Any order passed by the SEBI is contested before the Securities Appellate Tribunal.

Securities Appellate Tribunal

It is a statutory body established under the provisions of Section 15K of the SEBI (Securities and Exchange Board of India Act), 1992 to hear and dispose of appeals against orders passed by the Securities and Exchange Board of India, regarding imposition of penalties or by an adjudicating officer under the Act and to exercise jurisdiction, powers and authority conferred on the Tribunal by or under this Act or any other law for the time being in force.

Insider trading is an extremely complex issue and it is almost impossible to get rid of it because it evolves from a very basic human instinct i.e., greed. One who is having insider information arrive at a decision of future profit or reduction of loss by discounting such information, it is extremely difficult for him to keep himself abstained from trading based on that information.

Present effort is an endeavor to understand the magnitude of this problem and regulatory practices that exist to combat it. Stock market is also important and an effective way of allocating scarce resources from surplus unit to deficit unit.

However, this is only possible where different segments of the financial markets are able to operate efficiently. The competition for external capital amongst small, developing and emerging financial markets has resulted in a growing awareness of the importance of investor protection laws if markets are to be competitive and hence a need to control the behavior of insiders who are involved in illegal insider trading is felt.

CONCLUSION

The impact, extent and effects of insider trading might vary in each country but any amount of insider trading has a massive effect on the reputation of the country. Every shareholder invests his money in the market with the prior faith of transparency and efficiency in the market. Any investor while making his decision about investment (to sell, buy or hold stock) relies upon the available price sensitive information provided by the listed company in the stock exchange. The investment into securities market has increased many folds in recent times. The globalization has created many ways to invest money and investment is being made all over the world by citizens of different nations.

When an investor relies upon the available price sensitive information, he has the prior thought of trust about the correctness of the value of the security he is trading. Even after making the price sensitive information public, still one segment of the company has the information which finally decides the value of the security. When such persons use this information to invest in the market they are known as 'Insiders'. Such insiders get the price sensitive information prior to the listing of the stocks in the market because of the position they are holding in the company. When such persons pass such information to other or use the same for their benefit either to buy or sell the shares, they are involved in insider trading.

Over the last few decades, world securities markets have become significantly more sophisticated in terms of how securities are traded as well as the variety of securities traded. The integrity of securities markets is critical to the economy of a country and it is necessary for regulators to enforce laws, prohibiting market abuse in order to protect market integrity. As a result of these changes, markets are becoming truly global, thereby, allowing traders to trade almost instantly across a wide variety of products and in markets around the world.

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