Volume II Issue II ISSN NO: 2582-6034

LEGALFOXES LAW TIMES

EVOLUTION OF INSIDER TRADING REGULATIONS AND THEIR EFFICACY IN INDIA

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ABSTRACT

Insider Trading regulations are a fairly recent inclusion in market regulatory frameworks and have gone considerable changes and amendments. Granted there were some provisions in the 1956 Companies Act too to mandate disclosure requirements etc. but there was no explicit regulation for tackling the same until the SEBI PIT 1992 Regulations. The glaring need for Insider Trading regulations was apparent during the famous 1992 TISCO Case where the culprits could never be convicted due to the lack of regulations. Even now, in 2020, after setting up many committees to suggest ways to tackle the menace of insider trading in India and having a dedicated regulation to tackle it, India still hasn't seen many successful convictions. In this project we will trace this evolution in legislations and regulations right from the disclosure provision in the 1956 Companies Act to the last 2020 SEBI (PIT) Amendment along with the role of various committees like NK Sodhi Committee and Patel Committee in refining the regulations. We want to analyze how the regulations have evolved keeping in mind the ever-dynamic market and how successful has SEBI been in enforcing the regulations comparing it with the regulations present in a free market economy like the United States of America.

INTRODUCTION

The Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015 defines "insider" as a person who is a connected person or in possession of or having access to unpublished price sensitive information[1] and "trading" as meaning and including subscribing, buying, selling, dealing, agreeing to subscribe, buy, sell, deal in any securities, and "trade".[2]

Clubbing these two definitions together we can say that insider trading is when one who possesses some material information that isn't public proceeds to trade in securities on the basis of such information. Or the person communicates this information to another who trades.

In more common parlance insider trading is "the illegal use of information available only to insiders in order to make a profit in financial trading."[3]

Before going into the provisions and case laws we will first need to understand why is it imperative to regulate and render this practise illegal.

One of the major arguments against insider trading is that a minority trades in 'non-public information' that is material, this, may, in the perception of the public, be unfair. This might in turn result in undermined confidence in the financial system and dissuade retail investors from their participation in such rigged market.

When an investor invests in a particular stock, they take an inherent risk. However, avoiding losses and benefit off of gains would certainly become much easier for the insiders who possess that information. This would eliminate the aforementioned inherent risk that is taken by an investor who is not privy to non-public information.

Public might start giving up on markets which will consequently result in the difficulty of raising funds for firms. Soon there would be barely any outsider left.

Now, since it is impractical to completely prohibit the insiders from trading, insider trading is across the world strictly restricted and monitored. Some of the key measures adopted are:[4]

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[1] SEBI (Prohibition of Insider Trading) Regulations 2015, s 2(1)(g).
[2] ibid at s 2(1)(l).
[3]Merriam Webster 'insider trading' https://www.merriam-webster.com/dictionary/insider%20trading accessed 25 October 2020.

1. Disclosures

It happens at two levels. First is for the purpose of preventing insider trading the insider and the company have to immediately disclose any material "undisclosed price sensitive" information. This is to ensure a level playing field. Second is that in order to reveal if any insider trading has taken place there must be disclosure of transactions undertaken.

2. Trading Restrictions

The restrictions may be placed on insiders from dealing in securities for specific time periods. This is to ensure that they do not use some material information for their benefit before it is known to the public and others. They may also be prohibited from dealing in securities for a time period after the information is made public.

3. Pre-clearance of Trades

Here, there is a pre-condition that the insider can trade only after they have obtained a prior approval as per the prescribed procedure and policy by the Company. A time period may also be prescribed.

In this project we will be discussing on the regulations with respect to this unethical practice of insider trading. First we will trace the evolution of legislations and regulations with respect to insider trading right from the disclosure provision in the 1956 Companies Act[5] to the recent amendments in the SEBI (PIT) Regulations. While doing so we will be discussing the important committees and their relevant recommendations and how they helped refine and update the Insider Trading Regulations with changing times and market.

We also analyse the efficacy of the regulations and the power vested on SEBI along with a comparison with the regulations in the US.

Our aim here is to us to evaluate the effectiveness of existing framework regulating Insider Trading and thereafter make recommendations to strengthen the same.

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[4]'Insider Trading Regulations – A Primer' Nishith Desai Associates http://www.nishithdesai.com/fileadmin/user_upload/pdfs/Research%20Papers/Insider_Trading_Regulations_-_A_Primer.pdf accessed 25 October 2020.

[5]Companies Act 1965, s 307, 308.

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CHAPTER 1 – EVOLUTION OF INSIDER TRADING REGUALTIONS

The US Supreme Court established an Insider trading rule in 1909 in the case of Strong v Repide.[6] Although it didn't state who an 'insider' is, it ruled that an executive could not use privileged information for profit. This rule was further crystallised in subsequent laws.

Despite the Insider Trading regulations being quite new, the concept of Securities Market isn't new to India. The inception of the oldest stock exchange – Bombay Stock Exchange in 1875 marked the beginning of functioning of securities market in India.

Until the SEBI Act of 1992 mainly two acts were regulation and governing this market. The Acts were:

- Capital Issues (Control) Act, 1947 or CICA
- Securities Contracts (Regulation) Act 1956 or SCRA

The former Act got repealed after the inception of SEBI Act 1992. Under the CICA an office was established that "granted approval for issues of securities." It also had the responsibility of determination of:

- amount of issue,
- type of issue, and
- price of issue.

In light of the liberalisation of the economy the CICA was repealed by way of an Ordinance on May 29th of 1992. This was for "paving way for market determined allocation of resources."[7]

The latter Act was for the purpose of *"preventing undesirable transactions in securities."* For this, the business of dealings was regulating by way of prohibition in options. In this Act, unlike CICA, all functions and powers were exercised by the Government of India.

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[6] 213 US 419 (1909).

[7] M S Sahoo, 'Historical Perspective of Securities Laws' (Institute of Company Secretaries of India) *<https://www.icsi.edu/docs/webmodules/Programmes/31NC/HISTORICALPERSPECTIVEOFSECURITIESLAWS-MSSAHOO.doc/>*

After the Securities and Exchange Board of India was established in 1992, with the interest of having integrated regulation of securities market, the benefits of having a single agency regulating the market was recognised. Initially only some powers of the Government of India were transferred to the Board under the 1992 Act, however, in 1996 all powers were taken from the GOI and vested with the SEBI.

So, it is evident how the security markets have existed since before independence. However, no real or effective regulation for insider trading came into being until the SEBI Act of 1992 followed by the SEBI PIT Regulations.

Now, the first attempt at curbing Insider Trading was made during the incorporation of the 1956 Companies Act. It was by way of a requirement for the Company Directors to disclose their shareholding. The same was provided for in Section 307 and 308 of the Act.

Section 307 provides for the register of directors' shareholding[8] and Section 308 vests the duty of the directors to make such disclosurers.[9]

> *"308. Duty of directors and persons deemed to be directors to make disclosure of shareholdings*
>
> *(1) Every director of a company, and every person deemed to be a director of the company by virtue of sub-section (10) of section 307, shall give notice to the company of such matters relating to himself as may be necessary for the purpose of enabling the company to comply with the provisions of that section.*
>
> *(2) Any such notice shall be given in writing, and if it is not given at a meeting of the Board, the person giving the notice shall take all reasonable steps to secure that it is brought up and read at the meeting of the Board next after it is given.*
>
> (3) *Any person who fails to comply with sub-section (1) or (2) shall be punishable with imprisonment for a term which may extend to two years,· or with fine which may extend to fifty thousand rupees, or with both."*[10]

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[8]Companies Act 1956, s 307.
[9]Companies Act 1956, s 308.
[10]ibid.

However, insider trading wasn't explicitly recognised until the 1970s. Post this there were a series of committees set up to recommend how to curb this unethical practice and this finally led to the SEBI Act of 1992. The committees will be discussed in this section along with the 1992 TISCO case which further emphasised on the immediate need for curbing Insider Trading.

1. Sachar Committee 1979

The Sachar Committee was established in the June of 1977 for the purpose of *"reviewing of the Companies Act, 1956 and the MRTP Act, 1969."*[11]It was also known as the "High-powered Expert Committee on Companies and Monopolies and Restrictive Trade Practices Act (MRTP)."[12]

It took two years for the committee to submit their recommendations. With respect to Insider Trading the committee said:

- Firstly, there should be full and complete disclosure of transactions by the persons who have made price sensitive information. And secondly, these persons are prohibited from making transactions during a specified period unless there are some exceptional circumstances.[13]
- From among the insiders, a company director, statutory auditor, accountant, tax and management consultant or advisor and legal advisor etc. were identified as those persons could indulge in such activities. And hence prior to and after two months of the close of the accounting year these identified insiders could not take part in the purchasing or selling of share. The only exception is when the Board has granted explicit permission.
- A register must be maintained by all public companies. This register must disclose the dealing of the company in shares by the aforementioned persons who are:
  - full time employed in the company, and
  - drawing a salary of three thousand rupees or more every month.[14]

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[11]ShradhaRajgiri, 'An Analysis Of Insider Trading In India' [2019] 9(3) Pramana Research Journal <https://www.pramanaresearch.org/gallery/prj-p565.pdf> accessed on 25 October 2020.
[12] 'Prohibition of Insider Law and Practice ' [2007] The Institute of Company Secretaries of India 9.
[13]Ministry of Corporate Affairs, *Rajendra Sachar Committee Report* (1979) 8.28.
[14]ibid 8.19.

 ISSN NO: 2582-6034

- Additionally, amendments were recommended to the Companies Act of 1956 in the sections 307 and 308. The Committee recommended prohibition and restriction on specific dealings by these identified persons or insiders and their relatives.[15] They also recommended a provision for penalty if it is found that someone has misused information relating to a company. It also added that there should be a provision for remedies to those who are able to establish that this misuse resulted in loss to them.[16]
- They also stated that there must be some accountability on part of the insider for the profits made by him to the company.

2. Patel Committee 1987

Another High-Powered Committee was constituted by the Government in 1984 with the purpose of conducting a comprehensive review and making recommendations thereafter on the functioning of the stock exchanges.

This committee possessed a serious outlook towards the lack of legislation in India for curbing and regulating the misuse of insider information. Therefore they recommended strict penalties for those who commit insider trading.

The report mentions their findings that:

- This undesirable practise is pervasive in the stock exchanges and "one of the principal causes of excessive speculative activity".[17]
- The offenders included people beyond just the employees of the Company. Those in the office of solicitors, financial consultant, auditors, and financial institutions who possessed some "undisclosed price sensitive information" have indulged in Insider Trading.
- The committee pointed out the "unhealthy" practice of the stockbrokers, while transacting for their clients, of engaging in speculative transactions in their own accounts.

[15]ibid 8.28(iii).
[16]ibid 8.28(viii).
[1717]Ministry of Corporate Affairs, *Patel Committee Report* (1986) 7.26.

- The Committee recommended that it should be ensured that the concerned stock exchanges are made privy, as soon as possible, to the news or developments that affect the companies and are price-sensitive in nature. This information must be given as soon the company places it on the agenda of the board and thereby circulates it among the directors.
- The Committee was of the opinion that there is a necessity to have proper regulations for such trading in order to establish and foster a healthy and transparent practise in the stock exchanges and also in order to maintain the confidence and faith of the investors.
- There were also recommendations for amending the SCRA so as to effectively free the Stock Exchange from manipulative and undesirable practices like insider trading.
- Penalty was also recommended for any non-compliance and violation of the regulations:
  - In case the offender is an individual then there will be a penalty of Rs. 1 Lakhs and/or imprisonment for five years.
  - In case the offender is a body corporate and trust, the penalty would be of Rs. 5 Lakhs
- In addition to this, the Committee recommended that by law the person who engaged in insider trading could be compelled to surrender the amount of profit he had made by misusing the "undisclosed price sensitive information" or surrender the loss he may have averted using this, to the stock exchange.

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3. AbidHussain Committee 1989[18]

Also known as the "Working Group on the Development of Capital Market" this committee was set up in 1989. It recommendations in relation to insider trading were:

- It should be made a major offence with not just civil penalties but also criminal penalties.
- The said by having appropriate regulatory measures the menace of insider trading and secret takeover bids could largely be dealt with.
- Further, SEBI could be vested with the responsibility to formulate and oversee the proper enforcement of legislation as and when necessary.

[18] Planning Commission India, *AbidHussain committee: Report of the working Group on the Development of the Capital Market* (1989).

4. TISCO Case, 1992[19]

During the first half of FY 1992-93 Tata Iron and Steel Company recorded a fall in the profit before tax in comparison to year 1991-92 and 1990-91. Then between the dates 22nd October and 29th October, 1992 there was intense activity in volume of shares traded of TISCO.

Post this trading activity, TISCO experienced a sharp fall in the price of its share. SENSEX4 too registered a fall during the exact same period.

Now, this steep fall in the share price while the active trading pointed towards insider trading i.e. it could be said that the insiders who had information about poor results of the company manoeuvred the market with the purpose of making 'large short sale'.

Despite the initiation of investigation by the Bombay Stock Exchange and the repercussions on the small investors due to the actions of insiders, no action could be taken even if there is proof of insider trading. This was due to the lack or rather absence of regulations against insider trading in India.[20]

CHAPTER 2: DEVELOPMENT OF A REGULATORY FRAMEWORK

As mentioned in the chapter preceding this one, Insider trading laws in India developed much later as compared to other countries. The first time it was exclusively recognised was only in 1992. This marked the beginning of a series of regulations, committee recommendations and subsequent amendments that have framed the law that we have today.

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1. Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations 1992[21]

This was the first comprehensive law dedicated specifically to Insider Trading. It also clearly established SEBI as the regulatory authority to deal with such matters. Earlier that year, the SEBI

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[19]Saumya, 'Changes In The Insider Trading Laws In India' (JudicateMe, 8 August 2020).<https://judicateme.com/changes-in-the-insider-trading-laws-in-india/> accessed on 25th October 2020.
[20] H.R. Machiraju, 'The Working of Stock Exchanges in India' [2009] New Age International, 164-165.
[21]SEBI (Prohibition of Insider trading) Regulations 1992.

act[22] stated that it was the responsibility of the board to protect the interests of investors in securities and promote the development of, and to regulate the securities market, by such 'measures' as it thinks fit.[23] Such 'measures' can provide for the prohibition of insider trading in securities.[24] It is under this provision that the new regulations were formed.

The PIT regulations were the first to define insider trading. It defined insider as a person connected to the company and so is expected to have access to unpublished price sensitive information (UPSI) about securities.[25] It further defined 'price-sensitive information' and 'unpublished' to establish what kind of information comes under these provisions.[26]

The regulations prohibited insiders (having sensitive information) from dealing in securities of companies listed on stock exchange, or even communicate or procure such information.[27] The regulations give SEBI the power to not just try but investigate these matters, laying down a procedure for the same.[28] The insider is obliged to comply with the board's requirements like produce evidence, allow them reasonable access to their premises, etc.[29]

The penalties, inquiry and investigations are conducted by SEBI, which draws its powers from the SEBI act of 1992. Earlier, there was a single section, prescribing a punishment of maximum one year with or without fine for all offences under the act or its regulations.[30] This section was expanded in 1995, where a harsher punishment was imposed for not paying penalties.[31] However, in the same amendment, SEBI added a specific penalty for insider trading, prescribing a fine of maximum 5 lakh.[32] This penalty was then increased to 25 crore rupees or three times the profit made out of it, whichever is higher.[33] The current penalty is a maximum of 10 lakh, which may extend to 25 crore or three times the profit made out of insider trading, whichever is higher.

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[22]Securities and Exchange Board of India Act 1992.
[23] Ibid s11(1).
[24] Ibid s11(2)(g).
[25]SEBI (Prohibition of Insider trading) Regulations 1992 s 2(e).
[26]Ibid s 2.
[27]Ibid s3.
[28]Ibid s6.
[29]Ibid s7.
[30] Securities and Exchange Board of India Act 1992 (not amended) s24.
[31]Securities and Exchange Board of India (Amendment) Act 1995.
[32] Ibid.
[33]Securities and Exchange Board of India (Amendment) Act 2002.

This amendment was made to bring it in harmony with the newly implemented companies act, as discussed later.[34]

2. Companies Act 2013

While the previous version of the act[35] did not explicitly recognise insider trading, this version does. When initially enacted in 2013, the act included strictly prohibited insider trading of securities. Under the chapter of meetings and powers of board, the section prohibited any person, including the director or key managerial personnel to engage in insider trading, exempting communications required in ordinary course of business under law. The section further defined the terms ‘insider trading’ and ‘price-sensitive information’. It further prescribed a punishment for violation – imprisonment up to 5 years or a fine (5 lakh to 25 crore or thrice the profits made out of insider trading, whichever is higher).[36]

This section increased the scope of the prohibition on insider trading. The 1992 regulations were made by SEBI and so covered only listed companies, while including it in the Companies act made the prohibition applicable to all companies. The scope of its application was later clarified in the 2015 PIT regulations, which stated that it included listed companies, as well as companies ‘proposed to be listed’. Section 195 was later omitted by an amendment in 2017 so as to avoid discrepancy with the PIT regulations.[37] The procedure to conduct inquires and investigation are given under the SEBI act, which is done like any other inquiry or investigation. Additionally, in 2002, a provision was added in the SEBI act, prohibiting insider trading and dealing with securities while in possession of UPSI.[38]

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3. Justice NK Sodhi committee

In 2013, a high level committee was set up under the chairmanship of former chief justice, N.K. Sodhi which was given the task of reviewing the existing 1992 PIT regulations. The committee reviewed the insider trading regulations of various countries such as Australia, Canada, Israel,

[34]Securities and Exchange Board of India (Amendment) Act 2014.
[35] Companies Act 1956 (repealed).
[36] Companies Act 2013 s195 (omitted).
[37]The Companies (Amendment) Act 2017.
[38] Securities and Exchange Board of India (Amendment) Act 2002 s12A(d),(e).

New Zealand, Singapore, UK and USA. It also based its results on the public comments received. The committee realised that insider trading is difficult to prove but also felt that once it is proved, the delinquent should be dealt with severely. The committee introduced the idea of 'legislative notes', which are small notes proceeding every section of the regulations stating the legislative intent behind that particular section. This is done to give a better comprehensive understanding of the law, as well as to eliminate any ambiguities in it.[39] On the basis of these deliberations, it presented as a part of the report, a draft of the proposed regulations, which was later refined and enacted as the new PIT regulations in 2015.[40]

Firstly, it proposed increasing the scope of application of the regulations, in sync with the new Companies act. The definition of 'Insider' was simplified and categorised into 'connected persons' and 'persons with Unpublished price-sensitive information (UPSI)'. The new regulations further defined UPSI as a whole and also explained the term 'generally available information'. While the earlier provisions gave out a specific list of things that come under 'price sensitive information', various tribunal orders over the years had stated that the list isn't exhaustive. The new regulations take this into consideration, by giving definitions accompanied with explanatory notes rather than a list. The proposed regulations further clarified the extent of the offence, including mere disclosure of UPSI in certain cases. The committee suggested replacing the term 'dealing' with 'trading' so as to limit the scope to insider trading only and not include other forms of market abuse.

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Section 3B of the old regulations listed the defences available to accused persons. These were rebooted in the proposed regulations. While the 'Chinese wall defence' was retained, most of the others were modified. The concept of 'trading plans' was introduced. Insiders who have UPSI are expected to make a trading plan, including sufficient safeguards and the plan is to be approved by the company's compliance officer. The disclosure requirements were also enhanced.[41]

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[39]Securities and Exchange Board of India, *NK Sodhi Committee: Report of the high level committee to review the SEBI (Prohibition of Insider Trading) Regulations 1992* (2013) p 2-7.
[40] Ibid part 3, p45-70.
[41]Nishith Desai, 'Insider Trading Norms Revisited: An Analysis of the N.K. Sodhi Committee Report' (Nisith Desai Associates, 2014).
<http://www.nishithdesai.com/fileadmin/user_upload/pdfs/NDA%20Hotline/Regulatory_Hotline/Link_2.pdf > accessed on 2nd November 2020.

4. SEBI (PIT) Regulations 2015

In 2015, SEBI repealed the existing 1992 regulations and put a new one in place. It is on similar lines, but is more comprehensive. They apply to public companies that are already listed, as well as those which are 'proposed to be listed'. The regulations follow a unique format where most of the provisions are followed by explanatory 'notes', which clarify them. These PIT regulations define an insider as a person who is connected with the company or has any 'unpublished price sensitive information' about it.[42] Unpublished price sensitive information (UPSI) refers to information related to the company's securities and other affairs that are 'not generally available' (not in public domain) and is likely to affect the price of securities.[43] It is important to note that an insider may not always be connected to the company. In order to circumvent the law, traders often share such information with unrelated third parties but this law covers that. If the person has such information, irrespective of who he/she is or how they landed such information, he/she comes under the definition of an insider. Additionally, PIT prohibits not just trading, but also communication of UPSI by insiders.[44] This makes it more comprehensive in the sense that it allows for abolition of insider trading from the roots.

The regulation prohibits three things:

1. Insiders communicating UPSI.[45]
2. Any person procuring or causing the communication of UPSI.[46]
3. Insiders with UPSI trading listed securities.[47]

Thereafter, PIT prescribes, in detail, the disclosures to be made by insiders. This includes initial, continual and disclosures by other connected people.[48] PIT further provides a code for fair disclosure, where the company is supposed to have an established code of fair disclosure, which

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[42] SEBI (Prohibition of Insider trading) Regulations 2015 s2(g).
[43] Ibid s2(n).
[44] Ibid s3.
[45] Ibid s3(1).
[46] Ibid s3(2).
[47] Ibid s4(1).
[48] Ibid s6-7.

should be there on it's website.[49] They also have to develop a code of conduct in compliance with the other provisions.[50] Any violations of the regulations are to be dealt with by SEBI as prescribed in its act, the scope of which has been discussed in the earlier parts.[51]

5. TK Vishwanathan panel report

On August 8, 2018, a committee under the chairmanship of Dr. TK Vishwanathan submitted a report on fair market conduct, which included reviewing the PIT regulations, and suggesting a number of amendments. It focused on building a strong legal framework to tackle unfair trade practices like insider trading. It used an outcome-based approach in combination with a practice-area approach, where the work was divided in sub-committees with specialised knowledge in certain areas. The recommendations were then comprehensively by the main committee for finalising them. The committee noticed a small difference between section 12A of the SEBI act which prohibits insider trading and section 15G, which deals with the penalty for it. While 15G prescribes dealing with securities 'on the basis of' UPSI, section 12A mentions dealing with securities 'while in possession of' UPSI. The committee saw a need to align these sections.

The committee also saw a need to clarify some of the definitions on the PIT regulations, such as the term 'financially literate' and 'proposed to be listed'. Further, it felt companies should define their own policy for 'legitimate purposes', which is an exception to procuring UPSI under regulation 3. The committee then analysed the defences under regulation 4 and suggested a new set of defences since the existing ones were seen as narrow. It then recommended some clarifications with respect to filing of trading plans. They then moved on to the code of conduct under regulations 8 and 9 of the PIT. They recommended creating separate code of conducts for listed companies and others (market fiduciaries, auditors, accounting firms, or any persons who need to handle UPSI). They also suggested a draft code for this purpose.

Another important issue addressed by the committee is the implementation of the codes of conduct. This could be done by creating institutional responsibility for their implementation,

[49]Ibid s8.
[50]Ibid s9.
[51]Ibid s10.

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whereby the CEO/MD of a listed company would have to make an internal code of conduct based on the recommended guidelines. Intermediaries should have similar mechanisms. It then addressed the issue of leakage of UPSI, stating that such leaks severely harm the reputation of the company and so inquiries should be made. The companies should make their own policies and procedures to deal with it. Whistle-blower policies would help. Since investigating insider trading is very difficult, the committee recommended more disclosures by designated persons, making an online database to assist during investigations. They also suggested granting SEBI the power to tap phone records.[52] While sharing UPSI for legitimate purposes, confidentiality agreements should be signed, restricting individuals from discussing the information.

6. 2018 amendment to PIT regulations[53]

This amendment was based on the recommendations of the Vishwanathan Committee report. It incorporated the clarifications and definitions recommended. Another provision was added telling the board of directors to make a structured digital database having names and other information of people as suggested to help during investigation. They also expanded the scope of insider trading by adding an assumption, stating that when a person with UPSI trades securities, it is presumed that it was motivated by the knowledge of that information. This makes it easier for SEBI to hold offenders liable. The defences under regulation 4(1) were expanded, as suggested by the committee. The requirements to make a trading plan were relaxed for approved trading plans.[54] A number of clarifications were made regarding market intermediaries and the term ‘fiduciary’ was defined in the context.

Another major change that took place was the direction to form an institutional mechanism to prevent insider trading. As suggested by the committee, the responsibility has been shifted to the CEO, MD and other people in listed companies to make a database of people having UPSI and formulate written policies and procedures for inquiry in cases of leak. They also directed the companies to have a whistle-blower policy to report cases of leak. This was added in the new

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[52]Jayshree P Upadhyay, ‘How India cracks down on Insider Trading?’ (livemint, 28 Janurary 2020). <https://www.livemint.com/market/stock-market-news/how-india-cracks-down-on-insider-trading-11580199120367.html> accessed on 10th November 2020.

[53] Securities and Exchange Board of India (Prohibition of Insider Trading) (Amendment) Regulations, 2018.

[54] Ibid s3(4)

regulation 9A. The other major addition in the existing PIT regulations was Schedule C, which has prescribed the minimum standards for code of conduct for intermediaries and fiduciaries. The existing code of conduct in schedule B will now be applicable only to listed companies. This is in accordance with the committee's recommendations, which explicitly suggested separation of the code of conducts.

7. 2020 amendment to the PIT regulations.[55]

These amendments came into effect in July 2020, with an aim to enhance the digital database and automation of shareholding disclosures.[56] The previous amendment had provided for creating a database with information about people having UPSI. This had raised many doubts, clarified in FAQs by SEBI. By this amendment, SEBI has clarified how to make the digital database, what information to keep and to how maintain it with an internal control mechanism.[57] Secondly, listed companies have been given the power to take disciplinary action for not complying with the code of conducts given in the schedules. These actions include wage freeze, suspension, recovery. This is an attempt to strengthen the institutional mechanism for preventing insider trading, which would reduce SEBI's burden.

CHAPTER 3: EFFICACY OF SEBI IN HANDLING CASES OF INSIDER TRADING

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India despite tones of Regulations on Insider Trading has seen a significant rise in the cases pertaining to the same. The provisions, regulations and amendments laid down by SEBI for curbing insider trading have already been discussed in the previous chapter. We need to scrutinize the working of the Board in order to understand its powers and efficacy in handling such cases.

Despite the various amendments based on the recommendations of committees like the NK Sodhi Committee and T.K Viswanathan Committee, the instances of Insider Trading have still

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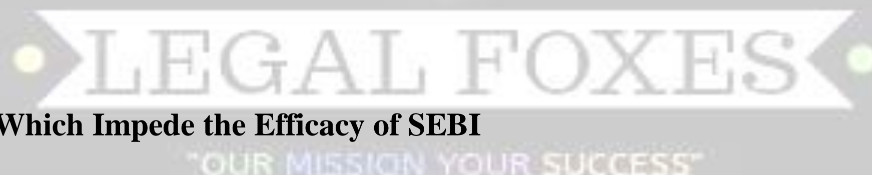
[55] Securities and Exchange Board of India (Prohibition of Insider Trading) (Amendment) Regulations, 2020.
[56]Rohan Banerjee, Tanya Nayyar and Anushka Shah, 'Recent Amendments to the Insider Trading Regime' (India Corporate Law: A Cyril AmarchandMangaldas Blog, 3 August 2020).<https://corporate.cyrilamarchandblogs.com/2020/08/recent-amendments-to-the-insider-trading-regime/> accessed on 28th October 2020.
[57] Ibid.

been rampant and the Indian securities market regulator have been criticized for the same.[58] A glance at the provisions of SEBI gives us the idea that the failure to curb such perpetrators is due to the lack of investigative powers vested upon the Board.

The Securities and Exchange Board of India despite taking up a number of cases of insider trading for investigation, has not succeeded in convicting the culprits accordingly. As per the reports of SEBI, it took up around 85 cases for investigation but succeeded in completing 25 of them.[59] However, from 1992 the evolution of laws relating to insider trading is evident and the recent amendments have tried to make the companies more accountable for the leak of Unpublished Price Sensitive Information (UPSI) and is also creating onus on them to protect the same. The 2015 Amendment and the recent Amendment in 2020 have made it mandatory for the companies to maintain a database with the details of the people in possession of UPSA so that transparency can be ensured.[60]

Despite the various models and schemes adopted by the regulatory body, the perpetrators are not dealt with the required sternness. The provision imposes a penalty of up to Rs. 25 crores or three times the amount of profits earned as result of insider trading (whichever is higher)[61] on the perpetrators which clearly shows that the monetary quantification do not amount to severe punishments thus encouraging people to indulge in such white collar crimes even more.



1. **Issues Which Impede the Efficacy of SEBI**

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We have already discussed that the investigative powers vested upon SEBI are not sufficient and its leniency in dealing with such white collar crimes has attracted much criticism. Thus we shall elucidate on the issues faced by the Board itself and how can the same be overcome.

i. SEBI's Limited Power in Accessing Call Records

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[58]'Why SEBI is Failing at Regulating Insider Trading in India' (*Indian Corp Law Blog*, 20 February 2018) <https://indiacorplaw.in/2018/02/sebi-failing-regulating-insider-trading-india.html>accessed 20 October 2020.

[59] Securities Exchange Board of India Annual Report 2017-18 <https://www.sebi.gov.in/reports/annual-reports/aug-2018/annual-report-2017-18_39868.html> accessed 20 October 2020.

[60] Prohibition of Insider Trading (Amendment) Regulations 2020.

[61]Securities Exchange Board of India (Amendment) Act 2002, s 15G.

Usually in such white collar crimes, it is necessary to collect and produce clinching evidence[62] to convict the perpetrator and it is therefore necessary to have a tool to trace the links of the person and establish his connection with the crime too. However till 2014, SEBI did not have the power to access call records of the accused which it all the more difficult for the body to collect evidence. The necessity for the same was recognized in the huge Saradha Chit fund Scam in 2013 when the Government was compelled to pass the Ordinance[63] which enabled SEBI to access the phone records of persons under investigation. This Ordinance got full effect retrospectively in 2014 through the Act.[64]

The law passed was a remarkable step taken by the Government but it is deeply saddening to witness that it took the Government a 6 billion dollar scam to realize the need for such amends especially in this digital era where crimes can be committed and very easily gotten away with. The lack of power to go through the phone records tied the hands of SEBI as before this amendment they had the power to only go after suspected offender and analyze their trade patterns on the stock market which gave the offenders an opportunity to easily evade the surveillance of SEBI as they always found a way out in the name of "dummy companies".

ii. SEBI's Lack of Power to Tap Phone Calls

Despite the recommendations of the TK Viswanathan Panel[65], SEBI still awaits the grant of power to tap phone calls. The practice of phone tapping is used extensively in other countries and jurisdictions including U.S.A as they prove to be one of the most crucial tools for any investigative body to establish the link of the offence with the suspect. In India, the power of phone tapping is used for very limited purposes apprehending the misuse of the same and is governed by an 1885 Act[66]. The guidelines for phone tapping in criminal cases have been laid down in cases[67] but SEBI is still barred from exercising this power.

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[62] *Samir C Arora v Securities Exchange Board of India* [2005] 59 SCL 96 SAT.
[63] Securities Laws (Amendment) Second Ordinance 2013.
[64] Securities Laws (Amendment) Act 2014.
[65] TK Viswanathan Committee, *Report on Fair Market Conduct* (8 August 2018).
[66] Indian Telegraph Act 1885
[67] *People's Union of Civil Liberties v Union of India* [1997] AIR SC 568.

ISSN NO: 2582-6034

The importance of phone tapping can be explained through the case of Rajat Gupta[68] and Rajatratnam in U.S.A for insider trading at Goldman Sachs.[69] Here, it would have been extremely difficult for the U.S Securities and Exchange Commission to unearth crucial evidence against them had phone tapping not been allowed. The conversation between Mr. Gupta and Mr. Raj Rajaratnam became the sole ground for their conviction. Similarly, if SEBI is granted such powers too, conviction rates would automatically shoot up.

iii. Adjudication of Penalties by SEBI

SEBI has been trying to persuade the Government to get additional powers pertaining to wiretaps and accessing phone records. However, we need to check whether SEBI has been able to successfully utilize all the powers vested upon it or not. SEBI though vested with the power to impose monetary penalties extending up to Rs. 25 crores or three times of the profit earned through Insider Trading[70], we haven't practically seen SEBI imposing penalties as huge as 25 crores. We are yet to witness onerous penalties being imposed on the perpetrators to discourage them.

In a recent incident of leak of UPSI through Whatsapp chats, SEBI penalized two people, Neeraj Kumar Agarwal and Shruti Vishal with a penalty of only Rs. 15 lakhs each. The two people were caught leaking UPSI with regards to the company, Ambuja Cements and earlier they were caught circulating such sensitive information of the company Bajaj Auto too.[71] Such petty penalties are not enough to discourage offenders from carrying out white collar crimes.

Apart from the low monetary penalties, another point of leniency shown by SEBI in cases of Insider Trading or other market related malpractices are that despite having the power to institute criminal proceedings against the offender, it has never exercised this power. The provision lays down that in case the accused is proven guilty, he will be sentenced

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[68] *United States v. Rajat K. Gupta* [2012] 11 Cr. 907 (JSR).
[69] *U.nitedStates. v. Rajaratnam* [2010] 09 Cr. 1184 (RJH).
[70] SEBI Act 2002 (n 61).
[71] 'SEBI Penalises Two Persons in Whatsapp Leak Case' *Economic times*(New Delhi, 1 June 2020) <https://economictimes.indiatimes.com/markets/stocks/news/sebi-penalises-two-persons-in-whatsapp-leak-case/articleshow/76135232.cms> accessed 20 October 2020.

with a maximum term of 10 years[72] but SEBI is often seen reluctant in approaching the Criminal Court even in massive cases of malpractice. However with regards to monetary penalty, we can see that SEBI is taking stringent actions with every passing year. In the case of Indiabulls Ventures Limited v SEBI[73], SEBI imposed a penalty of Rs. 87.21 lakhs and the penalty was the alleged gains of the two insiders with an additional interest of 12% on the gains. Such actions can act as deterrence considering that the penalty levied had the capacity to cause significant loss to the offenders.

iv. Lack of Manpower for Investigation

It is speculated that there are approximately 800 employees working for the Security Exchange Board of India which makes it nearly impossible for the Board to regulate every company on the Stock Exchange. In addition to lack of human resources, we cannot ignore the fact that cases of insider trading are difficult to investigate especially considering that SEBI has limited powers. The offender can easily get the benefit of doubt if direct corroborating evidence is absent.[74]

2. Comparison of Indian Regulation with USA Regulations

USA remains one of the prime enforcers of Insider Trading Regulations successfully within its jurisdiction while India still has regulations which are termed as "Paper Tiger" given the loose implementation of the same on the part of SEBI. US Laws on Insider Trading and their regulatory body, Securities Exchange Commission have especially hogged the limelight after the conviction of Mr.Rajat Gupta with an imprisonment for a term of 2 years[75] and Mr. Raj Rajaratnam[76] in the massive leak of price sensitive information of Goldman Sachs.

In US, the first legislation to tackle the problem of Insider Trading was brought into force in 1934[77] especially after the Great Depression which marred the country in 1929. One of the rules

[72]Securities Exchange Board of India Act 1992, s 24.
[73][2019] SCC OnLine SEBI 81.
[74]*Dilip S Pendse v Securities Exchange Board of India* [2009] Appeal No. 90 of 2007.
[75]Rajat Gupta (n 68).
[76]Rajaratnam (n 69).
[77]Securities Exchange Act 1934.

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which is commendable in US is that a general anti-fraud rule is made applicable on unlisted securities as well in order to curb any the practices of deception in the securities transaction in contravention of Securities Law.[78] This provision clearly shows that the ambit of powers conferred upon the SEC is greater than that of SEBI considering that SEBI is mostly concerned with public listed companies and listed securities or cases where public at large is involved.

Apart from the provisions and regulations laid down to govern the Securities Market, the Judiciary in US has been quite active in developing Jurisprudence pertaining to the issue of Insider Trading. The Courts have been successful in devising two theories: Disclose or Abstain Theory and Misappropriation Theory.

The Disclose theory is also known as the classical theory which majorly targets the directors, officials and employees or any other person involved in Insider Trading. Here the insider is supposed to disclose the Unpublished Price Sensitive Information to the public before either making the trade or abstaining from the same.

The Misappropriation Theory applies to people who are not exactly insiders but manage to get UPSI of the Company from an insider and use the same for trade with a third party. Apart from the Exchange Act, the Sanction Act[79] of US also aids in penalizing offenders who leak such non-public information and imposes a penalty up to three times the profit gained or loss avoided with the help of such information.

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Though a similar provision regarding penalty is included in the Indian Statute as well, it is imperative to note that such drastic step has never practically been taken by the SEBI. Despite being conferred with the requisite powers in certain field, SEBI has proved to be inefficient in exercising the same. US laws appear to be much more stringent and the law there also entitles the SEC to recover the profits within a period of 6 months obtained from the purchases and sales from such securities. This recovery can be made either from the Company itself or from any security holder on its behalf.

[78]Securities Exchange Act 1934, s 10(b).
[79] United States Sanction Act ,1984.

3. Issues Encountered by SEBI Considering the Rights Vested Upon Suspects

Though the Insider Trading Regulations remain silent on the standard of proof required in order to establish the case of Insider Trading, the same has developed over the years through an array of cases. The most prominent case which can be recollected was the case of Samir Arora v SEBI[80] which indirectly laid down certain criteria for SEBI to follow while adducing evidence. The Securities Appellate Tribunal (SAT) stated that though it might be difficult to collect evidence with respect to charges pertaining to market manipulation or Insider Trading, the mere difficulty cannot allow suspicions, conjectures or suspicions to take place of Evidence. It was further made clear by the SAT that reasonable standard of proof must be complied with by the evidence produced to satisfy the establishment of Insider Trading.

These guidelines or criteria as laid down by the Appellate Tribunal open our eyes towards the need of more powers by SEBI to investigate such matters. Courts have taken initiatives and pronounced verdicts taking into consideration the rights of the accused or suspects but equal proportion of eagerness is not seen among Courts in identifying more powers for the regulatory body so that the criteria of standard of proof can be met with.

CONCLUSION

The Stock Market works on the basis of trust and it becomes imperative to safeguard the interests of the investors and protect them from scams and frauds on the part of the companies. Therefore, the Regulatory body of India, Securities Exchange Board of India (SEBI) introduced various regulatory codes to supervise the Stock Market. Insider Trading is one of the most popular scams indulged into by "insiders" of the company thus causing a loss to the innocent investors.

Through this project we have marked the evolution of the laws on Insider Trading starting from Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations 1992 to the Amendment of 2020. It was brought to the notice of SEBI before 1992 that various big shot company employees were involved in such trading as they were in possession of unpublished price sensitive information which they used to their own advantage. However the SEBI in order

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[80] [2005] 59 SCL 96 SAT.

to keep up with the advancement of technology has kept on amending and inserting new provisions to the 1992 Regulations. We have not only discussed the current provisions to curb insider trading but we have also given a comparative picture of the market before and after the implementation of the Regulations.

The constant amendments and independent provisions with regards to Insider Trading have however resulted in lacunae in curbing insider trading which have been well identified and elucidated upon. The Regulatory body, SEBI is not seen vested with enough powers to investigate matters of insider trading and thus there have been recommendations of various High level Committees too on that aspect. There have been further amendments in the Code in lines with some of the recommendations but the others are yet to be implemented.

The discrepancies in the powers vested upon SEBI have been discussed at length and we have tried to put forth some of our suggestions to curb Insider Trading as well. We thus finally conclude though right now the instances of insider trading may not have reduced, we can be hopeful that in the near future the entire system will be revamped where the SEBI will be vested with more powers and it will be efficiency driven.

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