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"IMPACT OF INSIDER TRADING ON SECURITIES MARKET IN INDIA: A CRITICAL ANALYSIS"

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ABSTRACT

The 21st century has changed the ways of doing business. The online means of doing business has led to massive increase in business activities. The rapid expansion of corporate business all over the world has opened various new business ventures. In the era of corporate world, everyone aims to make big money in short period. In the era of globalization, and competitive world, the general public has started to invest their money in different modules taking derivation from traditional means of investment. The trading of shares in the securities market has become the common place to invest for everyone. One such trading which has earned a bad name in recent times is insider trading. The menace of insider trading is a fraud on the trust of common investors who invest in the market on the basis of available price sensitive information. The problem of insider trading is growing with each passing day and every market regulator all over the world is making regulations to curb insider trading. For the growth of securities market it is impediment to have transparent and shareholder friendly market. The continuous flow of investment is major requirement for a market to grow. Insider trading not only impacts the flow of trading in the market but also earns a bad name for the nation. In the *era of competitive world, each nation needs investment and for such investment each nation needs transparent and progressive market. The growth of market reflects the development of a nation. In India, SEBI is a regulatory body which control and administers the market. Though, the investment in the securities market depends on the market conditions still it is one of the most sought after investment destination. People by investing in the securities market can do more with their money than they would do in other investment.*

Keywords: Insider trading, Securities market, SEBI, Company law.

Introduction

"There is a sufficiency in the world for man's need but not man's greed."

Mahatma Gandhi

Whenever we talk about growth we assume it to be in financial sector only. The word growth has become synonymous to financial development. We are living in the era where development of a nation is measured generally by referring to its financial standards suppressing all the other basic indexes. With the growing global financial relationship between the countries all over the world, the investment in securities market has increased many folds. The investor is investing in the market mainly with the aim to earn profits and apart from profit making opportunities the trust and belief in the financial market led him to invest in the financial market. Therefore, it becomes the duty of every nation to establish an efficient, independent and autonomous market regulator which is supposed to provide for a transparent and efficient market to the investors and to protect their interests from any foul play.

This century belongs to new ideas, new thinking and new possibilities. The investment- be it in any form is seems to be a part of everyone's life all over the world. With the passage of time, new investment possibilities have been explored around the world. The investment in securities market has become the most sought after investment in the world. In the modern era, everyone from every sector and section of the society thinks and talks about investment, profit, management and security of funds; it grows the concern for the stable, efficient and transparent financial market. In the era of globalization and competence it becomes the duty of every nation to provide the safe and clean investment market for every investor from all around the world and prevent unfair trade practices. The stable and transparent market has the power to build the good image of every nation globally.

Definition of insider trading-

The term “insider trading” has no specific definition, but it is generally defined as trading based on inside information by insiders who have access to non public price sensitive information. Economic times defined insider trading as a malpractice wherein trade of a company's securities is undertaken by people who by virtue of their work have access to the otherwise non public information which can be crucial for making investment decisions. As defined by Business dictionary insider trading means buying or selling the securities of a publicly traded firm by an insider to benefit from insider information. As defined by Black’s Law dictionary the insider trading is the illegal use of information available only to insiders in order to make a profit in financial trading.

Legal and illegal Insider Trading

The issue of insider trading is as old as trading on equity markets itself. In all developed markets around the world it is seen as the biggest offense against the ethics of business and is also seen as a potential destroyer of public confidence in the stock exchange. Therefore, it should be legally regulated. This does not mean that insider trading is always associated with illegal conduct.[i]

1. It is perfectly legal for insiders to buy and sell stock in their company. In fact, there are thousands of insider trading reports every day. As long as the insider is trading on information that is generally available to the public no laws are broken.
2. Illegal insider trading is trading based on nonpublic information and may include "tipping" such information. For example, if the CEO knows the company is not going to get a big contract and sells before telling the world, that's illegal. Yet illegal insider trading is very difficult to prove.

Exceptions to Insider Trading-

The distinction between legally permitted trading and illegal insider trading must be carefully understood. It is quite natural for an insider who is working in a company to come across some inside information. It would be violation of human rights and would defy the logic of freely tradable securities, if Insiders are not permitted to trade for themselves. That would be unreasonable. It would be irrational to stop promoters of a company from dealing in their securities. Thus, the restriction on the corporate insider is directly or indirectly using the price sensitive information that they hold to the exclusion of the other shareholders in arriving at trading decisions. There is absolutely no restriction on insiders in trading in securities of the company if they do not hold any price sensitive information that the public is not already aware of. During the short while promoters and insiders can use the information to their advantage by guessing market reaction to the news or information.[ii]

Impact of Insider trading in securities market-

The securities market in many countries is relatively new and under regulated as compared to other securities market in developed nations. As a part of globalization where business activities have extended to entire world, the need for well regulated market has also increased to many folds. 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 transparent and efficient market. An investor while making his decision about investment (to Sell, buy or hold stock) relies on the available price sensitive information provided by the listed company. When an investor relies upon the available price sensitive information, he has the prior trust and faith of the correctness of the value of the security he is trading. Even after making the price sensitive information public still one sect of the company has the information which finally decides the value of the security. When such persons invest in the market they are known as insiders.[iii]

In simple words, Insider trading means trading of securities by persons who have access to non published price sensitive information by reason of position they hold in a company or during their course of work they get acquainted with such information and take decision accordingly; either to buy or sell their securities based on such unpublished price sensitive information. Thus, they use such information either to earn profits or avoid loss. In short insider trading is the better use of information. Despite many legislative enactments and administrative actions insider trading still continues to emerge in many nations. Growth of private sector and privatization of state companies around the world have led to the emergence of various stock markets, some of which are depicted by insider trading. The potential damage of insider trading is the public's perception of financial markets as scams. Perceptions of unethical trading in the stock markets are one of the biggest stumbling blocks which stop savings flows into the market. When the public lose faith in the stock market and put savings elsewhere, firms cannot raise domestic capital via stock issues.[iv]

Growth of private sector and privatization of state companies around the world have led to the emergence of various stock markets, some of which are depicted by insider trading. The potential damage of insider trading is the public's perception of financial markets as scams. Perceptions of unethical trading in the stock markets are one of the biggest stumbling blocks which stop savings flows into the market. When the public lose faith in the stock market and put savings elsewhere, firms cannot raise domestic capital via stock issues.[v]

The unchecked insider trading would be detrimental to the functioning of stable and transparent capital market. The impact of illegal insider trading is negative for the market as well as for the small investors. Illegal insider trading ensures that there is no fair play involved and there is no fair demand and supply of stocks, all detrimental to the functioning of a healthy capital market. Illegal insider trading weakens the faith of investors in the investing system and an unchecked insider trading could keep off people from investing capital and this could potentially harm the economy as a whole. An association of organizations that regulate the world's securities and futures markets IOSCO (The International Organization of Securities Commissions) in its report survey the regulations prohibiting the insider trading in member nations. The report consists of two parts. First part of the report deals with the common features of the insider trading and regulations preventing the same. Second part of the report consists of compilation of summaries of insider trading laws and regulations in particular countries and their experiences in the enforcement of such laws and regulations.[vi]

The first part of the report in detail discuss about the inside information, its source and procedure of making the legitimate disclosure of inside information public. The effect of disclosure and non-disclosure of the information and exemption from the same has been discussed in the first part of the report. Apart from inside information, the type of insiders has been divided into two parts for e.g. primary insiders and secondary insiders. Primary insiders are those who get the information from its original source being the members of the management and have the necessary knowledge to assess the materiality of the information and consequences of trading based on such information. Primary insiders also include special temporary insiders who are not the employees of the company, but get the information being professionals hired by the company for special purposes only. Such as lawyers, accountants, consultants, investment bankers, etc., who influence material corporate decisions (e.g. concerning mergers) and have the necessary knowledge to access the materiality of activities undertaken by the company.[vii]

Secondary insiders are the persons who get the inside information from someone else who has the access to inside information. They get the information due to special relationship with a person who knows the inside information such as a "tippee". Apart from these two main categories of insiders, the insiders also includes tippee i.e. passing material, non-public information by an insider to a second party, for the purpose of enabling that party to trade on it, is tipping. Those who receive information from a primary insider are defined as “tippees.” The regulations of various countries prohibit such insiders. Further, secondary insiders includes accidental insiders i.e. persons who neither receives the inside information from the original source nor from the tipped by a person who has access to such information, but learned inside information due to special circumstances. For example, overhearing of such conversation, receiving the information accidentally, received the information by mistake through fax or letter etc.[viii]

Rationale behind curbing Insider trading-

As we know insider trading means trading of securities by persons who have the knowledge of the non published price sensitive information by reason of position they hold in a company or during their course of work they get acquainted with such information and take decision accordingly either to buy or sell their securities based on such unpublished price sensitive information. Thus, they use such information either to earn profits or avoid loss. These persons who make the profits or avoid losses are known as Insiders.

In short, insider trading is the better use of information. Hiding such information from general shareholders impairs the efficiency of market. There will be less information available to the market; thereby insiders will make the best use of the information. The trading in the capital market is based on transparent flow of information; the menace of insider trading undermines investor confidence in the fairness and integrity of the securities market. Therefore, preventing such transactions is an important obligation for any capital market regulatory system.[ix]

The rationale behind prohibiting the insider trading is the obvious need and understandable concern about the damage to public confidence and public exchequer which insider trading is likely to cause. The clear intention to prevent, insider trading so far as possible, what amounts to cheating is when those with inside knowledge uses that knowledge to make a profit in their dealings with others. Permitting few people to take advantage of Unpublished Price Sensitive Information, will not only affects the performance of the company but also integrity of the financial market. Any market that is not fair in its dealings or cannot effectively control unfair dealings in companies will not be an attractive investment destination for investors. Rampant market manipulation and fluctuations will be frowned upon by the investors and will dry up the inflow of investment into such markets. Since, absolute prohibition of share trading by the insiders is not feasible; insider trading is restricted and monitored through a series of measures in different jurisdictions.[x]

Therefore, it becomes necessity to curb insider trading as it is a fraud upon the faith of fair dealing. The United State of America became the first nation to formulate legal sanctions curbing insider trading. After America most of the nations have enacted several legislations to curb insider trading. India, too was not late in recognizing the malpractice of insider trading and formulated SEBI (Prohibition of Insider Trading) Regulations, 1992 to curb and prevent this malpractice. Securities Exchange Board of India (SEBI) is responsible for managing trade securities and curbing every illegality in market. 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 other 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. The 1992 regulations have been amended several times and replaced with new regulations in 2015.

The Stock Exchange Board of India (SEBI)

Before the SEBI act, the Controller of capital issue was the first authority to approve issue of securities, amount, type and the price of securities. The Controller of Capital Issue was set up in 1947, under the Capital Issues Act. However, it was repealed by the Capital Issues (Control) Act, 1947. Thereafter, SEBI was set up in April 1988, for healthy growth of capital market and investor protection as its primary objective. With the growth of stock markets and dealings of stocks, lot of malpractice also stated in the market due to which the common investors started losing confidence and faith in the stock market. Due to this government of India decided to set up specialized and empowered regulatory body known as securities Exchange Board of India. The SEBI was established in accordance with the provisions of the Securities and Exchange Board of India Act, 1992 with the main purpose to keep check on the malpractices, protect the interest of investors and development of stock exchanges and to regulate the trading of stock market.

SEBI assumed the statutory status on 21 February, 1992, by way of an ordinance promulgated on 30 January, 1992. This Ordinance was replaced by the SEBI Act on 4 April, 1992. The Securities and Exchange Board of India was established on April 12, 1992. SEBI provides the common link between issuers, Investors and Intermediaries. The Preamble of the Securities and Exchange Board of India describes the basic functions of the Securities and Exchange Board of India as "to protect the interests of investors in securities and to promote the development of, and to regulate the securities market and for matters connected therewith or incidental thereto"[xi]

Role of SEBI-

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 other 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 is an independent body carries its functions as defined by the SEBI (Securities and Exchange Board of

India Act), 1992. Any order passed by the SEBI is contested before the Securities Appellant Tribunal (SAT).

The Hon'ble High Court of Delhi in the case of **K. Venkateswarlu vs. Securities and Exchange Board of India** dismissed the writ petition seeking direction to SEBI for investigation into alleged 'Insider Trading' has held that SEBI being a specialized body knows when an investigation is to be done.[xii]

The Hon'ble Supreme Court in the case of **N. Narayanan vs. Adjudicating Officer, SEBI** has emphasized on need for transparent share market and observed that the "SEBI, the market regulator, has to deal sternly with companies and their directors indulging in manipulative and deceptive devices, insider trading etc or else they will be failing in their duty to promote orderly and healthy growth of the securities market. Economic offence, people of this country should know, is a serious crime which, which if not properly dealt with, as it should be, will affect not only country's economic growth, but also slow the inflow of foreign investment by genuine investors and also casts a slur on India's securities market. The message should go that our country will not tolerate 'market abuse' and that we are governed by the "Rule of Law".[xiii]

The Hon'ble Supreme Court in the case of **Arun Kumar Agrawal vs. Union of India,** while hearing the arguments challenging the appointment of the SEBI chairman has discussed and defined the importance of SEBI in Indian Securities market and it has been observed by the Court in Para 29 of its judgment before dismissing the writ petition challenging the appointment of the SEBI chairman that "A bare perusal of the SEBI Act makes it apparent that SEBI was established to protect the interests of investors in securities and to promote the development of, and to regulate the securities market. In fact, the SEBI Act gives wide ranging powers to the Board to take such measures as it thinks fit to perform its duty to protect the interests of investors in securities and to promote the development of, and to regulate the securities market. These measures may provide for regulating the business in stock exchanges and any other securities markets. The wide sweep of the powers of SEBI leaves no manner of doubt that it is the supreme authority for the control and regulations and orderly development of the securities market in India. It would not be mere rhetoric to state that in this era of globalization, the importance of the functions performed by SEBI is of paramount importance to the well being of the economic health of the nation."[xiv]

Conclusion-

In India, the biggest problem is the lack of effective implementation of insider trading regulations. The ideal securities market is concerned with the allocation of capital in the economy. This function is enabled by market efficiency, the situation where the market price of each security accurately reflects the risk and return in its future. Thus, the primary function of regulation and policy is to foster market efficiency; hence we must evaluate the impact of Insider trading upon market efficiency. Insider trading appears to be biased especially to the speculators who invest in the market expecting there would be an appreciation in the value of shares. The rationale behind the prohibition of insider trading is the obvious need and understandable concern about the damage to public confidence which insider dealing is likely to cause and the clear intention to prevent so far as possible what amounts to cheating when those with inside knowledge use that knowledge to make a profit in their dealings with others. It is a known fact that the smooth operation of the securities market and its healthy growth and development depends to a great extent on the quality and integrity of the players in the market. Such a market can alone inspire the confidence of the investors.[xv]

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