# INSIDER TRADING AND MARKET MANIPULATION: A MENACE OR A STRATEGY

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## ABSTRACT

India is a vast country, full of opportunities and expectations for both individuals and firms operating here. The basic aim of floating a company is to make profits and this is clearly evidenced by the growing number of corporations in Indian market. Since the growth of a nation depends upon the growth of the corporations operating, therefore the onus of carrying on the business in a legal way is upon them. However, in the long run, some flouting mechanisms have been developed to make huge profits in a short span of time, thus devising the practice of "insider trading". Though such practices may favor the insiders of a company, but it ultimately leads to the reduction of confidence of the investors. India has witnessed such unethical way of market manipulation and the menace of insider trading, the result being the emergence of various laws and regulations to curb such practices. The establishment of SEBI with the sole objective to protect the investors from such malpractices, various regulations such as SEBI (Prohibition of Insider Trading) Regulations of 1992 and 2015, SEBI (Prohibition of Fraudulent & Unfair Trade Practices Relating to Securities Market) Regulation, 2003, Companies Act, 2013 are there to effect penalties on those who are involved in such practices. But the studies show that there is "no or minimal convictions" in such cases. Here the question arises that is India too soft on insider traders & market manipulators? In this paper the author has tried to analyze the reasons of the pendency of cases regarding insider trading, the low detection of cases of market manipulation and price rigging and low conviction rates even when the case has been detected and also that the insider trading and market manipulation being a strategy or malpractice detrimental to the interest of investors.

## INTRODUCTION

Insider trading, though subjected to many definitions, is basically a prohibited and illegal activity to increase the individual profits by utilizing those crucial and vital information which are not known to the public. Insider Trading is buying, selling or dealing with a security while breaching the company policies or regulations, thus breaching the trust and confidence of a company while possessing material or non-public information about the securities.[1]

## DEFINITION OF INSIDER TRADING

According to the Oxford dictionary, "insider trading means the crime of buying or selling of shares in a company with the help of information known only by those connected with the business, before this information is available to everyone". SEBI (Prohibition of Insider Trading) Regulations, 2015, though does not define the term 'insider trading' directly but it defines who an 'insider' is and also about 'connected person' and 'price-sensitive information'.

According to Regulation 2 (g), an insider is any person who is (i) a connected person or (ii) in possession of or in access to unpublished price sensitive information.[2] Regulation 2 (d) defines 'connected person' as any person who is or has during the six months prior to the concerned act been associated with a company, directly or indirectly, in any capacity including by reason of frequent communication with its officers or by being in any contractual, fiduciary or employment relationship or by being a director, officer or an employee of the company or holds any position including a professional or business relationship between himself and the company whether temporary or permanent, that allows such person, directly or indirectly, access to unpublished price sensitive information or is reasonably expected to allow such access[3] and also includes a list of 'deemed connected persons'.

Regulation 2 (n) defines 'unpublished price-sensitive information' (hereinafter as UPSI). It means any information, relating to a company or its securities, directly or indirectly, that is not generally available which upon becoming generally available, is likely to materially affect the price of the securities. It includes matters such as financial results, dividends, changes in capital structure, significant corporate transactions and changes in key managerial personal. Therefore, from the above definitions it can be said that an insider is a connected person who has some

[1] http://aditi.du.ac.in/uploads/econtent/Insider_Trading.pdf (accessed on 15th February, 2022)
[2] Regulation 2 (g) SEBI (Prohibition of Insider Trading) Regulation, 2015
[3] Regulation 2 (d) SEBI (Prohibition of Insider Trading) Regulation, 2015

price-sensitive information that is not available to the general public and uses that information to gain certain undue profits detrimental to the interest of the company.

**Insider trading: An illegal act**

The insider trading has always been discouraged by the Securities and Exchange Board of India in order to bring about the fair trade practices and thereby to boost the confidence of the investors in the market. When the insiders such as the key employees or any connected persons of the company have some unpublished price-sensitive information or any strategic information regarding the next steps of the company and uses the same for the purpose of making profits by trading in that company's stocks or securities, it will constitute an illegal insider trading. In such conditions of insider trading, one stock holder is at a great disadvantage with regard to those who have such inside information, thereby making it illegal and punishable by law.

**Insider trading: A legal strategy**

The term insider trading emphasizes a negative aspect. But it is legal in certain situations also, and not adhering to those regulations, will turn a legal insider trading into an illegal one. The mechanism of insider trading is always subjected to many definitions and it has variety of connotations, which encompasses both legal and prohibited activity. An insider trading is legal when an insider buys and sells stock in their company on that information which are generally available to the public and they disclose the transactions to avoid the misuse of any non-public price-sensitive information.[4] In India, corporate insiders are allowed to trade in their companies' stocks; barring it would be the violation of their rights which will be unreasonable.

## MARKET MANIPULATION

Throughout the history of the markets, there has always been the booms and busts, manias and panics, and unfortunately, there has always been an ingredient of market manipulation involved. According to Cambridge dictionary, 'manipulation' refers to controlling someone or something to one's own advantage and often unfairly and dishonestly. From this definition of manipulation one can easily contend that market manipulation means the unethical controlling of market to one's own advantage through unfair means.

[4] Anil Kr. Manchikatla, Rajesh H. Acharya, Insider Trading in India, 24 Journal of Finance Crime, 49 (2017)

**Meaning of market manipulation**

Market manipulation is when someone artificially affects the supply or demand of a security such as causing stock prices to dramatically rise or fall.[5] In market manipulation, there is an artificial influencing of the price of an asset so that it may differ from the actual price that is known to the public. The manipulators, instead of discovering the existing opportunities, try to deceive other market participants and create a presumption of mispricing of the assets so that the manipulators can make profit from it. Market manipulation may or may not involve making and publishing factually false statements as well, but it always involves acting to influence prices in order to create false impressions among other market participants.[6]

**Market manipulation: A result of insider trading**

It would not be wrong to say that market manipulation is the result of an illegal insider trading. Market manipulation occurs when a person who has some information about the material facts of the company deliberately spreads false information or omits to disclose certain facts which they are bound to disclose, thus influencing the prices by manipulation. The culprits are those who have been actively involved in company’s management, or the so called stock-market “gurus” who use to raise the price of the stocks they have purchased often by citing the inflated figures.

**Techniques of market manipulation:**

The market manipulators use various means to manipulate the prices of the stocks and to make profit out of it. Some of the known techniques of manipulations are as follows:

(a) Market rumors: One of the best known technique of market manipulation is spreading the fake rumors about the price of a stock being up or low in spite of knowing the opposite to be true. In the era of technological advancement, manipulators have found the internet to be a great tool for such fake news. Such techniques are widely used by the companies, stock brokers to spread the fake news about the prices of the stocks through chat rooms or message box, e-mails, making outlandish promises, etc.

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[5] Anil Kr. Manchikatla, Rajesh H. Acharya, Insider Trading in India, 24 Journal of Finance Crime, 49 (2017)

[6] https://rajdhanicollege.ac.in/admin/ckeditor/ckfinder/userfiles/files/Concept%20of%20Insider%20Trading.pdf (accessed on 17th February, 2022)

(b) Pumping and dumping: This technique is used to inflate the price of securities artificially. In this technique also, the market manipulators use the mass media like e-mails to promote a stock, promising an amazing prospect of the unknown companies, typically a penny stock.[7] The insiders and promoters play a very crucial role in obtaining ownership and control of a significant block of stock. Then they start hyping the stock to generate artificial interest and cause the price to hike such as claiming the company's profitable deals, contracts, launch of new product, record earnings, etc. Now further, it's the time for them to dump the block of stocks upon which they have significant control. It means they will sell their own shares and walkway with the profits and the general investors are left with worthless stocks.

(c) Churning: This is when traders place buy-and-sell orders at the same price, and this is usually meant to attract more investors and increase the price at the same time.[8] In this, the brokers use to increase the trade activity on behalf of the customers to generate commissions for them. It is basically the violation of fiduciary duty between the broker and the client.

(d) Front running or insider information: It is another unethical means in which the insider of a company is involved. In this, an individual with knowledge of a large market transaction places a trade before the transaction in a favorable manner.[9] It is called front running because an asset is being bought and sold ahead of a public announcement that could materially affect the value of security.[10]

(e) Spoofing: Its purpose is to make a veil that there are lots of buyers and sellers within the market and the manipulators typically post large orders without any intention of being filled on those orders, and in this way the spoofers makes profits out of that. It primarily affects the short term traders.

(f) Wash Trading: In this technique, the manipulators buy and sell the stocks nearly instantaneously and nearly continually. This gives a false presumption to the investors that the stock has a lot of activity and buying them would be profitable to them, thus leading to an artificial price hike. The schemer then shorts the stock, and the market then falls, thus left nothing in the hands of the investors.

[7] https://www.cmcmarkets.com/en/trading-guides/market-manipulation (accessed on 18th February, 2022)
[8] https://www.cleverism.com/lexicon/market-manipulation/ (accessed on 18th February, 2022)
[9] https://study.com/academy/lesson/forms-of-market-manipulation-definitions-examples.html (accessed on 19th February, 2022)
[10] *ibid*

(g) Bear raiding: There are two types of lobbies in the stock market; one is the "bull" and the other "bear". The bull believes in longing a stock while the bear believes that the prices would fall. In this, the bears will heavily sell the stocks in order to artificially lower the price and when the prices fall, the other investors start panicking and sell the stocks. Then the bear raiders purchase the stock at an artificial discount, knowing that it will soon go up.

## CONVICTIONS AND PENALTIES

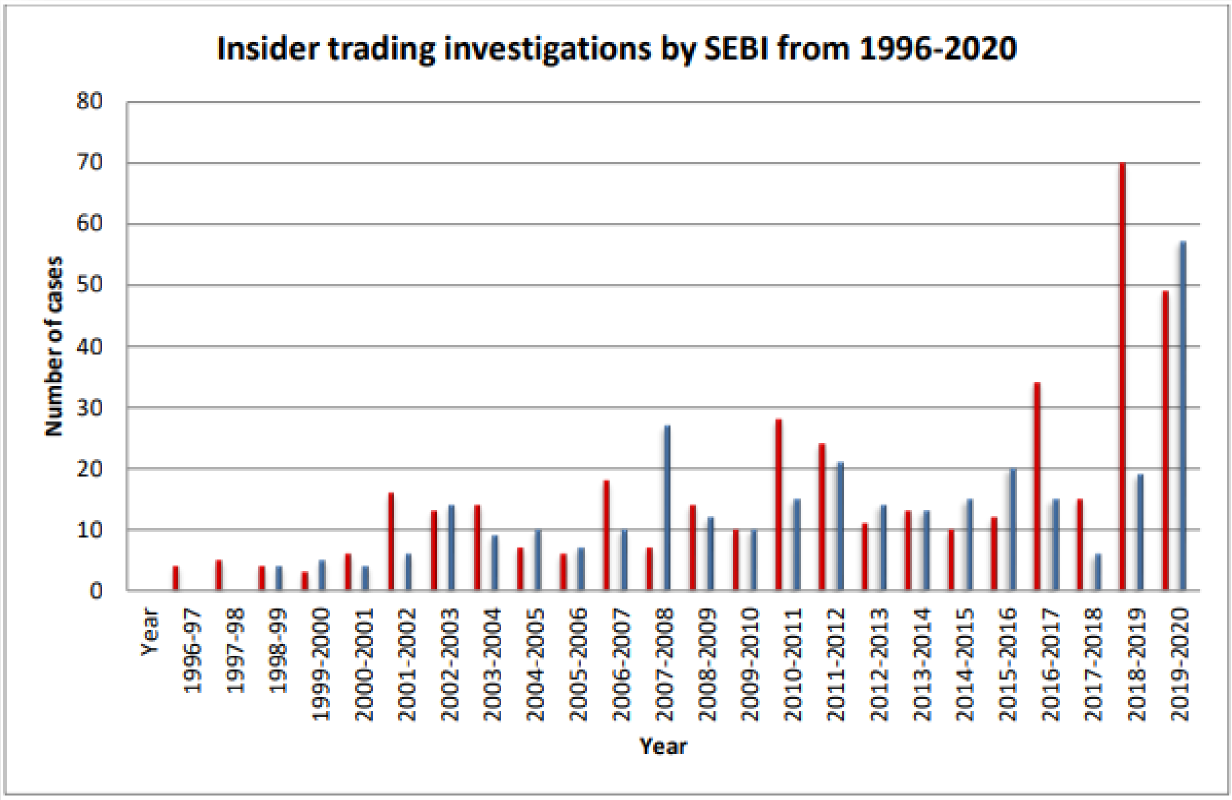
India is among the fastest growing economies in the world and with this development the financial crimes are also closely associated,[11] the most prevalent among them is the 'insider trading'. Therefore, an effective check on this was required to provide an equal and fair play field and after various committees' reports, the Government by notification established the Securities and Exchange Board of India in the year 1992. The very basic aim of this body was to protect the interest of the investors, and thereby to increase their confidence in the stock market, so that they cannot be deceived by the market "gurus". But by the time, some more stringent regulations were required which prompted to bring into force the SEBI (Prohibition of Insider Trading) Regulations, 1992, comprising 15 Regulations but in 2015, the Sodhi Committee report laid down the basis where the earlier regulation of 1992 was replaced by the SEBI (Prohibition of Insider Trading) Regulations, 2015 which prohibited this fraudulent practice.

### Low detection of cases

The problem in Indian insider trading prosecutions is regarding the lack of contemporary mechanisms for the surveillance and the detection of cases, which gives a upper-hand to the insiders to make profit out of the illegal means. Further, proving the cases of insider trading is a challenge because it is entirely based on circumstantial evidences. UK Sinha, SEBI Chairman once said, "The SEBI does not have the power to tap phones. It can only request for call data records in suspicious cases. In India only a few economic agencies like the Central Board of Direct Taxes have the power to tap phones."[12] Such a power can prove to be the most decisive piece of evidence in investigation to prove a case against the guilty.

[11] Vaibhav Sharma, "Prohibition on Insider Trading: A Toothless Law", Law School Research Paper No. 996
[12] "Stricter Disclosure Norms soon for Research Analysts" The Indian Express, July 18, 2015

The total number of insider trading cases registered since 1996 to 2014 are 203, out of which 185 investigations are carried out by the end of March, 2014. The number of investigations carried out in 2007-2008 was 28, and 28 more insider trading cases were registered in 2010-2011. It was found that SEBI has not resolved any cases during 2008-2009, 2009-2010 and 2013-2014 among its investigations.[13] In the financial years ranging from 2015 to 2020, SEBI took up 190 cases, but completed 132 cases only as shown in the chart below.




Investigation taken up Investigation completed

**Source:** Handbook of statistics on Indian Securities Market and SEBI Annual Reports.

This chart clearly shows that SEBI has failed in taking up the cases as well as in completing those cases because in a country like India where there are numerous companies and an average equities of worth 150,000 Crore are traded on a daily basis, only 20-30 cases of insider trading is really dubious. This emphasizes that, there is a lack of proper mechanism or the cases are

[13] Anil Kr. Manchikatla, Rajesh H. Acharya, Insider Trading in India, 24 Journal of Finance Crime, 53 (2017)

very difficult to prove due to the loopholes in the existing Act and Regulations pertaining to insider trading.

**No or minimal conviction ratio**

After 1991, the Indian economy adopted the model of liberalization which helped the Indian market to grow at a high pace and helped to bring in about huge foreign investments but alongside there came some felonious activities also and the menace of insider trading was one of them. During the same time, India was witnessing a rapid growth of the telecom sector and various technological advancements that paved the way for the market participants to use various ways for making profits and this resulted in major setbacks at regular intervals. The famous case of Hindustan lever Limited versus SEBI[14] was one of a kind. In this case the merger took place between the Hindustan Liver Ltd. (HLL) and Brooke Bond Lipton India Ltd. (BBIL) but before the merger HLL purchased 8 lacks of shares of BBIL from UTI. SEBI found this transaction under the scheme of insider trading as HLL was an insider under Section 2(e) of 1992 Regulation because both were subsidiary to the Uniliver and the management of the company had complete information about the said merger and were acting on an UPSI. Against this HLL filed as appeal before SAT Securities Appellate Tribunal) and it found that the element of UPSI was missing in the present case because for UPSI two conditions need to be satisfied. The first being, that it should not be publicly known or published by the company and second that if it is published or known then it likely to affect the prices of the securities. SAT held that for information to be publicly available or known doesn't always need to be certified or authenticated by the company and as various news had already covered the merger in their respective platforms hence the information failed to qualify the test of UPSI.[15]

However, in 2002 an amendment was brought to define the phrase "unpublished" but this amendment failed miserably because it didn't define the term which lead a loophole for various entities and therefore in 2015 the term got a clear definition and SEBI got the appropriate power to decide the intent and impact of published and non published information. This clearly shows that the ailment of 1998 was rectified in 2015, therefore it depicts that there is zero or minimal conviction rate in cases relating to insider trading.

[14] 5 (1998) 18 SCL 311 MOF

[15] https://taxguru.in/sebi/insider-trading-india-deficiency-prosecution-conviction.html#_ftn6 (accessed on 20th February, 2022)

## Role of judiciary

As of 31st March 2020,[16] 376 cases were pending before the SEBI for action which shows the high rate of pendency under SEBI which only deals with cases pertaining to securities. As per a SEBI report released in 2018 with respect to cases already decided and in which penalties have been already imposed, nearly 2183 entities have failed to pay penalty imposed on them for various offences related to securities market. This includes both individuals and companies and some of these cases are two decades old.[17] This clearly defeats the purpose of SEBI's enforcement mechanisms and put a question mark on them.

In the case of Ashok Dayabhai shah[18] the SAT clearly said "we have no hesitation in stating that SEBI as a regulator in the instant case has not performed its duties and has kept the complaint pending for more than six years, which speaks volumes by itself. The tribunal fails to fathom why the complaint could not have been decided unless SEBI officials had a vested interest in not deciding the matter." For a complaint to be not decided for a period of 6 years itself shows the penurious state of SEBI. SEBI also needs to adapt a proactive strategy in collection of evidence so as to achieve a better conviction rate for which it requires crack-teams that integrate cross-functional expertise.

## CONCLUSION AND SUGGESTIONS

Now it can be concludes that insider trading has been considered as the menace to the market in India, the same around the world too. There are many rules and regulations in force to curb such practices but these are still continuing. It can be pointed out here that an insider trading can be both legal and illegal, because if the insiders will not be allowed to trade in the market because of them being an insider will be prejudicial to their interest. However, it should not be illegal at any point of time. Insider trading hurts the integrity of the capital market which reduces the interest and confidence of the investors since trading on UPSI gives an insider an unfair advantage over the other general investors. And if the insider trading continues, then they lose the interest in the market and therefore the insider trading must be dealt firmly. Some important problems and suggestions:

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[16] https://economictimes.indiatimes.com/markets/stocks/news/sebi-probed-161-new-cases-in-2019-20/articleshow/80879699.cms (accessed on 21st February,2022)

[17] https://taxguru.in/sebi/insider-trading-india-deficiency-prosecution-conviction.html#_ftn6 (accessed on 22nd February, 2022)

[18] Ashok Dayabhai Shah & Ors. vs Sebi on 14 November, 2019

(1) SEBI Act provides for the penalty of 25 crore or three times the amount of profits made out of that and also an imprisonment of 10 years. But the willingness of SEBI in taking up of the cases and willingness to prosecute them is very dubious. Some of this is understandable since insider trading cases are difficult to prove. But even where prosecution is initiated, the matters are usually settled through consent orders or on the payment of minimal penalties. For example in the recent case of insider trading, Rakesh Jhunjhunwala and his family has been effected a penalty of Rs. 37 crore in total but it could been that the his management control over the Aptech company of which the share price hit a high and the trade combined were of Rs. 100 crore. The way Indian regulator or India settles insider trading cases now makes putative insider traders very confident about low risks.

(2) The laws regulating the insider trading and market manipulation is applicable only to India but it is the need of the time to extend the reach of the jurisdiction of the laws and regulations beyond the territory of India so as to curb it from root.

(3) There is also a duty of the Directors towards the shareholders as they stand in fiduciary duty towards each other that they should not use the information in their possession and take undue advantage over them at the cost of the shareholders.

(4) The another way to prevent insider trading is to prevent the employees of the company to trade on the company-owned stocks at a specific time, viz. when the balance sheet of the company is formed, or when there is a takeover or merger of a company with a popular company, etc.

(5) The investors must be properly educated so as to prevent them from being trapped in the false market impressions such as not to act on market rumors. (Investors' education).