AN ANALYSIS OVER THE IMPACT OF INSIDER TRADING IN FINANCIAL MARKETS IN INDIA

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ABSTRACT

Insider trading, the practice of trading securities based on material, non-public information, continues to pose significant challenges to financial market integrity and investor confidence. This unethical behavior results in unfair advantages, erodes trust within the corporate structure, and can lead to severe financial consequences. In India, the prohibition of insider trading was formalized with the enactment of the SEBI Act in 1992. Despite this, the practice remains a prevalent issue, as evidenced by the 141 insider trading investigations initiated by SEBI between 2015 and 2019, with 119 cases detected in the fiscal years 2018-19 and 2019-20—the highest recorded since SEBI's establishment. Globally, the problem persists, with regulators like the Financial Conduct Authority (FCA) in the United Kingdom identifying suspicious trading activity in 30.3% of takeover announcements in 2023. This article critically examines the evolution of insider trading laws, key regulatory challenges, and landmark cases that have shaped the enforcement landscape. It highlights the gaps in compliance, the difficulties in imposing criminal liability, and the necessity of robust investor protection mechanisms. The study also evaluates the impact of insider trading on market stability, emphasizing the importance of transparency, effective surveillance, and stringent penalties in deterring such practices. It concludes by proposing actionable solutions to strengthen existing frameworks and minimize the adverse effects of insider trading, thereby fostering a fair and equitable securities market that upholds investor confidence and market integrity.

Keywords: Insider Trading, Non-Public Information, Securities and Exchange Board of India, Investor, Stock Market.

1. INTRODUCTION

The Indian stock market is a dynamic and intricate environment, offering immense opportunities for traders and investors alike. However, like any financial market, its efficiency and transparency are vital for ensuring sustained growth and maintaining investor confidence. Among the various factors that influence the functioning of the market, insider trading emerges as a significant concern. Insider trading has been a long-standing issue in global financial markets, and India is no exception. The practice, which involves trading a company's securities based on material non-public information, poses significant risks to market integrity, potentially eroding investor confidence. As India's capital markets have expanded and evolved over time, the need for a comprehensive regulatory framework to combat insider trading has become more pressing. This article seeks to offer a thorough analysis of insider trading in the Indian context, charting its historical development, scrutinizing the existing regulatory environment, and identifying the challenges regulators and market participants continue to face. By examining these critical areas, we can gain a clearer understanding of the complexities of insider trading in the financial market and the ongoing efforts to ensure fair, transparent, and efficient markets in India.

2. A HISTORICAL OVERVIEW OF INSIDER TRADING REGULATIONS IN INDIA

The Evolution of Insider Trading Regulation in India began in the late 1970s, when policymakers and market observers recognized the potential risks of this practice to market integrity. The journey to regulate insider trading can be traced through various committee reports and legislative milestones that have shaped India's current regulatory framework.

In 1979, the Sachar Committee became the first team to officially acknowledge insider trading as a harmful practice. It recommended full disclosure of transactions by individuals with access to price-sensitive information and proposed prohibiting such transactions during specific periods, except in exceptional circumstances. It also identified key individuals, such as company directors, auditors, and consultants, who could engage in insider trading, suggesting the maintenance of a register to disclose their dealings in company shares[1].

In 1987, the Patel Committee emphasized the absence of specific legislation and called for

[1] Major Recommendations and the Implementation of the Sachar Committee Report, https://pib.gov.in/newsite/PrintRelease.aspx?relid=82679 (last visited Dec 17, 2024).

strict penalties for insider trading offenses, citing its prevalence in Indian stock exchanges. It also highlighted the involvement of various professionals with access to sensitive information, such as solicitors and financial consultants[2].

In 1989, the Abid Hussein Committee further advanced the cause, recommending that insider trading be classified as a major offense, punishable with both civil and criminal penalties. The committee also suggested that the newly established Securities and Exchange Board of India (SEBI) should be responsible for creating and enforcing relevant legislation[3].

3. SEBI'S ESTABLISHMENT AND ITS INITIAL IMPACT ON FINANCIAL MARKET

SEBI adopts a comprehensive, multi-step approach to identify and address insider trading in India. The process begins with identifying insiders, which includes key managerial personnel, board members, auditors, and others with access to sensitive financial information. SEBI also scrutinizes promoters, their associates, and close relatives. The next step involves defining unpublished price sensitive information (UPSI), which can include data such as major contracts, financial developments, or mergers, which, if made public, would significantly impact stock prices. SEBI then analyses trading patterns to detect suspicious activities, focusing on trades made around significant corporate events or announcements. Finally, SEBI investigates connections between those who traded and individuals with access to inside information, often tracing complex networks of relationships. While this broad approach helps identify potential insider trading, proving such cases remains challenging due to the covert nature of these activities.

Based on the Recommendations of the above said committee, it lids to the establishment of SEBI in 1992. The Regulatory and developmental functions in financial markets are closely linked, as effective regulation often leads to healthy market development. In India, SEBI plays an important role in regulating market and further focuses on its development. SEBI, established under the Securities and Exchange Board of India Act, 1992, operates within a legal framework that empowers it to regulate the securities market, protect investor interests, and

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[2] Vanshika Kapoor, *An Analysis of Insider Trading Regulations in India*, iPleaders (Feb. 16, 2024), https://blog.ipleaders.in/an-analysis-of-insider-trading-regulations-in-india/ (last visited Dec 17, 2024).

[3] Chairman Abid Hussain et al., Report of the Committee on Trade Policies (1985), http://archive.org/details/dli.csl.1489 (last visited Dec 17, 2024).

promote fair trading practices. The powers and functions of SEBI are detailed in the said act[4].

SEBI quickly introduced the SEBI (Insider Trading) Regulations, 1992, which marked the first comprehensive attempt to define and prohibit insider trading in India. These regulations laid the groundwork for future efforts to combat insider trading, including defining critical terms such as "insider" and "unpublished price-sensitive information," and empowering SEBI to enforce the rules. This regulatory framework has since evolved, reinforcing India's commitment to maintaining fair and transparent financial markets[5].

3.1 Notable Insider Trading Case Studies

A. In the present case[6], SEBI took action after Hindustan Lever Limited purchased a substantial number of shares from the Unit Trust of India just before announcing a merger with another subsidiary. SEBI concluded this constituted insider trading, a decision that was upheld on appeal and led to amendments in regulations, including a clearer definition of "unpublished" information[7].

B. The Reliance Industries was accused of insider trading in shares of Larsen & Toubro. Although SEBI initially found RIL at fault, the appellate tribunal reversed the decision due to insufficient evidence that information was passed by RIL's nominees on L&T's board. This case highlighted the challenges in gathering conclusive evidence in insider trading allegations[8].

C. This Present case attracted attention as SEBI investigated the prominent investor for alleged insider trading in shares of Aptech, a company in which he had managerial control. This ongoing case underscores the complexities involved in investigating insider trading, especially when high-profile market participants are involved.[9].

[4] Securities and Exchange Board of India Act, 1992, Sec. 11.
[5] Taxguru_in & AnushwetaMaharshi, *Latest Insider Trading Regulations: Prohibitions & Exceptions*, TaxGuru (2020), https://taxguru.in/sebi/latest-insider-trading-regulations-prohibitions-exceptions.html (last visited Dec 17, 2024).
[6] Hindustan Lever Limited (HLL) vs. SEBI (1998) 18 SCL 311.
[7] Ankoosh Mehta Team CAM Disputes, *Insider Trading: Hindustan Lever Limited v. SEBI*, India Corporate Law (2017), https://corporate.cyrilamarchandblogs.com/2017/10/insider-trading-hindustan-lever-limited-v-sebi/ (last visited Dec 17, 2024).
[8] Reliance Industries Ltd. vs. Securities and Exchange Board of India, (2004) 55 SCL 81 SAT.
[9] Rakesh Jhunjhunwala faces Sebi probe for Aptech insider trading in 2016, The Week, https://www.theweek.in/news/biz-tech/2020/01/28/rakesh-jhunjhunwala-faces-sebi-probe-for-aptech-insider-trading-in-2016.html (last visited Dec 17, 2024).

D. The Satyam scandal of 2009 stands as one of the most notorious cases of corporate fraud and insider trading in India. The company's founder and chairman, Ramalinga Raju, confessed to manipulating the company's financial statements by inflating profits and assets, which led to the exposure of widespread insider trading and fraudulent activities. This scandal severely impacted the Indian stock market and prompted major regulatory reforms, highlighting the need for stronger enforcement against insider trading and corporate misconduct[10].

E. In a more recent instance, the Infosys case of 2021, two employees of the company were fined by SEBI for violating insider trading regulations. These employees were found to have traded in Infosys shares based on unpublished price-sensitive information, which led to significant price movements in the stock. SEBI's action in this case emphasized the importance of protecting market integrity and enforcing regulations to prevent insider trading, even in large, well-established companies.

The above cases underscore the critical role of regulatory frameworks in maintaining trust in India's financial markets. It further reflects the dynamic evolution of insider trading regulation in India and the ongoing difficulties regulators face in enforcing these laws.

3.2 Enforcement Mechanisms For Preventing Insider Trading

The **SEBI (Prohibition of Insider Trading) Regulations, 2015**, marked a crucial overhaul of earlier rules, broadening the scope to include a wider range of unlawful transactions and addressing previous regulatory gaps.

The current primary legislation governing insider trading is the SEBI (Prohibition of Insider Trading) Regulations, 2015, as amended. This is supplemented by key sections of the SEBI Act, particularly which prohibits insider trading[11], further it outlines penalties for violations[12]. Notable features of the current regulatory framework include the broad definition of "insider," encompassing not just company employees and directors but also those with access to unpublished price-sensitive information (UPSI). UPSI is defined as

[10] The Satyam Scandal: A Watershed Moment in Indian Corporate Governance and Financial Regulation » Lawful Legal, (Jul. 23, 2024)., https://lawfullegal.in/the-satyam-scandal-a-watershed-moment-in-indian-corporate-governance-and-financial-regulation/ (last visited Dec 17, 2024).
[11] SEBI (Prohibition of Insider Trading) Regulations, 2015, Sec 12A.
[12] SEBI (Prohibition of Insider Trading) Regulations, 2015, Sec 15G.

any material, non-public information that, once disclosed, is likely to affect the price of a company's securities. In the present case the SEBI, clarified that false or uncertain information cannot be considered UPSI, as the prohibition only applies to true, material information[13]

These regulations impose restrictions on insiders from trading when in possession of UPSI, including mandatory trading window closures, typically before the announcement of financial results. Insiders are also required to make initial and continuous disclosures of their trading activities. Companies and market intermediaries must establish codes of conduct to monitor and regulate insider trading within their organizations. Violations of these provisions attract substantial penalties, both monetary and criminal, reinforcing the importance of maintaining integrity and transparency in the securities market.

The SEBI (Prohibition of Insider Trading) Regulations, 1992 have undergone several amendments since its establishment. The most recent amendment came into effect on 17th September 2019, bringing in significant changes to the regulatory framework. These amendments introduced new provisions aimed at strengthening the fight against insider trading and improving the accountability of those involved in the market.

In 2019, further amendments were introduced to strengthen the framework, aiming to cover both direct and indirect transactions. These changes reflected the growing sophistication of insider trading activities and included provisions to encourage whistleblowers, acknowledging their role in identifying and prosecuting violations.

A key change in the 2019 amendment was the insertion of Chapter IIIA between Chapter III and Chapter IV, containing Sections 7A to 7M. This chapter introduced several important provisions, including

a. ***Inclusion of the term "Informant***" This allows any individual to inform SEBI about potential insider trading activities or the disclosure of confidential company information. The informant must voluntarily submit information, free from coercion or external influence[14].

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[13] Samir Arora v. SEBI, 2004 SCC Online SAT 90.

[14] SEBI (Prohibition of Insider Trading) Regulations, 2019 (Section 7A(b)).

b. ***Original Information*** This term refers to independent knowledge or information related to insider trading violations that SEBI does not already possess. It ensures that only relevant and non-frivolous information is considered for action[15].

c. ***Confidentiality for Informants*** The identity of the informant is protected under the Right to Information Act, 2005, except in certain exceptional cases. Informants are not compelled to disclose their identity, ensuring a level of protection and confidentiality.

d. **Legal Protection for *Informants*** If an informant faces retaliation from their employer or any other party for providing information to SEBI, such victimization is penalized. Employers found guilty of threatening or coercing an informant can face suspension, penalties, or criminal charges.

e. ***Informant Rewards*** An informant who provides original information may be eligible for a reward of up to Rs. 10 lakhs, at SEBI's discretion. The reward is granted based on the recovery of information that leads to actionable findings[16].

These amendments also underscore SEBI's responsibility to detect insider trading activities and initiate legal action promptly. However, gathering direct evidence and linking it to insider trading activities remains a challenging task, requiring months of investigation. This legal framework aims to enhance market integrity by encouraging whistleblowing, ensuring accountability, and protecting both informants and investors from illegal market practices.

4. TECH-DRIVEN SOLUTIONS TO COMBAT INSIDER TRADING

As financial markets become increasingly digital and fast-paced, technology has become a crucial tool in both facilitating and combating insider trading. To stay ahead of potential insider trading activities, regulators and market participants must harness the power of technological advancements.

a. **Advanced Analytics and Artificial Intelligence (AI)** play a key role in identifying unusual trading patterns that could indicate insider trading. These technologies process

[15] SEBI (Prohibition of Insider Trading) Regulations, 2019 (Section 7A(h)).
[16] SEBI (Prohibition of Insider Trading) Regulations, 2019 (Section 7D).

vast amounts of market data in real-time, enabling the rapid flagging of suspicious activities for further investigation.

b. Additionally, **Blockchain and Distributed Ledger Technology** offer the potential for more transparent and immutable records of trades, simplifying the tracing and verification of trading activities.

c. **Enhanced Market Surveillance Systems** are also being developed to monitor multiple markets simultaneously, allowing for the detection of cross-market irregularities, thus improving the ability to spot insider trading schemes.

d. **Machine Learning** can be utilized for predictive analysis, forecasting potential insider trading events based on historical data and market trends, which allows regulators to take pre-emptive actions.

e. Furthermore, the creation of **Secure Information Sharing Platforms** can help prevent the unauthorized spread of material non-public information, thus reducing the chances of insider trading.

To effectively combat insider trading, regulators must continuously adapt and enhance their technological tools to keep pace with the evolving landscape[17].

5. IMPACT OF INSIDER TRADING IN FINANCIAL MARKET

The impact of insider trading on financial markets in the current year, continues to be significant, with ongoing concerns about market integrity, investor confidence, and the efficient functioning of capital markets. Despite advancements in regulatory frameworks, the rise of new technologies, and increased focus on transparency, insider trading remains a threat to the trust fundamental to the financial ecosystem.

In 2024, the digital transformation of financial markets, including the increased use of algorithmic trading and blockchain technology, has made insider trading more sophisticated. This requires regulators to continuously adapt their surveillance systems, using advanced tools

[17] Taxguru_in & Bhatt & Joshi Associates, *Insider Trading in India: Evolution, Regulation and Challenges*, TaxGuru (2024), https://taxguru.in/sebi/insider-trading-evolution-regulation-and-challenges.html (last visited Dec 17, 2024).

like artificial intelligence and machine learning to detect suspicious patterns. While these technologies provide new ways to track insider activities, they also create new avenues for manipulation, making enforcement more challenging.

Moreover, the global interconnectedness of markets today amplifies the impact of insider trading. Cross-border trading, multinational corporations, and the rise of retail investors through online platforms have increased the complexity of monitoring and enforcing insider trading regulations. Global financial scandals involving insider trading, if not quickly addressed, can shake investor confidence across borders, affecting not just the country of origin but also international markets.

The trust deficit caused by insider trading is especially concerning in 2024, as investors are more cautious and demand greater transparency in the wake of high-profile corporate scandals and economic uncertainty. The reputation of a company can be severely harmed if linked to insider trading, leading to reduced investor participation and a loss of capital inflows. In a time when capital markets are crucial for economic recovery, any erosion of trust can have broader economic consequences, affecting job creation, innovation, and economic stability.

Furthermore, the increasing focus on Environmental, Social, and Governance (ESG) factors has led investors to demand higher ethical standards from companies. Insider trading is seen as a violation of these ethical standards, and companies involved in such activities may face reputational damage that undermines their ESG goals. In 2024, the pressure on regulators to strengthen laws, penalties, and enforcement mechanisms has grown, with the expectation that stricter action will be taken against those involved in insider trading.

Despite technological advancements and regulatory improvements, the challenge lies in maintaining investor confidence, ensuring market efficiency, and addressing the growing sophistication of insider trading activities. The continued effort by regulators, like SEBI in India, to adapt to these challenges is vital to preserving a fair, transparent, and efficient market in the coming years.

6. ADDRESSING REGULATORY GAPS IN INSIDER TRADING

To address the challenges and to improve the effectiveness of insider trading regulations, several measures can be implemented. First, greater collaboration and information-sharing among regulatory authorities, exchanges, and market intermediaries are essential to enhance surveillance and detection capabilities. The use of advanced technologies, such as data analytics and artificial intelligence, can help identify suspicious trading patterns and unusual market activities more efficiently. Further, SEBI should strengthen enforcement mechanisms by imposing more severe penalties for insider trading violations, including disgorgement of profits that exceed the gains from the illegal activity. Exploring alternative sanctions, such as criminal prosecution for severe offenses, could further deter wrongdoers. Additionally, streamlining the adjudication process and expediting the resolution of cases is necessary to ensure swift justice.

In order to, address these regulatory gaps and ambiguities in the existing framework is crucial. SEBI should periodically review and amend the SEBI (Prohibition of Insider Trading) Regulation, 2015, and 2019 to clarify provisions, incorporate emerging trends, and align with international best practices[18].

And the most important is to, enhance investor education and awareness about insider trading regulations will empower investors to make informed decisions and contribute to maintaining market integrity. While SEBI's regulatory framework has been a significant step toward safeguarding market integrity, addressing these areas for improvement will further strengthen the regulatory regime and ensure a fair, transparent, and efficient securities market in India[19].

7. CONCLUSION

Insider trading remains a complex challenge for India’s financial markets. Despite significant progress in establishing a comprehensive regulatory framework, issues related to detection, enforcement, and prosecution it continues to highlight the need for ongoing improvements. Addressing insider trading effectively requires a holistic approach that includes strengthening legal frameworks, enhancing detection capabilities, improving corporate governance, fostering international cooperation, and promoting investor education.

As India's markets continue to grow and integrate with the global financial system, maintaining

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[18] Shigufta Hena Uzma, *International Financial Reporting Standards Convergence in the Indian Context: Insights from Practitioners*, 23 Journal of Public Affairs e2861 (2023), https://onlinelibrary.wiley.com/doi/10.1002/pa.2861 (last visited Dec 17, 2024).
[19] Roopali Vasudharini, *Analysis of Insider Trading with Case Laws*, TaxGuru (2024)., https://taxguru.in/sebi/analysis-insider-trading-case-laws.html (last visited Dec 17, 2024).

market integrity through robust insider trading regulations becomes even more critical. Regulators, market participants, and policymakers must remain vigilant and adaptable in response to evolving market practices and technologies. By drawing on international best practices, utilizing technological advancements, and promoting a culture of transparency and ethical behaviour, India can strengthen its defences against insider trading. This will not only safeguard individual investors but also improve the overall integrity and efficiency of the financial markets, supporting their long-term growth and stability.

Ultimately, the goal is to create a level playing field where all market participants have equal access to information and opportunities, and the continued refinement of insider trading regulations is a crucial step towards achieving a transparent and trustworthy financial ecosystem in India.