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The Law of Insider Trading The Huge Costs of Being a Faithless Servant

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Abstract- Several recent high-profile insider trading losses have not stopped the government from aggressively prosecuting insider trading cases. Insider trading is one of the frequent securities frauds concerning mainly the equity markets. Insider trading violation in relation to the stock of a company has various morphologies and can involve both company's employees and directors and service providers (attorneys, consultants, printing firms). The first of its kind, this law review article offers a legal analysis that would aid the government in detecting and prosecuting insider trading. Reconstituting the social network of the individuals having access to material nonpublic information into a company can help in the understanding of further insider trading violations. Insider trading is far from being the easiest fraud to detect and mainly whistleblowers or investigations similar to classic organized crime can produce relevant evidence for such cases.

I. INTRODUCTION

Insider trading refers to the practice of purchasing or selling a publicly-traded company's securities while in possession of material information that is not yet public information. Material information refers to any and all information that may result in a substantial impact on the decision of an investor regarding whether to buy or sell the security. Non-public information is not legally out in the public domain and that only a handful of people directly related to the information possess. When insiders, e.g. key employees or executives who have access to the strategic information about the company, use the same for trading in the company's stocks or securities, it is called insider trading and is highly discouraged by the Securities and Exchange Board of India to promote fair trading in the market for the benefit of the common investor.

The definition of an "insider" can differ significantly under different jurisdictions. Some may follow a narrow definition and only consider people within the company with direct access to the information as an "insider." On the other hand, some may also consider people related to company officials as "insiders."

The Securities Appellate Tribunal (SAT) highlighted the significance of preventing insider trading by stating that not only is it against ensuring a level-playing field but is also detrimental to the interests of the ordinary shareholders and general public. It has also been viewed as a breach of the fiduciary duty an insider owes by virtue of his position. Thus, stringent provisions prohibiting insider trading have been enacted across various jurisdictions in order to promote investor confidence in the securities market.

Insider trading is an unfair practice, wherein the other stock holders are at a great disadvantage due to lack of important insider non-public information. However, in certain cases if the information has been made public, in a way that all concerned investors have access to it, that will not be a case of illegal insider trading.

II. TYPES OF INSIDER TRADING

2.1 Legal vs. illegal insider trading

Legal insider trading happens all the time. You've probably heard of employees of a publicly listed company trading equities of the company they're working. Insider trading of this nature is perfectly legal as long as corporate insiders report their trades pursuant of the SEBI regulation.

Illegal insider trading, however, refers to any trading activity that's based on corporate information that's not disclosed to the public. Such trading activity undermines everyone's confidence in the integrity and fairness of the equities market. Additionally, it is deemed as a breach of trust and fiduciary duties of the employee to their company.

III. FORMS OF ILLEGAL INSIDER TRADING

3.1 Classic Insider Trading

Most widely understood illegal insider trading activities are classic ones: a top executive of a company knows undisclosed information of the corporation and buys/sells company stocks based on those non public materials. The details may vary a bit but in this instance, it's a clear-cut illegal insider trading scenario.

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3.2 Tipper and Tippee
Another common illegal insider trading scenario is when an employee of a company who is privy to essential nonpublic information does not trade directly the company's stock. Instead, he passes the information to another person who will use the information to profit from it. In such cases, both the tipper and the tippee are liable for illegal insider trading activities.

3.3 Misappropriation
Another illegal activity that's closely related to insider trading is the misappropriation of a company's information for personal gains.

3.4 Disclosure
When one has confidential information, , he must either disclose the information or refrain from trading based on that information altogether. The guidelines are very simple: disclose or abstain. Since mere possession of confidential information is not a crime on his part, in order to avoid insider trading liability, he can simply abstain from trading on the information. However, if he really wants to trade, disclosure of the information in a public forum will also make the information public, rather than confidential. Trading can't be insider trading when that trading is based on public information.
Insiders play a crucial role in the securities market. Big market players in the stock market may destabilize securities market through their insider activities. Insiders or their relatives or connected persons of the company are using unpublished price sensitive information for their own benefits. Ultimately, common investors may be hurt and foreign institutional investors may deter from the securities market.

IV. IRREGULARITIES AND VIOLATION OF RULES AND REGULATIONS OF SECURITIES MARKET OF INDIA

Irregularities and violation of rules and regulations of securities market of India may broadly fall under:
(a) price manipulation;
(b) creation of artificial market;
(c) insider trading;
(d) public issue related irregularities;
(e) irregularities in the event 54 of Mergers and Acquisitions and
(f) other misconducts.
The SEBI (Prohibition of Insider Trading) Regulations, 2018 have brought in a series of advantages for all stakeholders. Such as :

4.1 Insertion of additional definitions for clarity
'Financially literate', A compliance officer (a person who is responsible for the adherence of the SEBI (PIT) Regulations, 2015) is required to be financially literate.
'Proposed to be listed. The definition of 'proposed to be listed' was an extremely significant insertion as the applicability of the Insider Trading Regulations on unlisted companies is dependent on the same.
'Legitimate purpose'. Persons who have received unpublished price sensitive information (UPSI) pursuant to a "legitimate purpose" shall be considered insiders and due notice shall be given to them to maintain confidentiality.

4.2 Sharing of information for due-diligence purposes
It was impractical for the board of directors to be able to form an opinion regarding whether the transaction was in the best interests of the company or not at the preliminary stage of conducting due-diligence exercises. Considering this anomaly, an amendment was made stating that the board may opine on whether the sharing of the UPSI for due diligence is in the best interests of the company instead of determining the same for the proposed transaction.

4.3 Maintenance of digital database
In accordance with the new provision, the board of directors are required to ensure that a structured digital database is maintained comprising the names of such persons or entities with whom information is shared under Regulation 3 of the SEBI (PIT) Regulations, 2015 along with the Permanent Account Number. These structural databases are to be maintained sufficient internal controls in order to avoid tampering of the same. Thus, this would be beneficial in maintaining a record of the persons who have UPSI of the company and would help in investigative purposes.

4.4 Restriction of ambit by introducing additional defenses
India is known to have one of the most stringent insider trading laws in the world. Instead of the classical insider standard, we adopt the possession standard while imposing liability on persons. While the classical theory refers to criminalizing trading by insiders (or their tippees) in the stocks of their own companies, the possession standard affixes liability on the mere possession of information. The Amendment sought to reasonably dilute the ambit of the applicability of insider trading in order to save innocent persons from unnecessary litigation. Thus, the following defenses have been added:
(i) Off-market inter-se transactions between insiders
(ii) Transactions through the block deal window mechanism
(iii) Statutory or regulatory obligation to carry out a bona fide transaction like achieving Minimum Public Shareholding Requirements as per the
(iv) Exercise of stock options in respect of which the exercise price was predetermined in compliance with SEBI (Share Based Employee Benefits) Regulations, 2014

4.5 Separation of Code of Conduct for listed entities and fiduciaries
The 2018 Amendment Act, two separate Codes of Conduct have been prescribed for listed companies (Schedule B) and other persons, known as fiduciaries, who are required to handle UPSI during the course of their business operations such as market intermediaries and fiduciaries which include auditors, accountancy firms, law firms, consultants etc. (Schedule C).

4.6 Reduction of scope and applicability of Code of Conduct and disclosure of trades
The restriction of the applicability of the Code of Conduct from ‘employees and connected persons’ to ‘designated person and their immediate relatives’ through the Amendment brought a major respite for
all the concerned stakeholders.

4.7 Introduction of institutional responsibility for Insider Trading
The new Regulation 9A provides for an entire institutional framework for prevention of insider trading. The responsibility of establishing internal controls has been placed on the Chief Executive Officer, Managing Director or such other analogous person of a listed company, intermediary or fiduciary to ensure the requirements to prevent insider trading are met. Additionally, the board of directors and Audit Committee have been instructed to keep a check on the CEO/MD/other person to ensure his compliance.

4.8 Addressing concerns regarding leakage of UPSI
SEBI has provided that every listed company is required to formulate written policies and procedures for inquiry in case of leak or suspected leak of UPSI. Moreover, all entities are required to formulate a whistle blower policy and make employees aware of such policy to enable employees to report instances of leak of UPSI.
(i) Provision for aiding investigations on insider trading
The Amendment has provided that designated persons shall be required to disclose the name and Permanent Account Number or any other identifier authorized by law of the following to the intermediary or fiduciary on an annual basis and as and when the information changes:
a) immediate relatives
b) persons with whom such designated person(s) shares a material financial relationship
c) Phone, mobile, and cell numbers which are used by them.

V. ACCIDENTALLY CONDUCT INSIDER TRADING

Innocent investors may accidentally conduct insider trading. There are a few precautions you can take to make sure that you are acting within SEBI regulations and not putting yourself at risk of prosecution or losing any trading licenses you may hold. Some suggestions are:
1)Watch the questions you ask when you are receiving information about a security.
2)Check your sources.
3)Report to the proper authorities when you receive information relevant to your portfolio that you are unsure is public or not.
4) Identify when someone providing information to you is violating a breach of duty.
5)Make sure everyone you trade with is clear on insider trading policies.
6)Be careful how you repay favors.

India prohibits trading on inside information. There are strong laws and penalties for breach. Anyone convicted of insider trading can be asked to transfer proceeds equivalent to the cost price or market price of securities, whichever is higher. The SEBI Act provides for penalties as high as Rs 25 crores or three times the amount of profits made out of insider trading, whichever is higher. The Act also prescribes that insider trading is punishable with a prison term of up to 10 years.

VI. CONCLUSION

The act of insider trading is a serious crime. Before you are tempted to trade securities based on information that is not publicly available, you should be aware of the consequences for doing so.. If professional investors and financial managers have been convicted of securities fraud, you should do everything you can to avoid these charges.

The insider trading regime in India has extremely benefitted with the SEBI (Prohibition of Insider Trading) Regulations, 2018 amendment. The strengthening of system of internal controls and providing for whistle blower policies indicates that the Securities and Exchange Board of India is determined to resolve contemporary issues like social media leakage of UPSI. However, some clarifications relating to the definition of ‘performance of duties’, person responsible for providing notices etc. would help in better implementation.