Chapter 6

Indian Regulations on Insider Trading

6.1 Introduction

The aim of insider trading laws and regulations is to assure that no one would gain by trading on ‘insider’ or ‘unpublished’ information – information that is not available to all market participants. The ultimate goal is to create a level playing field by making information accessible to all market participants. The enforcement of insider trading laws increases market liquidity and decreases the cost of equity\(^1\). This has been found to be the objective in the developed countries where stringent insider trading regulations are adopted. Insider trading laws exists on the strong foundation of equity and efficiency. With regard to equity the government wants to ensure that (i) everyone involved in the stock market has access to same set of information and (ii) any information available to one active participant in the market is available to all participants.

Perfect information is an abstraction that exists only in the elementary micro-economic text books. It is argued that by enforcing insider trading laws government is expected to enforce an unattainable ideal on the securities market. Insider trading laws encourage the free distribution of securities related information which helps to ensure more efficient pricing of stocks. However, when insider trading regulations discourage insiders from buying or selling based on inside information that only results in stock being priced in a manner consistent with all available information.

Since liberalisation of the Indian economy and consequential opening of the securities markets to the foreign institutional investors (FIIs), it has been found that the common investors are attracted towards quick returns from the markets. Indian securities market witnessed irregularities and violations such as price
manipulation, creation of artificial market, insider trading, initial public offer (IPO) imbroglio, takeover violations and other misconducts. The objective of regulation of Indian securities market is to ensure the growth of a normal market in a stable manner. In India, SEBI (Insider Trading) Regulations 1992 framed under the section 11 of the SEBI Act, 1992 are intended to prevent and curb the menace of insider trading in securities.

The objective of this chapter is to examine insider trading regulatory practices in India. Efforts have also been made to examine the overall effectiveness of the regulatory system and not the individual regulations. This chapter mainly focuses on Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 1992. This chapter is divided into nine sections. Section-6.2 deals with the need for insider trading regulation. Section-6.3 discusses the evolution of insider trading regulation in India. Section-6.4 examines the insider trading regulations by Self Regulatory Organisations (SROs). Role and powers of SEBI in curbing insider trading are discussed in Section-6.5. SEBI (Prohibition of Insider Trading) Regulations, 1992 is dealt in Section 6.6. Disclosure policies for insiders are discussed in Section 6.7. Evaluation of SEBI (Prohibition of Insider Trading) Regulations, 1992 is taken up in Section-6.8. Section- 6.9 concludes the chapter.

6.2 Need for insider trading regulation

Regulations are fundamentally rules of behaviour. Every country establishes a wide range of behavioural rules as a means of reconciling and conflicting rights and interests of its citizens. Many of these rules are designated to govern how individuals interact socially. Absence of conditions of perfect competition and existence of information asymmetry make it possible for certain participant to take unfair advantage of investors by exploiting regulatory inadequacy. Here lies the significance of an effective securities market regulation.
Financial regulations are rules that govern commercial behaviour in the financial system. Financial regulations establish a legal and ethical framework within which trade and commerce may flourish to the mutual benefit of all involved. Herring and Santomero (1999) identified four broad rationales for financial regulation:

a) Safeguarding the system against systematic risk;
b) Protecting consumers against opportunities behaviour by suppliers of financial services;
c) Enhancing the efficiency of the financial system and
d) Achieving a range of social objectives (such as increasing homeownership or channelling resources to particular sectors of the economy or population).

The objective of the regulation of securities markets is to ensure the growth of a normal market in a stable manner. Stability is an essential prerequisite for vibrancy and viability of the stock markets. Stability ensures fair and orderly price movements and builds up investor confidence. A stable market should reflect not only demand but also market values. It is based on a good performance of the corporate sector in terms of earnings and cash flows against the backdrop of overall growth and prospects of the economy.

The stable and efficient financial system provides the foundation for implementation of effective stabilisation policies, more accurate pricing of risk and more efficient use of capital. During last one-decade Indian financial system gets increasingly globalised. Increased integration of India’s securities markets with global markets implies that the state of the regulatory environment in the Indian securities market is now of relevance to both domestic investors as well as foreign investors. Securities regulation monitors the trading of securities with the purpose of ensuring that trading is fair.

The need for statutory regulations and regulatory authorities is to oversee the operations in securities markets that have been recognised the world over. The
vast majority of securities regulations in all countries aim primarily at promoting
fair and full disclosure of material information relating to the securities markets
and to specific securities transactions. It includes all aspects of market trading as
well as the financing and financial reporting by public companies so as to present
all investors with a level playing field. Insider trading activities could undermine
confidence of securities market. If the rules of the game are perceived to be
uncertain and unfair, these could have the effect of reducing the trading activity.
The markets would be less efficient unless the level playing field is perceived to
be fair for all. By level playing field we mean equal opportunities for everybody in
the system. Therefore, these activities are required to be identified, addressed and
regulated properly for greater interest of the large number of investors as well as
securities markets. Insider trading has been recognised as one of the important
problems for destabilising of the securities market. For smooth development and
functioning of securities market like India, it is required to be regulated and
controlled properly.

The call for regulation is not merely an illogical response based on vague
notions of fairness and morality. Factors that influence public confidence might
not necessarily be articulated in a logical expression but the need to eliminate
abuses in the market follows logically from the recognition that it is imperative to
preserve public confidence. Regulation is framed in order to combat a problem.
Civil society cannot tolerate criminal activity and therefore we frame criminal
laws. The society cannot tolerate white-collar-crime and we frame insider trading
regulation. The concept of civil society again is based on a very strong foundation
of level playing field. One of the purposes of insider trading regulation is to offer
level playing field to all the market participants and at the same time it is expected
that the market regulators like SEBI, SEC or others would not interfere at the
individual level for micro-level commercial decisions.

In the context of insider trading regulation, the concept of level playing
field deserves a special attention. The concept of level playing field that is
desirable in the area of sports cannot be applicable in economics with equal spirit because the later is based on unequal strength of the market participants. Making balance between a free and fair trade is the consistent challenge in the market economy. Regulators should be cautious that their regulation would not result into inefficiency in order to create level playing field. Maintaining these two contradictory philosophies is a consistent challenge on the part of the securities market regulators.

Law in a free society should seek to force people to change the way they conduct their everyday affairs. At the same time it continues to act within the framework of set of rules that promote the common good without altering the basic rhythm of the society. The case for insiders trading laws therefore, falls even on fairness ground. Hence insider trading laws are supported on the basis of fairness. However, the situation in the financial markets in the world governed by insider trading laws is not fair. In most of the developed countries with relatively transparent market, insider trading is quite common and accepted in some situations. A law that prohibits an activity as common and accepted as insider trading can hardly be described as fair.

6.3 Evolution of insider trading regulation in India

Indian securities market started functioning since 1875 when Bombay Stock Exchange was established. After independence, two exclusive acts that governed the securities market in India until early 1992 were the Capital Issues (Control) Act, 1947, (CICA) and the Securities Contracts (Regulation) Act, 1956 (SCRA). Under the CICA, the office of the Controller of Capital Issues was set up which granted approval for issues of securities and also determined the amount, type and price of the issue. The CICA was repealed in 1992 with the enactment of Securities Exchange Board of India (SEBI) Act, 1992. There was no specific provision in law which could address effectively the problem of insider trading.
The SCRA was enacted to prevent undesirable transactions in securities by regulating business of dealings therein by prohibiting option and by providing for certain other matters connected therewith. All the powers under the SC(R)A were exercised by the Government of India (GOI). The SEBI Act created a Board to regulate Indian securities market. In the interest of integrated regulation of securities market it was felt that only one agency should regulate the securities market. In order to do so the SEBI Act transferred some of the powers under of the GOI under the SCRA to SEBI. All powers under the Securities Contracts Regulation (Rules), 1957 have also been transferred to SEBI in 1996.

The history of stock exchanges in India is almost 134 years old although insider trading regulatory regime is only 17 years old. For most part of those 134 years, insider trading went unhindered in India. The first attempt that was made to curb insider trading in India was in the shape of a disclosure requirement by company directors of their shareholdings. Provisions were incorporated in sections 307 and 308 of the Companies Act 1956 on the recommendation of the Company Law Committee. It was only in the late 1970's insider trading, for the first time, was officially recognised as an undesirable practice. A series of committee reports recommended its strict regulation; as a result, a regulatory authority was set up in 1992.

A. Sachar Committee (1979): The High-powered Expert Committee on Companies and Monopolies and Restrictive Trade Practices Act (MRTP) (Sachar Committee) was constituted in June 1977 for reviewing of the Companies Act, 1956 and the MRTP Act, 1969. In 1979, the Sachar Committee submitted its report. The Committee made two-fold recommendations – one relating to full disclosure of transactions by those who have made price sensitive information and another; prohibition of transactions by such persons during certain specified period unless there are exceptional circumstances. Among the insiders, a company director, statutory auditor, accountant, tax and management consultant or advisor and legal advisor etc. could indulge in such activities. They were prohibited from
purchasing or selling shares prior to and after two months of the close of the accounting year unless permitted by the Board.

All public companies are required to maintain a register disclosing dealings in shares of the company by the above persons including dealings by their spouses and dependent children and also of those persons who are in full time employment of the company and drawing a salary of three thousand rupees or more per month\(^\text{10}\). This Committee also recommended amendments to section 307 and 308 of the Companies Act, 1956. It has included to prohibit and restrict certain dealings by insiders and their relatives with provisions of penalties, for those who have misused information relating to a company and remedy for persons who could establish that they suffered loss on account of such misuse. The committee also suggested that an insider should be held accountable to the company for the profits made by insider trading.

**B. Patel Committee (1987):** The Government of India constituted a High-powered Committee (Patel Committee) in May 1984, to make a comprehensive review of the functioning of the stock exchanges and to make recommendations in the matter. The committee’s final report took a serious view of the absence of specific legislation in India curbing misuse of insider information and recommended strict penalties for the offence of insider trading. In its report it has been found that insider trading is rampant in stock exchanges in the country and is one of the principal cause of excessive speculative activity\(^\text{11}\). Even persons employed in the office of the solicitors, auditors, financial consultants and financial institutions in possession of undisclosed price sensitive information are reported to be indulging in such activity. It is unhealthy that most of the stock brokers engaged themselves in speculative transaction in their accounts while making transactions for their client insiders. The stock exchange should take effective steps to check this menace. The stock exchanges should also be immediately informed about any news or developments affecting the companies, which may be price-sensitive in nature as soon as such matters are placed on the agenda of the board and circulated
to the directors. To establish healthy and transparent practice in stock exchanges and to sustain the confidence of the investors such trading should be regulated by law.

The committee also recommended that the Securities Contracts (Regulation) Act, 1956 be amended to make stock exchange free from manipulations including curb trading, insider trading and such other undesirable activities. Non-compliance and violation of the regulations by the individual person should be imposed cash penalty of Rs. 1 lac or imprisonment for 5 years or both and in case of body corporate and trust, penalty would be Rs. 5 lacs. Additionally, as a deviation from the Sachar Committee, it was recommended that person misusing inside information could be compelled by law to surrender to the stock exchanges the profit they have made or the amount equivalent to the losses they have averted.

C. Abid Hussein Committee (1989): The Working Group on the ‘Development of the Capital Market’ which was popularly known as Abid Hussein Committee was formed in 1989. The group recommended that the insider trading should be made as a major offence punishable with civil penalties as well as criminal proceedings. The problems of insider trading and secret take-over bids could be tackled largely by appropriate regulatory measures. It was suggested that the SEBI might be asked to formulate the necessary legislation and be equipped with the authority to enforce the provisions.

6.4 Insider trading regulations by Self Regulatory Organisations (SROs)

Self regulation usually involves an organisation or association developing a system of rules that it monitors and enforces against its own members or in some cases a large community. Self-regulatory organisations (SROs) are basically quasi-governmental bodies implementing the external regulations as well as their
own rules. The stock exchange being a self-regulatory body, the training and other
activities of the brokers are regulated to the extent necessary for smooth and
orderly functioning of the stock market and the trading therein and post trading
settlement. The stock exchanges are empowered to make rules and regulations for
their members and for regulating the trading activities such as malpractices,
insider trading etc. In the broker-owned exchanges regime, brokers have elected
their representatives to regulate activities of the exchange, including those of the
brokers themselves. This has raised fairness issues, because the members of stock
exchange governing boards have access to valuable information about market
participants. Two main sources of self regulations of the stock exchanges are (i)
Securities Contracts (Regulation) Act, 1956 and (ii) the codified rules, byelaws
and regulations of the respective stock exchanges.

One of the parameters of the success of self-regulation depends on how
well the stock exchanges are able to control insider trading amongst their
members. Although, the performance of the stock exchanges in India is not
satisfactory, members of the stock exchanges were asked whether the regulation of
insider trading was the role of the stock exchange. There are some members in the
stock exchanges who argued favourably in regulating insider trading and few
members opposed it13.

However, self-regulation is not always effective, because the current
ownership and governance structures of many stock exchanges allow scope for
conflict of interest. Elimination of such conflict of interest through
demutualisation implies separation of ownership of exchange from the right to
trade on it, which can promote fairness and reinforce investor protection. In India
most of the stock exchanges have been converted into corporatised and
demutualised stock exchanges. National Stock Exchange Ltd. (NSE) and Bombay
Stock Exchange (BSE) have strong surveillance mechanism system to look into
the activities of their markets. If any discrepancy is noticed in the market, the
Governing Body of the BSE may by a special resolution and for reasons to be
recorded close the market on days other than on holidays. The president may at any time close the market for twenty four hours whenever requires.

The SEBI Act, 1992 provides for promotion and regulation of self-regulatory organisations (SROs). The International Organisation of Securities Commissions (IOSCO) also sets two principles of securities regulation for SROs. First, the regulatory regime should make appropriate use of SROs that exercise some direct oversight responsibility for their respective areas of competence to the extent appropriate to the size and complexity of the markets. Second, SROs should be subject to the oversight of the regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities.

These SROs can take an important role in adopting insider trading regulations primarily in (a) defining disclosure requirements, (b) defining procedures for handling inside information, (c) defining restrictions concerning trading by insiders and (d) limiting possibilities of trading based on inside information and education. In order to protect the interest of common investors form insider trading activity, measures like buy-fridge, sell-fridge, circuit filters, and circuit breakers may be adopted. In case of extreme situation the whole market might be kept closed. When authorities feel that common investors are buying scrip without taking note of the fundamentals or there is nexus between unscrupulous brokers to hike up the price artificially, they may adopt buy fridge to the scrip under observation. In that case common investors are not allowed to buy for a certain period of time. Alternatively, there might be a situation that calls for initiative on the part of the regulations to bring down the price artificially and investors may sell out of panic. In that situation the strategy on the part of the exchanges could be sell fridge. On the other hand when exchange authority feels a high degree of speculation but cannot determine the direction, they might go for circuit filters i.e., they determine the price range within which price may be allowed to oscillate. Circuit breaker is a different method. If price of scrip opens
next day with a difference of 16% or more in comparison to its previous day, transaction in that script may be stopped for a few days\textsuperscript{16}.

6.5 Role and powers of SEBI in curbing insider trading

The role of a regulatory body of stock market in a country is determined by the stage of development of stock market in that country. In the Indian context, having regard to the emerging nature of the market, the regulatory body must necessarily have the twin role of development and regulation. Regulatory and development functions are strongly interlinked and have almost the same objectives. Rapid and healthy developments in most of the cases are outcomes of well-regulated structures. SEBI is a statutory body, which operates within the legal framework of Securities and Exchange Board of India Act 1992. Powers and functions of SEBI are discussed in section 11 of the SEBI act. The duty of the SEBI is to protect the interest of investors and to regulate the securities market. Prohibition of insider trading is one of the important regulatory measures of securities market of the SEBI\textsuperscript{17}.

If SEBI suspects that any person has violated any provision of SEBI (Prohibition of Insider Trading) Regulations, 1992, it may make enquiries with such persons or any other person\textsuperscript{18}. Those persons (e.g. stock exchanges, mutual funds and other persons associated with the securities market and intermediaries and self-regulatory organisations in the securities market) might have been associated with such transactions. For this purpose, SEBI may also appoint officers to inspect the books and records of insiders and other connected persons. SEBI may investigate into the complaints received from investors, intermediaries or any other person on any matter having bearing on the allegations of insider trading. In this connection, SEBI may appoint one or more officers to inspect the books and records of insider(s) or any other persons for the purpose of investigation\textsuperscript{19}. Before undertaking an investigation the Board shall give a reasonable notice to insider for that purpose. The investigating authority may
examine any books, records, documents and computer data or other relevant statements of any member, director, partner, proprietor or employee of the insider or other persons. SEBI may also appoint an auditor to investigate the books of accounts and affairs of the insider or other persons.

Under regulation 7(3), the investigating authority is entitled to examine record, statements of any member, director, partner, proprietor and employee of the insider or any other person mentioned in section 11(1)(i) of the SEBI act. The power of SEBI is to examine and record statements which does not extend up to the insider alone but extends also to member, proprietor, director, partner and employees of the insider. However, the investigating authority has neither any power to examine on oath, nor does it have the same power as are vested in a civil court under the Code of Civil Procedure, 1908 while trying a suit20. It is the duty of insider to produce necessary documents and other related papers to the investigating authority. The investigating authority shall within a reasonable time conclude investigation and submit an investigation report to the Board.

On completion of the investigation, the investigating authority must submit its report to the SEBI within a reasonable time21. The 1992 Regulations prescribed a period of one month from the conclusion of the investigation, within which the investigating authority had to submit its report to the SEBI. This has now been amended to a reasonable time from the conclusion of investigation. Reasonable time may also depend on seriousness of the matter being investigated. Generally, the time required under normal circumstances for preparing the report of investigation made should be the reasonable time within which the investigation report shall be submitted. The investigating authority has discretion to take a longer period to submit its report. On reviewing the report, the SEBI must communicate the findings to the insiders or other persons, who are permitted to show cause within 21 (twenty-one) days of receipt of the communication.

After consideration of investigating report, SEBI communicate the findings to the persons suspected to be involved in insider trading or violating insider
trading regulations. The persons to whom such findings have been communicated should reply the same within 21 days. On receipt of such a reply or explanation, the Board may take such measures as it deems fit to protect the interest of investors and the interest of securities market.

The SEBI may, if satisfied of insider trading, direct the insider or other persons not to deal in securities in any particular manner. It prohibits the insider or other person from disposing of any of the securities acquired in violation of the new regulations. SEBI restrains the insider from communicating or counselling any person to deal in securities and to declare the transaction(s) in securities as null and void. SEBI directs the person who acquired the securities in violation of the regulations to deliver the securities back to the seller. However, if the buyer is not in a position to deliver the securities, the higher of the market price prevailing at the time of issue of the directions or at the time of transactions, must be paid to the seller. It directs the person in violation of the regulations to transfer an amount or proceeds, equivalent to the higher of the cost price or market price of securities, to the investor protection fund of a recognised stock exchange.

The Expert Group (headed by Justice M.H.Kania) constituted by the SEBI in August, 2004, recommended in its Report that, section 11(2)(i) of SEBI Act be amended to empower SEBI to call for information from professionals, subject to the professional’s rights (for not parting with the privileged information in their possession). It was further suggested that if any professional while rendering his services indulges in malpractices such as certifying false information, etc., restrictions like debarring him from appearing before SEBI may be considered.

The committee also made some recommendations for amending section 11 of the SEBI act.

A person who is aggrieved by the directions of the SEBI may appeal to the Securities Appellate Tribunal (Regulation 15). The Central Government framed the Securities Appellate Tribunal (SAT) (Procedure) Rules, 2000 (notified on
An appeal may be made within 45 days of receipt of copy of the order from the date on which the appeal had been filed.

The SEBI may prejudice its right to initiate criminal prosecution under section 24 of the SEBI Act to protect the interests of investors and the market and also for due compliance with the provisions of the act. SEBI may issue any of the following orders:

(a) directing the insider or such person not to deal in securities in any particular manner;

(b) prohibiting the insider or such persons from disposing of any of the securities acquired in violation of these regulations;

(c) restraining the insider to communicate or counsel any person to deal in securities;

(d) declaring the transaction(s) in securities as null and void;

(e) directing the person who acquired the securities in violation of these regulations to deliver the securities back to the seller and

(f) directing the person who has dealt in securities in violations of these regulations to transfer an amount or proceeds equivalent to the cost price or market price of the securities, whichever is higher to the investor protection fund of a recognised stock exchange. Regulation 11 merely empowers the SEBI to pass certain interim directions for the purpose of maintaining the status quo during the course of the investigation and/or immediately thereafter upon receipt of the said investigative report.

6.6 SEBI (Prohibition of Insider Trading) Regulations, 1992

Securities Exchange Board of India (SEBI) had come with a draft regulation on insider trading in December 1991. The draft defined insider, unpublished price-sensitive information and envisaged prohibition on dealings in securities or communicating or counselling by the insider. It contained detailed
provisions for investigation proceedings, prosecution and penalties. Ultimately the SEBI, framed first set of insider trading regulations, which are Securities and Exchange Board of India (Insider Trading) Regulations, 1992. These regulations come into force from 19th November, 1992. The objective of the regulation was to tackle insider trading so that stock market could get stable.

SEBI (Insider Trading) Regulations, 1992 consisted of three chapters and twelve regulations. Insider, connected persons, persons who are considered as deemed to be connected persons, dealing in securities and unpublished price sensitive information have been defined in Chapter-I. Prohibition on dealing, communicating or counselling on matters relating to insider trading has been dealt in Chapter- II. Chapter- III empowers SEBI to investigate the insider trading cases.

SEBI has constituted a committee headed by Kumar Mangalam Birla\textsuperscript{25} to look into the existing regulations of insider trading and to develop more comprehensive, broad—based guidelines. In early March 2001 leader of the opposition party raised the point of extreme volatility in the stock markets in the parliament. Erstwhile Finance Minister had proposed legislative changes to strengthen the provisions in the SEBI Act, 1992 to ensure investors protection. In pursuance to this, the SEBI amendment Act, 2002 was enacted to make provisions to strengthen the Securities Appellate Tribunal (SAT) and the SEBI in terms of organisational structure and institutional capacity. It enhanced the powers of SEBI substantially, particularly in respect of inspection. SEBI has notified the SEBI (Insider Trading) (Amendment) Regulations, 2002 which have come into force from the said date of notification i.e. February 20, 2002\textsuperscript{26}. The amended regulations have been called SEBI (Prohibition of Insider Trading) Regulations, 1992. This regulation incorporated one more chapter which specifies the model code of conduct for prevention of insider trading for listed companies in part- A and part- B for other entities. The amended regulations have empowered the SEBI to tackle violators and to curb the evils of insider trading in the capital markets. The said regulations were amended five times.\textsuperscript{27}
6.6.1 Insider

Concept of the term 'insider' has been discussed in chapter-2 as well as chapter-5. The term has been defined in Regulation 2(e) of SEBI (Prohibition of Insider Trading) Regulations, 1992.

Three broad categories of insiders have been found in SEBI insider trading regulations, which are: (a) persons who are connected to the company, (b) persons who were connected with the company and (c) persons who are deemed to be connected to the company. To become an insider it requires satisfying the three elements, viz.; (i) the person should be a natural person or legal entity; (ii) he should be connected person or deemed to be connected person and (iii) acquisition of the unpublished price sensitive information by virtue of such connection.

The words ‘by virtue of such connection’ had been omitted by the SEBI amendment regulation in 2002 in the definition of insider. It implies that a person would be treated as an insider simply if he is or was a connected person with a company and has had access to unpublished price sensitive information without the necessity of proving that he has or had access to such information.

The term ‘connected person’ is an important aspect for establishing the charge of insider trading. Connected person represents a person who is a director of a listed company or is an officer or an employee of a listed company or holds a position involving a professional or business relationship between himself and the listed company either temporary or permanent. These persons have reasonable access to the unpublished price sensitive information of the company. Director has been defined in Section 2(13) of the Companies Act, 1956. It includes a person who is deemed to be the director of that company by virtue of Section 307(10) of the said act. Every person working as an officer or an employee of the company or holding a position involving a professional or business relationship with the company (temporarily or permanently) and is expected to have a reasonable access to the unpublished price sensitive information in relation to the company shall also be called connected person. Persons rendering professional services such as audit,
taxation, project preparation, financial and other advisory services to the company and having access to the unpublished price sensitive information of the company shall be treated as connected person. 'Connected person' also includes a person who was connected person six months prior to the implementation of the insider trading regulations. But it leaves a scope for confusion for fixing time frame of six months. If a connected person deals in shares after six months period just after ceasing his connection, he will not be treated as connected person.

A person who was a connected person at any point of time and dealt shares may be accused of the charge of insider trading. However, merely by reason of some professional and business relationship a person cannot be termed as 'connected person' unless there is some evidence to establish nexus between the aforesaid two conditions. This will depend on the facts and circumstances in each case having due regard to the nature of relationship and degree of probability as to accessibility to unpublished price-sensitive information.

Other important persons are persons deemed to be connected person. Exhibit 6.1 shows list of persons deemed to be connected person.

Exhibit 6.1: Persons deemed to be connected person

<table>
<thead>
<tr>
<th>Regulation</th>
<th>Persons deemed to be connected person</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regulation 2(h)(i)</td>
<td>An officer or an employee of a company under the same management or group or any subsidiary company thereof within the meaning of subsection (1B) of section 370(1B) or subsection (11) of section 372 of Companies Act, 1956, or subsection (g) of section 2 of the Monopolies and Restrictive Trade Practices Act, 1969, as the case may be.</td>
</tr>
<tr>
<td>Regulation 2(h)(ii)</td>
<td>An intermediary as specified in section 12 of the SEBI Act, investment company, trustee company, asset management company or an employee or director thereof or an official</td>
</tr>
<tr>
<td>Regulation 2(h)(iii)</td>
<td>A merchant banker, share transfer agent, registrar to an issue, debenture trustee, broker, portfolio manager, investment advisor, sub-broker, investment company or an employee thereof, or a member of Board of Trustees of a mutual fund, or a member of the Board of Directors of the Asset Management Company of a mutual fund or is an employee thereof who has a fiduciary relationship with the company</td>
</tr>
<tr>
<td>Regulation 2(h)(iv)</td>
<td>A member of the Board of Directors, or an employee of a public financial institution as defined under section 4A of the Companies Act 1956</td>
</tr>
<tr>
<td>Regulation 2(h)(v)</td>
<td>An official or an employee of a Self-regulatory Organisation, recognised or authorised by the SEBI of a regulatory body</td>
</tr>
<tr>
<td>Regulation 2(h)(vi)</td>
<td>A relative of any of the aforementioned persons</td>
</tr>
<tr>
<td>Regulation 2(h)(vii)</td>
<td>A banker of the company</td>
</tr>
<tr>
<td>Regulation 2(h)(viii)</td>
<td>A relative of the connected person</td>
</tr>
<tr>
<td>Regulation 2(h)(ix)</td>
<td>A concern, firm, trust, Hindu Undivided Family (HUF), company or association of persons mentioned in sub clause (i) of clause (c), of this regulation or any of the persons mentioned in sub-clause (vi), (vii) or (viii) of regulation 2(h) who has more than 10% of the holding or interest.</td>
</tr>
</tbody>
</table>

Source: SEBI (Prohibition of Insider Trading) Regulations, 1992. Regulations 2(h)

It has been found that a if a director of the company, or a relative of persons mentioned in sub-clauses (i) to (v) of regulation 2(h), or a banker of the company, or a relative of the connected person, holds more than 10% shares or voting rights in the company, shall be ‘deemed to be a connected person’. The
regulation has not identified secondary insiders known as tippees as a separate class of insiders. Tippees are connected persons but they are not directly connected with the companies. However, the amendment has failed to include directors of stock exchanges or clearing house or corporation within the scope of definition.

6.6.2 Nature of price-sensitive information

Information regarding securities markets is the key element to the insiders. Based on unpublished price-sensitive information, insiders earn profits or avoided losses. SEBI (Insider Trading) Regulations, 1992 defined unpublished price-sensitive information\(^{31}\) which means any information which relates directly or indirectly to a company and is not generally known or published by such company for general information, but which, if published or known is likely to materially affect the price of securities of that company in the market. It came under eight parameters. These are (i) the periodical results of the company; (ii) intended declaration of dividends (both interim and final); (iii) issue of securities or buy back of securities; (iv) any major expansion of plans or execution of new projects; (v) amalgamation, mergers or takeovers; (vi) disposal of the whole or substantial part of the undertaking; (vii) such other information as may affect the earnings of the company and (vii) any significant changes in policies, plans or operations of the company.

The definition of 'unpublished price-sensitive information' stated above has been split into two separate parts in the amended regulations in 2002 such as (i) price-sensitive information\(^{32}\) and (ii) unpublished information. Price sensitive information means any information that relates directly or indirectly to a company, which is unpublished and is likely to materially affect the price of securities of company. The scope of price sensitive information is now more stringent and includes only such information which if published is likely to materially affect the price of securities of a company. Unpublished information means information
which is not published by the company or its agents and is not specific in nature. Speculative reports in print or electronic form shall not be considered as published information. Information can be considered as price sensitive information if all the following conditions are fulfilled: (a) it relates to the company in whose securities insider trading has been allegedly indulged in; (b) it falls directly or indirectly within the purview of one or more seven parameters in sub-clause (ha) of regulation 2 of SEBI insider trading regulations; (c) it is not generally known or published by the company for general information and (d) if it is published or known it may likely to affect the price of securities of the company in stock market.

6.6.3 Dealing in securities

In 2002 regulations the term ‘dealing in securities’ would mean an act of subscribing, buying, selling or agreeing to subscribe, buy, sell or deal in any securities by any person as principal or agent. The earlier regulations excluded the term subscribing or agreeing to subscribe as a component of dealings in securities. Presently if a person subscribes or agrees to subscribe to securities through a public issue, rights issue, or on a private placement method on the basis of price sensitive unpublished information, then such a person should be convicted for insider trading.

Prohibition on dealing, communicating or counselling on matters relating to insider trading is dealt in chapter-II of the regulations. An insider being in possession of any unpublished price sensitive information shall not deal in the securities of a company listed on any stock exchange either on his own behalf or on behalf of any other person. An insider while in possession of insider information shall not communicate, counsel or procure directly or indirectly any unpublished price-sensitive information to any person. This is prohibited with respect to (a) dealing (b) communicating (c) counselling and (d) procuring in or about securities of such a company, directly or indirectly. The words ‘while in
possession of any unpublished price sensitive information' signify that if a person
is not in possession of any unpublished price-sensitive information though he may
be an insider but he does not remain prohibited to deal in securities. It has
mentioned in Regulation 3A that no company shall deal in the securities of another
company or associates of other companies while in possession of any unpublished
price sensitive information. Any insider deals in securities in contravention of the
provisions of regulation 3 and 3A shall be guilty of insider trading. Chapter-III of
the regulations dealt with investigation. This chapter contains nine regulations.
Investigation for violating insider trading regulations has been discussed in
chapter-III.

6.6.4 Punishment by company

In most of the insider trading cases culprits are left scoot free because of
lack of evidences. There are instances where Chief Executive Officer of Indian
Companies have been punished by the company. Fortunately Sri Gopalkrishnan,
Chief Executive Officer of Infosys Technologies Ltd. had inherited 12,800 equity
shares from his mother on December 2007. But he had inadvertently failed to
notify those shares to the company within one business day after the change of this
inheritance. The Company sent a notice to him for violation of insider trading
rules. It imposed a penalty of Rs.5 lacs and directed him to donate the same to a
charitable institution of his choice. He violated regulation 13 of SEBI insider
trading regulations for not disclosing the change of shareholding pattern. As per
this regulation, responsibility of a company is to follow up disclosure policies of
SEBI insider trading regulations. Ultimately Gopalkrishnan had to make the
donation to the charity.

In Infosys Technologies Ltd., the first instance in India where the offence
of insider trading was detected, Sri Gopalkrishnan its Chief Executive Officer was
penalised. Besides Gopalkrishnan, Jeffrey Lehman, an independent director, also
has been fined $2000 for the same violation. Mr. Lehman was also imposed a
penalty for failure to correctly follow the procedure on sale of shares and that amount, too had been given to another charitable institution⁴⁵.

6.6.5 Penalties for committing insider trading

Offenders in securities fraud or violations of any sections or regulations may be punished by the regulators and other provisions of the respective laws. A penal provision includes cash penalty as well as imprisonment. Chapter VI-A of the SEBI Act provides for penalties and adjudication. It is pertinent to note that section 24 of the SEBI Act deals with criminal offences under the act and its punishment. Section 15A of the SEBI Act imposes the penalty for failure to furnish information, return etc. If any person, who is required under this Act or any of this rules or regulations made thereunder to furnish any document, return or report to the SEBI, fails to furnish the same, shall be liable to a penalty not exceeding Rs.150,000 for each day of such failure. Under this regulation if any person fails to file any return or furnish any return any information, books or other documents within the time specified in the regulations he shall be liable to a penalty not exceeding five thousand rupees per day during which such failure continues. Exhibit 6.2 shows penalties against violation of insider trading regulations.

**Exhibit 6.2: Penalties under the SEBI (Amendment) Act, 2002**

<table>
<thead>
<tr>
<th>Section</th>
<th>Nature of Violations</th>
<th>Penalty</th>
</tr>
</thead>
<tbody>
<tr>
<td>15G(i)</td>
<td>Dealing by an insider either on his own behalf or on behalf of any other person in any securities of a body corporate on any stock exchange on the basis of any unpublished information</td>
<td>Up to Rs.25 crores for insider or 3 times of the amount of the profits made, whichever is higher</td>
</tr>
<tr>
<td>15G(ii)</td>
<td>Communicating by an insider, any</td>
<td>Up to Rs.25 crores for</td>
</tr>
</tbody>
</table>
unpublished price-sensitive information to any person with or without his request for such information except as required in the ordinary course of business or as required by law.

| 15G(iii) | Counselling or procuring by an insider, any other person to deal in securities of any body corporate on the basis of any published price-sensitive information. | Up to Rs.25 crores for insider or 3 times of the amount of the profits made, whichever is higher. |

Section 15G of SEBI Act, 1992 has empowered SEBI to impose penalty for committing insider trading by the insiders. If an insider on his own behalf or on behalf of any other person deals in securities on the basis of any unpublished price sensitive information or communicate any unpublished price sensitive information to any person with or without his request or counsels or procures any other person to deal in any securities of anybody corporate on the basis of unpublished price sensitive information shall be liable to a penalty of rupees twenty five crore or three times of the amount of profits made out of insider trading whichever is higher. It was rupees five lacs before amendment of the regulation in 2002. Earlier this amount was quite meagre in relation to profit earned or loss avoided by the insiders from the insider trading.

In 1995, the amendment to the SEBI Act, 1992 led to establishment of Securities Appellate Tribunal (SAT) to adjudicate the appeal of person who is aggrieved by an order of the SEBI. The SAT has the same powers vested in a civil court under the Code of Civil Procedure, 1908 (5 of 1908) while trying a suit in respect of the following matters namely: (a) summoning and enforcing the attendance of any person and examining him on oath; (b) requiring the discovery and production of documents; (c) receiving evidence on affidavits; (d) issuing
commissions for the examination of witnesses or documents; (e) dismissing an application for default or deciding it ex parte; and (f) setting aside any order of dismissal of any application for default or any order passed by it ex parte. A person being aggrieved by an order of the SEBI under provisions of its regulations has a right to make an appeal in the matter to the SAT.

6.7 Disclosure policies for insiders
Chapter-IV of the SEBI insider trading regulations discusses ‘Policy on Disclosure and Internal Procedure for Prevention of Insider Trading’. This chapter included four regulations (Regulations 12-15). All listed companies and organisations associated with the securities markets are now required to frame a code of internal procedures and conduct for the prevention of insider trading, on the basis of the model code specified in Schedule -I of the regulations. The companies covered under this provision are listed companies and organisations associated with securities markets. Besides listed companies, Exhibit 6.3 has shown organisations which are associated with securities market to follow disclosure policies.

Exhibit 6.3: Organisations who are supposed to follow disclosure policies.

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Intermediaries, asset management company and trustees of mutual funds</td>
</tr>
<tr>
<td>2</td>
<td>Self- regulatory organisations recognised or authorised by the SEBI</td>
</tr>
<tr>
<td>3</td>
<td>Recognised stock exchanges and clearing house or corporations</td>
</tr>
<tr>
<td>4</td>
<td>Public financial institutions</td>
</tr>
<tr>
<td>5</td>
<td>Professional firms such as auditors, accountancy firms, law firms, analysts, consultants, etc., assisting or advising listed companies</td>
</tr>
</tbody>
</table>

Source: Regulations 12(1) of the SEBI (Prohibition of Insider Trading) Regulations, 1992

The abovementioned entities shall abide by the Code of Corporate Disclosure Practices as per the Schedule–II of the regulations. These entities
need to follow guidelines on corporate disclosure policy, prompt disclosure of price sensitive information, overseeing and coordinating disclosure, responding to market rumours, timely reporting of shareholding, ownership and changes in ownership, disclosure/dissemination of price sensitive information with special reference to analysts and institutional investors, medium of disclosure/dissemination, dissemination by stock exchanges as per schedule –II.

Every person holding more than 5% of the shares or voting rights in a listed company shall disclose to the company, the number of shares or voting rights held by such person in Form A of Schedule-III of the regulation. Any change in shareholding or voting rights must also be disclosed, if such change exceeds 2% of the total shareholding or voting rights in the company. Such disclosures shall be made within 4 working days of receiving intimation of allotment of shares, or the acquisition of shares or voting rights.

Similarly, a director or officer of a listed company shall also disclose to the company number of shares held by him and positions taken in derivatives within two working days of becoming such director/officer in Form B of Schedule III of the regulations. If there has been a change in such holdings from the last disclosure and the change exceeds Rs. 5 lacs in value or 25000 shares or 1% of the total shareholding or voting rights whichever is lower shall disclose in Form D of the regulations. These disclosures shall be made within four working days of receipt of intimation of allotment or acquisition or sale of shares or voting rights as the case may be.

Every listed company must promptly disclose price sensitive information to stock exchanges where its shares are listed within two days of receipt of information. Such information can also be made available to the company or stock exchange website. Listed companies must appoint a compliance officer or any other senior official to supervise corporate disclosure. The compliance officer shall be responsible for setting forth policies, procedures, monitoring adherence to the rules for the preservation of price sensitive information; maintain record of the
designated employees and any changes made in the list. The designated official may approve disclosure or dissemination of price sensitive information in advance. The designated officer must be immediately intimated of any accidental disclosure of information without his prior approval, even if the information is not considered price sensitive. If requested by Exchanges, listed companies must lay down procedures to clear or verify any market rumours. The designated officer is responsible to decide whether a public announcement is required to verify or deny rumours and subsequently make the disclosure. Disclosure of shareholdings by major shareholders and changes in ownership must be made promptly. Exhibit 6.4 depicts the lists disclosure requirements in four different forms.

**Exhibit 6.4: Disclosure by the Insiders under Schedule III of the SEBI (Prohibition of Insider Trading) Regulations, 1992**

<table>
<thead>
<tr>
<th>Form No.</th>
<th>Disclosure Requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Form A</td>
<td>Details of acquisition of 5% or more shares in a listed company by a person</td>
</tr>
<tr>
<td>Form B</td>
<td>Details of shares held by director or officer of a listed company</td>
</tr>
<tr>
<td>Form C</td>
<td>Details of change in shareholding in respect of persons holding more than 5% shares in a listed company</td>
</tr>
<tr>
<td>Form D</td>
<td>Details of change in shareholding of director or officer of a listed company</td>
</tr>
</tbody>
</table>

The designated employees or specified executive and directors are obligated to maintain the confidentiality of price sensitive information. The designated or specified employees and directors shall not pass on such information to any person directly or indirectly by way of making a recommendation for the purchase or sale of securities of the company. Unpublished price sensitive information should be disclosed by the company only to those who need the information in connection with discharge of their duty and whose possession will
not give rise to a conflict of interest or appearance of misuse of such information. Files containing confidential information shall be kept secure. Computer files must have adequate security of login and passwords etc. The company shall specify a trading window for trading in the company’s securities. The trading window shall be closed during the time of (a) declaration of financial results (quarterly, half-yearly and annual); (b) declaration of dividends; (c) issue of securities by way of public/rights/bonus issues etc. (d) any major expansion plans or execution of new projects; (e) amalgamation, merger, takeovers and buy-back of shares; (f) disposal of whole or substantially of the undertaking and (g) any changes in policies, plans or operations of the company. When the trading window is closed, the designated employees or specified executive and directors shall not trade in the company’s securities in such period.

To prevent the misuse of confidential information the organisation should adopt a Chinese wall policy which separates those areas of the organisation which routinely have access to confidential information, considered as ‘inside areas’. Those areas are distinguished from areas which deal with sale/marketing/investment advice or other departments providing support services, which are considered as public areas. The employees in the inside area shall not communicate any price sensitive information.

6.8 Evaluation of SEBI (Prohibition of Insider Trading) Regulations, 1992

SEBI (Insider Trading) Regulations in 1992 had been suffering from some drawbacks. Thereafter this regulation has been amended several times. The amended (2002) regulations are more stringent than the previous one. SEBI has been empowered to pass orders, initiate criminal proceedings and take other actions against persons who did not comply with the Regulations. The amended regulations have further fortified the earlier regulations and have increased the list
of persons that are deemed to be connected to insiders. Relatives of deemed to be connected persons and companies in which they hold more than 10% interest are also deemed to have been connected. The entities that have fiduciary relationships with listed companies have been brought within the purview of the new regulations. In addition to monitoring trades by listed companies, the amended regulations seek to monitor entities such as intermediaries and professional firms dealing with listed companies. Listed companies and other entities are now required to frame internal policies, code and guidelines to preclude insider trading by directors, employees, partners, etc. Further, they have to abide by the disclosure code as laid down in the amended regulations.

The time given to the appellant by the SEBI to respond to the summons are four days to appear before the investigating officer with certain specific information relating to his holding in the shares and their trading activities. The same appears to be extremely short.

6.9 Conclusions

As noted above, the insider regulations in India prohibit dealing, communicating or counselling on matters relating to insider trading. Violations of these prohibitions are considered as committing the offence of insider trading. SEBI can launch an investigation and inspection of books of accounts, other records and documents of an insider trader on the basis of complain received from investors or intermediaries or suo moto upon its knowledge or information in its possession to protect the interest of investors in securities against breach of insider trading regulations. SEBI after investigations and hearing the insider can give directions to protect the interest of investors as well as securities market. The directions to insider traders would be not to deal in securities in any particular matter prohibit the insider from disposing of any of the securities accord in violations of the regulations and restraining the insiders from communicating or
counselling any person deal in securities. SEBI has power to initiate criminal prosecution under section 24 of SEBI Act 1992.

Depending on situations all such measures like buy fridge, sell fridge, circuit filters, circuit breakers or market closure methodologies are adopted on a rule of thumb method. Unlike advanced countries like the USA there is no scientific basis of disclosure in India. No empirical research has yet been conducted by the SROs to adopt such policies. In developed stock exchanges like National Association of Securities Dealers Automated Quotation (NASDAQ), New York Stock Exchange (NYSE) or American Stock Exchange (AMEX) it is based on empirical research. We would suggest our stock exchanges like NSE or BSE and SEBI to take care of this important change regarding putting embargo on transactions.

There was no specific provision in the Indian Companies Act or Income Tax Act to combat insider trading in India. However, Sachar Committee (1979), Patel Committee (1987) and Abid Hussein Committee (1989) have made various recommendations to curb insider trading in India. After enactment of the SEBI Act in 1992, insider trading regulations has been framed by SEBI which is called SEBI (Insider Trading) Regulations. During 1992-2002 a few important insider trading cases have come out in the financial press. But, SEBI regulations on insider trading 1992 were not comprehensive in nature. Many of these regulations [viz., section 2(k)(v)] were found to have been loosely drafted. In 2002 this regulation was thoroughly revised as SEBI (Prohibition of Insider Trading) Regulations 1992 to strengthen the existing insider trading regulations and to create a new framework for the prevention of insider trading in securities market. A new Chapter- IV relating to framing of policies on disclosure and prevention of insider has been added. All listed companies and organisations (non-listed) associated with the securities markets are now required to frame a ‘code of internal procedures and conduct’ for the prevention of insider trading in the lines of the model code specified in Schedule- I of the new regulations. In new regulation
temporary insiders have also been defined. The price sensitive information has been bifurcated into two parts. One is 'unpublished' and another one is 'sensitive information'. A model code of conduct for the prevention of insider trading for listed companies and other entities such as merchant bankers, law firms, and analysts, who advise listed companies in respect of trading of securities, has also been specified. Disclosure requirements, initial and continual in respect of shareholding in the listed companies have also been specified. Penalties for violating insider trading regulations have been increased from Rs.5 lakh to Rs25 crore.

Disclosure by persons holding more than 5% shares or voting rights already exists in SEBI Takeover Code. It has also been found that there were no remedies provided at all by the SEBI 1992 regulations to an investor who had been adversely affected by the insider trading. The SEBI can only direct an insider not to enter into further transactions. The SEBI regulation has also not identified secondary insiders known as tippees as a separate class of insiders.
Notes and References


3 Information asymmetry means where buyers and sellers of particular products or services will never be equally well informed, regardless of how much information is disclosed.


7 Bombay Stock Exchange was established in 1875 and insider trading regulation in India first implemented in 1992.

8 Report of the Company Law Committee, 1952


10 Sachar Committee Recommendations, No-18.104 (iv)

11 Patel Committee Recommendations, No-7.26


16 In case when market volatility goes to an extreme level as happened when there was a huge turmoil in the market due to dilemma regarding Mrs. Sonia Gandhi’s acceptance or rejection of the post of Prime Ministership of India. The entire market was kept closed for three successive days. When age-old badla system was totally withdrawn for the first time then the members of Bombay Stock Exchange took same action.

17 Section 11(g) of the SEBI Act 1992

18 Regulation 4A of the SEBI (Prohibition of Insider Trading) Regulations, 1992

19 Regulation 4(A) of SEBI (Prohibition of Insider Trading) Regulations, 1992

20 Prohibition of Insider Trading Law and Procedure (2007), The Institute of Company Secretaries of India

21 SEBI (Prohibition of Insider Trading) Regulations, 1992, Regulation 8

22 Regulation 10(3) of SEBI (Prohibition of Insider Trading) Regulations, 1992
23 CLA (2005) 68(St.)

24 Regulation 11 of SEBI (Prohibition of Insider Trading) Regulations, 1992

25 Kumar Mangalam Birla Committee Report, 2000

26 Vide Notification No. SO 221(E) dated the 12th February 2002


28 SEBI (Prohibition of Insider Trading) Regulations, 1992, Regulation 2(e)

29 SEBI (Prohibition of Insider Trading) Regulations, 1992, Regulation 2(c)(i), (ii)

30 SEBI (Prohibition of Insider Trading) Regulations, 1992, Regulation 2(h)

31 SEBI (Prohibition of Insider Trading) Regulations, 1992, Regulation 2(k)

32 SEBI (Prohibition of Insider Trading) Regulations, 1992, Regulation 2(ha)

33 SEBI (Prohibition of Insider Trading) Regulations, 1992, Regulation 2(d)

34 SEBI (Prohibition of Insider Trading) Regulations, 1992, Regulation 3

35 The Economics Times, January 03, 2008

36 SEBI (Prohibition of Insider Trading) Regulations, 1992, Regulation 12

37 Schedule-H of SEBI insider trading regulations consisted of prompt disclosure of price sensitive information, overseeing and co-ordinating disclosure, responding to market rumours, timely reporting of shareholdings/ ownership and changes in ownership and changes in ownership, disclosure/ dissemination of price sensitive information with special reference to analysts, institutional
investors, medium of disclosure/ dissemination and dissemination by stock exchanges.

38 SEBI (Prohibition of Insider Trading) Regulations, 1992, Regulation 13 (2) and 13(4)

39 Chinese wall: An imaginary separation placed between a brokerage firm’s investment banking business and its trading and retail business. A Chinese wall prevents investment bankers who frequently are privy to information that could substantially influence the price of a client’s securities from leaking that information to the firm’s traders and sales personnel. The exchange of such information is legally prohibited.