



## A Study on the Role of Securities Exchange Board of India (SEBI) Towards Insider Trading Practices in Indian Capital Market

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### ABSTRACT

*The first statutory regulatory body that the government of India set up post the reforms of 1991 was the Securities and Exchanges Board of India (SEBI). As a regulator for the securities markets, SEBI was given the powers to prohibit insider trading practices in the capital market and to investigate wrong-doing and impose relevant penalties. In this paper, we examine and describe the legal processes at SEBI with a focus on the enforcement process and on the preventive actions against insider trading practices. The newly unleashed forces of deregulation, disintermediation, institutionalization, globalization and tax reforms are making the minority shareholder more powerful and are forcing the companies to adopt code of conduct for prohibiting insider trading practices in the corporate world. These trends are expected to become even stronger in future.*

### Keywords :

#### Introduction :

Insider trading refers to buying or selling the securities of a publicly traded firm by an insider to gain benefit from insider information. Insider trading is commonly restricted or prohibited by law. It is also called as Insider dealing. The term Insider trading is popularly used in the negative sense as it is perceived that the persons having access to the price sensitive and unpublished information used the same for their personal gains. But the term actually includes both negative as well as positive sense, means illegal and legal conduct.

- the term illegal refers to buying and selling a security, in breach of a fiduciary duty or other relationship of trust and confidence, while in possession of material, non-public information about the security. Illegal insider trading therefore includes tipping others when you have any sort of public information.
- insider trading is legal, once the material information has been made public, at which time the insider has no direct advantage over other investors. The SEBI, however still requires all insiders to report all their transactions.

#### **Insider Trading Laws in India – A Brief History**

Insider trading continued unabated until 1970 which in sum and substance would imply that it was practiced for 125 years in a country like India. Securities regulators around the world have framed various regulations to deal with the problem of insider trading. The existence of regulations does not necessarily mean that they are enforced. In South Africa, for example, a recent report on insider trading pointed out that in the quarter century that the insider trading law has been in existence in that country, there has not been a single prosecution. The situation is not very much better in many other countries. However, in the United States and the United Kingdom there have been a large number of well publicized and successful actions against insider trading. Most instances of insider trading have nothing to do with the dominant shareholder. Many of them involve small trades by junior employees who come to know of price sensitive information. In a few instances, insider trading may be indulged in by directors and other senior employees. Market gossip has long speculated on the prevalence of such trades in the build up to large mergers especially between group companies. Some promoters have merged small companies in which they have a large stake into a larger more widely held company at a swap ratio which is highly un-

favorable to the widely held company. These allegations have been difficult to prove in most instances as the promoters can act through numerous friends, relatives and other fronts.

Due to inadequate provisions of enforcement in the companies act, 1956, many committees proposed recommendations for a separate statute regulating Insider trading like the Sachar Committee in 1979, the Patel Committee in 1986 and the Abid Hussain Committee in 1989. complying with the recommendations by these committees, India through Securities exchange board of India ( insider trading ) Regulation, 1982 prohibited this mal practice. These regulations were drastically amended in 2002 and renamed as Securities exchange board of India ( Prohibition of Insider trading ) Regulation, 1992. All listed companies and market intermediaries have to comply with the directions of these regulations.

#### **Meaning of Insider**

An 'Insider' as defined by the Securities exchange board of India ( prohibition of insider trading ) regulations, 1992 is " means any person who, is or was connected with the company or is deemed to have been connected with the company, and who is reasonably expected to have access to unpublished price sensitive information in respect of securities of the company, or who has received or has had access to such unpublished price sensitive information.

SEBI experienced complexities in the above definition, in proving a case of insider trading because of the word by virtue of such connection. It proved to be a very tedious and problematic task for the SEBI, to prove a person to be an insider, even before proving the liability of the accused, SEBI had to first establish first a connection with the company and how he acquired such information. In most of the cases, SEBI could not establish connection of the person accused to be an insider with the company. In 2002, SEBI introduced amendments in which the words 'by virtue of such connection' omitted from the definition of an insider, this simplified SEBI's task.. SEBI has amended the Securities exchange board of India ( prohibition of insider trading ) regulations, 1992 with vide notification dated 19<sup>th</sup> November 2008. With this Notification, Capital market regulator SEBI has tightened its insider trading norms by broadening the definition of the term insider, now any person who has received or has had access to such unpublished price sensitive information will be considered to be an insider. After all these amendments, new definition of

'Insider' is defined under securities exchange board of India ( prohibition of insider trading ) regulations under sec 2(e), which is as under : Insider is the person who is "connected" with the company, who could have the unpublished price sensitive information or receive the information from somebody in the company.

#### Connected Person

It could be a director of the company or is to be deemed to be a director, by virtue of sub-clause (10) of section 307 of the companies Act, 1956. Any person having unpublished price sensitive information from any subsidiary or group company is also stated to be connected person. Connected person may hold the position as an officer or an employee of the company; or holds a position involving a professional or business relationship between himself and the company whether temporary or permanent including consultants, advisors, statutory and internal auditors, relatives of all directors and officers and who may reasonably be expected to have an access to unpublished price sensitive information in relation to the company. Connected person can also be form intermediary's like Stock exchange, Merchant bank, Transfer agent, Debenture trustee, Banker's or relative of promoter or of Bpard of Director.

#### Unpublished Price Sensitive information

Price sensitive information is the one which relates directly or indirectly to a company. Such information as and when published is likely to materially affect the price of the securities of the company. This is known as "Price Sensitive Information".

The following can be deemed to be "Price sensitive information" :

- i. periodical financial 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 plans or execution of new projects;
- v. amalgamation & mergers or takeovers;
- vi. disposal of the whole or substantial part of the undertaking;
- vii. disruption of operations due to natural calamities.
- viii. any significant changes in policies, plans or operations of the company, such as:
  - (a) Commencement of any new commercial operations where the contribution there from is likely to exceed 5% of the total turnover of the company during that financial year.
  - (b) Developments with respect to changes in pricing/realization on goods and services arising out of changes in government policy (c) Litigation/dispute with a material impact.
  - (d) Revision of credit ratings assigned to any debt or equity instrument of the company.
  - (e) Any information which, if disclosed, in the opinion of the person disclosing the same is likely to materially affect the prices of the securities of the Company.

#### Insider Traders :

- Directors and employees who traded the corporation's securities after learning significant and confidential corporate development
- Friends, Family members who traded the securities after receiving such confidential information
- Other persons who misappropriated and took advantage of confidential information from their employers.

#### Trading Window :

In order to prevent the misuse of Price sensitive information,

The company shall specify a trading period, to be called "trading window", for trading in the company's securities. The trading window shall be closed during the time the information is unpublished. When the trading window is closed, the employees/directors shall not trade in the company's securities in such period.

The trading window shall be closed at the time :

- (a) Declaration of financial results (quarterly, half-yearly and annually).
- (b) Declaration of dividends (interim and final).
- (c) Issue of securities by way of public/rights/bonus etc.
- (d) Any major expansion plans or execution of new projects.
- (e) Amalgamation, mergers, takeovers and buy-back.
- (f) Disposal of whole or substantially whole of the undertaking.
- (g) Any changes in policies, plans or operations of the company.

The time for commencement of closing of trading window shall be decided by the company. The trading window shall be opened 24 hours after the information is made public. All directors/officers/designated employees of the company shall conduct all their dealings in the securities of the Company only in a valid trading window and shall not deal in any transaction involving the purchase or sale of the company's securities during the periods when trading window is closed, or during any other period as may be specified by the Company from time to time. In case of ESOPs, exercise of option may be allowed in the period when the trading window is closed. However, sale of shares allotted on exercise of ESOPs shall be allowed when trading window is closed.

#### Compliance Officer

The listed company shall appoint a Compliance Officer, senior level employee who shall report to the Managing Director/Chief Executive Officer. The compliance officer shall be responsible for setting forth policies, procedures, monitoring adherence to the rules for the preservation of "Price Sensitive Information", pre-clearing; of designated employees' and their dependents' trades (directly or through respective department heads as decided by the company), monitoring of trades and the implementation of the code of conduct under the overall supervision of the Board of the listed company. The compliance officer shall maintain a record of the designated employees and any changes made in the list of designated employees. He shall assist all the employees in addressing any clarifications regarding the Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 1992 and the company's code of conduct.

#### Prevention of insider trading

To ensure timely and adequate disclosure of price sensitive information, the following norms shall be followed by listed companies: Price sensitive information shall be given by listed companies to stock exchanges and disseminated on a continuous and immediate basis. Listed companies may also consider ways of supplementing information released to stock exchanges by improving Investor access to their public announcements. Listed companies shall designate a senior official (such as compliance officer) to oversee corporate disclosure. This official shall be responsible for ensuring that the company complies with continuous disclosure requirements. Overseeing and co-coordinating disclosure of price sensitive information to stock exchanges, analysts, shareholders and media and educating staff on disclosure policies and procedure. Information disclosure/dissemination may normally be approved in advance by the official designated for the purpose. If information is accidentally disclosed without prior approval, the person responsible may inform the designated officer immediately, even if the information is not considered price sensitive. Listed companies shall have clearly laid down procedures for responding to any queries or requests for verification of market rumors by exchanges. The official designated for corporate disclosure shall be responsible for deciding

whether a public announcement is necessary for verifying or denying rumors and then making the disclosure.

Listed companies should follow the guidelines given hereunder while dealing with analysts and institutional investors:—

- (i) Only Public information to be provided - Listed companies shall provide only public information to the analyst/research persons/large investors like institutions. Alternatively, the information given to the analyst should be simultaneously made public at the earliest.
- (ii) Recording of discussion - In order to avoid misquoting or misrepresentation, it is desirable that at least two company representative be present at meetings with Analysts, brokers or Institutional Investors and discussion should preferably be recorded.
- (iii) Handling of unanticipated questions - A listed company should be careful when dealing with analysts' questions that raise issues outside the intended scope of discussion. Unanticipated questions may be taken on notice and a considered response given later. If the answer includes price sensitive information, a public announcement should be made before responding.
- (iv) Simultaneous release of Information - When a company organises meetings with analysts, the company shall make a press release or post relevant information on its website after every such meet. The company may also consider live webcasting of analyst meets.

#### Medium of disclosure/dissemination

- (i) Disclosure/dissemination of information may be done through various media so as to achieve maximum reach and quick dissemination.
- (ii) Corporate 's shall ensure that disclosure to stock exchanges is made promptly.
- (iii) Corporate 's may also facilitate disclosure through the use of their dedicated Internet website.
- (iv) Company websites may provide a means of giving investors a direct access to analyst briefing material, significant background information and questions and answers.
- (v) The information filed by corporate 's with exchanges under continuous disclosure requirement may be made available on the company website.

#### Information to SEBI in case of violation of SEBI (Prohibition of Insider Trading), Regulations, 1992

In case it is observed by the company / compliance officer that there has been a violation of SEBI (Prohibition of Insider Trading), Regulations, 1992, SEBI will be informed by the company through the adoption of the respective Forms :

FORM I- Application to the Compliance Officer for pre-clearance of trade, indicating the estimated number of securities that the Designated Employee/ Officer / Director intends to deal in, the details as to the depository with which he has a security account.

FORM II- Undertaking

FORM III- Pre clearance order

FORM IV- Application for waiver of Holding period

FORM V- Statement of any transactions in securities of the Company, whether pre-clearance of trades was obtained or not, on quarterly basis within 15 days from the end of quarter.

FORM VI- Annual Statement of all holdings in securities of the Company as on 31st March of each year, before 30th April of

that year.

FORM A- Details of Acquisition of 5% or more shares or voting rights in a company

FORM B- Initial Disclosure by Directors / Officers at the time of appointment of shares held by them. (Within 4 days )

FORM C- Details of change in shareholding in respect of persons holding more than 5% shares

FORM D- Details of change in shareholding of Director or Officer of company

#### Insider Trading Cases in India

##### ABS Industries

This case highlighted the vulnerability of SEBI's 1992 regulations. Rakesh Agarwal, MD of ABS Industries Ltd was involved in negotiations with Bayer, with intention to takeover ABS. SEBI charges MD of ABS industries with insider trading as he had allegedly purchase his own company's shares from the market prior to the takeover. The case was settled through consent order with Agarwal paying a monetary penalty.

##### Wockhardt Ltd

Rajiv Gandhi former company secretary and CFO of wockhardt, along with his family members were alleged to have traded in the pharma company's shares on the basis of unpublished price sensitive information. SEBI imposed a penalty of Rupees 5 lakh on his wife sandhiya Gandhi and his sister.

##### Alliance capital mutual fund

Samir Arora former Asia-pacific head of Alliance Capital mutual fund was the fund manager of the company. Knowing that the company was inviting bids for takeover of the same, he made special arrangement with Henderson global investors. For helping this company's takeover his present company, he purchased shares and when the prices rose sold off the shares to get a considerable profit. In 2004, SEBI debarred Arora from dealing in securities directly or indirectly for 5 years. SEBI charged penalty of 15 crore on ACM and two associated Alliance entities.

##### Hindustan Lever

SEBI pulls up Hindustan lever ( now Hindustan Unilever ) with it's directors for alleged insider trading. The insider trading charges against HLL were with regard to the merger with Brooke Bond Lipton India Ltd. The case focuses on the legal controversies involved into HLL's purchase of 8 Lakh shares of BBLIL two weeks prior to the public announcement of the merger of the two companies ( HLL & BBLIL ) Which, according to SEBI was price sensitive information . SEBI conducted enquiries after about 15 month. SEBI issued a show cause notice to the Chairman, Directors and other members of HLL. It's a first case where SEBI passed an order on Insider trading.

##### Penalty for Insider Trading

Penalty for Insider trading is defined in Securities exchange board of India ( prohibition for insider trading ) regulations, 1992 under sec -15 G, according to which

- insider is liable for penalty or rupees 25 Crore of rupees or 3 times of profit whichever is higher
- In case he deals on his own behalf or on behalf of any other person in securities of body corporate listed on the stock exchange on the basis of unpublished price sensitive information.
- In case he communicates unpublished price sensitive information to any person with or without request unless it is necessary in the usual course of business or it is necessary under any provision of law.
- In case he procures for any person unpublished price sensitive information to deal on the basis of such information.

**Conclusion :**

In order to make sense of insider trading, we must go back to a basic understanding of markets, prices and the role of market in the economy. The ideal securities market is one which does a good job of allocating capital in the economy. This function is enabled by market efficiency, the situation where the market price of each security accurately reflects the risk and return in it's future. The primary function of regulation and policy is to foster market efficiency, hence we must evalu-

ate the impact of the insider trading upon market efficiency. Insider trading is a practice that has been prevalent since the very inception of stock markets and can never be ended completely. But an endeavor can be made to curb this practice at all levels of the society and not just by the SEBI but also by the people, aware of any kind of insider trading practice being indulged in. Practically speaking, the practice of Insider Trading cannot be eradicated completely but an effort can be made to limit it to a great extent.

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