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INSIDER TRADING VIOLATIONS AND THE IMPACT OF RECENT SEBI RULINGS

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ABSTRACT

The act of violating insider trading regulations presents a notable obstacle to the impartiality and integrity of global financial markets. This abstract investigates the effects of recent regulatory decisions made by the Securities and Exchange Board of India (SEBI) on instances of insider trading infractions within the Indian market. The practise of insider trading, which involves the trading of securities on the basis of confidential information that has not been made public, has the potential to erode investor trust and impede the effectiveness of the market. Regulatory bodies, such as the Securities and Exchange Board of India (SEBI), are instrumental in mitigating the problem of insider trading by implementing and enforcing regulations that serve as a deterrent and carry penalties for those who engage in such activities. This article analyses the effects of SEBI's recent regulatory decisions on insider trading infringements within the Indian market. The aforementioned regulations pertain to a multitude of facets, such as the characterization of insider trading, the proscription of unapproved dissemination of unpublished price-sensitive information (UPSI), and the responsibility of market participants to disclose their transactions. SEBI has endeavoured to enhance the efficacy of enforcement mechanisms, augment transparency, and rationalise investigation procedures.

Keywords: SEBI, Insider Trading, Financial Market, UPSI.

DEFINITION

Insider trading is a grave form of white-collar crime that transpires when an individual who possesses privileged information regarding a publicly traded corporation exploits such information

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to gain financial benefits or evade losses in the stock market. The act of engaging in this form of trading is considered unlawful in India, as well as in numerous other nations, and may lead to significant repercussions for the individuals involved. This article aims to examine the issue of insider trading violations in India, encompassing their definition, detection methods, and potential sanctions.

WHAT IS INSIDER TRADING?

Insider trading pertains to the act of purchasing or vending securities by an individual who possesses privileged information regarding a company that is publicly traded. The confidential data in question pertains to any undisclosed information that is not accessible to the wider public, including but not limited to financial outcomes, consolidations, procurements, or any other consequential occurrences that may potentially affect the organization's share value. The illegality of insider trading is rooted in the fact that it confers an inequitable advantage upon those who possess the information, while simultaneously causing harm to other investors who lack access to such information.

The regulations of the Securities and Exchange Board of India (SEBI) are responsible for the governance of insider trading in India. As per the Securities and Exchange Board of India (SEBI), insider trading encompasses the act of divulging undisclosed price-sensitive information (UPSI) to an unauthorised individual.[1] According to the definition, UPSI refers to information that, if disclosed, is expected to exert a substantial influence on the value of securities.

HOW ARE INSIDER TRADING VIOLATIONS DETECTED?

Investigation and analysis are often used to find insider trading offences. Utilising data analysis technologies that can spot odd trading activity patterns is one popular approach of detection. For instance, insider trading may be suspected if the stock price of a firm suddenly increases and a lot of people who are not generally active in that stock purchase a significant number of shares.

The use of tips from insiders or whistleblowers is another approach of detection. An insider may sometimes notify SEBI or the company's compliance department of suspected insider trading. In India, whistleblower protections have recently been expanded, making it simpler for individuals to come out with information about wrongdoing without concern for reprisals.

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[1] Apoorva Satapathy, 'Insider Trading In India: How Is It Regulated?' (2018) LexisNexis <https://lexisnexisindia.wordpress.com/2018/04/03/insider-trading-in-india-how-is-it-regulated/> accessed 18 May 2023.

INDIAN SANCTIONS FOR INSIDER TRADING OFFENCES

India has harsh punishments for insider trading offences, such as fines, jail time, and a prohibition on investing in the stock market. Insider trading has a maximum punishment of 10 years in jail and a fine of up to 25 crore rupees, or three times the gains gained from the insider trading, whichever is larger.

In addition to these criminal sanctions, SEBI may also apply civil sanctions for breaches of the prohibition on insider trading. Fines, the return of earnings, and a prohibition on trading on the securities market are all examples of civil penalties. Companies or other entities that are determined to have participated in insider trading may also face sanctions from SEBI, including fines, licence revocations, or other regulatory measures.

RECENT INSIDER TRADING CASES IN INDIA

In recent years, India has seen a number of high-profile insider trading instances. In one of the most prominent examples, Rajat Gupta, a former Goldman Sachs board member, was found guilty of insider trading in the US in 2012.[2] Raj Rajaratnam, a hedge fund manager, was accused of using Gupta's secret knowledge to execute bets that brought him millions of dollars in gains.

One recent incident in India included Sun Pharmaceuticals, one of the biggest pharmaceutical companies in the nation. Dilip Shanghvi, the founder and previous CEO of the business, was penalised by SEBI for insider trading in 2018. Just days before Sun Pharmaceuticals announced a merger with Ranbaxy Laboratories, which raised the stock price, Shanghvi was accused of selling shares in the firm.

SEBI NEW RULING

The Securities and Exchange Board of India (SEBI) has recently issued two orders imposing sanctions against two individuals for their involvement in insider trading activities related to shares of Biocon Ltd. (Biocon). Both parties contended that individuals engaged in stock trading in 2017 with awareness of substantial non-public information (MNPI) concerning the Biocon and Sandoz partnership that had not been made public. While the factual basis underlying these orders may be comparable, each order presents unique challenges that require thorough analysis.

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[2] Peter Lattman and Azam Ahmed, 'Rajat Gupta Convicted of Insider Trading' The NewYork Times (15 June 2012) < https://archive.nytimes.com/dealbook.nytimes.com/2012/06/15/rajat-gupta-convicted-of-insider-trading/> accessed 18 May 2023.

An individual holding the position of executive vice president and designated person (DI) at Biocon, with a high level of authority, was implicated in insider trading and subsequently became the focus of an initial investigation. The rationale behind this was that the individual in question had divested a specific quantity of Biocon stocks prior to the disclosure of the firm's partnership with Sandoz. Undoubtedly, the announcement of the agreement with Sandoz had a favourable impact, evidenced by the 5-6% surge in Biocon's share value subsequent to its dissemination.

Individuals who divest their shares prior to the release of positive news should not be charged with insider trading, as they did not gain an unjust advantage from the information. Although the employee contended that he had obtained pre-clearance from his employer and that the shares were sold to finance the acquisition of a self-occupied residence, SEBI determined that he had engaged in insider trading and was therefore culpable.[3] The sequence of the findings explicated in this text presents a marked divergence from the prevalent legal norms of common law that regulate insider trading legislation and classify insider trading as a dual civil and criminal transgression. The primary justification is to impose penalties for a breach that arises from an individual with privileged access to Unpublished Price Sensitive Information (UPSI) utilising it in a manner that is detrimental to the welfare of others. The international legal framework against insider trading is grounded on the fiduciary duty of insiders to refrain from exploiting their official position and privileged information to the detriment of ordinary shareholders. Throughout the course of time, this responsibility has been established and upheld.

The committee, chaired by Justice NK Sodhi, underscored the significance of the matter by asserting that insider trading ought not to be deemed as an illicit act provided that the trades were not in line with the Unpublished Price Sensitive Information's (UPSI) objective. The case of Chandrakala v. SEBI[4] was examined by the Securities Appellate Tribunal (SAT), which investigated the matter and concluded that an individual who has access to favourable Unpublished Price Sensitive Information (UPSI) is more inclined to purchase shares rather than sell them prior to the release of UPSI.

The Securities and Exchange Board of India's classification of a trade as a violation of the Prohibition of Insider Trading Regulations, irrespective of its direction, can be perceived as a downplaying of the gravity of insider trading as a major offence. Such a classification may result in the categorization of insider trading as a mere technical violation. This order contravenes the

[3] *Ibid.*
[4] Chandrakala v. SEBI [2011] Appeal No. 209 of 2011.

fundamental tenets that form the basis of insider trading restrictions, and furthermore imposes unwarranted sanctions on individuals who engage in entirely ethical and morally sound conduct within publicly traded corporations. It is recommended that Sebi revise its findings in consideration of the regulatory objectives of the insider trading legislation, which primarily aim to prohibit the inappropriate exploitation of unpublished price sensitive information (UPSI) rather than restricting all transactions executed by an individual while in possession of UPSI.

With respect to the second order, an accusation was levied against a director of the Mazumdar Shaw Foundation for having acquired specific shares of Biocon prior to the declaration of Biocon's partnership with Sandoz. It would be unreasonable to assume that he possessed knowledge regarding Biocon and specifically, the Sandoz acquisition, as he lacked any official association with Biocon and it fell outside the scope of his customary business activities.

The ruling in question lacks substantiation for the claim that an employee or staff member of the company granted the individual in question access to confidential information pertaining to the transaction. The chronology of events implies that the individual obtained access to the information due to their status as a "connected person," stemming from their leadership role in the Foundation established by Biocon's promoters and their involvement in an advisory capacity during the discussions surrounding a deal between Biocon and CIMAB, which occurred concurrently with the Biocon-Sandoz transaction.

Considering the extensive scope of the aforementioned directive and the absence of any additional proof indicating the communication of said information to the defendant, it is probable that their association with the involved parties granted them exclusive awareness of the Sandoz transaction. The assertion posits that individuals in authoritative positions and those with privileged access within publicly traded companies indiscriminately disclose undisclosed price-sensitive information to all parties they interact with, even in the course of intricate business transactions such as collaborating with Sandoz.[5] The aforementioned verdict would logically infer that individuals who engage in communication with an official of a publicly traded corporation are deemed to possess insider knowledge pertaining to the organisation. In this scenario, the provision of evidence to substantiate the claim of being informed of said information may not be deemed imperative.

The evidentiary standard in insider trading allegations may become uncertain when an inference is made that an individual possesses knowledge of undisclosed price-sensitive information (UPSI)

[5] Quentin Cregan, 'Intellectual Property Enforcement: Remedies, Procedures and Processes in an International and EU Copyright Context' [2018] Uni. Of Oxford 36.

solely based on their affiliation with a listed entity's key managerial personnel or their employment during the period of UPSI existence. In order to gain access to UPSI, SEBI must furnish substantial evidence, as mere conjecture cannot substantiate allegations of insider trading. Additionally, a viable relationship must be established.

The two aforementioned categories exhibit discernible characteristics and establish a trend in which individuals affiliated with publicly traded corporations are implicated in grave offences such as insider trading solely on the basis of their participation in trading the securities of said corporation during a period of significant negotiations.[6] The aforementioned guidelines are expected to impede insider trading and potentially criminalise activities that may be deemed harmless but initially contradict insider trading regulations. It is recommended that Sebi consider the evaluation made by the HLC, which suggests that implementing a prohibition on insider trading would be the most convenient, albeit simplistic, approach. The implementation of the aforementioned plan would not only exhibit inefficacy comparable to that of complete prohibition legislation, but would also be impractical and incongruous with the present regulatory and economic milieu.

[6] OICU, 'Investigating and Prosecuting Market Manipulation' (2000) IOSCO <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD103.pdf > accessed 18 May 2023.